

# Sapphire Foods India | BUY

## Resilient KFC performance while challenges persist for PH

Sapphire Foods' 2QFY24 earnings print was broadly inline with our muted expectations. Construct of earnings performance was similar to 1Q – sales performance was largely driven by store additions as muted same store sales along with scale deleverage impacted the overall operating profitability. On the positive side –a) KFC delivered another resilient performance with flat SSSG despite higher vegetarian days in the quarter & restaurant margins were healthy at c.19% aided by higher gross margins; b) Sri Lanka business saw further recovery with ADS up 11% yoy & as well as uptick in margin trajectory. On the flip side, PH business remained inline but quite weak – management attributed the same to challenging demand, increased competition activity and high base. A lot of initiatives (innovation, higher marketing spends, consumer experience & closure of loss making stores) are being undertaken to revive the brand performance. While operating environment has been challenging, we believe a resilient KFC (65% of sales) and recovery in SL should help offset the impact of weakness in PH. Valuations at 19x FY25E EBITDA (pre-IND AS) not demanding; however, pace of recovery in SSSG will be key monitorable.

- Revenue performance inline primarily led by store additions:** Consolidated sales of INR 6.4bn, up 14.2% yoy (-1.8% qoq) was 2% below our estimate. India sales grew by 12% yoy (-2.7% qoq), while SL business outperformed yet again with sales growth of 29%yoy (+8% CC & +4.7% qoq). Sales growth was led by store additions (+23.7% yoy). India store count was up 25.8% while average sales/store declined by 12% yoy (-7% qoq) – a function of muted same store sales across brands due to challenging operating scenario & high base (for PH) and impact of higher incidence of vegetarian days (for KFC). GMs were up 231bps yoy (led by easing of input costs across brands) to 68.7%. Impact of scale deleverage was much sharper in PH which was to some extent offset by margin expansion in KFC & SL business. Resultant Pre-IND AS Restaurant/Company EBITDA margins compressed by 67/50bps yoy to 16.1%/10.6% respectively.
- KFC & SL performance relatively better, lot more work needs to be done in PH:**
  - 1) KFC India** revenues up 19.3% yoy (SSSG/SSTG was flat), led by store additions (+26.6% yoy). ADS was down 6.7% yoy/9.4% qoq owing to higher incidence of vegetarian days. GM were up 230bps yoy to 67.9% led by benign chicken prices & price hike benefit. Store level costs were controlled well, thereby curtailing impact of scale deleverage resulting in restaurant margins still expanding 130bps yoy to 19.2%.
  - 2) PH India** sales declined 5.7% yoy. Store additions remained healthy (+24.9% yoy), ADS decline was much steeper at 25% yoy (-7.7% qoq). SSS declined by 20% yoy, albeit on high base (+23% in Q2FY23) – mgmt. attributed it to tough demand conditions and high competitive intensity. GM surprised positively (+140bps/+100 bps yoy/qoq to 76.1%) due to benign RM; however, scale deleverage resulted in restaurant margin compression of 750bps yoy to 7.6%.
  - 3) Sri Lanka** sales grew 29.1% yoy (ADS +11% yoy/flat qoq). CC growth was 8% yoy (SSSG +1%). Geography saw 4 store additions after a gap of 2 quarters. Profitability improved sequentially with GM/ Restaurant margins improving 170bps/230bps to 62.2%/15.3%.



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### Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	1,520
Upside/(Downside)	15.3%
Previous Price Target	1,630
Change	-6.7%

### Key Data – SAPPHERE IN

Current Market Price	INR1,318
Market cap (bn)	INR84.0/US\$1.0
Free Float	53%
Shares in issue (mn)	63.5
Diluted share (mn)	63.5
3-mon avg daily val (mn)	INR232.6/US\$2.8
52-week range	1,568/1,102
Sensex/Nifty	64,081/19,133
INR/US\$	83.3

