

Sapphire Foods

Estimate changes

TP change

Rating change



Bloomberg	SAPPHIRE IN
Equity Shares (m)	64
M.Cap.(INRb)/(USDb)	80.2 / 1
52-Week Range (INR)	1573 / 910
1, 6, 12 Rel. Per (%)	-5/-3/-3
12M Avg Val (INR M)	253

Financials & Valuations (INR b)

Y/E March	2023E	2024E	2025E
Sales	23.2	29.3	35.7
Sales Gr. (%)	34.8	26.1	21.8
EBITDA	4.4	5.8	7.4
EBITDA Margin (%)	18.9	19.7	20.9
Adj. PAT	1.1	1.5	2.2
Adj. EPS (INR)	17.0	23.1	35.2
EPS Gr. (%)	134.3	36.1	52.6
BV/Sh.(INR)	175.5	198.5	233.7
Ratios			
RoE (%)	10.2	12.3	16.3
RoCE (%)	10.3	11.1	13.1
Valuation			
P/E (x)	74.4	54.7	35.8
P/BV (x)	7.2	6.4	5.4
EV/Sales (x)	3.3	2.6	2.0
EV/EBITDA (x)	17.8	13.1	9.6
Pre-IND AD 116	28.7	20.7	14.6
Ev/EBITDA (x)			

Shareholding pattern (%)

As On	Dec-22	Sep-22	Dec-21
Promoter	44.9	51.3	51.3
DII	25.0	16.8	8.6
FII	16.5	12.6	16.0
Others	13.6	19.3	24.2

FII Includes depository receipts

CMP: INR1,262

TP: INR1,670 (+32%)

Buy

In-line EBITDA; near-term demand outlook subdued

- SAPPHIRE's 3QFY23 EBITDA was broadly in line with expectations, as a beat on EBITDA margin (19.6% v/s our estimate of 19.2%) made up for a 4.5% miss on net sales.
- SSSG in KFC was marginally below expectations (3% v/s our expectation of 5%), but Pizza Hut's SSSG came in lower (at -4% v/s our estimate of +2%). However, sequentially, gross margin increased ~70bp and EBITDA margin increased ~130bps, owing to easing material cost pressure in KFC. Sri Lanka business ADS has been stable in recent months but full recovery will take time.
- We retain our **BUY** rating with a TP of INR1,670, given SAPPHIRE's healthy earnings growth trend and relatively inexpensive valuations v/s QSR peers.

SSSG miss lower than peers

- SAPPHIRE's consolidated sales grew 17.5% YoY to INR5,961m in 3QFY23 (est. INR6,241m).
- SSSG: KFC at +3% (est. 5%), PH at -4% (est. 2%), and SL at +18% in LKR terms.
- Net new units (NNU): 24 for KFC, 25 for PH, and 8 for SL.
- Number of stores as of 3QFY23: KFC at 325, PH at 274, and SL at 114; total 715 stores as of 3QFY23.
- Consolidated gross margin contracted ~210bp YoY but expanded ~70bp QoQ to 67.1%.
- SAPPHIRE's EBITDA (post-IND AS) was flat YoY at INR1,167m (est. INR1,197m). EBITDA margin contracted ~300bp YoY but expanded ~130bp QoQ to 19.6% (est. 19.2%).
- EBITDA (pre-IND AS) stood at INR738m (v/s INR823m YoY) with a margin of 12.4%.
- Adj. PAT declined 35.9% YoY to INR327m v/s our estimate of INR347m..
- In 9MFY23, sales/EBITDA/adj. PAT grew 39.2%/60.9%/401.4% YoY to INR17.1b/INR3.3b/INR977m.

Highlights from the management commentary

- **Demand** – It was a difficult quarter with post-Diwali demand challenges as inflation affected customers' wallets. Demand softness is likely to continue.
- **Brand impact** – The demand impact was more acute for Pizza Hut than it was for KFC and it was exacerbated by cannibalization by the newly launched Flavour Fun value product.
- **Margins** - KFC margins will be at 3QFY23 levels going forward, while Pizza Hut gross margins are likely to decline in 4QFY23 as a result of cheese cost inflation.
- **Sri Lanka** – Dine-in has come back strongly, but ADS is stable sequentially in INR terms due to the cross-currency impact. EBITDA contribution of Sri Lanka will be ~10% in FY23 v/s over 20% in FY22. While Inflation has started to ease, management expects muted demand in Sri Lanka for 6-9 months.

