



Powered by the Sharekhan 3R Research Philosophy

3R MATRIX			
	+	=	-
Right Sector (RS)	✓	■	✗
Right Quality (RQ)	✓	■	✗
Right Valuation (RV)	✓	■	✗
+ Positive	= Neutral	- Negative	

What has changed in 3R MATRIX

	Old	New
RS	■	↔
RQ	■	↔
RV	■	↔

ESG Disclosure Score NEW

ESG RISK RATING	30.72
Updated Dec 08, 2022	

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

Company details

Market cap:	Rs. 19,155 cr
52-week high/low:	Rs. 215 / 141
NSE volume: (No of shares)	30.5 lakh
BSE code:	543330
NSE code:	DEVYANI
Free float: (No of shares)	44.8 cr

Shareholding (%)

Promoters*	62.8
FII	14.9
DII	7.9
Others	14.43

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-7.0	-12.2	-21.8	-11.3
Relative to Sensex	-8.1	-10.6	-24.3	-15.3

Sharekhan Research, Bloomberg

Devyani International Ltd

Soft Q3; Store expansion to aid growth

Consumer Discretionary

Sharekhan code: DEVYANI

Reco/View: Buy

CMP: Rs. 159

Price Target: Rs. 215



↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- Devyani International Limited (DIL) posted soft Q3FY2023, in line with other QSR players with revenue growing by 27% (largely led by store addition), while SSSG remained muted; EBITDA margin fell 167 bps y-o-y, hit by higher input costs.
- KFC's SSSG was lower at 3%, while Pizza Hut's SSSG fell 6%. Management expects SSSG to recover in another two quarters with the expected correction in inflation.
- DIL will add 250-300 stores in FY2024. KFC might see higher store addition with the introduction of large-format flagship stores to drive average daily sales.
- The stock is trading at attractive valuation of 19.7x/15.7x its FY2024E/FY2025E EV/EBITDA. In view of its strong business model and long-term growth prospects, we maintain Buy with a revised PT of Rs. 215.

Devyani International Limited's (DIL's) revenue grew by 26.6% y-o-y to Rs. 790.6 crore in Q3FY2023, driven by 27% and 18% y-o-y revenue growth in KFC and Pizza Hut, while Costa Coffee's revenue grew by 2x y-o-y. Double-digit revenue growth was largely driven by store addition, while same-store-sales growth (SSSG) remained muted in Q3, impacted by weak consumer sentiments. KFC's average daily sales (ADS) came in at Rs. 116,000 (down 6% y-o-y); Pizza Hut's ADS stood at Rs. 43,000 (down 9% y-o-y), and Costa Coffee's ADS was reported at Rs. 37,000 (flat y-o-y). Gross margin decreased by 204 bps y-o-y to 69.3%, impacted by higher input cost inflation, while EBITDA margin declined by 167 bps y-o-y to 22%. EBITDA grew by 17.7% y-o-y to Rs. 174 crore. Adjusted PAT grew by 18.6% y-o-y to Rs. 77.5 crore. In 9MFY2023, DIL's revenue grew by 50% y-o-y, with EBITDA margin remaining flat at 22.5%, while adjusted PAT grew by 2.3x y-o-y. The company opened 81 stores in Q3, taking the total count to 1,177 stores across all brands.

Key positives

- DIL added 81 stores in Q3FY2023; KFC/Pizza Hut/Costa added 38/17/15 stores, respectively.
- Costa Coffee's revenue grew by 2x y-o-y; International business revenue grew by 16% y-o-y.

Key negatives

- Gross/EBITDA margins decreased by 204 bps/167 bps y-o-y.
- KFC's SSSG came in at 3%; Pizza Hut's SSSG declined by 6%.
- KFC's ADS came in lower at Rs. 1.16 lakhs compared to 1.24 lakhs in Q3FY2022; Pizza Hut's ADS declined by 9% y-o-y to Rs. 0.43 lakhs.

