

Retail

Prolonged slowdown; Prefer SAPPHIRE/WESTLIFE on outperformance

Sector Report

SECTOR REPORT

November 9, 2023

NIFTY 50: 19,395

Q2 saw muted sequential trends on a weak Q1 base, suggesting continued macro-weakness. BK India/WESTLIFE/KFC (SAPPHIRE) delivered 3.5%/1.0%/0% SSG, while others saw SSG declines. Even the Q3 outlook suggested only a normal seasonal pick-up sequentially vs. a pent-up expectation (World Cup/low-Q1 base). Focus across players is on driving SSG through transaction growth vs. increased bill values, which is a good strategy in a weak demand environment. Burger/Chicken players have launched limited-period value offers with products at Rs99-179. Despite weak trends, store additions picked up sequentially and companies have retained their annual targets, suggesting continued growth investments. Capex (as a % of sales) remained largely in line with historical trends in H1FY24 (refer Exhibit 7). Among QSR categories, Pizza/Burger categories saw sequential share gains at the cost of Chicken, likely due to the extended *Shravan* period in Q2, which should reverse in H2. Otherwise, the pizza category is witnessing intense competition and consumers are downtrading to other categories. RM pains (ex-wheat) are largely behind, with gross margin improving 20-100 bps across players. However, negative leverage and muted near-term outlook drove significant earnings cuts across companies. While our long-term view is constructive for QSRs, a prolonged slowdown and high valuation are driving our SELL rating on JUBI/DEVYANI. Our BUY rating stays for SAPPHIRE/WESTLIFE, led by better SSG, narrowing margin gap vs. peers, and attractive valuation (SAPPHIRE). BK India is currently not under active coverage.

QSR growth has moderated on weak macros; growth investments continue: Our analyses of listed QSRs suggest that: i) The overall listed space has seen 9%/11% growth in Q2/H1, indicating a moderating growth trend vs. FY20-23 CAGR of ~15%, amid inflation-led demand woes. ii) Among QSR categories, Pizza/Burger chains saw sequential share gains at the cost of Chicken, likely due to the extended *Shravan* period in Q2, which should reverse in H2. We believe headwinds persist for the pizza category due to intense competition and a shift to lower price points amid inflation. Chicken/Burger together contributed 55% revenue share in H1FY24 vs. 52% in H1FY23 and 45% pre-Covid (FY19). We remain confident about the Burger/Chicken category's outperformance, led by lower price points, promotional value offers, and festive demand pickup.

BK India took a higher share of footfalls; KFC should benefit from the low base in Q3: Among listed burger QSR chains, BK India fared better with 3.5%/23% SSG/revenue growth in Q2 vs. 1%/7% growth of WESTLIFE, albeit WESTLIFE SSG's performance was better than other QSR names. In our view, BK India's performance has been propped by an attractive entry-level meal offering at Rs99 vs. Rs179 offering for WESTLIFE (Mc-Veggie /Mc Chicken – relatively premium). For KFC, SAPPHIRE/DEVYANI delivered 0%/-4% SSG in Q2, likely impacted by higher vegetarian consumption days, but performance was better than significant SSG declines in the pizza category. In our view, KFC should benefit more in Q3, from a low base sequentially.

Focus remains on value launches to drive footfall growth: The intensity of value launches has definitely increased, as focus remains on improving accessibility for new consumers through entry-level launches (Rs99/179). In our view, McDonald's/KFC/BK India are reaping more benefits vs. pizza players due to higher moderation in the RM bucket (lower dairy and higher palm oil exposure). H1 saw the launch of the Rs99/179 value meal offer by BK India/WESTLIFE, which helped them report healthy SSG. KFC launched the Snacker range (7 products @Rs99), helping it log flat SSG (vs. a decline for pizza players).