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Investors are advised to refer through important disclosures made at the last page of the Research Report.

Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

Valuation and view

- Despite in-line EBITDA in 3QFY23, easing material cost pressures and relative stability in Sri Lanka, we have cut our EBITDA forecasts for FY23/FY24 by around 4-6% given the demand environment remaining weak in 4QFY23 as well.
- The stock has done well with over 26% return since our [coverage initiation note](#) in May'22 in spite of the recent correction. Despite a strong pre-Ind AS EBITDA growth outlook (30%+ CAGR over FY23-25E), the stock trades at inexpensive multiples of 20.7x/14.6x FY24E/FY25E Pre Ind-AS EBITDA.
- We have assigned an FY25E EV/EBITDA (pre-Ind AS 116) multiple of 23x to the KFC business on account of its robust metrics (ADS and restaurant EBITDA margin), and 12x to the PH business. These multiples are at a 35%/50% discount to the target multiples for DEVYANI's KFC/PH businesses (35x/25x) due to the following disadvantages that SAPPHIRE faces in terms of trade: 1) its territorial rights in KFC are largely in states with a relatively higher vegetarian population, and 2) DEVYANI can venture into SAPPHIRE's territories with PHD format stores, which require lower capex. While some discount to multiples is justified given the abovementioned reasons, the earnings growth opportunity for SAPPHIRE is still attractive enough to warrant an investment case despite near-term uncertainty on demand recovery. **We retain our BUY rating with a TP of INR1,670 on an SoTP basis.**

Quarterly Performance

(INR m)

Y/E March	FY22				FY23				FY22	FY23E	FY23 3QE	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE				
KFC - No. of stores	208	219	250	263	281	301	325	335	263	335	316	
PH - No. of stores	171	188	209	219	235	249	274	289	219	289	264	
KFC - SSSG (%)	149.0	NA	29.0	15.0	65.0	15.0	3.0	10.0	31.0	11.0	5.0	
PH - SSSG (%)	-29.0	NA	22.0	3.0	47.0	23.0	-4.0	10.0	42.0	9.0	2.0	
Net Sales	3,031	4,142	5,075	4,968	5,463	5,628	5,961	6,158	17,216	23,210	6,241	-4.5
YoY change (%)	173.0	76.9	52.0	45.9	80.3	35.9	17.5	24.0	68.8	34.8	23.0	
Gross Profit	2,130	2,884	3,510	3,414	3,707	3,737	3,998	4,162	11,938	15,603	4,192	-4.6
Margin (%)	70.3	69.6	69.2	68.7	67.9	66.4	67.1	67.6	69.3	67.2	67.2	
EBITDA	341	566	1,145	998	1,104	1,032	1,167	1,078	3,050	4,380	1,197	-2.5
EBITDA growth %	L/P	70.7	93.1	78.8	223.9	82.2	1.9	8.0	145.2	43.6	4.5	
Margin (%)	11.2	13.7	22.6	20.1	20.2	18.3	19.6	17.5	17.7	18.9	19.2	
Depreciation	534	512	513	576	609	628	681	744	2,135	2,662	700	
Interest	172	190	185	233	197	206	217	243	781	863	220	
Other Income	109	95	78	98	59	71	67	55	380	252	100	
PBT	-256	-41	525	286	356	269	336	147	514	1,108	377	-10.9
Tax	8	10	16	21	-25	1	9	46	54	30	30	
Rate (%)	-	-	2.9	7.3	-7.1	0.3	2.6	31.5	10.5	2.8	8.0	
Adjusted PAT	-264	-51	510	265	381	269	327	100	460	1,078	347	-5.7
YoY change (%)	-	-	N/M	-	L/P	L/P	-35.9	-62.1	-	134.3	-32.0	

