

Sapphire Foods

Refer to important disclosures at the end of this report

Good margin performance in a challenging quarter; maintain BUY

CMP	Target Price
Rs 1,255 as of (February 9, 2023)	Rs 1,620 (▼) 12 months
Rating	Upside
BUY (■)	29.1 %

Sapphire's Q3 EBITDA was largely in line with expectations. SSG performance for KFC was similar to DIL's at 3%, but PH performance was better at (4%) vs. (6%) for DIL. Brand margin performance was better for Sapphire, which saw 80-100bps decline across formats vs. 270-330bps decline for DIL. Management's near-term commentary was cautious, but Sapphire retained its outlook of 5-7% SSG for both formats, underpinned by a strong pipeline of new launches, brand marketing and entry into the value-pizza segment. Store additions for Sapphire were lower vs. DIL's, but remained robust with net additions of 57/136 stores in Q3/9M. Guidance of 140-180 additions was retained. Retention of store targets and peaking of consumer-level inflation suggest anticipation of demand recovery sooner than later. Near-term demand and inflation challenges persist in SL, but operating conditions have normalized. Factoring-in brand investments and elevated cheese prices leads to a ~5% cut to FY24E/25E EBITDA. We expect Sapphire to deliver a strong EBITDA CAGR of ~35% over FY22-25E, led by a 20% store-count CAGR, 8% SSG, and gradual margin gains. We maintain BUY on the stock, with TP of Rs1,620/share (19x Mar-25E EBITDA - Pre IndAS-116).

Result summary: KFC revenues grew by 26%, led by growth of 34% in store-count and 3% in SSG, while PH revenues saw 20% growth, led by growth of 32% in store-count and -4% in SSG. With new menu launches, marketing initiatives and deeper penetration, Sapphire continues to expect 5-7% SSG for the PH/KFC formats. Store additions at 57 remained robust, with 24/25 store adds for KFC/PH and 8 in SL, despite inflation-led challenges. Inflationary pressures impacted brand EBITDA margins by 80-100bps for PH/KFC-India, adjusting for one-off incentives in the base. However, a 950bps fall in SL brand-margins led to a ~200bps decline in overall EBITDA margins. HO costs remained flat in Q3, at 5.6%.

Earnings-call KTAs: 1) Sapphire indicated Q3 to be a challenging quarter post Diwali, due to softening of demand which is expected to continue in this calendar year. 2) Sapphire expects to reach 5-7% SSG for both the brands in coming 3-4 years, while maintaining its rate of store expansion at 17-18%. 3) Sapphire indicated that it has sufficient new launches in the next 12 months, to create enough excitement by focusing on product innovation and overall marketing investments. 4) It reiterated its aim to double its store-count (from 550 in FY22) in the next 2-3 years (140-180 stores per year). 5) Going forward, Sapphire plans to enhance focus on marketing, for improving visibility in the Pizza category. 6) In Sri Lanka, short-term profitability is challenged due to macro factors, despite operating conditions having stabilized. Sapphire remains bullish on the long-term prospects; EBITDA contribution to overall profitability has come down to 10% from 25% last year.

Financial Snapshot (Consolidated)

(Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	10,196	17,216	23,093	30,797	39,142
EBITDA	1,244	3,050	4,539	6,001	7,705
EBITDA Margin (%)	12.2	17.7	19.7	19.5	19.7
APAT	(999)	460	1,260	2,016	2,397
EPS (Rs)	(18.9)	7.2	19.8	31.7	37.7
EPS (% chg)	0.0	0.0	174.0	60.0	18.9
ROE (%)	(19.9)	6.2	11.8	16.3	16.5
P/E (x)	(66.3)	173.4	63.3	39.6	33.3
EV/EBITDA (x)	57.8	27.4	18.6	13.8	10.6
P/BV (x)	13.8	7.9	7.0	6.0	5.1

Source: Company, Emkay Research

Change in Estimates

EPS Chg FY23E/FY24E (%)	1/(9)
Target Price change (%)	(4.7)
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

	EPS Estimates	
	FY23E	FY24E
Emkay	19.8	31.7
Consensus	20.4	27.7
Mean Consensus TP (12M)	Rs 1,661	

Stock Details

Bloomberg Code	SAPPHIRE IN
Face Value (Rs)	10
Shares outstanding (mn)	64
52 Week H/L	1,574 / 909
M Cap (Rs bn/USD bn)	80 / 0.97
Daily Avg Volume (nos.)	2,81,926
Daily Avg Turnover (USD mn)	4.6

