

Macro uncertainties remain; growth investments to sustain

Retail ▶ Result Update ▶ May 13, 2023

TARGET PRICE (Rs): 1,380

Q4 EBITDA is 7-11% short of Street/our estimate, on weaker SSG in KFC/SL and lower margin in PH. Persisting weak macros kept SSG for KFC/PH low at 2%/-4% in Q4, and we believe a high base should further dampen performance ahead (in Q1FY24). Sapphire sees this only as a near-term blip and expects investments in store additions/mass-marketing for new innovations (PH menu revamp) to continue. With RM price moderation, gross margin (GM) fared better but negative leverage in PH drove the margin miss. Our FY24 estimates factor in a V-shaped recovery, leading to flat SSG/margin for the India business in FY24. But continued store adds/SL recovery should lead to 24%/30% revenue /EBITDA growth in FY24E. Post the recent cut, there is no major change to our estimates. We stay confident on QSR's long-term growth prospects, but have a HOLD on Sapphire on near-term uncertainty, with revised TP of Rs1,380 (16.5x Jun-25E EBITDA). TP review is led by 3M rollover.

Sapphire Foods: Financial Snapshot (Consolidated)

Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	17,216	22,656	28,036	36,370	43,688
EBITDA	3,050	4,284	5,432	7,386	9,289
Adj. PAT	460	2,332	1,410	2,029	2,778
Adj. EPS (Rs)	7.2	36.7	22.2	31.9	43.7
EBITDA margin (%)	17.7	18.9	19.4	20.3	21.3
EBITDA growth (%)	145.2	40.4	26.8	36.0	25.8
Adj. EPS growth (%)	0.0	407.1	(39.5)	43.9	36.9
RoE (%)	6.2	20.6	10.6	13.5	16.0
RoIC (%)	14.7	47.2	23.0	27.2	34.3
P/E (x)	176.5	34.8	57.6	40.0	29.2
EV/EBITDA (x)	25.5	18.1	14.2	10.3	7.9
P/B (x)	8.1	6.5	5.8	5.1	4.3
FCFF yield (%)	0.0	2.0	2.5	4.8	7.3

Source: Company, Emkay Research

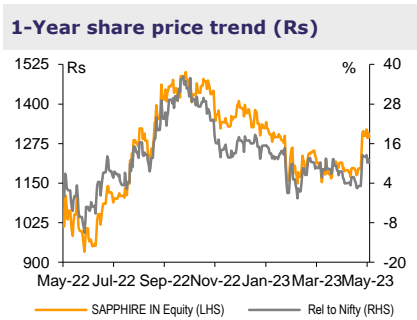
Result summary: KFC's revenue grew 24% led by 30% growth in store-count and a low 2% SSG, while PH saw 18% growth led by 31% growth in store-count and a 4% drop in SSG. KFC's SSG was partially impacted by early onset of the Navratri festival in Mar-23 vs. Apr-22 last year. While weak trends persist, Sapphire expects to gain market share even in the challenging environment, on continued investments (in store additions /marketing). New product innovations have been particularly strong, with a huge menu revamp in PH and introduction of value chicken rolls (Rs99 onwards) in KFC. The medium-term outlook, of 7%/5% SSG, was maintained for the PH/KFC formats. For SL, sourcing/operations have normalized and Sapphire expects gradual improvement in store-margins to 20% over the next 12-24 months (vs. 15% in FY23). Store additions were healthy, with 28/164 additions in Q4/FY23, of which 16/78 were for KFC and 12/67 were for PH. Despite the ~100bps dip in GM, store-level margin for KFC was flat at 19%, while the negative leverage caused a ~300bps margin decline for PH to 8.6%. The high inflationary environment effected a 1,020bps fall in SL store-margins which, together with a 60bps increase in overall HO costs, led to overall EBITDA margin of 280bps.