### Price Performance

%	1M	6M	12M
Absolute	-9.3	6.3	-10.1
Relative*	-7.2	1.5	-14.7

\* To the BSE Sensex

### Financial Summary

Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Sales	17,154	22,571	27,175	32,873	38,588
Sales Growth (%)	68.8%	31.6%	20.4%	21.0%	17.4%
EBITDA	3,050	4,284	5,120	6,500	7,738
EBITDA Margin (%)	17.8%	19.0%	18.8%	19.8%	20.1%
Adjusted Net Profit	465	2,329	816	1,277	1,608
Diluted EPS (INR)	7.3	36.6	12.8	20.1	25.3
Diluted EPS Growth (%)	NA	400.3%	-65.0%	56.5%	26.0%
ROIC (%)	9.1%	13.9%	10.4%	13.9%	15.5%
ROE (%)	6.3%	20.6%	6.3%	9.1%	10.4%
P/E (x)	NA	36.0	NA	65.6	52.1
P/B (x)	8.3	6.7	6.3	5.7	5.2
EV/EBITDA (x)	26.3	19.0	15.8	12.3	10.2
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, JM Financial. Note: Valuations as of 02/Nov/2023

JM Financial Research is also available on:  
Bloomberg - JMFR <GO>,  
Thomson Publisher & Reuters,  
S&P Capital IQ, FactSet and Visible Alpha

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

**Exhibit 1. 2Q & 1HFY24 result snapshot: Soft quarter – Revenue tad below estimate while lower-than-envisaged overhead costs led to marginal beat on EBITDA**

	2QFY24	2QFY23	YoY chg	2QFY24E	% var	1HFY24	1HFY23	YoY chg
<b>Net Sales</b>	<b>6,426</b>	<b>5,628</b>	<b>14.2%</b>	<b>6,586</b>	<b>-2.4%</b>	<b>12,970</b>	<b>11,090</b>	<b>17.0%</b>
<b>Gross Profit</b>	<b>4,417</b>	<b>3,737</b>	<b>18.2%</b>	<b>4,513</b>	<b>-2.1%</b>	<b>8,899</b>	<b>7,444</b>	<b>19.6%</b>
Gross Profit Margin %	68.7%	66.4%	231 bps	68.5%	20 bps	68.6%	67.1%	149 bps
Staff Cost	875	747	17.1%	910	-3.9%	1,725	1,431	20.5%
Other Expenses	2,391	1,959	22.1%	2,480	-3.6%	4,809	3,878	24.0%
<b>EBITDA</b>	<b>1,151</b>	<b>1,032</b>	<b>11.6%</b>	<b>1,123</b>	<b>2.5%</b>	<b>2,366</b>	<b>2,136</b>	<b>10.8%</b>
EBITDA margin %	17.9%	18.3%	-42 bps	17.1%	86 bps	18.2%	19.3%	-102 bps
<b>Comparable EBITDA (Pre Ind-AS 116)</b>	<b>678</b>	<b>624</b>	<b>8.7%</b>	<b>644</b>	<b>5.3%</b>	<b>1,450</b>	<b>1,346</b>	<b>7.7%</b>
Comparable EBITDA margin %	10.6%	11.1%	-54 bps	9.8%	77 bps	11.2%	12.1%	-96 bps
Depreciation	768	628	22.2%	760	1.0%	1,495	1,238	20.8%
EBIT	384	404	-5.0%	363	5.5%	871	898	-3.1%
Net Financial Income	-170	-134	26.3%	-160	6.0%	-321	-273	17.6%
PBT	214	269	-20.6%	203	5.2%	550	626	-12.1%
<b>Net Profit</b>	<b>153</b>	<b>269</b>	<b>-43.0%</b>	<b>152</b>	<b>0.6%</b>	<b>403</b>	<b>652</b>	<b>-38.2%</b>