Management Commentary

- Management indicated that demand slowdown is temporary and expects the sentiment to improve with consumer inflation cooling off in the next six months.
- Management expects margins to see sequential improvement with the stabilisation of raw-material prices. However, y-o-y improvement in gross margins would be visible as SSSG improves.
- KFC's gross margins are expected to remain stable q-o-q; however, Pizza Hut may witness some margin pressure due to higher price of cheese and milk and unfavourable product mix.
- In FY2024, DIL will continue its strong store expansion strategy with the addition of 250-300 stores. However, large store expansion would be seen in KFC brand with the introduction of large format flagship stores (around 10% of new store addition). The idea of the flagship store is to improve average daily sales of KFC in future.
- For Costa Coffee, DIL plans to open smaller stores and flagship stores in metro locations, where demand is higher.

Revision in estimates – We have lowered our earnings estimates for FY2023/FY2024/FY2025 due to lower-than-earlier-expected margins.

Our Call

View – Retain Buy with a revised PT of Rs. 215: DIL's Q3 performance was in line with the slowdown in the quick service restaurants (QSR) industry, impacted by weak consumer sentiments. However, management indicated it to be a temporary phenomenon and expects recovery in the next two quarters. Further, with correction in input prices, margins are expected to improve in the coming quarters. An aggressive store expansion plan, strong brands under kitty coupled with an experienced parental background will help DIL's revenue and EBITDA to post CAGR of 34% and 45%, respectively, over FY2022-FY2025E. The stock trades at 19.7x and 15.7x its FY2024E and FY2025E EV/EBITDA, respectively. In view of the strong business model and long-term growth prospects, we maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 215.

Key Risks

Any slowdown in demand environment, heightened competition due to entry of new brands or slowdown in expansion in key markets are some of the key risks to our earnings estimates.

Valuation (consolidated)

Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenue	1,135	2,084	3,025	4,129	5,039
EBITDA margin (%)	20.0	22.8	22.2	22.8	23.1
Adjusted PAT	-90	172	267	396	526
% Y-o-Y growth	-	-	54.9	48.5	32.7
Adjusted EPS (Rs.)	-0.8	1.5	2.3	3.4	4.6
P/E (x)	-	106.7	68.9	46.4	35.0
P/B (x)	-	28.0	20.1	14.2	12.2
EV/EBITDA (x)	81.8	40.5	28.4	19.7	15.7
RoNW (%)	-	43.1	32.5	34.4	36.0
RoCE (%)	3.9	15.4	20.1	25.3	27.5

Source: Company; Sharekhan estimates

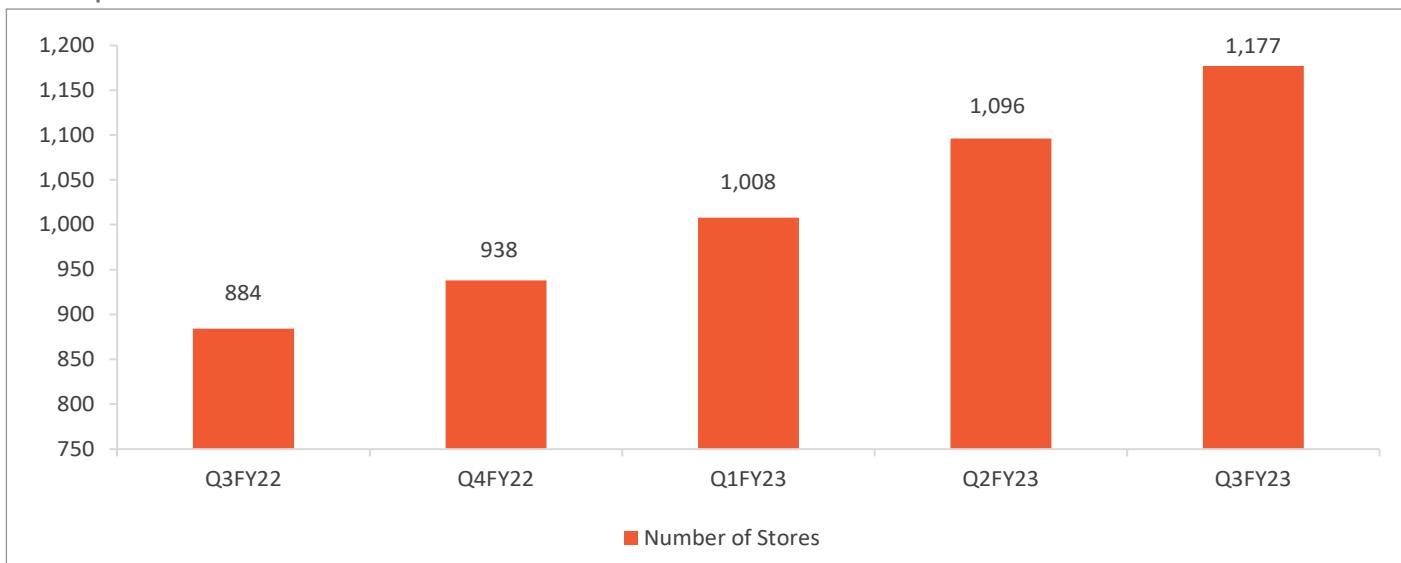
Soft Q3 – Revenue growth at 27% y-o-y; EBITDA margin contracted by 167 bps y-o-y