Rating, Target Price and Valuation

	Rating	CMP (Rs)	TP (Rs)	Upside (%)	P/E (x)		RoE (%)	
					FY24	FY25	FY24	FY25
Devyani International	Sell	180	165	(9)	104.4	86.2	20.2	20.7
Jubilant FoodWorks	Sell	506	380	(25)	104.5	72.5	14.1	18.1
Sapphire Foods	Buy	1,295	1,550	20	84.5	51.3	7.5	11.2
Westlife Foodworld	Buy	811	1,040	28	123.4	80.3	17.2	23.4

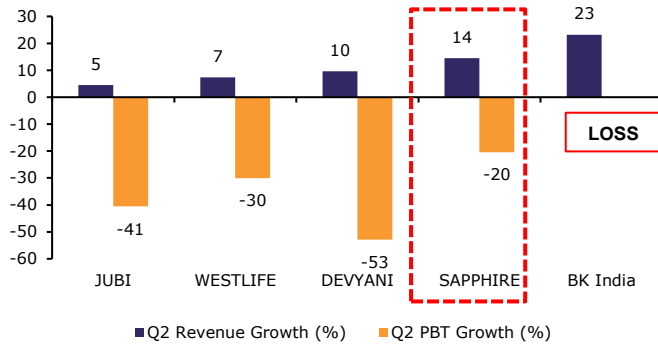
Source: Company, Emkay Research

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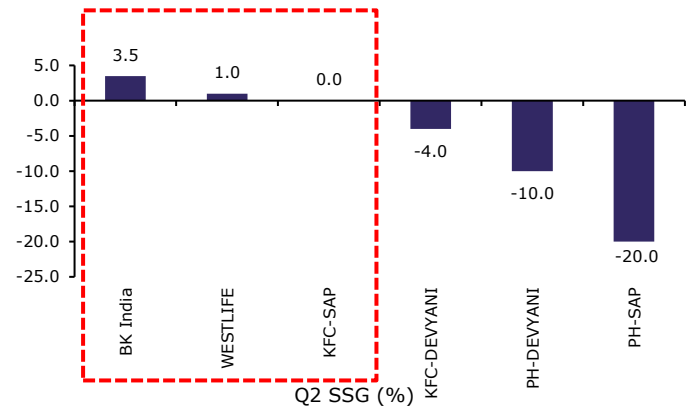
Story in Chart

Exhibit 1: Weak SSG and growth investments drove PBT decline for most players; Sapphire outperformed with lower PBT decline



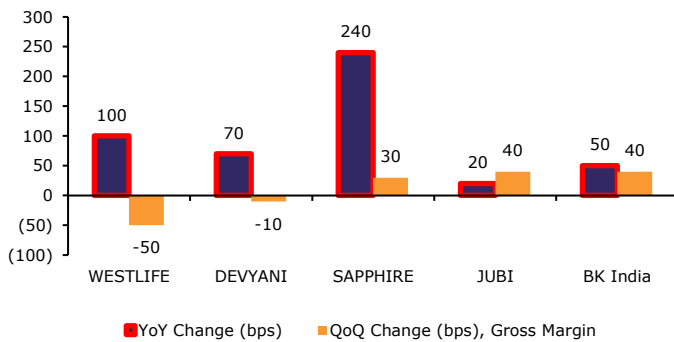
Source: Company, Emkay Research, *BK reported PBT loss in Q2FY24

Exhibit 2: BK India/WESTLIFE/KFC (Sap) outperformed in terms of SSG, while other players saw significant SSG decline



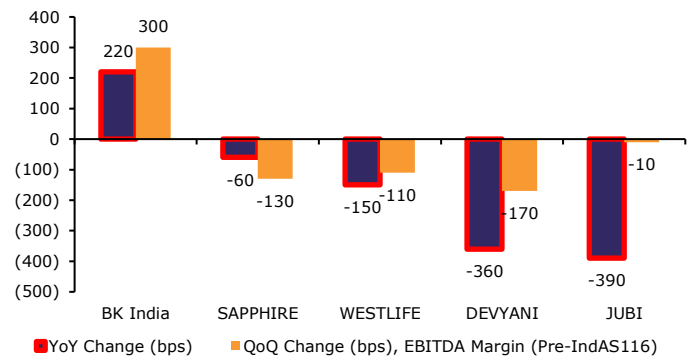
Source: Company, Emkay Research

Exhibit 3: Benign RM drove gross-margin gains across players



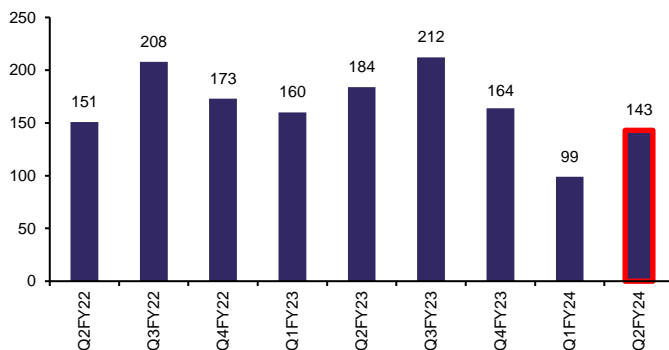
Source: Company, Emkay Research

Exhibit 4: Most players saw a dip in EBITDA margin led by negative operating leverage; BK India outperformed the pack with gains