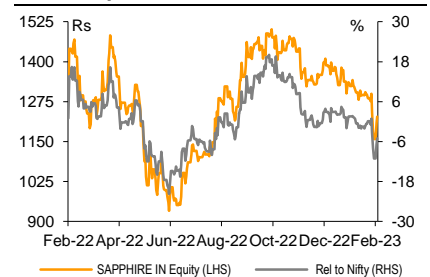
Shareholding Pattern [Quarter]

Promoters	%
FIIIs	%
DIIIs	%
Public and Others	%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(6)	(9)	(2)	(1)
Rel. to Nifty	(5)	(8)	(4)	(4)

Relative price trend



Source: Bloomberg

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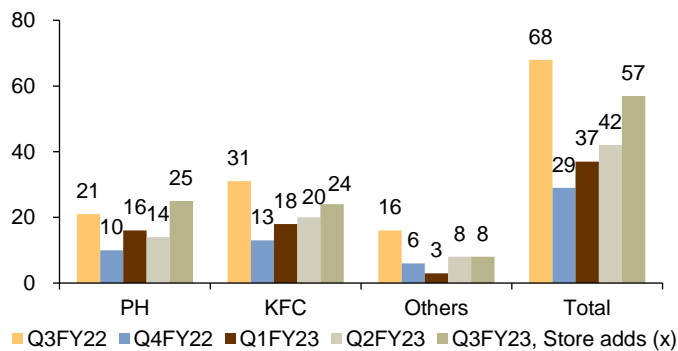
Story in Charts

Exhibit 1: Performance across key metrics over the past few quarters

Key Metrics (Rs mn)	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
KFC India						
Number of stores	219	250	263	281	301	325
ADS ('000)	1,34,000	1,44,000	1,32,000	1,44,000	1,34,000	1,36,000
Revenue	2,565	3,031	2,966	3,537	3,491	3,810
Gross margin (%)	68.5	68.0	67.9	67.3	65.6	66.5
Brand contribution margin (%)	20.7	22.5	19.0	20.3	17.9	20.2
PH India						
Number of stores	188	209	219	235	249	274
ADS ('000)	57,000	64,000	55,000	61,000	64,000	58,000
Revenue	884	1,134	1,032	1,219	1,410	1,364
Gross margin (%)	75.8	75.4	74.8	75.3	74.7	74.4
Brand contribution margin (%)	16.2	17.3	11.5	14.8	15.1	14.1
Sri Lanka (Pizza Hut)						
Number of stores	73	89	95	98	106	114
ADS ('000)	1,05,000	1,21,000	1,12,000	75,000	73,000	75,000
Revenue	653	858	917	650	669	731
Gross margin (%)	66.2	67.2	64.9	58.8	55.4	57.3
Brand contribution margin (%)	21.5	26.4	24.4	15.5	15.0	14.6
Others (Maldives)						
Revenue	28	32	28	30	34	34
Brand contribution margin (%)	8.6	13.5	21.5	16.1	5.4	3.9
Sapphire - Consolidated						
Number of stores	482	550	579	616	658	715
Store additions (no. of)	32	68	29	37	42	57
Revenue	4,130	5,055	4,943	5,436	5,604	5,939
Gross margin (%)	69.8	69.4	69.1	68.2	66.7	67.3
Brand contribution margin (%)	19.8	21.9	18.5	18.5	16.8	18.0
Overhead opex/revenue (%)	13.6	5.7	5.6	5.2	5.6	5.6
Consol. EBITDA	256	823	636	722	624	738
EBITDA margin (%)	6.2	16.3	12.9	13.3	11.1	12.4

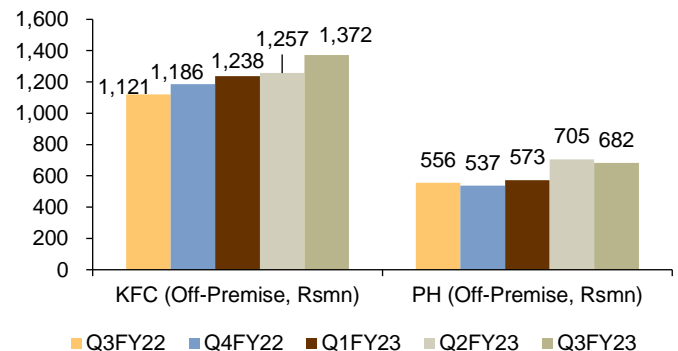
Source: Company, Emkay Research; *EBITDA/margins are pre IndAS-116