DIL's revenue grew by 26.6% y-o-y to Rs. 790.6 crore, driven by 27% and 18% y-o-y growth in revenue of KFC and Pizza Hut, while Costa Coffee's revenue grew by 2x y-o-y. KFC ADS came in at Rs. 1,16,000 (down 6% y-o-y); PH ADS stood at Rs. 43,000 (down 9% y-o-y); and Costa ADS was reported at Rs. 37,000 (flat y-o-y). Gross margin decreased by 204 bps y-o-y to 69.3%, impacted by higher input cost inflation, while EBITDA margin declined by 167 bps y-o-y to 22%. EBITDA grew by 17.7% y-o-y to Rs. 174 crore. Contribution from KFC stood at 19.7% (down from 23% in Q3FY2022); and for Pizza Hut, it stood at 14.1% (down from 16.8% in Q3FY2022). In line with the 18% growth in operating profit, adjusted PAT grew by 18.6% y-o-y to Rs. 77.5 crore. The company opened 81 stores in Q3, taking its total count to 1,177 stores across all brands.

Store additions continued in Q3FY2023

DIL opened 81 stores (net) in Q3, taking the total count to 1,177 stores. Net store openings for KFC came in at 38 stores, Pizza Hut at 17 stores, Costa Coffee at 15 stores, and 3 stores for other brands. In the international market, DIL added 8 new stores (net) in Q3FY2023. Total store count increased from 1,096 stores at Q2FY2023-end to 1,177 stores at Q3FY2023-end. The company had 1,102 stores of core brands (KFC, Pizza Hut, and Costa Coffee) as of December 31, 2022 compared to 1,024 stores as of September 30, 2022.