Source: Company, JM Financial

**Exhibit 2. Costs Breakdown**

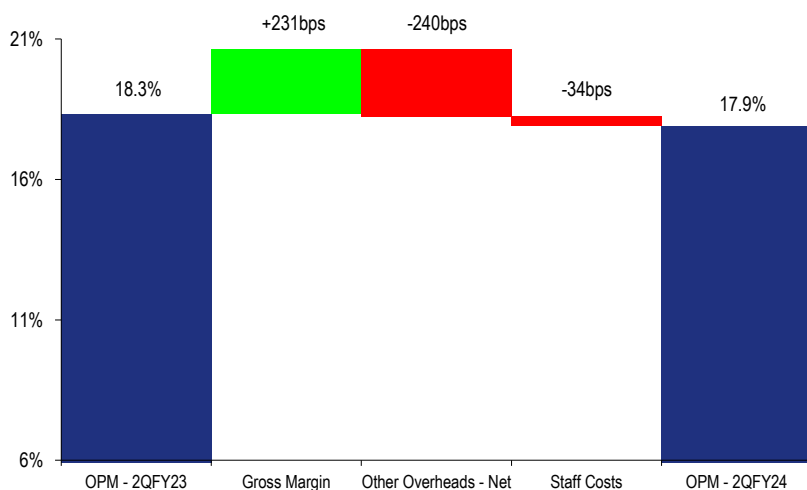
% of sales	2QFY24	2QFY23	2QFY24E	1HFY24	1HFY23
Cost of Goods Sold	31.3%	33.6%	31.5%	31.4%	32.9%
Staff Cost	13.6%	13.3%	13.8%	13.3%	12.9%
Other Expenses	37.2%	34.8%	37.7%	37.1%	35.0%
Depreciation	11.9%	11.2%	11.5%	11.5%	11.2%

Source: Company, JM Financial

**Exhibit 3. Per store economics**

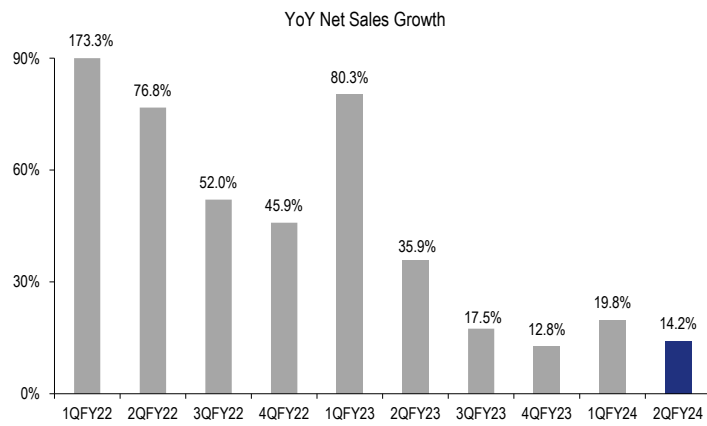
Per store basis (INR mn)	2Q24	1Q24	2Q23	% chg. YoY	% chg. QoQ
Average revenue / store	8.1	8.6	8.8	-8.6%	-6.2%
Staff cost / store	1.1	1.1	1.2	-6.3%	-1.7%
Other expenses / store	3.0	3.2	3.1	-2.3%	-5.6%
<b>EBITDA</b>	<b>1.3</b>	<b>1.5</b>	<b>1.5</b>	<b>-11.8%</b>	<b>-11.8%</b>

