

Estimate changes	↓
TP change	↔
Rating change	↔

CMP: INR1,338 TP: INR1,585 (+18%) Buy

SSSG remains weak but RM trends improving

- SAPPHIRE's revenue grew 20% YoY (in line), led by steady store adds and KFC's flat SSSG. Pizza Hut remained weak (-9% SSSG). A cool-off in inflation led to a sequential improvement of 60bp in margins, but low SSSG pulled down EBITDA margin (pre IND-AS 116) by 140bp YoY. As a result, EBITDA grew 7%, while PAT declined 35% YoY.
- SSSG remained weak due to the challenging business environment. In order to revive demand, the company has launched new products and increased its marketing investments in both brands. We reiterate our **BUY** rating with a TP of INR1,585, given the long term-growth opportunity and moderate valuations vs. QSR peers.

Weak SSSG; strong store adds

- Consol. sales grew 20% YoY to INR6.5b (in line), led by 26% store adds.
 - SSSG: KFC at 0% (est. +1%), PH at -9% (est. -5%), and SL at 0% in LKR terms
 - Added 17/16 net new units for KFC/PH; total 778 stores as of 1QFY24 — 358 for KFC, 302 for PH, 114 for SL (flat) and 4 stores in Maldives
- Consolidated gross profit increased by 21% YoY to INR4.5b (in line), aided by a cool-off in RM inflation.
 - Consolidated gross margin improved 60bp YoY and QoQ to 68.5% (est. 68.3%).
- Reported EBITDA grew 10% YoY to INR1.2b (in line), but it was affected by higher employee and other expenses.
 - Margins contracted 160bp YoY to 18.6% (est. 18%).
 - Consolidated ROM decreased 80bp YoY to 17.2% and Pre Ind AS EBITDA declined 150bp YoY to 11.8%.
- PAT declined 35% YoY to INR249m (17% beat) due to higher depreciation and interest income.
 - Margins contracted 320bp YoY to 3.8% (est. 3.2%).

Highlights from the management commentary

- The management has reiterated its previous guidance to double the store count in the next three to four years, implying a 15-25% store CAGR. PH store additions are expected to be lower in FY24 compared to FY23.
- The company said the majority of RM inflation had already been factored in, and it does not see any significant gross margin improvement. However, it will focus on attaining 20%+ EBITDA margins for KFC.
- SAPPHIRE intends to strengthen the PH model by a) increasing marketing expenditure (particularly on television), b) developing customer franchisees, and c) innovating products.
- 2QFY24 SSSG for KFC could be lower owing to Hindu festivals, with Sri Lanka expected to recover in FY24.



Bloomberg	SAPPHIRE IN
Equity Shares (m)	64
M.Cap.(INRb)/(USDb)	85.1 / 1
52-Week Range (INR)	1573 / 1102
1, 6, 12 Rel. Per (%)	-4/2/-1
12M Avg Val (INR M)	222

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	22.7	27.7	34.1
Sales Gr. (%)	31.6	22.1	23.3
EBITDA	4.3	5.1	6.7
Margins (%)	18.9	18.6	19.6
Adj. PAT	1.1	1.1	1.6
Adj. EPS (INR)	17.0	18.1	25.5
EPS Gr. (%)	134.6	6.3	41.1
BV/Sh.(INR)	197.7	215.7	241.2

Ratios

RoE (%)	9.5	8.7	11.1
RoCE (%)	20.9	8.0	9.5

Valuations

P/E (x)	79.0	74.3	52.7
P/BV (x)	6.8	6.2	5.6
EV/Sales (x)	3.7	3.0	2.4
EV/EBITDA (x)	19.3	16.0	12.3
Pre-IND AS 116 EV/EBITDA (x)	31.1	25.7	19.1

Shareholding pattern (%)

As On	Jun-23	Mar-23	Jun-22
Promoter	44.9	44.9	51.3
DII	29.6	27.5	12.5
FII	18.7	15.5	12.6
Others	6.9	12.2	23.7