Exhibit 2: Sapphire added 57 stores in Q3FY23 – With 25/24 stores in PH/KFC and 8 in other formats

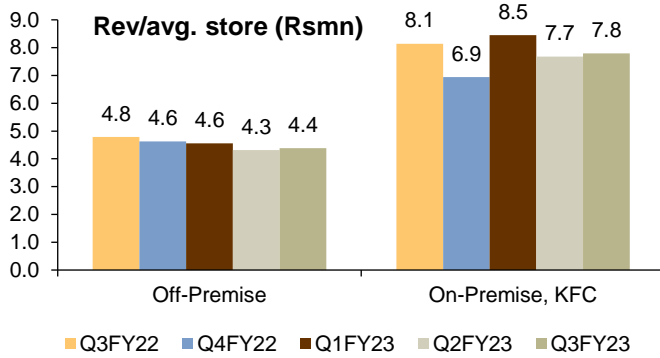


Source: Company, Emkay Research

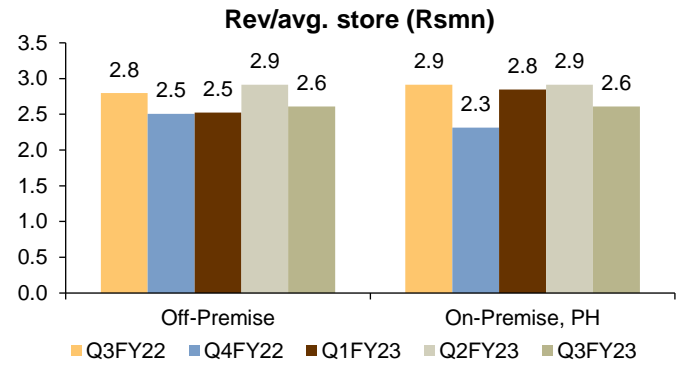
Exhibit 3: Channel-wise, off-premise sales grew 22% for KFC and 23% for Pizza Hut



Source: Company, Emkay Research

Exhibit 4: KFC's off-premise sales per store sustained sequentially, while on-premise sales/store saw a slight pick-up

Source: Company, Emkay Research

Exhibit 5: PH's off-premise sales per store as well as on-premise sales per store witnessed a decline

Source: Company, Emkay Research

Exhibit 6: Actual vs. Estimates (Q3FY23)

Rs mn	Actual	Estimates		Variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenue	5,961	6,052	6,093	-1.5%	-2.2%	Revenues were 1-2% lower than street/our estimates
EBITDA*	1,167	1,139	1,157	2.4%	0.8%	Better cost controls led to better margins
EBITDA Margin*	19.6%	18.8%	19.0%	75	58	
PAT	327	303	336	7.8%	-2.8%	PAT beat was largely due to higher EBITDA and lower tax

Source: Company, Emkay Research; *EBITDA/Margins are post-IndAS-116

Exhibit 7: Quarterly performance (Consolidated)