E: MOFSL Estimates

Quarterly brand-wise performance

	3QFY21	4QFY21	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23
KFC									
No. of stores	196	203	208	219	250	263	281	301	325
Net store addition	8	7	5	11	31	13	18	20	24
SSSG (%)	(10)	12	149	NA	29	15	65	15	3
Net sales (INR m)	1,983	2,081	1,788	2,565	3,031	2,966	3,537	3,491	3,810
YoY growth (%)	(4.9)	NA	245.5	94.8	52.8	42.5	97.9	36.1	25.7
ADS (INR '000)	115	118	105	134	144	132	144	134	136
Gross Margins (%)	68.1	68.6	69.3	68.7	68.0	67.9	67.3	65.6	66.5
Restaurant EBITDA Margin (%)	18.7	18.1	13.5	20.6	21.2	19.0	20.3	17.9	20.2
Channel mix (%)									
Delivery	34	33	62	NA	37	40	35	36	36
Dine-in + Takeaway	66	67	38	NA	63	60	65	64	64
Pizza Hut									
No. of stores	161	162	171	188	209	219	235	249	274
Net store addition	2	1	9	17	21	10	16	14	25
SSSG (%)	(19)	8	(29)	NA	22	3	47	23	(4)
Net sales (INR m)	751	776	660	884	1,134	1,032	1,219	1,410	1,364
YoY growth (%)	(18.3)	NA	203.2	87.1	51.0	33.0	84.6	59.5	20.3
ADS (INR '000)	53	54	49	57	64	55	61	64	58
Gross Margins (%)	75.4	76.6	76.5	75.8	75.4	74.8	75.3	74.7	74.4
Restaurant EBITDA Margin (%)	11.2	11.2	5.8	10.7	14.9	11.5	14.8	15.1	14.1
Channel mix (%)									
Delivery	49	45	78	NA	49	52	47	50	50
Dine-in + Takeaway	51	55	22	NA	51	48	53	50	50
Sri Lanka									
No. of stores	66	70	69	73	89	95	98	106	114
Net store addition	1	4	(1)	4	16	6	3	8	8
SSSG (%)	3	8	56	NA	44	29	53	37	18
Net sales (INR m)	570	501	555	653	858	917	650	669	731
YoY growth (%)	6.1	-	51.7	23.6	50.5	83.1	17.1	2.5	(14.8)
ADS (INR '000)	98	97	91	105	121	112	75	73	75
Gross Margins (%)	66.8	-	66.9	66.0	67.2	64.9	58.8	55.4	57.3
Restaurant EBITDA Margin (%)	20.2	26.3	18.0	19.6	23.9	24.4	15.5	15.0	14.6

Source: MOFSL, Company



Highlights from the management commentary

Environment and outlook

- It was a difficult quarter with post-Diwali demand challenges, as inflation affected customers' wallets.
- Even with the expansion, KFC SSSG would have been in the 6-7% range instead of 3% if not for the demand slowdown.
- Demand softness is likely to persist.
- The demand impact was more acute for Pizza Hut than it was for KFC.
- No impact of McDonalds chicken entry on demand incrementally.

Expansion and brands

- Management has maintained its previous guidance of 130-160 store additions per year.

Costs and margins

- Material costs are stabilizing for KFC but are inflating for Pizza Hut.
- KFC margins will be at 3QFY23 levels going forward, but Pizza Hut gross margins are likely to decline in 4QFY23 as a result of cheese cost inflation.
- Corporate overheads stood at 5.7%, of which 0.8% accounted for ESOP costs (which isn't there for Devyani). ESOP costs to sales will come down by 30bp going ahead.

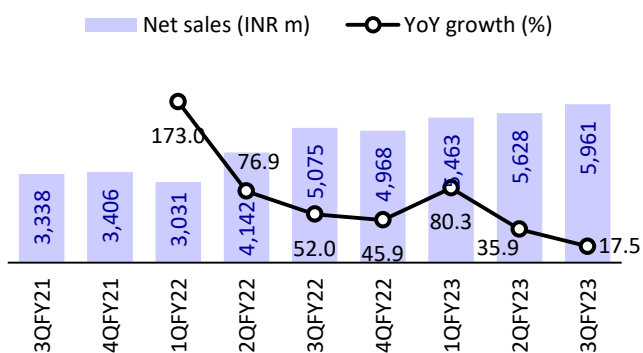
- As of now there are no plans for a price increase.
- The Flavor Fun product is at an early stage, which is leading to a lower average ticket size for now. Demand slowdown, not the Flavour Fun product, was a bigger factor for lower SSSG.