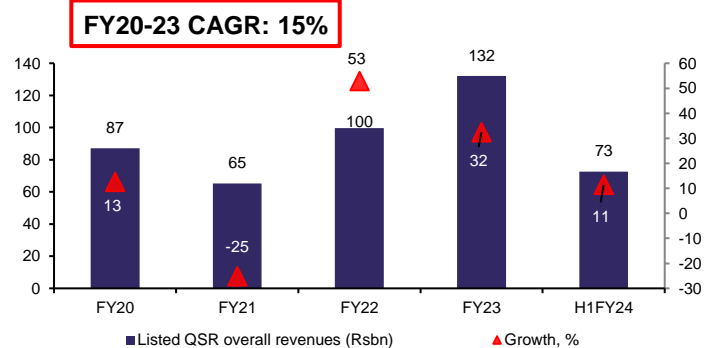
Source: Company, Emkay Research

Exhibit 5: Pace of store additions improved over Q1; all players have retained their annual store addition target

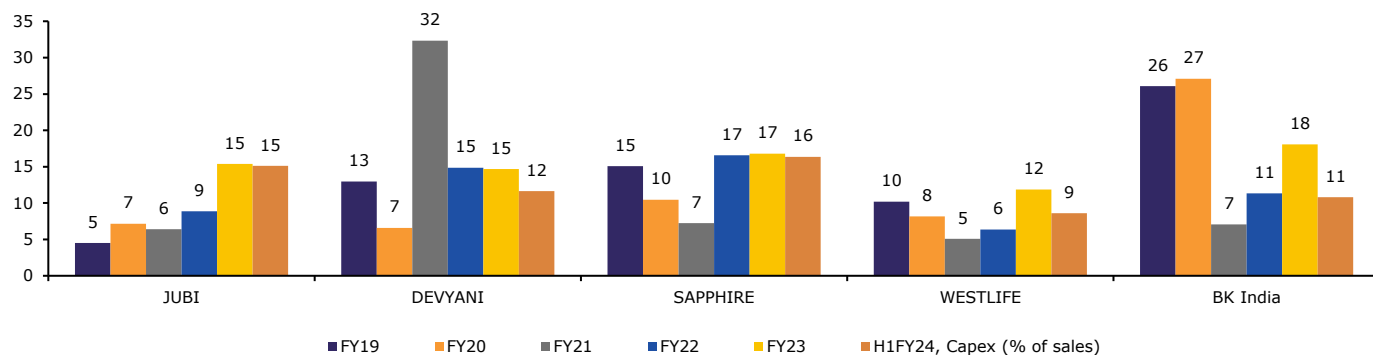


Source: Company, Emkay Research

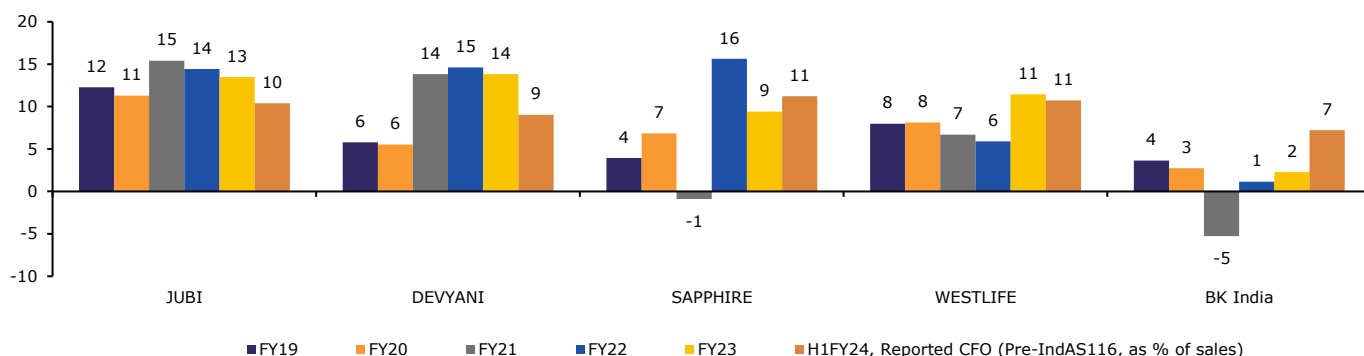
Exhibit 6: Listed QSRs saw growth moderation with 11% growth in H1 vs. 15% growth CAGR between FY20-23