Earnings-call KTAs: 1) While meeting Yum!'s dine-in cover requirement, Sapphire has been able to further optimize its PH store-size to 1,000sqft (vs. 1,200sqft earlier), led by reduction in back-end storage space. Going forward, 10-15% of PH's annual store additions will be in this format, as back-end reduction is only possible in top-metros, where RM delivery schedules are relatively shorter vs. other towns. The format offers 5-8% reduction in capex/store vs. earlier format stores. 2) Sapphire reiterated its plan of doubling its store count, which implies an annual addition of 130-160 stores (vs. 164 additions in FY23). 3) With inflation, capex/store for KFC/PH has increased to Rs20/15mn vs. Rs19/14mn earlier. Sapphire spent Rs3.6bn as capex in FY23; of this, ~Rs3bn went towards opening of 164 net stores, Rs0.4bn towards resizing/refurbishments and the rest was used for maintenance/warehouse. 4) With focus on improving brand experience, Sapphire has added self-ordering kiosks in 16 KFC stores in FY23 which it plans to further expand. 5) On a same-store-transaction-growth (SSTG) basis, PH saw positive growth, while KFC witnessed a decline. This contrasted with the SSG trends in these brands, likely owing to relatively higher price-hikes in KFC.

Target Price – 12M	Jun-24
Change in TP (%)	2.2
Current Reco.	HOLD
Previous Reco.	HOLD
Upside/(Downside) (%)	8.0
CMP (12-May-23) (Rs)	1,277.2

Stock Data	Ticker
52-week High (Rs)	1,574
52-week Low (Rs)	909
Shares outstanding (mn)	63.5
Market-cap (Rs bn)	81
Market-cap (USD mn)	988
Net-debt, FY24E (Rs mn)	-3,755
ADTV-3M (mn shares)	-
ADTV-3M (Rs mn)	116.9
ADTV-3M (USD mn)	1.4
Free float (%)	48.0
Nifty-50	18,315
INR/USD	82.2
Shareholding, Mar-23	
Promoters (%)	44.9
FPIs/MFs (%)	20.9/14.5

Price Performance			
(%)	1M	3M	12M
Absolute	7.5	6.0	22.8
Rel. to Nifty	4.6	3.3	6.0



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Story in Charts

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

Key Metrics (Rs mn)	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
KFC India						
Number of stores	250	263	281	301	325	341
ADS ('000)	1,44,000	1,32,000	1,44,000	1,34,000	1,36,000	1,27,000
Revenue	3,031	2,966	3,537	3,491	3,810	3,691
Gross margin (%)	68.0	67.9	67.3	65.6	66.5	66.8
Brand contribution margin (%)	22.5	19.0	20.3	17.9	20.2	19.1
PH India						
Number of stores	209	219	235	249	274	286
ADS ('000)	64,000	55,000	61,000	64,000	58,000	50,000
Revenue	1,134	1,032	1,219	1,410	1,364	1,221
Gross margin (%)	75.4	74.8	75.3	74.7	74.4	74.3
Brand contribution margin (%)	17.3	11.5	14.8	15.1	14.1	8.6
Sri Lanka (Pizza Hut)						
Number of stores	89	95	98	106	114	114
ADS ('000)	1,21,000	1,12,000	75,000	73,000	75,000	65,000
Revenue	858	917	650	669	731	667
Gross margin (%)	67.2	64.9	58.8	55.4	57.3	61.0
Brand contribution margin (%)	26.4	24.4	15.5	15.0	14.6	14.2
Others (Maldives)						
Revenue	32	28	30	34	34	13
Brand contribution margin (%)	13.5	21.5	16.1	5.4	3.9	40.8
Sapphire - Consolidated						
Number of stores	550	579	616	658	715	743
Store additions (no. of)	68	29	37	42	57	28
Revenue	5,055	4,943	5,436	5,604	5,939	5,592
Gross margin (%)	69.4	69.1	68.2	66.7	67.3	68.1
Brand contribution margin (%)	21.9	18.5	18.5	16.8	18.0	16.3
Overhead opex/revenue (%)	5.7	5.6	5.2	5.6	5.6	6.2
Consol. EBITDA	823	636	722	624	738	563
EBITDA margin (%)	16.3	12.9	13.3	11.1	12.4	10.1