Sri Lanka

- Dine-in has come back strongly but ADS stable sequentially in INR terms due to the cross-currency impact.
- EBITDA contribution of Sri Lanka will be ~10% in FY23 v/s over 20% in FY22.
- Expect 6-9 months of muted demand in Sri Lanka.
- The restaurant addition pace will decline going forward.

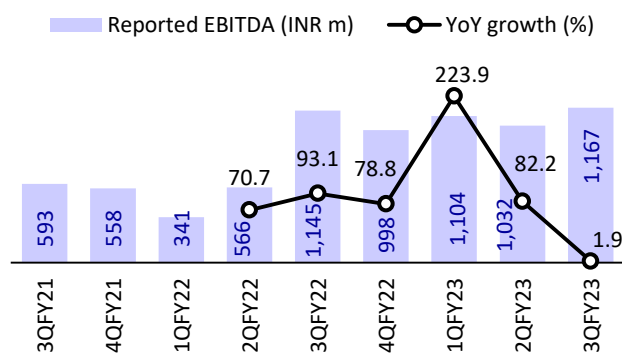
Key exhibits

Exhibit 1: Net sales grew 17.5% YoY to INR6.0b in 3QFY23



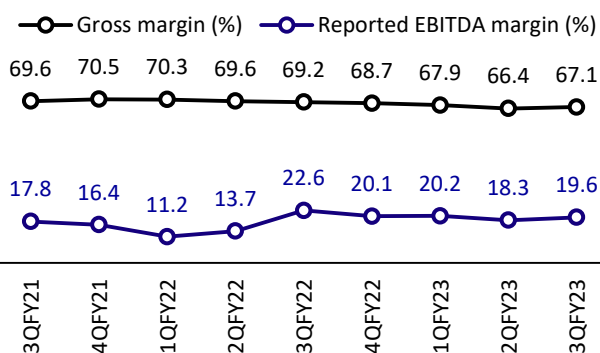
Source: Company, MOFSL

Exhibit 2: EBITDA was flat YoY at INR1.2b



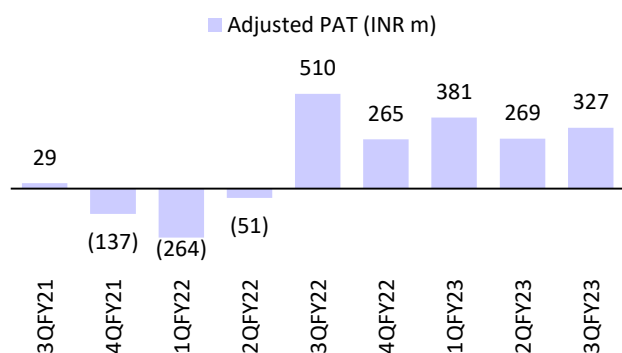
Source: Company, MOFSL

Exhibit 3: Gross/reported EBITDA margin came in at 67.1%/19.6% in 3QFY23, respectively



Source: MOFSL, Company

Exhibit 4: Adjusted PAT came in at INR327m



Source: MOFSL, Company

Valuation and view

- Despite in-line EBITDA for 3QFY23, easing material cost pressures and relative stability in Sri Lanka, we have cut our EBITDA forecasts for FY23/FY24 by around 6% given the demand environment remaining weak in 4QFY23 as well.
- The stock has done well with over 26% return since our [coverage initiation note](#) in May'22 in spite of the recent correction. Despite a strong pre-Ind AS EBITDA growth outlook (30%+ CAGR over FY23-25E), the stock trades at inexpensive multiples of 20.7x/14.6x FY24E/ FY25E Pre Ind-AS EBITDA.
- We have assigned an FY25 EV/EBITDA (pre-Ind AS 116) multiple of 23x to the KFC business on account of its robust metrics (ADS and restaurant EBITDA margin), and 12x to the PH business. These multiples are at a 35%/50% discount to the target multiples for DEVYANI's KFC/PH businesses (35x/25x) due to the following disadvantages that SAPPHIRE faces in terms of trade: 1) its territorial rights in KFC are largely in states with a relatively higher vegetarian population, and 2) DEVYANI can venture into SAPPHIRE's territories with PHD format stores, which require lower capex. While some discount to multiples is justified given the abovementioned reasons, the earnings growth opportunity for SAPPHIRE is still attractive enough to warrant an investment case despite near-term uncertainty on demand recovery. **We retain our BUY rating with a TP of INR1,670 on an SoTP basis.**