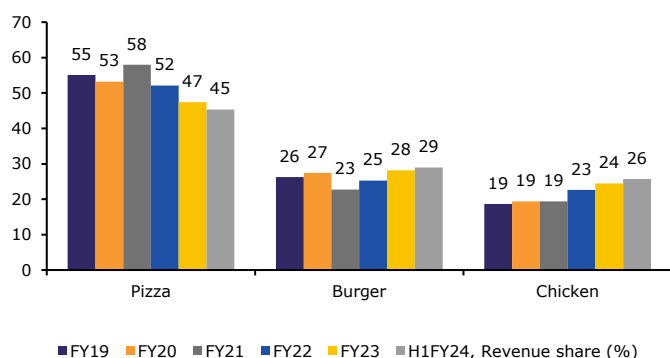
Source: Company, Emkay Research

Exhibit 7: Despite muted demand environment, Capex (% of sales) remained buoyant across players, as growth investments continued

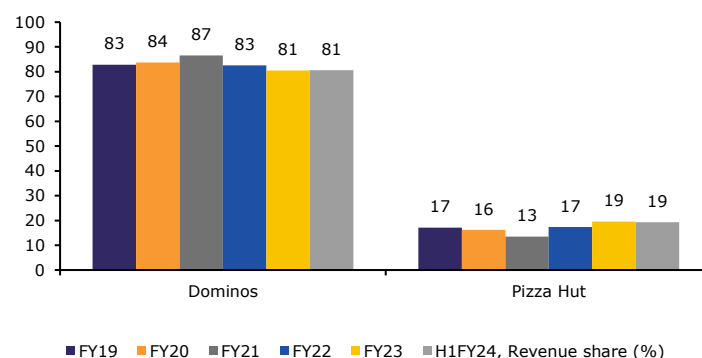
Source: Company, Emkay Research

Exhibit 8: Operating cash flows (Pre-IndAS; % of sales) reduced across players with margin pressures; BK India fared better in H1 with healthy margin improvement

Source: Company, Emkay Research

Exhibit 9: Burger/chicken categories gain share at the expense of share loss for the pizza category; Q2 saw gains for Pizza category, likely due to higher vegetarian consumption days

Source: Emkay, Pizza includes India sales for PH (DIL + Sapphire)/JUBI, Burger includes WESTLIFE/BK and Chicken includes KFC (DIL + Sapphire)

Exhibit 10: Within PH/Domino's, PH's revenue share stagnated, led by category pain/higher competitive intensity

Source: Emkay Research, PH includes combined sales for DIL/Sapphire

Exhibit 11: BK runs a promotional offer on Whopper to attract footfall



Source: Online marketing platforms, Emkay Research

Exhibit 12: KFC introduced 5in1 combo meal at Rs149 to drive growth



Source: Online marketing platforms, Emkay Research

Exhibit 13: Domino's has introduced the Red Hot Pizza Range to address the whitespace (price) in the portfolio



Source: Online marketing platforms, Emkay Research

Exhibit 14: BK has introduced meals at Rs99 to increase the value offerings and improve footfalls



Source: Online marketing platforms, Emkay Research

Exhibit 15: Westlife launched meals at Rs179 to plug a key price gap in the meal portfolio; gourmet/chicken meals are priced higher



Source: Online marketing platforms, Emkay Research

Exhibit 16: KFC has introduced entry-level KFC snackers, with a focus on improving brand accessibility



Source: Online marketing platforms, Emkay Research

Exhibit 17: SAPPHIRE has devised a 6-12 month plan to revive the PH brand and improve overall category traction

PIZZA HUT INDIA

SPECIFIC PLANS NEXT 6-12 MONTHS



Build Brand Salience

- Product Innovation
 - : Large Pizza (launched initially in 2 states)
 - : Detailed innovation pipeline (6-12 months)
- Enhanced marketing spends (over & above mandated agreement)