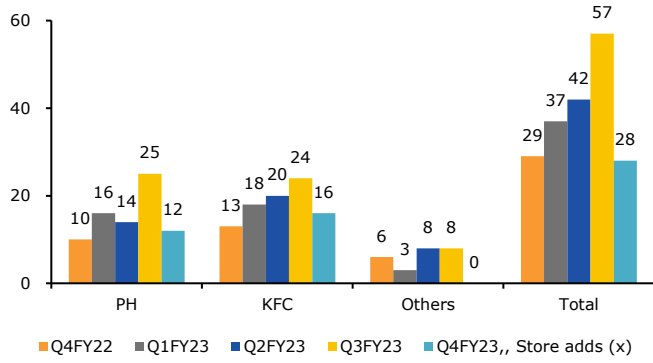
Source: Company, Emkay Research; *EBITDA/margins are pre IndAS-116

Exhibit 2: Actual vs. Estimates (Q4FY23)

(Rs mn)	Actual	Estimates		Variation		Comments
		Emkay	Consensus	Emkay	Consensus	
Net Sales	5,604	5,788	5,794	-3.2%	-3.3%	Weaker KFC/SL SSG led to lower revenues
EBITDA*	981	1,102	1,057	-10.9%	-7.1%	EBITDA was lower, owing to weaker PH margins
EBITDA margin*	17.5%	19.0%	18.2%	-153	-72	
PAT	1,355	203	341	565.9%	297.5%	PAT was higher, due to deferred tax benefit of Rs1.25bn

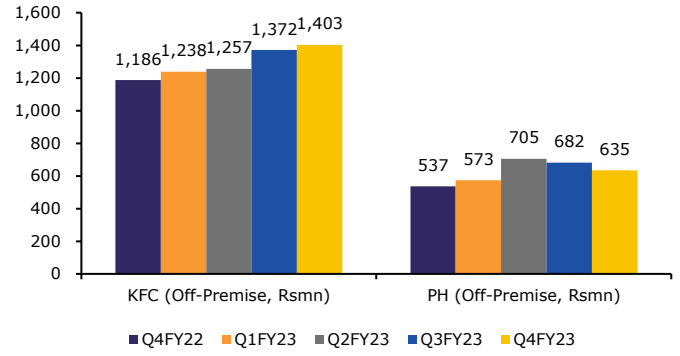
Source: Company, Emkay Research; *Post IndAS-116 EBITDA

Exhibit 3: Sapphire added 28 stores in Q4FY23 – With 12/16 stores in PH/KFC, respectively



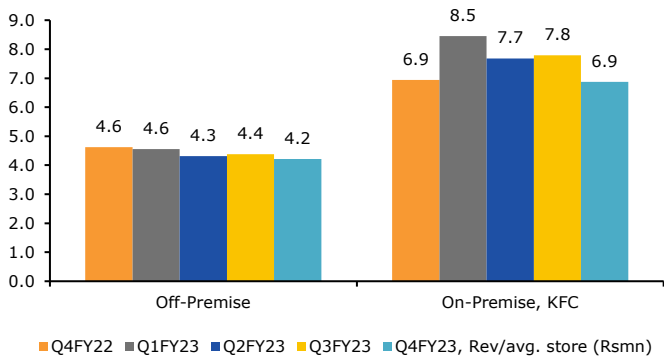
Source: Company, Emkay Research

Exhibit 4: Channel-wise, off-premise sales grew 18% YoY for KFC/Pizza Hut, in Q4



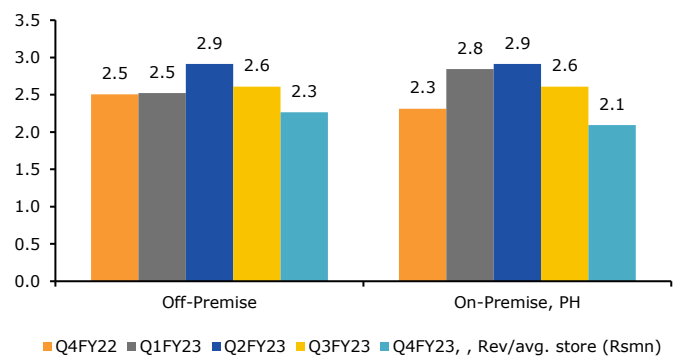
Source: Company, Emkay Research

Exhibit 5: KFC's off-premise sales per store declined, while on-premise sales per store remained flat



Source: Company, Emkay Research

Exhibit 6: For PH, both, on-premise and off-premise sales per store, saw a decline