FII Includes depository receipts

Valuation and view

- We cut our EBITDA estimate by 5% for FY24/FY25, implying a 25% CAGR over FY23-25 with an expectation of a recovery in 2HFY24 in KFC and PH formats.
- The stock has delivered over 25% returns since our **coverage initiation** in May'22 in spite of the recent correction. We factor in revenue/pre-Ind AS EBITDA CAGRs of 23%/27% over FY23-25E. The stock trades at inexpensive multiples of 26x/19x FY24E/FY25E Pre Ind-AS EBITDA.
- We have assigned FY25E EV/EBITDA (pre-Ind AS 116) multiple of 25x to the KFC business, given its robust metrics (ADS and restaurant EBITDA margin), and 12x to the PH business. These multiples are at a 40%/65% discount to the target multiples for DEVYANI's KFC/PH businesses (43x/35x) 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 reiterate our BUY rating with a TP of INR1,585 (based on SoTP).**

Quarterly Performance

(INR m)

Y/E March	FY23				FY24E				FY23	FY24E	FY24 1QE	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q				
KFC - No. of stores	281	301	325	341	358	373	388	406	341	406	356	
PH - No. of stores	235	249	274	286	302	317	332	346	286	346	301	
KFC - SSSG (%)	65.0	15.0	3.0	2.0	0.0	2.0	6.0	7.7	15.0	4.0	1.0	
PH - SSSG (%)	47.0	23.0	-4.0	-4.0	-9.0	-5.0	3.0	2.9	12.0	-2.0	-5.0	
Net Sales	5,463	5,628	5,961	5,604	6,544	6,811	7,327	6,980	22,656	27,662	6,593	-0.7
YoY change (%)	80.3	35.9	17.5	12.8	19.8	21.0	22.9	24.6	31.6	22.1	20.7	
Gross Profit	3,707	3,737	3,998	3,807	4,483	4,641	5,032	4,812	15,249	18,968	4,506	-0.5
Margin (%)	67.9	66.4	67.1	67.9	68.5	68.1	68.7	68.9	67.3	68.6	68.3	
EBITDA	1,104	1,032	1,167	981	1,214	1,201	1,392	1,342	4,284	5,150	1,189	2.2
EBITDA growth %	223.9	82.2	1.9	-1.7	10.0	16.3	19.3	36.8	40.4	20.2	7.7	
Margin (%)	20.2	18.3	19.6	17.5	18.6	17.6	19.0	19.2	18.9	18.6	18.0	
Depreciation	609	628	681	724	727	749	772	796	2,642	3,044	766	-5.1
Interest	197	206	217	249	226	233	240	262	869	960	275	-17.9
Other Income	59	71	67	114	75	75	75	159	311	384	97	
PBT	356	269	336	123	336	294	456	444	1,084	1,529	245	37.5
Tax	-25	1	9	-1,232	88	73	114	107	-1,248	382	32	
Rate (%)	-7.1	0.3	2.6	NA	26.0	25.0	25.0	24.2	-115.1	25.0	13.0	
Adjusted PAT	381	269	327	102	249	220	342	336	1,079	1,147	213	16.9
YoY change (%)	L/P	L/P	-35.9	-61.6	-34.8	-18.0	4.5	230.2	134.6	6.3	-44.2	