Store expansion trend



Source: Company; Sharekhan Research

KFC's revenue growth at 27% y-o-y; Robust store addition

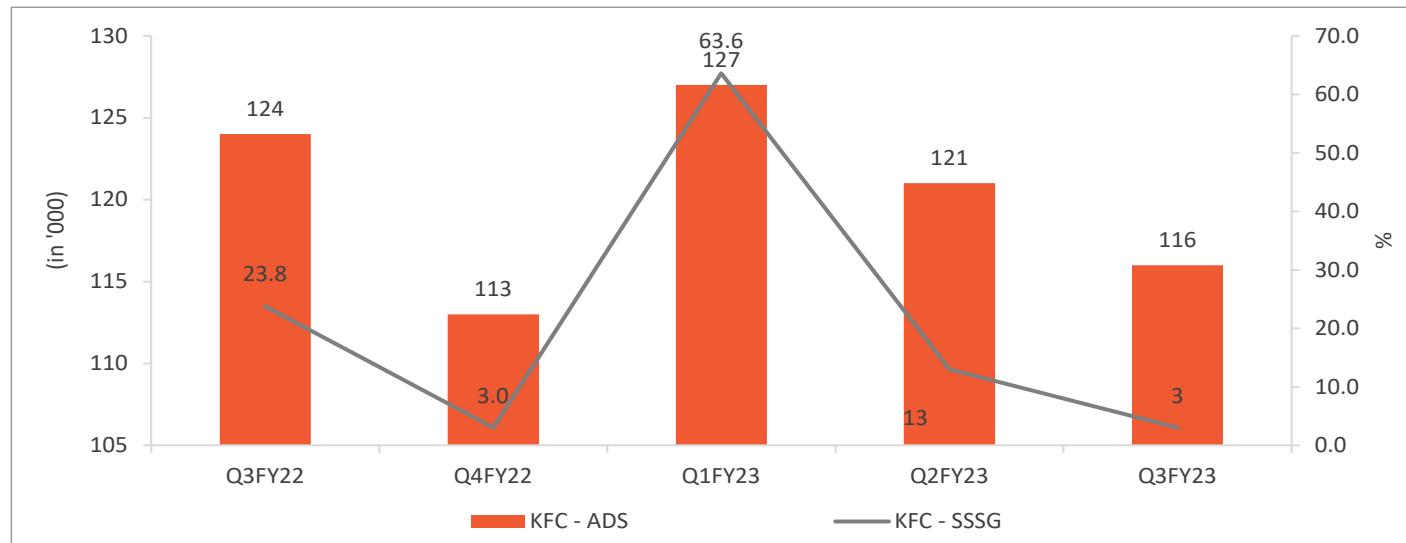
KFC's revenue grew by 27% y-o-y to Rs. 460 crore, aided by new store additions. The company had 461 KFC stores at Q3FY2023-end compared to 339 stores at Q3FY2022-end, resulting in net addition of 122 stores in one year (38 net new stores were added in Q3FY2023). ADS for the quarter came in lower at Rs. 1.16 lakhs in Q3FY2023 compared to 1.24 lakhs in Q3FY2022 (lower vs. 1.21 lakhs in Q2). SSSG came in at 3% in Q3FY2023, impacted by demand slowdown. Gross margin of KFC business decreased by 170 bps to 67.6%, while brand contribution declined by 330 bps y-o-y to 19.7% in Q3FY2023. Dine-in and takeaway contribution to sales stood stable at 64% in Q3FY2023.