Source: Company, JM Financial

**Exhibit 4. GM benefit more than offset by higher overhead costs**


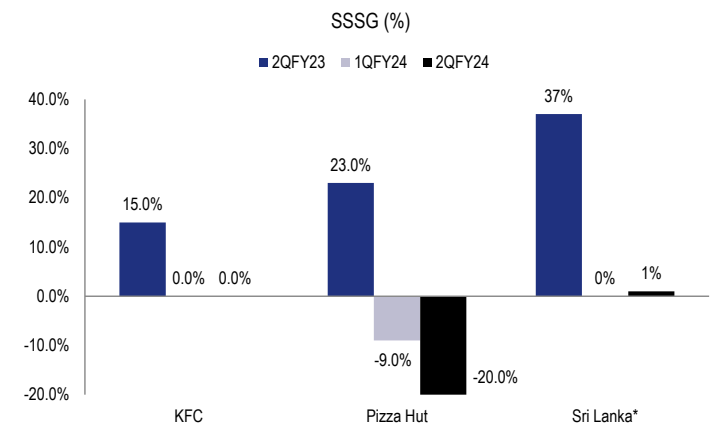
Source: Company, JM Financial

**Exhibit 5. Sales growth trend**



Source: Company, JM Financial

**Exhibit 6. SSSG trends remained subdued**



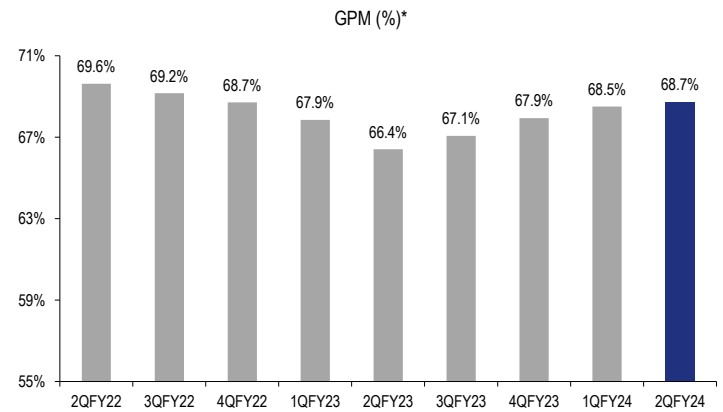
Source: Company, JM Financial

**Exhibit 7. 36 restaurants were added during the quarter**



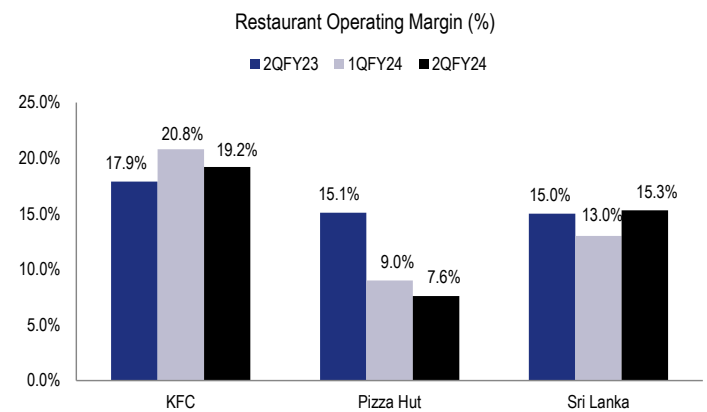
Source: Company, JM Financial

**Exhibit 8. Gross margin expanded 231bps yoy and 22bps qoq**



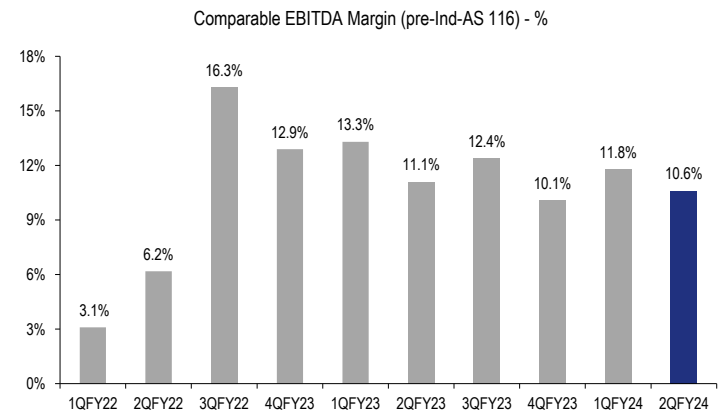
Source: Company, JM Financial  
\*Includes other operating income