Y/E, March (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	YoY (%)	QoQ (%)	FY22TD	FY23TD	Gr (%)
Revenue	5,075	4,968	5,463	5,628	5,961	17.5	5.9	12,247	17,052	39.2
Expenditure	3,930	3,970	4,359	4,596	4,795	22.0	4.3	10,195	13,749	34.9
Consumption of RM	1,565	1,555	1,756	1,890	1,964	25.5	3.9	3,723	5,610	50.7
as % of sales	30.8%	31.3%	32.1%	33.6%	32.9%			30.4%	32.9%	
Employee Cost-Store	684	678	684	747	731	6.9	-2.1	2,062	2,162	4.9
as % of sales	13.5%	13.7%	12.5%	13.3%	12.3%			16.8%	12.7%	
Other expenditure	1,681	1,737	1,919	1,959	2,100	24.9	7.2	4,410	5,977	35.5
as % of sales	33.1%	35.0%	35.1%	34.8%	35.2%			36.0%	35.1%	
EBITDA	1,145	998	1,104	1,032	1,167	1.9	13.1	2,052	3,303	60.9
Depreciation	513	576	609	628	681	32.6	8.3	1,559	1,918	23.1
EBIT	632	421	495	404	486	-23.1	20.4	494	1,384	180.5
Other Income	78	98	59	71	67	-15.0	-6.6	282	197	-30.1
Interest	185	233	197	206	217	17.4	5.5	548	620	13.2
PBT	525	286	356	269	336	-36.1	24.6	228	961	
Total Tax	16	21	-25	1	9			33	-16	
Adjusted PAT	510	265	381	269	327	-35.9	21.7	195	977	
Extra ordinary items	0	0	0	0	0			0	0	
Reported PAT before MI	510	265	381	269	327	-35.9	21.7	195	977	
Minority Interest	0	0	-1	0	1			-1	-1	
Reported PAT	510	265	383	269	326	-36.1	21.3	196	978	
Reported EPS (Rs)	8.0	4.2	6.0	4.2	5.1	-36.1	21.3	2	15	
(%)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	YoY (%)	QoQ (%)	FY22TD	FY23TD	Gr (%)
EBITDA margin	22.6	20.1	20.2	18.3	19.6	-300	120	16.8	19.4	260
EBIT margin	12.4	8.5	9.1	7.2	8.2	-430	100	4.0	8.1	410
EBT margin	10.4	5.8	6.5	4.8	5.6	-470	80	1.9	5.6	380
PAT margin	10.1	5.3	7.0	4.8	5.5	-460	70	1.6	5.7	410
Effective Tax rate	2.9	7.3	-7.1	0.3	2.6	-30	230	14.5	-1.6	-1,620

Source: Company, Emkay Research; *EBITDA/Margins are post IndAS-116

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Exhibit 8: Peer Comparison

Company	Price (Rs)	M-Cap (Rs bn)	Rating	TP (Rs)	P/E (x)			EV/EBITDA (x) Pre-IND AS 116			EBITDA CAGR (%) FY23-25E	EV/E-G (x)*
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E		
Jubilant FoodWorks	443	293	Hold	480	66.8	52.4	41.9	35.2	27.9	22.7	24.5	1.4
Devyani International	159	191	Buy	215	69.5	65.5	48.2	41.3	32.6	24.8	29.1	1.4
Westlife Development	693	108	Hold	810	87.9	67.2	53.5	35.2	29.2	24.4	20.2	1.7
Sapphire Foods	1,258	80	Buy	1,620	63.4	39.6	33.4	27.7	19.7	14.8	36.5	0.8

Source: Company, Emkay Research; *EV/E-G is the ratio of FY23E EV/EBITDA to FY23E-25E EBITDA CAGR expectations

Exhibit 9: Changes in estimates

Y/E, March (Rs mn)	FY23E			FY24E			FY25E		
	Earlier	Revised	% Change	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	23,368	23,093	(1.2)	31,469	30,797	(2.1)	40,010	39,142	(2.2)
EBITDA*	2,710	2,767	2.1	4,085	3,875	(5.1)	5,408	5,153	(4.7)
EBITDA Margin* (%)	11.6	12.0	40 bps	13.0	12.6	-40 bps	13.5	13.2	-40 bps
PAT	1,245	1,260	1.2	2,214	2,016	(8.9)	2,582	2,397	(7.2)
EPS (Rs)	19.6	19.8	1.2	34.8	31.7	(8.9)	40.6	37.7	(7.2)

Source: Company, Emkay Research; *EBITDA/Margins are Post IndAS-116

Exhibit 10: Sapphire – Growth construct of the business, on the supply front

	FY20	FY22	FY25E	FY35E	CAGR (%)	
					FY25-35E	FY35+
No. of KFC stores (Sapphire)	187	263	460	1,167	9.8	2.5
No. of PH stores (Sapphire)	174	219	409	875	7.9	2.5
No. of Others stores (SL/Maldives)	66	97	146	256	5.8	2.5
Total Sapphire stores (no. of)	427	579	1,015	2,298	8.5	2.5
SSG (%)					5.9	5.0
Sapphire - Revenue (Rs bn)	13	17	39	157	14.9	7.6
EBITDA margins (%)	4.9	10.5	13.2	16.2		0.0
Sapphire – EBITDA (Rs bn)	0.7	1.8	5.2	25	17.3	
Depreciation (% of EBITDA)	153.9	61.3	36.7	25.0		
Sapphire – EBIT (Rs bn)	-0.4	0.7	3.3	19	19.3	7.6
EBIT margins (%)	(2.7)	4.0	8.3	12.2		