Grow Dine-In Sales

- Operations**
- Speed of service & quality of customer experience: investment in Dragon Tail tech (intelligent kitchen production planning tool) to enable serving of hot & fresh pizzas
- Customer**
- Reinforcement of Pizza Hut's Dine-In experience through curated deals via analytics and CRM
 - Build Lunch Dine-In occasion: launch of attractive combos



Our focus is to continually improve operational execution and customer experience

Strengthen Home Service

- Building late night occasions: 65% of our stores now deliver 2 a.m. and beyond
- Delivering 'Hot & Fresh' pizzas: Dragon Tail integration with Aggregator platforms to improve customer experience and ratings



Real Estate Strategy (existing/new restaurants)

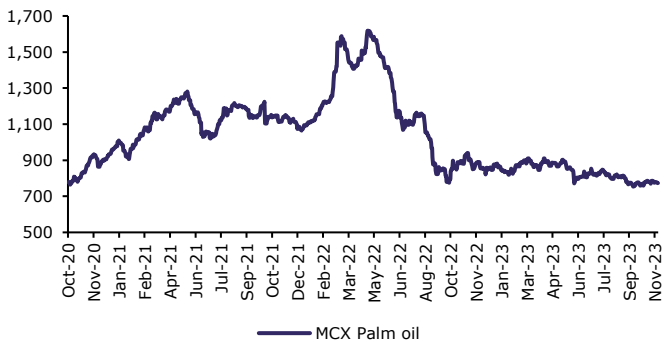
- Cautious expansion of new restaurants
- 3-5% portfolio corrections: closure of long non-performing restaurants
- 12-15% restaurants refurbishments: enhanced customer experience
- Restaurant Capex Optimisation: Process reengineering on back-end