**Exhibit 9. KFC & SL did well on profitability; PH margins remain weak**



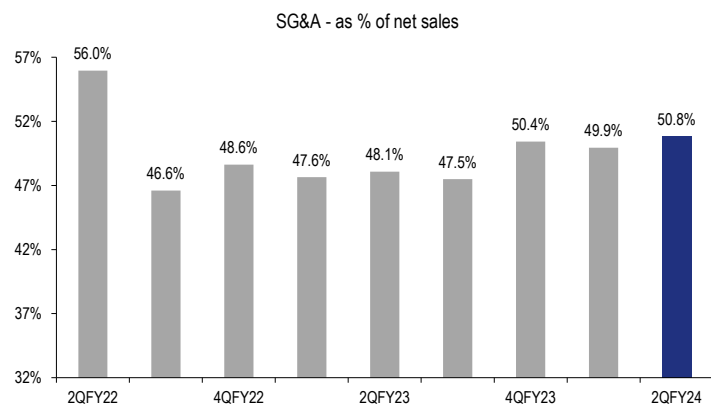
Source: Company, JM Financial

**Exhibit 10. Comparable EBITDA margin stood at 10.6%, lower 50bps yoy and 120bps qoq**



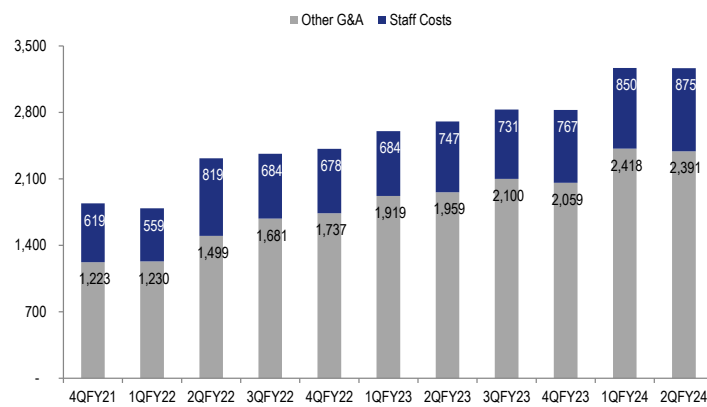
Source: Company, JM Financial

Exhibit 11. SG&amp;A grew at 1.5 times the rate of growth in revenue



Source: Company, JM Financial

Exhibit 12. Staff costs grew 17.1% yoy



Source: Company, JM Financial

Exhibit 13. Our 12-month DCF based price target works out to INR1,520/share

(INR mn)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E	FY33E	FY34E	FY35E
Revenue	11,938	13,404	10,196	17,216	22,656	27,272	32,997	38,725	44,769	51,003	57,462	64,248	71,395	78,893	86,907	95,471	104,620
yoy growth		12.3%	-23.9%	68.8%	31.6%	20.4%	21.0%	17.4%	15.6%	13.9%	12.7%	11.8%	11.1%	10.5%	10.2%	9.9%	9.6%
Comparable EBITDA (Pre Ind As 116)	435	662	382	1,808	2,647	3,184	4,200	5,034	5,875	6,842	7,798	8,869	9,923	11,052	12,271	13,586	15,003
EBITDA margin %	3.6%	4.9%	3.7%	10.5%	11.7%	11.7%	12.7%	13.0%	13.1%	13.4%	13.6%	13.8%	13.9%	14.0%	14.1%	14.2%	14.3%
Comparable EBIT	-309	-357	-728	703	1,281	1,501	2,223	2,747	3,278	3,950	4,615	5,393	6,159	7,007	7,948	8,989	10,137
EBIT margin %	-2.6%	-2.7%	-7.1%	4.1%	5.7%	5.5%	6.7%	7.1%	7.3%	7.7%	8.0%	8.4%	8.6%	8.9%	9.1%	9.4%	9.7%
Tax Rate	-1.6%	1.1%	-1.2%	10.5%	-115.1%	26.0%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%	25.5%
<b>NOPAT</b>	<b>-314</b>	<b>-353</b>	<b>-737</b>	<b>630</b>	<b>2,755</b>	<b>1,110</b>	<b>1,656</b>	<b>2,046</b>	<b>2,442</b>	<b>2,943</b>	<b>3,438</b>	<b>4,018</b>	<b>4,588</b>	<b>5,220</b>	<b>5,921</b>	<b>6,697</b>	<b>7,552</b>
Depreciation	744	1,019	1,110	1,105	1,366	1,684	1,977	2,287	2,597	2,892	3,183	3,476	3,764	4,045	4,323	4,597	4,865
Capex	-6,871	-1,165	-426	-2,221	-3,693	-2,992	-3,347	-3,687	-3,746	-3,857	-4,133	-4,423	-4,586	-4,892	-5,212	-5,547	-5,898
Net working capital investment	3,528	-2,979	23	-312	73	282	60	87	101	85	101	89	114	113	125	128	142
<b>Free Cash Flow</b>	<b>-2,913</b>	<b>-3,478</b>	<b>-30</b>	<b>-798</b>	<b>501</b>	<b>84</b>	<b>346</b>	<b>735</b>	<b>1,393</b>	<b>2,062</b>	<b>2,589</b>	<b>3,161</b>	<b>3,880</b>	<b>4,486</b>	<b>5,157</b>	<b>5,875</b>	<b>6,662</b>
YoY Growth - %						-83.2%	311.4%	112.4%	89.7%	48.0%	25.5%	22.1%	22.8%	15.6%	15.0%	13.9%	13.4%
Discounting Factor						1.00	0.95	0.86	0.78	0.71	0.64	0.58	0.52	0.47	0.43	0.39	0.35
<b>Present Value of FCF</b>						<b>84</b>	<b>329</b>	<b>632</b>	<b>1,086</b>	<b>1,454</b>	<b>1,652</b>	<b>1,825</b>	<b>2,028</b>	<b>2,122</b>	<b>2,207</b>	<b>2,275</b>	<b>2,335</b>
<b>Fade period forecast</b>	<b>FY36E</b>	<b>FY37E</b>	<b>FY38E</b>	<b>FY39E</b>	<b>FY40E</b>	<b>FY41E</b>	<b>FY42E</b>	<b>FY43E</b>	<b>FY44E</b>	<b>FY45E</b>							
<b>FCF</b>	<b>7,512</b>	<b>8,422</b>	<b>9,389</b>	<b>10,407</b>	<b>11,469</b>	<b>12,565</b>	<b>13,686</b>	<b>14,819</b>	<b>15,951</b>	<b>17,068</b>							
Discounting Factor	0.32	0.29	0.26	0.24	0.21	0.19	0.17	0.16	0.14	0.13							
Present Value of FCF	2,383	2,418	2,439	2,447	2,440	2,419	2,385	2,337	2,276	2,204							