Source: Emkay Research; *EBITDA/Margins are Pre IndAS-116

Exhibit 11: Sapphire – Target EV/EBITDA derived from a two-stage dividend growth model

(Rs bn)	
Revenue CAGR [FY22E-25E] (%)	31
EBITDA CAGR [FY22E-25E] (%)	42
Net debt-to-EV (%)	-3
Stage-1: FY25E-35E	
EBITDA in Yr-0 [FY25E] (Rs)	5.2
EBITDA in Yr-1 (Rs bn)	6.1
EBITDA CAGR (%)	18.0
Years of growth [n]	10.0
Incremental RoIC (%)	63.0
WACC (%)	12.50
Tax rate (%)	25.2
Sustainable D&A-to-EBITDA (%)	25.0
Net debt-to-EV (%)	-3
Implied FCFF ratio (%)	71
Revenue in FY35E	205
Terminal stage	
Terminal EBITDA growth (%)	7.5
Incremental RoIC (%)	63.0
Implied FCFF ratio (%)	88.1
Fair value EV/EBITDA in Mar-25E (x)	19.0
EV in Mar-25E	115
Mar-24E NPV of FCFFs	2.7
Mar-24E EV	105
Adj. net debt	(3.4)
Fair value of Equity in Mar-24E (x)	109
Mar-25E EBITDA	5.2
Implied fair value EV/EBITDA in Mar-24E (x)	20.4
Premium applied to FV (%) [a]	-5.0
Target EV/EBITDA in Mar-24E (x)	19
Target market-cap in Mar-24E	103
Shares o/s (mn)	64
Target price in Mar-24E (Rs/share)	1,620

Source: Emkay Research; [a] Revenue growth and margin expansion are likely to be front-loaded than assumed.

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	10,196	17,216	23,093	30,797	39,142
Expenditure	8,952	14,166	18,554	24,796	31,438
EBITDA	1,244	3,050	4,539	6,001	7,705
Depreciation	2,091	2,135	2,654	3,228	3,801
EBIT	(847)	915	1,885	2,773	3,904
Other Income	616	380	250	384	542
Interest expenses	756	781	862	1,035	1,242
PBT	(987)	514	1,273	2,122	3,204
Tax	12	54	13	106	807
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	(999)	460	1,260	2,016	2,397
Adjusted PAT	(999)	460	1,260	2,016	2,397

Balance Sheet

Y/E Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
Equity share capital	528	635	635	635	635
Reserves & surplus	4,271	9,436	10,696	12,712	15,109
Net worth	4,799	10,071	11,331	13,347	15,744
Minority Interest	(12)	(17)	(17)	(17)	(17)
Loan Funds	6,449	7,893	7,871	8,279	8,970
Net deferred tax liability	206	197	227	284	347
Total Liabilities	11,442	18,144	19,412	21,894	25,044
Net block	10,844	13,898	16,174	17,280	18,315
Investment	0	0	0	0	0
Current Assets	2,341	7,415	6,480	8,877	12,022
Cash & bank balance	768	4,071	3,412	4,954	7,250
Other Current Assets	0	0	0	0	0
Current liabilities & Provision	2,048	3,495	3,568	4,590	5,619
Net current assets	294	3,920	2,912	4,287	6,403
Misc. exp	0	0	0	0	0
Total Assets	11,442	18,144	19,412	21,894	25,044

Cash Flow

Y/E Mar (Rs mn)	FY21	FY22	FY23E	FY24E	FY25E
PBT (Ex-Other income) (NI+Dep)	(1,603)	134	1,023	1,738	2,662
Other Non-Cash items	0	0	0	0	0
Chg in working cap	23	(312)	365	209	226
Operating Cashflow	1,255	2,685	4,891	6,104	7,124
Capital expenditure	(826)	(2,672)	(3,430)	(2,835)	(2,835)
Free Cash Flow	429	13	1,461	3,269	4,289
Investments	0	0	0	0	0
Other Investing Cash Flow	0	0	0	0	0
Investing Cashflow	(210)	(2,292)	(3,180)	(2,451)	(2,293)
Equity Capital Raised	506	5,166	0	0	0
Loans Taken / (Repaid)	34	(164)	(599)	15	17
Dividend paid (incl tax)	0	0	0	0	0
Other Financing Cash Flow	(1,244)	(1,965)	(1,772)	(2,126)	(2,551)
Financing Cashflow	(824)	2,911	(2,371)	(2,111)	(2,534)
Net chg in cash	221	3,304	(660)	1,542	2,296
Opening cash position	547	768	4,071	3,412	4,954
Closing cash position	768	4,071	3,412	4,954	7,250