Source: Company, Emkay Research

Exhibit 7: Summary of quarterly results

Y/E, Mar (Rs mn)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	YoY (%)	QoQ (%)	FY22	FY23	YoY (%)
Revenue	4,968	5,463	5,628	5,961	5,604	12.8	-6.0	17,216	22,656	31.6
Expenditure	3,970	4,359	4,596	4,795	4,623	16.4	-3.6	14,166	18,372	29.7
Consumption of RM	1,555	1,756	1,890	1,964	1,797	15.6	-8.5	5,278	7,407	40.3
as % of sales	31.3%	32.1%	33.6%	32.9%	32.1%			30.7%	32.7%	
Employee Cost	678	684	747	731	767	13.1	4.9	2,740	2,929	6.9
as % of sales	13.7%	12.5%	13.3%	12.3%	13.7%			15.9%	12.9%	
Other expenditure	1,737	1,919	1,959	2,100	2,059	18.5	-2.0	6,148	8,036	30.7
as % of sales	35.0%	35.1%	34.8%	35.2%	36.7%			35.7%	35.5%	
EBITDA	998	1,104	1,032	1,167	981	-1.7	-15.9	3,050	4,284	40.4
Depreciation	576	609	628	681	724			2,135	2,642	23.7
EBIT	421	495	404	486	258	-38.8	-47.0	915	1,642	79.5
Other Income	98	59	71	67	114			380	311	-18.1
Interest	233	197	206	217	249	6.7	14.7	781	869	11.3
PBT	286	356	269	336	123	-57.0	-63.4	514	1,084	111.0
Total Tax	21	-25	1	9	-1,232			54	-1,248	
Reported PAT	265	381	269	327	1,355	411.3	314.4	460	2,332	407.1
Extra ordinary items	0	0	0	0	0			0	0	
PAT before minority interests	265	381	269	327	1,355	411.3	314.4	460	2,332	407.1
Minority Interests	0	-1	0	1	-1			-2	-2	
PAT after MI	265	383	269	326	1,356	411.4	315.8	461	2,334	
EPS (Rs)	4.2	6.0	4.2	5.1	21.3	411.7	315.8	6.2	36.7	
(%)	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	(bps)	(bps)	FY22	FY23	(bps)
EBITDA	20.1	20.2	18.3	19.6	17.5	-260	-210	17.7	18.9	120
EBIT	8.5	9.1	7.2	8.2	4.6	-390	-360	5.3	7.2	190
EBT	5.8	6.5	4.8	5.6	2.2	-360	-340	3.0	4.8	180
PAT	5.3	7.0	4.8	5.5	24.2	1,890	1,870	2.7	10.3	760
Effective Tax rate	7.3	-7.1	0.3	2.6	-1003.2	NA	NA	6.4	-1.4	NA

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

Exhibit 8: Changes in estimates

(Rs mn)	FY24E			FY25E			FY26E
	Old	New	% change	Old	New	% change	New
Revenue	28,285	28,036	(0.9)	36,634	36,370	(0.7)	43,688
EBITDA*	3,398	3,362	(1.0)	4,755	4,758	0.1	6,083
EBITDA margin (%)*	12.0	12.0	0 bps	13.0	13.1	10 bps	13.9
PAT	1,436	1,410	(1.8)	2,030	2,029	(0.1)	2,778
EPS (Rs)	22.6	22.2	(1.8)	31.9	31.9	(0.1)	43.7

Source: Company, Emkay Research, *Pre-IndAS-116 EBITDA

Exhibit 9: Peer Comparison

Companies	Price (Rs)	Mcap (Rs bn)	Reco	Target Price (Rs)	P/E (x)			Pre IndAS-116 EV/EBITDA (x)		
					FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Jubilant FoodWorks	467	308	Hold	465	73.3	60.2	45.2	37.8	31.5	24.5
Devyani International	176	213	Hold	165	90.8	87.9	60.4	47.0	39.4	28.7
Westlife Foodworld	764	119	Buy	915	106.7	73.2	58.8	40.7	30.6	25.9
Sapphire Foods	1,277	81	Hold	1,380	34.8	57.6	40.0	35.1	27.0	19.1