**12M Forward Equity Valuation**

PV of Cash Flow - Explicit Period	17,945
PV of Cash Flow - Fade Period	23,748
PV of Terminal Value	51,921
<b>Enterprise Value</b>	<b>93,614</b>

Debt - Mar23	221
Cash - Mar23	3,053
Net Debt	-2,832
<b>Equity value</b>	<b>96,445</b>
Mn no of shares	64
<b>12M Target (DCF value) - Rs per share</b>	<b>1,520</b>

Source: Company, JM Financial

## Financial Tables (Consolidated)

Profit & Loss Statement						(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E	
<b>Sales</b>	<b>17,154</b>	<b>22,571</b>	<b>27,175</b>	<b>32,873</b>	<b>38,588</b>	
Sales Growth	68.8%	31.6%	20.4%	21.0%	17.4%	
Other Operating Income	61	85	97	124	138	
<b>Total Revenue</b>	<b>17,216</b>	<b>22,656</b>	<b>27,272</b>	<b>32,997</b>	<b>38,725</b>	
Cost of Goods Sold/Op. Exp.	5,278	7,407	8,520	10,287	12,021	
Personnel cost	2,740	2,929	3,604	4,276	4,991	
Other expenses	6,148	8,036	10,028	11,933	13,976	
<b>EBITDA</b>	<b>3,050</b>	<b>4,284</b>	<b>5,120</b>	<b>6,500</b>	<b>7,738</b>	
EBITDA (%)	17.8%	19.0%	18.8%	19.8%	20.1%	
EBITDA Growth (%)	145.2%	40.4%	19.5%	27.0%	19.0%	
<b>Comparable EBITDA</b>	<b>1,808</b>	<b>2,647</b>	<b>3,184</b>	<b>4,200</b>	<b>5,034</b>	
Comparable EBITDA (%)	10.5%	11.7%	11.7%	12.8%	13.0%	
Depn & Amort	2,135	2,642	3,244	3,877	4,537	
EBIT	915	1,642	1,876	2,624	3,201	
Other Income	380	311	266	304	387	
Finance Cost	781	869	1,040	1,214	1,430	
PBT before Excep & Forex	514	1,084	1,102	1,714	2,159	
Excep & forex Inc/Loss(-)	0	0	0	0	0	
PBT	514	1,084	1,102	1,714	2,159	
Taxes	54	-1,248	287	437	551	
Extraordinary Inc/Loss(-)	0	0	0	0	0	
Assoc. Profit/Min. Int.(-)	5	2	0	0	0	
Reported Net profit	465	2,334	816	1,277	1,608	
<b>Adjusted Net Profit</b>	<b>465</b>	<b>2,329</b>	<b>816</b>	<b>1,277</b>	<b>1,608</b>	
Net Margin (%)	2.7%	10.3%	3.0%	3.9%	4.2%	
Diluted share capital (mn)	63.5	63.5	63.5	63.5	63.5	
<b>Diluted EPS (Rs)</b>	<b>7.3</b>	<b>36.6</b>	<b>12.8</b>	<b>20.1</b>	<b>25.3</b>	
Diluted EPS Growth	-146.2%	400.3%	-65.0%	56.5%	26.0%	
Total Dividend + Tax	0	0	0	0	0	
Dividend Per Share (Rs)	0.0	0.0	0.0	0.0	0.0	