Source: Company, Emkay Research

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Key Ratios

Profitability (%)	FY21	FY22	FY23E	FY24E	FY25E
EBITDA Margin	12.2	17.7	19.7	19.5	19.7
EBIT Margin	(8.3)	5.3	8.2	9.0	10.0
Effective Tax Rate	(1.2)	10.5	1.0	5.0	25.2
Net Margin	(9.8)	2.7	5.5	6.5	6.1
ROCE	(2.0)	8.8	11.4	15.3	18.9
ROE	(19.9)	6.2	11.8	16.3	16.5
RoIC	(8.0)	6.8	12.7	16.3	17.1

Per Share Data (Rs)	FY21	FY22	FY23E	FY24E	FY25E
EPS	(18.9)	7.2	19.8	31.7	37.7
CEPS	20.7	40.8	61.6	82.5	97.5
BVPS	90.9	158.5	178.3	210.1	247.8
DPS	0.0	0.0	0.0	0.0	0.0

Valuations (x)	FY21	FY22	FY23E	FY24E	FY25E
PER	(66.3)	173.4	63.3	39.6	33.3
P/CEPS	70.3	35.6	23.6	17.6	14.9
P/BV	13.8	7.9	7.0	6.0	5.1
EV / Sales	7.1	4.9	3.6	2.7	2.1
EV / EBITDA	57.8	27.4	18.6	13.8	10.6
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Gearing Ratio (x)	FY21	FY22	FY23E	FY24E	FY25E
Net Debt/ Equity	1.2	0.4	0.4	0.2	0.1
Net Debt/EBIDTA	4.6	1.3	1.0	0.6	0.2
Working Cap Cycle (days)	(17.0)	(3.2)	(7.9)	(7.9)	(7.9)

Growth (%)	FY21	FY22	FY23E	FY24E	FY25E
Revenue	(23.9)	68.8	34.1	33.4	27.1
EBITDA	(33.0)	145.2	48.8	32.2	28.4
EBIT	0.0	0.0	106.0	47.1	40.8
PAT	0.0	0.0	174.0	60.0	18.9

Quarterly (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23
Revenue	5,075	4,968	5,463	5,628	5,961
EBITDA	1,145	998	1,104	1,032	1,167
EBITDA Margin (%)	22.6	20.1	20.2	18.3	19.6
PAT	510	265	383	269	326
EPS (Rs)	8.0	4.2	6.0	4.2	5.1

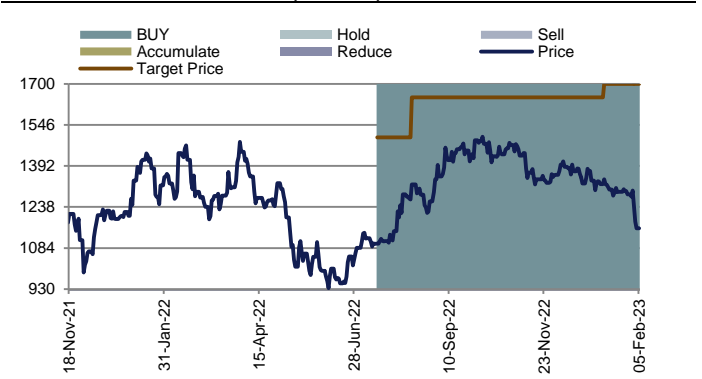
Source: Company, Emkay Research

RECOMMENDATION HISTORY (Rs/share)

Date	Closing Price	TP	Period	Rating	Analyst
09-Jan-23	1,342	1,700	12m	Buy	Devanshu Bansal
04-Nov-22	1,431	1,650	12m	Buy	Devanshu Bansal
12-Aug-22	1,322	1,650	12m	Buy	Devanshu Bansal
16-Jul-22	1,101	1,500	12m	Buy	Devanshu Bansal

Source: Company, Emkay Research

RECOMMENDATION HISTORY (Rs/share)



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

Completed Date: 10 Feb 2023 04:09:31 (SGT)

Dissemination Date: 10 Feb 2023 04:10:31 (SGT)

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