Trend in KFC stores



Source: Company; Sharekhan Research

Trend in KFC ADS & SSG



Source: Company; Sharekhan Research

Pizza Hut – Revenue growth at 18% y-o-y

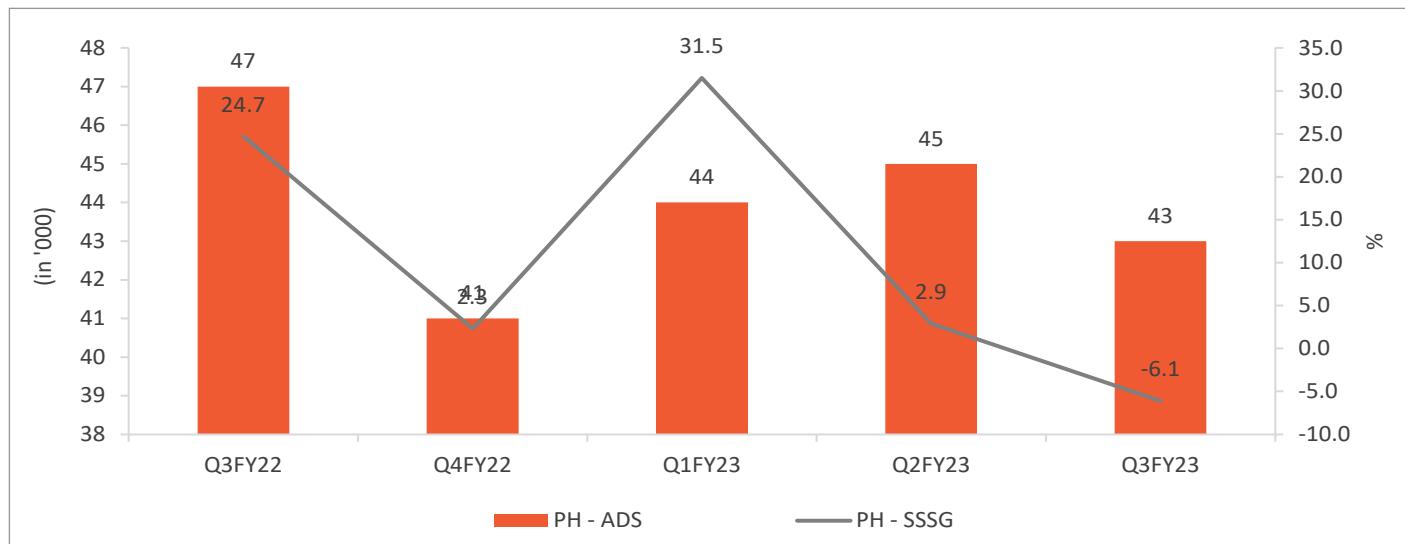
Pizza Hut's revenue grew by 18% y-o-y to Rs. 184 crore majorly led by new store additions. The company had 483 Pizza Hut stores at Q3FY2023-end compared to 391 stores at Q3FY2022-end, resulting in net addition of 92 stores in one year (17 net new stores were added in Q3FY2023). ADS declined by 9% y-o-y to Rs. 0.43 lakhs, while the company witnessed a 6.1% decline in SSSG in Q3FY2023, hit by demand slowdown. Gross margin of Pizza Hut business declined by 200 bps y-o-y to 73.6%, while brand contribution fell by 270 bps y-o-y to 14.1% in Q3FY2023. Dine-in and takeaway contribution to sales remained largely stable at 43% in Q3FY2023.