Source: Company, JM Financial

Balance Sheet						(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E	
Shareholders' Fund	10,071	12,559	13,375	14,652	16,260	
Share capital	635	635	635	635	635	
Reserves & Surplus	9,436	11,924	12,740	14,016	15,625	
Preference Share Capital	0	0	0	0	0	
Minority Interest	-17	-20	-20	-20	-20	
Total Loans	612	443	221	111	55	
Def. Tax Liab / Assets (-)	87	-1,184	-1,184	-1,184	-1,184	
<b>Total - Equity &amp; Liab</b>	<b>10,754</b>	<b>11,798</b>	<b>12,392</b>	<b>13,558</b>	<b>15,111</b>	
Net Fixed Assets	6,944	9,269	9,956	10,532	10,966	
Gross Fixed Assets	11,978	15,433	18,425	21,772	25,458	
Intangible Assets						
Less: Depn. & Amort.	4,329	5,458	7,142	9,119	11,407	
Capital WIP & Net lease asset	-705	-706	-1,327	-2,120	-3,086	
Investments	1,525	659	659	659	659	
Current Assets	5,890	5,607	6,234	7,688	9,702	
Inventories	652	993	1,117	1,351	1,586	
Sundry Debtors	141	179	223	270	317	
Cash & Bank Balances	2,546	2,204	2,394	3,043	4,249	
Loans & Advances	2,131	1,578	1,902	2,301	2,701	
Other Current Assets	420	653	598	723	849	
Current Liab. & Prov.	3,605	3,738	4,457	5,321	6,216	
Current Liabilities	3,429	3,561	4,248	5,081	5,943	
Provisions & Others	176	177	208	240	274	
Net Current Assets	2,285	1,870	1,777	2,367	3,486	
<b>Application of Funds</b>	<b>10,754</b>	<b>11,798</b>	<b>12,392</b>	<b>13,558</b>	<b>15,111</b>	

Source: Company, JM Financial

Cash Flow statement						(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E	
Profit before Tax	514	1,084	1,102	1,714	2,159	
Depn. & Amort.	2,135	2,642	3,244	3,877	4,537	
Net Interest Exp. / Inc. (-)	401	558	774	910	1,043	
Inc (-) / Dec in WCcap.	592	-669	282	60	87	
Others	393	225	0	0	0	
Taxes Paid	-86	-21	-287	-437	-551	
<b>Operating Cash Flow</b>	<b>3,949</b>	<b>3,818</b>	<b>5,115</b>	<b>6,123</b>	<b>7,275</b>	
Capex	-2,844	-3,825	-2,992	-3,347	-3,687	
Free Cash Flow	1,105	-6	2,123	2,776	3,589	
-Inc/dec in investments	-1,184	910	0	0	0	
Other current assets	-2,889	879	266	304	387	
<b>Investing Cash Flow</b>	<b>-6,916</b>	<b>-2,036</b>	<b>-2,726</b>	<b>-3,043</b>	<b>-3,299</b>	
Inc(dec) in capital	4,690	0	0	0	0	
Dividend+Tax Thereon	0	0	0	0	0	
Inc/dec in loans	-176	-192	-221	-111	-55	
Other assets	-1,384	-1,756	-1,978	-2,320	-2,714	
<b>Financing Cash Flow</b>	<b>3,130</b>	<b>-1,948</b>	<b>-2,200</b>	<b>-2,431</b>	<b>-2,769</b>	
<b>Inc / Dec (-) in Cash</b>	<b>162</b>	<b>-166</b>	<b>189</b>	<b>649</b>	<b>1,207</b>	
Opening cash balance	2,384	2,370	2,204	2,394	3,043	
Closing cash balance	2,546	2,204	2,394	3,043	4,249	