E: MOFSL Estimates

Quarterly brand-wise performance

	1QFY22	2QFY22	3QFY22	4QFY22	1QFY23	2QFY23	3QFY23	4QFY23	1QFY24
KFC									
No. of stores	208	219	250	263	281	301	325	341	358
Net store addition	5	11	31	13	18	20	24	16	17
SSSG (%)	149	NA	29	15	65	15	3	2	0
Net sales (INR m)	1,788	2,565	3,031	2,966	3,537	3,491	3,810	3,691	4,286
YoY growth (%)	245.5	94.8	52.8	42.5	97.9	36.1	25.7	24.4	21.2
ADS (INR '000)	105	134	144	132	144	134	136	127	138
Gross Margins (%)	69.3	68.7	68.0	67.9	67.3	65.6	66.5	66.8	68.1
Restaurant EBITDA Margin (%)	13.5	20.6	21.2	19.0	20.3	17.9	20.2	19.1	20.8
Channel mix (%)									
Delivery	62	NA	37	40	35	36	36	38	36
Dine-in + Takeaway	38	NA	63	60	65	64	64	62	64
Pizza Hut									
No. of stores	171	188	209	219	235	249	274	286	302
Net store addition	9	17	21	10	16	14	25	12	16
SSSG (%)	(29)	NA	22	3	47	23	(4)	(4)	(9)
Net sales (INR m)	660	884	1,134	1,032	1,219	1,410	1,364	1,221	1,362
YoY growth (%)	203.2	87.1	51.0	33.0	84.6	59.5	20.3	18.3	11.7
ADS (INR '000)	49	57	64	55	61	64	58	50	52
Gross Margins (%)	76.5	75.8	75.4	74.8	75.3	74.7	74.4	74.3	75.1
Restaurant EBITDA Margin (%)	5.8	10.7	14.9	11.5	14.8	15.1	14.1	8.6	9.0
Channel mix (%)									
Delivery	78	NA	49	52	47	50	50	52	50
Dine-in + Takeaway	22	NA	51	48	53	50	50	48	50
Sri Lanka									
No. of stores	69	73	89	95	98	106	114	114	114
Net store addition	(1)	4	16	6	3	8	8	-	-
SSSG (%)	56	NA	44	29	53	37	18	-3	0
Net sales (INR m)	555	653	858	917	650	669	731	667	825
YoY growth (%)	51.7	23.6	50.5	83.1	17.1	2.5	(14.8)	(27.3)	26.9
ADS (INR '000)	91	105	121	112	75	73	75	65	81
Gross Margins (%)	66.9	66.0	67.2	64.9	58.8	55.4	57.3	61.0	60.5
Restaurant EBITDA Margin (%)	18.0	19.6	23.9	24.4	15.5	15.0	14.6	14.2	13.0

Source: MOFSL, Company

Exhibit 1: SoTP valuation for SAPPHIRE based on pre-Ind AS EV/EBITDA

	Mar'25E EBITDA*	Multiple	EV
KFC	3.4	23	87.8
Pizza Hut	0.6	12	7.4
Sri Lanka	0.4	5	2.1
Others	0.0	1	0.0
Total	4.5	29.0	97.3
Net debt	FY25E		-3.4
Equity value			100.7
TP (INR)			1,585
Upside (%)			18%

*Pre-Ind AS 116

Source: Company, MOFSL



Highlights from the management commentary

Summary notes

- The management has reiterated its previous guidance to double the store count in the next three to four years, implying a 15-25% store CAGR. PH store additions are expected to be lower in FY24 compared to FY23.
- The company said the majority of RM inflation had already been factors in and it does not see any significant GM improvement. However, the company will focus on attaining 20%+ EBITDA margins for KFC.
- The company intends to strengthen the PH model by a) increasing marketing expenditure (particularly on television), b) developing customer franchisees and c) innovating products.
- 2QFY24 SSSG for KFC could be lower owing to Hindu festivals, with Sri Lanka expected to recover in FY24

Detailed notes

Witnessing RM cooling off in all the formats

- The company said the majority of RM inflation had already been factors in and it does not see any significant GM improvement. However, the company will focus on attaining 20%+ EBITDA margins for KFC.
- In addition to the RM cool-off benefit, the firm has tightened cost control, resulting in KFC delivering the highest ever ROM at 20.8%.
- Lower RM costs also benefited the PH and SL formats.
- In SL, the condition is now improving, and the company expects GM to stabilize and not to witness any significant increase in costs.

KFC format-

- The price hike in Apr'23 had no effect on SSSG (as every year it hikes prices), but SSSG was impacted by strong pent-up demand last year.
- 2QFY24 is expected to remain weak due to Hindu festivals.
- The company maintains its guidance to double the store count in 3-4 years (on the base of CY21), implying a 15-25% store add CAGR.
- The company wants to create a value range option for the snacking category, therefore it started the menu from INR99.
- It would like to deliver frictionless customer experience through Digital Kiosk, KFC app and aggregators app with express pickup time of ~7 minutes.

Pizza Hut format

- **Current environment**
 - a) 1HFY23 was the best for PH, but after Diwali, the format delivered low returns; hence, ADS is hovering around INR50k.
 - b) The company is delivering negative SSSG, although the number of transactions is not decreasing. High competition in Pizza from both national and local players could be a factor contributing to low SSSG.
 - c) SAPPHIRE expects store adds for the year would be lower vs. FY23.
- **To strengthen the format, the company is planning to**
 - a) Continue marketing spending, particularly through television and the launch of a new app
 - b) Create a customer franchisee through new geographies and trade areas

- c) Innovate new range of products (including value options) and expand the delivery channel
- d) Improve accessibility by opening 1,000sqft stores and densify in top 6 cities
- e) maintains its guidance to double the store count in 3-4 years (on the base of CY21), implying 15-25% store add CAGR.
- f) Had already reduced the transaction value from INR700/order to INR 450/order in the last 3 years.