Source: Company, Emkay Research

Sapphire Foods: Consolidated Financials and Valuations

Profit & Loss					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Revenue	17,216	22,656	28,036	36,370	43,688
Revenue growth (%)	68.8	31.6	23.8	29.7	20.1
EBITDA	3,050	4,284	5,432	7,386	9,289
EBITDA growth (%)	145.2	40.4	26.8	36.0	25.8
Depreciation & Amortization	2,135	2,642	3,214	3,908	4,643
EBIT	915	1,642	2,217	3,478	4,646
EBIT growth (%)	0.0	79.5	35.0	56.9	33.6
Other operating income	0	0	0	0	0
Other income	380	311	315	330	350
Financial expense	781	869	1,048	1,272	1,524
PBT	514	1,084	1,484	2,536	3,472
Extraordinary items	0	0	0	0	0
Taxes	54	(1,248)	74	507	694
Minority interest	0	0	0	0	0
Income from JV/Associates	0	0	0	0	0
Reported PAT	460	2,332	1,410	2,029	2,778
PAT growth (%)	0.0	407.1	(39.5)	43.9	36.9
Adjusted PAT	460	2,332	1,410	2,029	2,778
Diluted EPS (Rs)	7.2	36.7	22.2	31.9	43.7
Diluted EPS growth (%)	0.0	407.1	(39.5)	43.9	36.9
DPS (Rs)	0.0	0.0	0.0	0.0	0.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0
EBITDA margin (%)	17.7	18.9	19.4	20.3	21.3
EBIT margin (%)	5.3	7.2	7.9	9.6	10.6
Effective tax rate (%)	10.5	(115.1)	5.0	20.0	20.0
NOPLAT (pre-IndAS)	819	3,532	2,106	2,782	3,717
Shares outstanding (mn)	63.5	63.5	63.5	63.5	63.5

Source: Company, Emkay Research

Cash flows					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
PBT	514	1,084	1,484	2,536	3,472
Others (non-cash items)	2,135	2,642	3,214	3,908	4,643
Taxes paid	(54)	1,248	(74)	(507)	(694)
Change in NWC	(312)	59	(226)	28	25
Operating cash flow	2,685	5,591	5,132	6,907	8,619
Capital expenditure	(2,672)	(4,052)	(3,158)	(3,260)	(3,260)
Acquisition of business	0	(1,220)	100	500	620
Interest & dividend income	380	311	315	330	350
Investing cash flow	(2,292)	(4,961)	(2,743)	(2,430)	(2,290)
Equity raised/(repaid)	5,166	0	0	0	0
Debt raised/(repaid)	(164)	(221)	5	6	7
Payment of lease liabilities	(1,249)	(1,696)	(2,070)	(2,628)	(3,207)
Interest paid	(126)	(100)	(110)	(90)	(70)
Dividend paid (incl tax)	0	0	0	0	0
Others	(716)	180	0	0	0
Financing cash flow	2,911	(1,838)	(2,174)	(2,712)	(3,270)
Net chg in Cash	3,304	(1,208)	214	1,765	3,060
OCF	2,685	5,591	5,132	6,907	8,619
Adj. OCF (w/o NWC chg.)	2,996	5,532	5,358	6,879	8,595
FCFF	13	1,539	1,974	3,647	5,359
FCFE	(388)	981	1,241	2,705	4,186
OCF/EBITDA (%)	88.0	130.5	94.5	93.5	92.8
FCFE/PAT (%)	(84.4)	42.1	88.0	133.3	150.7
FCFF/NOPLAT (%)	1.6	43.6	93.7	131.1	144.2