Source: Company, JM Financial

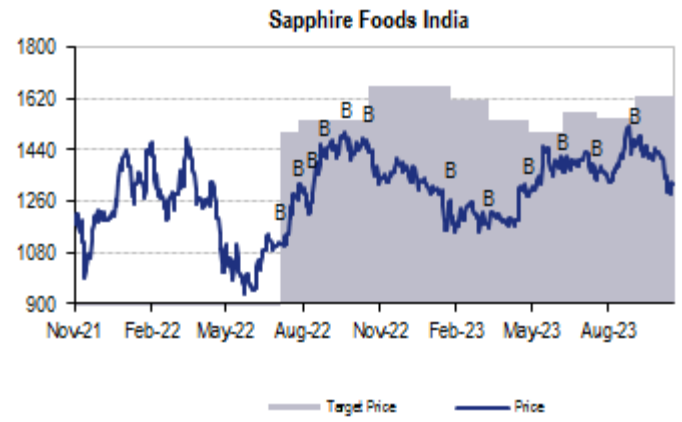
Dupont Analysis					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Margin	2.7%	10.3%	3.0%	3.9%	4.2%
Asset Turnover (x)	2.1	2.0	2.2	2.5	2.7
Leverage Factor (x)	1.1	1.0	0.9	0.9	0.9
RoE	6.3%	20.6%	6.3%	9.1%	10.4%
Key Ratios					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
BV/Share (Rs)	158.5	197.7	210.5	230.6	255.9
ROIC (%)	9.1%	13.9%	10.4%	13.9%	15.5%
ROE (%)	6.3%	20.6%	6.3%	9.1%	10.4%
Net Debt-equity ratio (x)	-0.3	-0.2	-0.2	-0.2	-0.3
PER	NA	36.0	NA	65.6	52.1
PBV	8.3	6.7	6.3	5.7	5.2
EV/EBITDA	26.3	19.0	15.8	12.3	10.2
EV/Net Sales	4.7	3.6	3.0	2.4	2.0
Debtor days	3	3	3	3	3
Inventory days	14	16	15	15	15
Creditor days	88	71	70	70	70

Source: Company, JM Financial

## History of Recommendation and Target Price

Date	Recommendation	Target Price	% Chg.
20-Jul-22	Buy	1,500	
11-Aug-22	Buy	1,540	2.7
29-Aug-22	Buy	1,540	0.0
13-Sep-22	Buy	1,540	0.0
7-Oct-22	Buy	1,540	0.0
3-Nov-22	Buy	1,665	8.1
9-Feb-23	Buy	1,610	-3.3
27-Mar-23	Buy	1,545	-4.0
13-May-23	Buy	1,500	-2.9
23-Jun-23	Buy	1,570	4.7
3-Aug-23	Buy	1,550	-1.3
18-Sep-23	Buy	1,630	5.2

## Recommendation History



## APPENDIX I

## JM Financial Institutional Securities Limited

Corporate Identity Number: U67100MH2017PLC296081

Member of BSE Ltd. and National Stock Exchange of India Ltd.

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Rating	Meaning
Buy	Total expected returns of more than 10% for stocks with market capitalisation in excess of INR 200 billion and REITs* and more than 15% for all other stocks, over the next twelve months. Total expected return includes dividend yields.
Hold	Price expected to move in the range of 10% downside to 10% upside from the current market price for stocks with market capitalisation in excess of INR 200 billion and REITs* and in the range of 10% downside to 15% upside from the current market price for all other stocks, over the next twelve months.
Sell	Price expected to move downwards by more than 10% from the current market price over the next twelve months.

\* REITs refers to Real Estate Investment Trusts.

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