Sri Lanka format

- A recovery is expected to begin in FY24, with the country posting positive GDP growth and single-digit inflation.
- Consumer demand is currently being hampered by high taxes and inflation. However, the operating condition of the format remains stable.
- Inflation stabilized from 18-19% in Oct'22 to 10% in Jun'23.
- Dining segment improved to 29% in 1QFY24 vs. 22% in 1QFY23.

New products launched

- The company continues to focus on delivering value and product innovation in the KFC and PH formats.
- In KFC, it has launched KFC Snackers, a range of seven products at INR99, which include Chicken Rolls, Longer Chicken Burger, Popcorn, Fries and Beverage options.
- In PH, it has launched a range of 10 new core pizzas and fries. It targets to serve Indian and International flavors in Pizza.

Others

- Last year it did not pay any tax and this year it deferred tax expenses; hence, there will not be any cash outflow.
- New store contribution in KFC is roughly 75% of old store ADS, while the contribution in PH is roughly 75-80% of old PH stores.
- According to the management, any location that saw double-digit inflation experienced a year-long impact on customer demand, which gradually normalized.
- Pizza Hut has been recognized by YUM! as No.1 franchisee globally for Guest Experience Score.
- SAPPHIRE was recognized by YUM! among top 3 in food safety.

Key exhibits

Exhibit 2: Net sales grew 20% YoY led by KFC

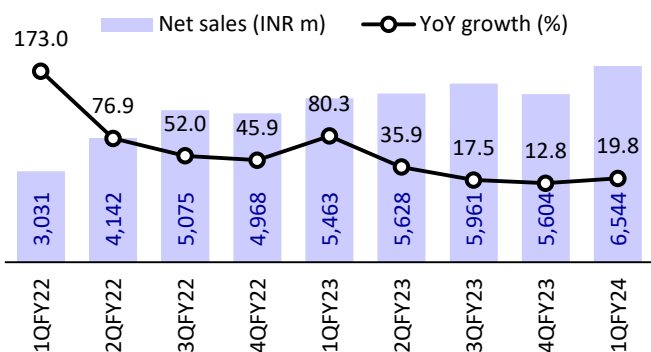


Exhibit 3: EBITDA grew 10% YoY

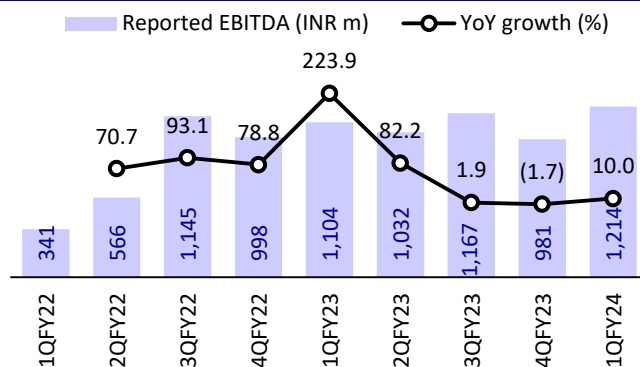


Exhibit 4: Gross margins showing signs of recovery

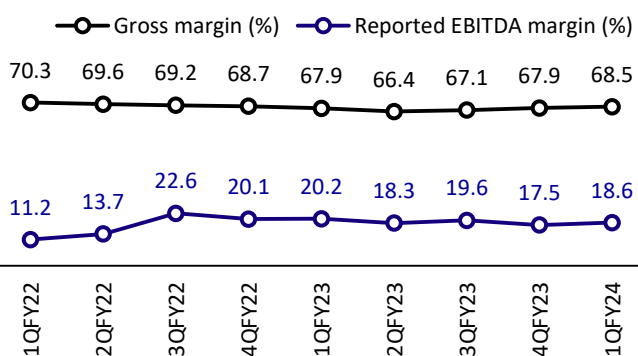
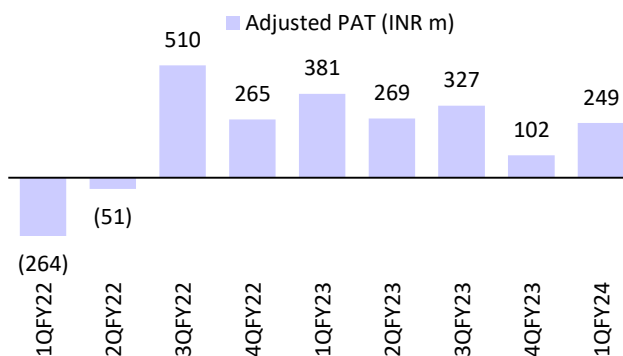