Trend in Pizza Hut stores



Source: Company; Sharekhan Research

Trend in Pizza Hut ADS and SSSG

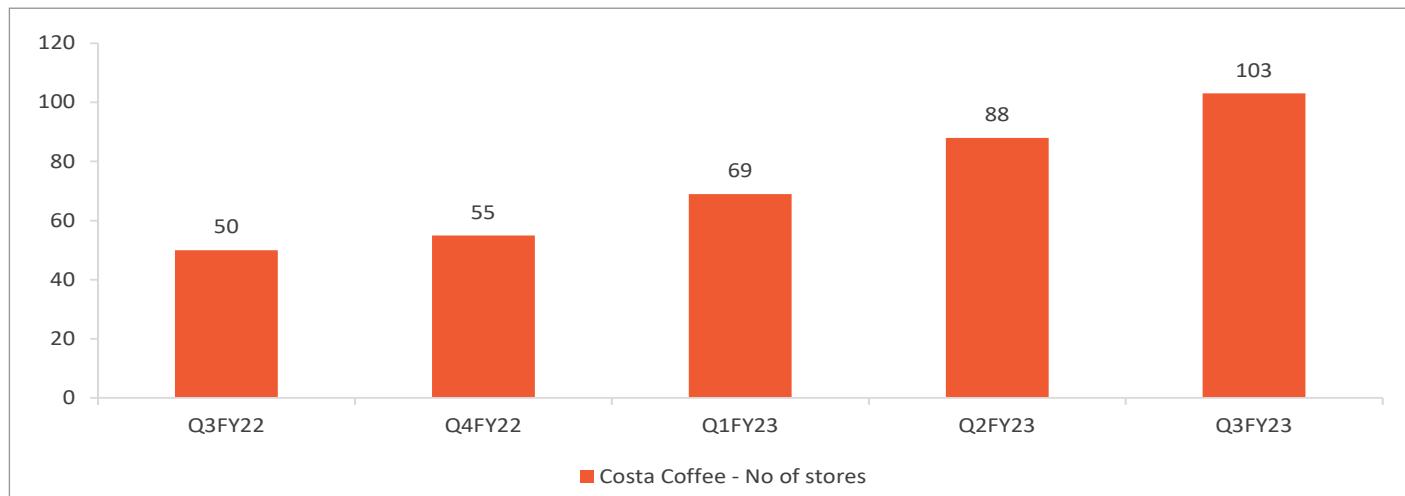


Source: Company; Sharekhan Research

Costa Coffee gaining momentum

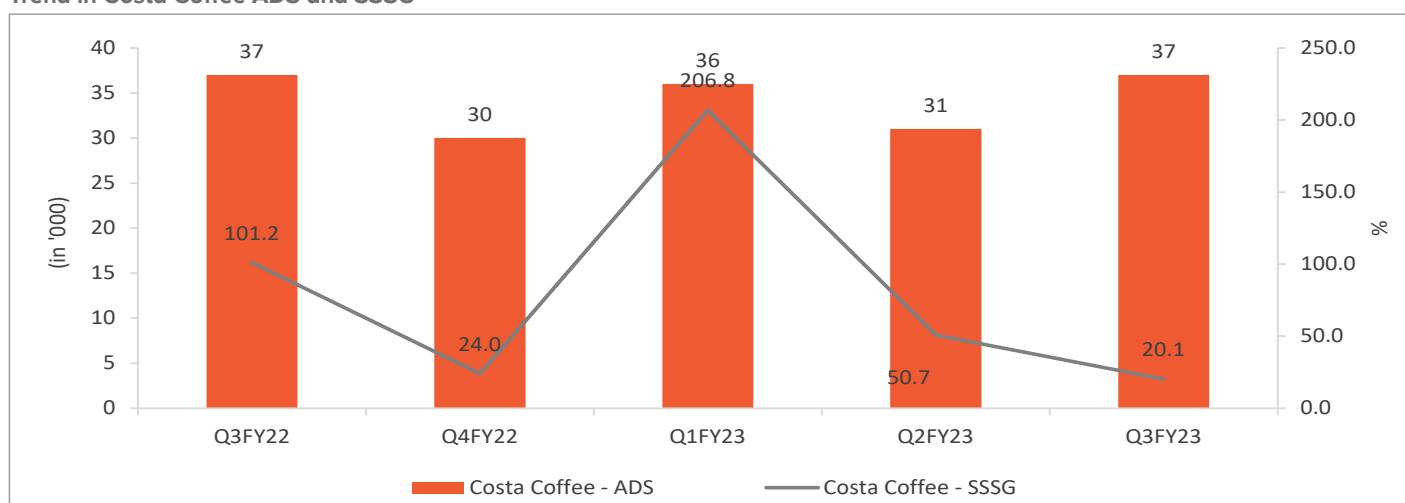
Costa Coffee's revenue grew by 2.0x y-o-y to Rs. 29 crore on a low base of Q3FY2022. The company added net 53 stores (net) in one year, taking the total store count to 103 stores at Q3FY2023-end (15 net new stores were added in Q3FY2023). ADS for the quarter stood flat y-o-y at Rs. 0.37 lakhs in Q3FY2023, up from Rs. 0.31 lakhs in Q2FY2023. SSSG came in at 20.1% in Q3FY2023. Gross margin of Costa Coffee business declined by 200 bps y-o-y to 77.8%, while brand contribution witnessed a steep decline of 570 bps y-o-y to 26.4% in Q3FY2023 due to aggressive store openings.

Trend in Costa Coffee stores



Source: Company; Sharekhan Research

Trend in Costa Coffee ADS and SSSG



Source: Company; Sharekhan Research

Double-digit revenue growth in the international business

International business revenue grew by 16.1% y-o-y to Rs. 66.2 crore, aided by new store additions. The company added 11 stores (net) in one year (8 added in Q3), taking the total store count to 57 stores at Q3FY2023-end. ADS for the international business reduced to Rs. 1.34 lakhs in Q3FY2023 from Rs. 1.48 lakhs in Q3FY2022.

Key highlights of the conference call

- **Demand expected to be impacted in the near term; Long-term outlook positive:** The company witnessed weakness in demand in November post the festive season, while October and December saw good traction to demand. Volumes are stable, but the ticket price is lower owing to high consumer inflation. As per management, the current demand slowdown is temporary, and management expects the sentiment to improve with consumer inflation cooling off. The company is confident about the long-term outlook aided by the positive outlook for the overall QSR sector.
- **Margins to stabilise over the next couple of quarters:** As per management, raw-material inflation has moderated for other inputs, but price of milk and cheese is still at elevated levels. Management expects margins to see a sequential improvement with the stabilisation of raw-material prices. However, y-o-y improvement in gross margins would be visible as SSSG improves. KFC's gross margins are expected to remain stable q-o-q; however, Pizza Hut may witness some pressure on margins due to higher price of cheese and milk and unfavourable product mix.