Exhibit 5: SoTP valuation for SAPPHIRE based on pre-Ind AS EV/EBITDA

	Mar'25E EBITDA*	Multiple	EV
KFC	3.7	23x	84.1
Pizza Hut	0.9	12x	11.0
Sri Lanka	0.5	5x	2.3
Others	0.0	1x	0.0
Total	5.0	25.7x	97.4
Net debt	FY25E		-8.9
Equity value			106.3
TP (INR)			1,670
Upside (%)			32%

*Pre-Ind AS 116

Source: Company, MOFSL

Exhibit 6: We lower FY23/FY24/FY25 EBITDA estimates by 4.4%/5.8%/2.2%, respectively

INR m	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Sales	23,210	29,278	35,664	23,680	29,729	36,323	-2.0	-1.5	-1.8
EBITDA	4,380	5,754	7,446	4,581	6,110	7,618	-4.4	-5.8	-2.2
PAT	1,078	1,466	2,238	1,330	1,862	2,386	-19.0	-21.2	-6.2

Source: Company, MOFSL

Financials and valuations

Income Statement consol.							(INR m)
Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	11,938	13,404	10,196	17,216	23,210	29,278	35,664
Change (%)		12.3	-23.9	68.8	34.8	26.1	21.8
Raw Materials	3,946	4,317	3,099	5,278	7,607	9,269	11,005
Gross Profit	7,992	9,087	7,097	11,938	15,603	20,009	24,659
Margin (%)	66.9	67.8	69.6	69.3	67.2	68.3	69.1
Operating Expenses	6,532	7,232	5,853	8,888	11,223	14,255	17,212
EBITDA	1,460	1,856	1,244	3,050	4,380	5,754	7,446
Change (%)		27.1	-33.0	145.2	43.6	31.4	29.4
Margin (%)	12.2	13.8	12.2	17.7	18.9	19.7	20.9
Depreciation	1,547	1,913	2,091	2,135	2,662	3,479	4,184
Int. and Fin. Charges	720	722	756	781	863	951	1,049
Other Income	125	113	616	380	252	361	583
Profit before Taxes	-683	-666	-987	514	1,108	1,685	2,797
Change (%)		-2.5	48.2	-152.1	115.6	52.1	66.0
Margin (%)	-5.7	-5.0	-9.7	3.0	4.8	5.8	7.8
Total tax	11	-17	12	54	30	219	559
Tax Rate (%)	-1.6	2.6	-1.2	10.5	2.8	13.0	20.0
Adjusted PAT	-694	-649	-999	460	1,078	1,466	2,238
Change (%)		-	-	L/P	134.3	36.1	52.6
Margin (%)	-5.8	-4.8	-9.8	2.7	4.6	5.0	6.3
Minority Interest	0	0	-14	-5	0	0	0
Exceptional/Prior Period inc	0	944	0	0	0	0	0
Reported PAT	-694	-1,592	-985	465	1,078	1,466	2,238