Exhibit 5: Adjusted PAT came in at INR249m



Source: MOFSL, Company

Source: MOFSL, Company

Exhibit 6: Estimate change

	FY24E	FY25E
Revenue (INR m)		
Old	27,837	34,453
Actual/New	27,662	34,108
Change (%)	-0.6	-1.0
Gross Profit (INR m)		
Old	19,062	23,687
Actual/New	18,968	23,432
Change (%)	-0.5	-1.1
Gross margin (%)		
Old	68.5%	68.8%
Actual/New	68.6%	68.7%
Change (bp)	9	-5
EBITDA (INR m)		
Old	5,420	7,050
Actual/New	5,150	6,675
Change (%)	-5.0	-5.3
EBITDA margin (%)		
Old	19.5%	20.5%
Actual/New	18.6%	19.6%
Change (bp)	-85	-89
Net Profit (INR m)		
Old	1,429	1,849
Actual/New	1,147	1,618
Change (%)	-19.7	-12.5
EPS (INR)		
Old	22.5	29.1
Actual/New	18.1	25.5
Change (%)	-19.7	-12.5

Financials and valuations

Income Statement consol.							(INR m)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Net Sales	11,938	13,404	10,196	17,216	22,656	27,662	34,108
Change (%)		12.3	-23.9	68.8	31.6	22.1	23.3
Raw Materials	3,946	4,317	3,099	5,278	7,407	8,694	10,675
Gross Profit	7,992	9,087	7,097	11,938	15,249	18,968	23,432
Margin (%)	66.9	67.8	69.6	69.3	67.3	68.6	68.7
Operating Expenses	6,532	7,232	5,853	8,888	10,965	13,818	16,758
EBITDA	1,460	1,856	1,244	3,050	4,284	5,150	6,675
Change (%)		27.1	-33.0	145.2	40.4	20.2	29.6
Margin (%)	12.2	13.8	12.2	17.7	18.9	18.6	19.6
Depreciation	1,547	1,913	2,091	2,135	2,642	3,044	3,733
Int. and Fin. Charges	720	722	756	781	869	960	1,127
Other Income	125	113	616	380	311	384	343
Profit before Taxes	-683	-666	-987	514	1,084	1,529	2,157
Change (%)		-2.5	48.2	-152.1	111.0	41.0	41.1
Margin (%)	-5.7	-5.0	-9.7	3.0	4.8	5.5	6.3
Total tax	11	-17	12	54	-1,248	382	539
Tax Rate (%)	-1.6	2.6	-1.2	10.5	-115.1	25.0	25.0
Adjusted PAT	-694	-649	-999	460	1,079	1,147	1,618
Change (%)		-	-	L/P	134.6	6.3	41.1
Margin (%)	-5.8	-4.8	-9.8	2.7	4.8	4.1	4.7
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	2,332	1,147	1,618