- ♦ **Fun flavour pizza to help in adding volume in Pizza Hut:** As per management, though the fun flavour pizza range led to some downtrading, it helped the company to retain its existing customers in the current inflationary times (the company would have lost sales in the absence of the value range) and expects the fun flavour pizza to aid in adding more customers going ahead. The fun flavour pizza range has lower margins currently, impacting the overall margins for Pizza Hut. However, management has indicated that the company is working on improving margins from this range, and it would take time to recover margins to regular pizzas.
- ♦ **Costa Coffee gaining salience:** For Costa Coffee, DIL plans to open smaller stores and flagship stores in metro locations where demand is higher. As per management, SSSG in Costa Coffee is largely volume-driven, as price impact is minimal. The company aims to further scale up the Costa brand in the coming quarters.
- ♦ **Store expansion to focus on KFC:** The company has maintained its outlook of opening 250-300 stores per annum. In FY2024, DIL's focus would be on rapid expansion in KFC. The company is currently experimenting on the flagship store strategy, wherein 10% of new stores to be opened would be flagship stores. The flagship stores would be bigger and have better looks with a digital focus. The idea of the flagship stores is to improve KFC's ADS in future. The company has already opened five flagship stores in Q3 and plans to take the flagship store count to 10% of overall stores if the strategy is yielding good profitability.

Results (Consolidated)

Particulars	Q3FY23	Q3FY22	y-o-y %	Q2FY23	Rs cr q-o-q %
Net revenue	790.6	624.4	26.6	747.4	5.8
Material cost	242.4	178.7	35.6	222.9	8.8
Employee cost	86.0	72.8	18.1	88.1	-2.4
Other expenditure	288.3	225.1	28.1	271.0	6.4
Total expenditure	616.7	476.6	29.4	581.9	6.0
Operating profit	173.9	147.8	17.7	165.5	5.1
Other income	8.1	3.9	-	4.5	78.5
Interest expenses	37.8	29.6	27.6	34.8	8.6
Depreciation	70.6	55.8	26.7	65.2	8.4
Profit Before Tax	73.5	66.3	10.9	70.0	5.0
Tax	-4.0	0.9	-	4.9	-
Adjusted PAT	77.5	65.4	18.6	65.2	18.9
Extra-ordinary gain / loss	-6.5	0.6	-	-8.4	-22.4
Reported PAT	71.0	66.0	7.6	56.8	25.0
Adjusted EPS (Rs.)	0.6	0.5	18.6	0.5	18.9
			bps		bps
GPM (%)	69.3	71.4	-204	70.2	-84
OPM (%)	22.0	23.7	-167	22.1	-14
NPM (%)	9.8	10.5	-67	8.7	108
Tax rate (%)	-5.4	1.4	-681	6.9	-178

Source: Company, Sharekhan Research

Brand-wise revenue performance

Particulars	Q3FY23	Q3FY22	y-o-y %	Q2FY23	Rs cr q-o-q %
KFC	459.5	362.1	26.9	443.0	3.7
Pizza Hut	183.6	155.6	18.0	181.2	1.3
Costa Coffee	29.1	14.3	103.5	22.0	32.3
Others	52.2	35.4	47.3	45.3	15.2
DIL India revenue	724.4	567.4	27.7	691.5	4.8
International	66.2	57.0	16.1	55.9	18.4
DIL Consolidated revenue	790.6	624.4	26.6	747.4	5.8

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Long-term growth prospects of the QSR industry are intact

After COVID-led disruptions caused a lull for two years, QSRs are geared up for a solid recovery in FY2023 and FY2024. Most companies bounced back in Q1FY2023, with their ADS crossing pre-COVID levels. This was led by strong recovery in the dine-in business, higher footfalls, sustained frequency of orders through digital platforms, and a large shift to branded products. The industry expects strong momentum to sustain in the quarters ahead with stark improvement in SSSG. Further, companies have opted for strong store expansions in every market to improve brand penetration in the coming years. QSR's long-term growth prospects are intact and QSRs are poised to beat the food services industry on higher demand for out-of-home consumption, market share gains from unorganised players, increased online delivery and food technology, menu innovation driving new demand, and incremental demand on account of offers and discounts. With robust growth drivers, QSRs are likely to grow strongly, outpacing other sub-segments in the food service industry in the coming years.