Source: Company, Emkay Research

Balance Sheet					
Y/E Mar (Rs mn)	FY22	FY23	FY24E	FY25E	FY26E
Share capital	635	635	635	635	635
Reserves & Surplus	9,436	11,924	13,334	15,363	18,141
Net worth	10,071	12,559	13,970	15,998	18,776
Minority interests	(17)	(20)	(20)	(20)	(20)
Deferred tax liability (net)	197	143	195	246	294
Total debt	612	443	443	443	443
Total liabilities & equity	10,864	13,125	14,587	16,667	19,492
Net tangible fixed assets	5,462	7,706	8,939	9,972	10,704
Net intangible assets	566	647	747	816	854
Net ROU assets	(1,032)	(1,270)	(1,528)	(1,832)	(2,232)
Capital WIP	327	550	550	550	550
Goodwill	1,622	1,622	1,622	1,622	1,622
Investments [JV/Associates]	0	0	0	0	0
Cash & equivalents	4,071	4,083	4,198	5,463	7,902
Current assets (ex-cash)	3,344	3,403	4,370	5,669	6,810
Current Liab. & Prov.	3,495	3,616	4,311	5,592	6,717
NWC (ex-cash)	(151)	(213)	59	77	92
Total assets	10,864	13,125	14,587	16,667	19,492
Net debt	(3,459)	(3,641)	(3,755)	(5,020)	(7,460)
Capital employed	10,864	13,125	14,587	16,667	19,492
Invested capital	6,466	8,491	9,838	10,654	11,039
BVPS (Rs)	158.5	197.7	219.8	251.8	295.5
Net Debt/Equity (x)	(0.3)	(0.3)	(0.3)	(0.3)	(0.4)
Net Debt/EBITDA (x)	(1.1)	(0.8)	(0.7)	(0.7)	(0.8)
Interest coverage (x)	0.6	0.4	0.4	0.3	0.3
RoCE (%)	15.6	16.3	18.3	24.4	27.6

Source: Company, Emkay Research

Valuations and key Ratios					
Y/E Mar	FY22	FY23	FY24E	FY25E	FY26E
P/E (x)	176.5	34.8	57.6	40.0	29.2
P/CE(x)	31.3	16.3	17.5	13.7	10.9
P/B (x)	8.1	6.5	5.8	5.1	4.3
EV/Sales (x)	4.5	3.4	2.8	2.1	1.7
EV/EBITDA (x)	25.5	18.1	14.2	10.3	7.9
EV/EBIT(x)	84.9	47.2	34.9	21.9	15.9
EV/IC (x)	12.0	9.1	7.9	7.1	6.7
FCFF yield (%)	0.0	2.0	2.5	4.8	7.3
FCFE yield (%)	(0.5)	1.2	1.5	3.3	5.2
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
DuPont-RoE split					
Net profit margin (%)	2.7	10.3	5.0	5.6	6.4
Total asset turnover (x)	2.1	1.9	2.0	2.3	2.4
Assets/Equity (x)	1.1	1.1	1.0	1.0	1.0
RoE (%)	6.2	20.6	10.6	13.5	16.0
DuPont-RoIC					
NOPLAT margin (%)	4.8	15.6	7.5	7.7	8.5
IC turnover (x)	3.1	3.0	3.1	3.5	4.0
RoIC (%)	14.7	47.2	23.0	27.2	34.3
Operating metrics					
Core NWC days	(29.2)	(25.6)	(23.1)	(22.6)	(23.4)
Total NWC days	(3.2)	(3.4)	0.8	0.8	0.8
Fixed asset turnover	2.1	2.0	2.0	2.1	2.2
Opex-to-revenue (%)	51.6	48.4	48.4	48.0	47.7

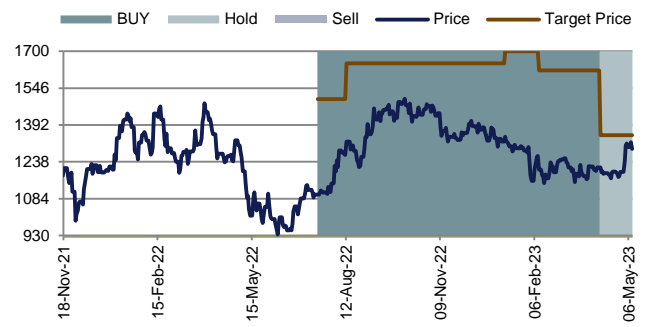
Source: Company, Emkay Research

RECOMMENDATION HISTORY - DETAILS

Date	CMP (INR)	TP (INR)	Rating	Analyst
20-Apr-23	1,195	1,350	Hold	Devanshu Bansal
09-Apr-23	1,215	1,350	Hold	Devanshu Bansal
10-Feb-23	1,205	1,620	Buy	Devanshu Bansal
09-Jan-23	1,342	1,700	Buy	Devanshu Bansal
04-Nov-22	1,431	1,650	Buy	Devanshu Bansal
12-Aug-22	1,322	1,650	Buy	Devanshu Bansal
16-Jul-22	1,101	1,500	Buy	Devanshu Bansal

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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