Balance Sheet							(INR m)
Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Share Capital	431	502	528	635	635	635	635
Reserves	3,585	4,742	4,271	9,436	10,514	11,980	14,217
Net Worth	4,016	5,245	4,799	10,071	11,149	12,615	14,853
Loans	853	592	520	612	612	612	612
Other Liability	5,455	5,744	5,692	7,280	7,667	8,591	9,662
Minority Interest	11	3	-12	-17	-17	-17	-17
Capital Employed	10,335	11,582	11,000	17,947	19,411	21,802	25,110
Gross Block	5,473	6,567	6,905	8,948	11,908	14,427	17,254
Less: Accum. Depn.	1,587	2,221	2,974	3,487	6,003	9,482	13,666
Net Fixed Assets	3,886	4,346	3,932	5,462	5,905	4,945	3,588
Capital WIP	210	215	304	327	327	327	327
Goodwill	2,539	1,622	1,622	1,622	1,622	1,622	1,622
Other Intangible assets	767	688	551	566	623	685	753
Right to Use Assets	4,859	4,953	4,739	6,249	8,347	9,136	9,726
Investments	0	155	267	1,525	2,000	2,500	3,000
Current	0	155	267	1,525	2,000	2,500	3,000
Curr. Assets, L&A	3,414	1,828	2,074	5,890	5,113	7,966	12,373
Inventory	381	444	474	652	879	1,108	1,350
Account Receivables	224	46	78	141	190	239	291
Cash and Bank Balance	1,865	392	500	2,546	1,035	3,066	6,540
Others	944	947	1,022	2,551	3,010	3,552	4,192
Curr. Liab. and Prov.	5,340	2,224	2,490	3,692	4,525	5,378	6,280
Account Payables	1,142	1,307	1,440	1,991	2,684	3,386	4,125
Other Liabilities	4,051	767	887	1,525	1,647	1,779	1,921
Provisions	147	151	163	176	193	213	234
Application of Funds	10,335	11,582	11,000	17,947	19,411	21,802	25,110

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Basic (INR)							
EPS	-16.1	-12.9	-18.9	7.2	17.0	23.1	35.2
Cash EPS	19.8	25.2	20.7	40.8	58.8	77.8	101.1
BV/Share	93.2	104.4	90.9	158.5	175.5	198.5	233.7
Valuation (x)							
P/E	N/M	N/M	N/M	174.3	74.4	54.7	35.8
Cash P/E	63.7	50.1	61.0	30.9	21.4	16.2	12.5
EV/Sales	4.5	4.7	6.5	4.5	3.3	2.6	2.0
EV/EBITDA	36.6	34.2	53.3	25.2	17.8	13.1	9.6
P/BV	13.5	12.1	13.9	8.0	7.2	6.4	5.4
Return Ratios (%)							
RoE		-14.0	-19.9	6.2	10.2	12.3	16.3
RoCE		0.5	-2.1	8.0	10.3	11.1	13.1
RoIC		-0.6	-8.1	6.5	10.1	10.9	14.2
Working Capital Ratios							
Debtor (Days)	7	1	3	3	3	3	3
Asset Turnover (x)	1.2	1.2	0.9	1.0	1.2	1.3	1.4
Leverage Ratio							
Debt/Equity (x)	0.2	0.1	0.1	0.1	0.1	0.0	0.0

Cash Flow Statement

Y/E March	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
(INR m)							
OP/(loss) before Tax	-683	-1,610	-987	514	1,108	1,685	2,797
Depreciation	1,547	1,913	2,091	2,135	2,662	3,479	4,184
Net interest	627	620	697	677	610	590	466
Others	94	1,052	-378	117	0	0	0
Direct Taxes Paid	-38	-27	-30	-86	-30	-219	-559
(Incr)/Decr in WC	-46	182	147	592	98	32	-31
CF from Operations	1,501	2,130	1,541	3,949	4,448	5,566	6,856
Incr in FA	-1,744	-1,415	-734	-2,844	-2,960	-2,518	-2,827
Free Cash Flow	-243	715	807	1,105	1,488	3,048	4,028
Pur of Investments	-1,585	1,313	-55	-4,078	-475	-500	-500
Others	1,697	-1,419	-128	1,890	-2,300	-851	-659
CF from Invest.	-1,632	-1,522	-917	-5,032	-5,735	-3,870	-3,986
Issue of Shares	2,321	0	444	4,690	0	0	0
Incr in Debt	646	-218	61	-176	386	925	1,070
Dividend Paid	0	0	0	0	0	0	0
Net interest Paid	-709	-699	-758	-780	-610	-590	-466
Others	-490	-1,165	-263	-604	0	0	0
CF from Fin. Activity	1,767	-2,081	-515	3,130	-224	335	605
Incr/Decr of Cash	1,636	-1,473	109	2,046	-1,512	2,032	3,474
Add: Opening Balance	228	1,865	392	500	2,546	1,035	3,066
Closing Balance	1,865	392	500	2,546	1,035	3,066	6,540

E: MOFSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall be within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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