■ Company outlook - Strategies in place to drive revenue and earnings growth

In 9MFY2023, DIL's revenue grew by 50% y-o-y, with EBITDA margin remaining flat at 22.5%, while adjusted PAT grew by 2.3x y-o-y. The company opened 239 stores in 9MFY2023 and is on track to achieve its target of opening 250-300 stores during the year. The company has multiple strategies in place, including aggressive store openings, focusing on the flagship stores with higher ADS for Pizza Hut, improving the penetration of KFC, and developing the Costa Coffee brand, which will aid in strong revenue growth in the medium to long term. Increased contribution from (relatively high margin) KFC brand, improving store fundamentals of Pizza Hut brand, and fast scale-up in Costa Coffee will help in consistent improvement in gross margins in the coming years. This along with cross-brand synergies and improved profitability per unit will help EBIDTA margins to improve to 23% in FY2025E from 20.0% in FY2021.

■ Valuation - Retain Buy with a revised PT of Rs. 215

DIL's Q3 performance was in line with the slowdown in the quick service restaurants (QSR) industry, impacted by weak consumer sentiments. However, management indicated it to be a temporary phenomenon and expects recovery in the next two quarters. Further, with correction in input prices, margins are expected to improve in the coming quarters. An aggressive store expansion plan, strong brands under kitty coupled with an experienced parental background will help DIL's revenue and EBIDTA to post CAGR of 34% and 45%, respectively, over FY2022-FY2025E. The stock trades at 19.7x and 15.7x its FY2024E and FY2025E EV/EBIDTA, respectively. In view of the strong business model and long-term growth prospects, we maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 215.

Peer Comparison

Companies	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Jubilant Foodworks	67.9	67.9	46.2	28.6	25.3	20.3	21.3	18.7	22.4
Restaurant Brands Asia	-	-	-	45.7	39.6	16.9	-	-	0.4
Devyani International	-	68.9	46.4	40.5	28.4	19.7	15.4	20.1	25.3

Source: Company; Sharekhan Research

About company

DIL is the largest franchisee of Yum Brands in India and is among the largest operators of chain QSR in India, on a non-exclusive basis, and operates 1,177 stores across more than 224 cities in India, Nigeria, and Nepal, as of December 31, 2022. DIL's business is broadly classified into three verticals that includes stores of KFC, Pizza Hut, and Costa Coffee operated in India – Core Brands Business; stores outside India primarily comprising KFC and Pizza Hut stores operated in Nepal and Nigeria – International Business; and certain other operations in the food and beverage (F&B) industry, including stores of the company's own brands such as Vaango and Food Street – Other Business.

Investment theme

DIL is a multi-dimensional QSR player with a strong portfolio of global brands (including KFC, Pizza Hut, and Costa Coffee). The company's strong association with Yum Brands will help it create more opportunities in India's growing QSR market. DIL plans to add 250-300 outlets p.a. (as against 60-70 stores added p.a. in the earlier years) with a cluster-based approach in India. A strong recovery in out-of-home consumption, rising traction for branded products, strong store expansion plans, boosting value proposition through an innovated menu, widening delivery reach, and various cost-saving initiatives will help DIL's revenue and EBITDA to post a CAGR of 34% and 45%, respectively, over FY2022-FY2025E. The company is likely to generate a cumulative FCF of ~Rs. 400 crore over FY2022-FY2025.

Key Risks

- ♦ **Slowdown in demand:** Any slowdown in the demand environment would impact revenue growth.
- ♦ **Increased raw-material costs:** A significant increase in key raw-material prices would impact profitability.
- ♦ **Increased competition:** Increased competition in the QSR category would act as a threat to revenue growth.

Additional Data

Key management personnel

Ravi Kant Jaipuria	Chairman
Virag Joshi	CEO
Manish Dawar	Chief Financial Officer
Varun Kumar Prabhakar	Company Secretary & Compliance Officer

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Tamasek Holdings Pte. Ltd.	5.95
2	Yum Restaurants India Pvt. Ltd.	4.41
3	Nippon Life India AMC	1.91
4	Sabre Investment Consultant	1.42
5	Nomura Holdings Inc.	0.95
6	ICICI Prudential Life Insurance	0.87
7	FIL Ltd.	0.67
8	Vanguard Group Inc.	0.54
9	Invesco AMC	0.50
10	Goldman Sachs Group Inc.	0.39

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Registered Office: Sharekhan Limited, The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA, Tel: 022 - 67502000/ Fax: 022 - 24327343. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O/ CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183.

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