Balance Sheet							(INR m)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Share Capital	431	502	528	635	635	635	635
Reserves	3,585	4,742	4,271	9,436	11,924	13,071	14,689
Net Worth	4,016	5,245	4,799	10,071	12,559	13,706	15,324
Loans	853	592	520	612	443	443	443
Other Liability	5,455	5,744	5,692	7,283	9,185	10,473	11,735
Minority Interest	11	3	-12	-17	-20	-20	-20
Capital Employed	10,335	11,582	11,000	17,949	22,167	24,602	27,482
Gross Block	5,473	6,567	6,905	8,948	12,134	14,841	17,817
Less: Accum. Depn.	1,587	2,221	2,974	3,487	4,428	6,046	8,087
Net Fixed Assets	3,886	4,346	3,932	5,462	7,706	8,795	9,730
Capital WIP	210	215	304	327	565	565	565
Goodwill	2,539	1,622	1,622	1,622	1,622	1,622	1,622
Other Intangible assets	767	688	551	566	647	712	783
Right to Use Assets	4,859	4,953	4,739	6,251	7,915	8,867	9,770
Investments	0	155	267	1,525	659	2,500	3,000
Current	0	155	267	1,525	659	2,500	3,000
Curr. Assets, L&A	3,414	1,828	2,074	5,890	5,607	4,610	5,735
Inventory	381	444	474	652	993	1,212	1,495
Account Receivables	224	46	78	141	179	219	270
Cash and Bank Balance	1,865	392	500	2,546	2,204	546	864
Others	944	947	1,022	2,551	2,231	2,632	3,106
Curr. Liab. and Prov.	5,340	2,224	2,490	3,692	2,554	3,067	3,722
Account Payables	1,142	1,307	1,440	1,991	2,170	2,649	3,267
Other Liabilities	4,051	767	887	1,525	207	224	242
Provisions	147	151	163	176	177	194	214
Application of Funds	10,335	11,582	11,000	17,949	22,167	24,602	27,482

E: MOFSL Estimates

Financials and valuations

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Basic (INR)							
EPS	-16.1	-12.9	-18.9	7.2	17.0	18.1	25.5
Cash EPS	19.8	25.2	20.7	40.8	58.6	66.0	84.2
BV/Share	93.2	104.4	90.9	158.5	197.7	215.7	241.2

Valuation (x)

P/E	N/M	N/M	N/M	185.3	79.0	74.3	52.7
Cash P/E	67.7	53.3	64.8	32.8	22.9	20.3	15.9
EV/Sales	4.8	5.0	6.9	4.7	3.7	3.0	2.4
EV/EBITDA	38.9	36.3	56.7	26.8	19.3	16.0	12.3
P/BV	14.4	12.8	14.8	8.5	6.8	6.2	5.6

Return Ratios (%)

RoE		-14.0	-19.9	6.2	9.5	8.7	11.1
RoCE		0.5	-2.1	8.0	20.9	8.0	9.5
RoIC		-0.6	-8.1	6.5	20.5	7.4	8.9

Working Capital Ratios

Debtor (Days)	7	1	3	3	3	3	3
Asset Turnover (x)	1.2	1.2	0.9	1.0	1.0	1.1	1.2

Leverage Ratio

Debt/Equity (x)	0.2	0.1	0.1	0.1	0.0	0.0	0.0
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Cash Flow Statement

(INR m)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
OP/(loss) before Tax	-683	-1,610	-987	514	1,084	1,529	2,157
Depreciation	1,547	1,913	2,091	2,135	2,642	3,044	3,733
Net interest	627	620	697	677	666	576	784
Others	94	1,052	-378	117	117	0	0
Direct Taxes Paid	-38	-27	-30	-86	-21	-382	-539
(Incr)/Decr in WC	-46	182	147	592	-669	-147	-153
CF from Operations	1,501	2,130	1,541	3,949	3,818	4,620	5,983
Incr in FA	-1,744	-1,415	-734	-2,844	-3,825	-2,772	-3,047
Free Cash Flow	-243	715	807	1,105	-6	1,849	2,935
Pur of Investments	-1,585	1,313	-55	-4,078	910	-1,841	-500
Others	1,697	-1,419	-128	1,890	879	435	396
CF from Invest.	-1,632	-1,522	-917	-5,032	-2,036	-4,177	-3,152
Issue of Shares	2,321	0	444	4,690	0	0	0
Incr in Debt	646	-218	61	-176	-192	0	0
Dividend Paid	0	0	0	0	0	0	0
Net interest Paid	-709	-699	-758	-780	-864	-62	-62
Others	-490	-1,165	-263	-604	-1,068	-2,039	-2,452
CF from Fin. Activity	1,767	-2,081	-515	3,130	-2,125	-2,101	-2,514
Incr/Decr of Cash	1,636	-1,473	109	2,046	-342	-1,658	318
Add: Opening Balance	228	1,865	392	500	2,546	2,204	546
Closing Balance	1,865	392	500	2,546	2,204	546	864

E: MOFSL Estimates

Investment in securities market are subject to market risks. Read all the related documents carefully before investing

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

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