As consumer demand improves, the execution as above will hold us in good stead

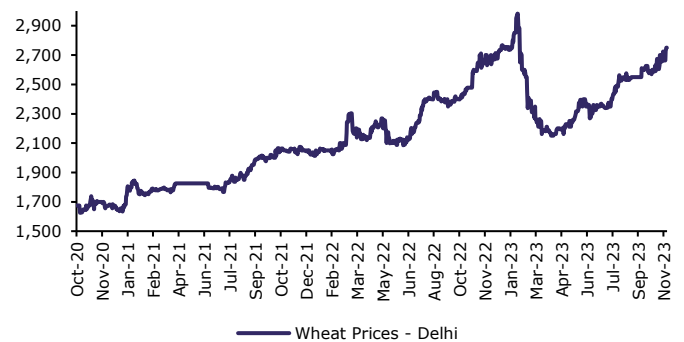
Source: Company, Emkay Research

Exhibit 18: Palm oil price has moderated; positive for KFC/McD/BK



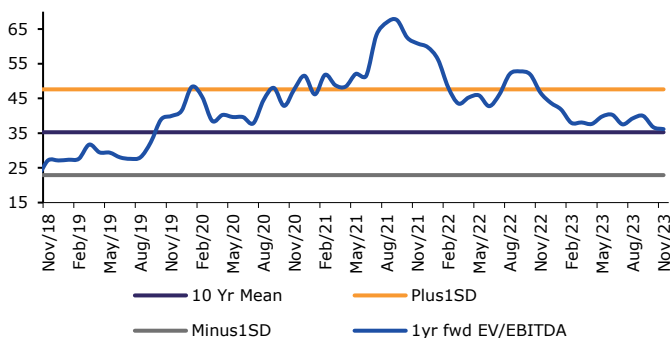
Source: Company, Emkay Research

Exhibit 19: Wheat prices are seeing an increase in Q3TD



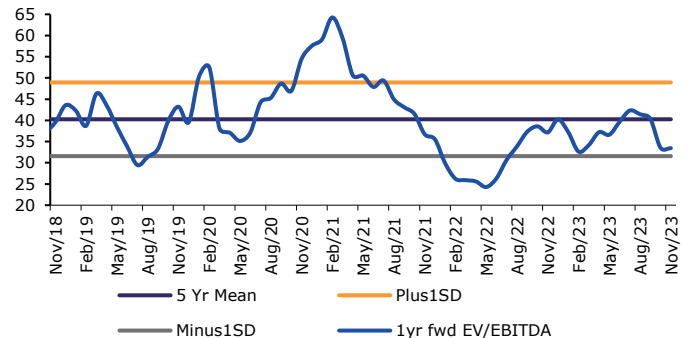
Source: Company, Emkay Research

Exhibit 20: JUBI's one-year fwd. EV/EBITDA trend



Source: Emkay Research

Exhibit 21: Westlife's one-year fwd. EV/EBITDA trend



Source: Emkay Research, *Excludes Covid impact in FY21

Exhibit 22: Peer Comparison

Companies	Price (Rs)	Mcap (Rs bn)	Reco	Target Price (Rs)	P/E (x)			Pre IndAS-116 EV/EBITDA (x)		
					FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Jubilant FoodWorks	506	334	Sell	380	104.5	72.5	56.4	43.8	33.3	27.2
Devyani International	181	218	Sell	165	152.6	86.3	58.6	45.8	34.6	26.0
Westlife Foodworld	810	126	Buy	1,040	123.2	80.1	53.6	40.4	30.8	23.5
Sapphire Foods	1,297	83	Buy	1,550	84.6	51.3	36.8	30.5	22.0	16.6

Source: Company, Emkay Research

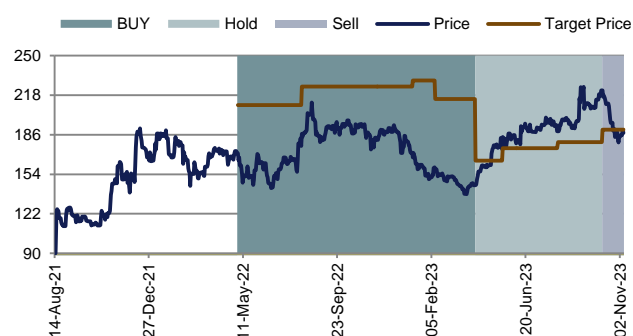
DEVYANI INTERNATIONAL

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
08-Nov-23	184	165	Sell	Devanshu Bansal
08-Oct-23	222	190	Sell	Devanshu Bansal
05-Aug-23	189	180	Hold	Devanshu Bansal
10-Jul-23	190	175	Hold	Devanshu Bansal
21-May-23	183	175	Hold	Devanshu Bansal
18-May-23	184	175	Hold	Devanshu Bansal
20-Apr-23	161	165	Hold	Devanshu Bansal
09-Apr-23	145	165	Hold	Devanshu Bansal
10-Feb-23	158	215	Buy	Devanshu Bansal
09-Jan-23	168	230	Buy	Devanshu Bansal
04-Nov-22	188	225	Buy	Devanshu Bansal
03-Aug-22	187	225	Buy	Devanshu Bansal
03-May-22	171	210	Buy	Devanshu Bansal

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

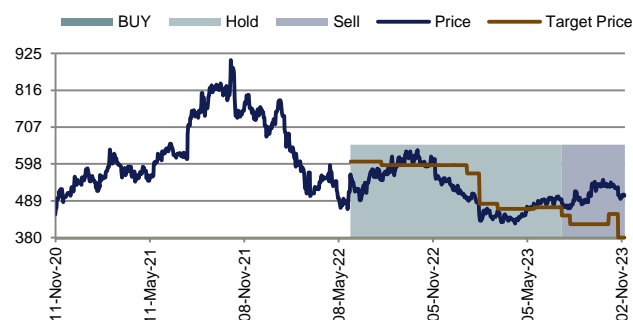
JUBILANT FOODWORKS

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
26-Oct-23	506	380	Sell	Devanshu Bansal
08-Oct-23	533	450	Sell	Devanshu Bansal
12-Sep-23	528	420	Sell	Devanshu Bansal
26-Jul-23	468	420	Sell	Devanshu Bansal
10-Jul-23	482	445	Sell	Devanshu Bansal
21-May-23	469	470	Hold	Devanshu Bansal
18-May-23	475	470	Hold	Devanshu Bansal
09-Mar-23	461	465	Hold	Devanshu Bansal
02-Feb-23	436	480	Hold	Devanshu Bansal
09-Jan-23	500	570	Hold	Devanshu Bansal
08-Nov-22	613	595	Hold	Devanshu Bansal
21-Aug-22	597	595	Hold	Devanshu Bansal
29-Jul-22	550	595	Hold	Devanshu Bansal
31-May-22	551	605	Hold	Devanshu Bansal

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

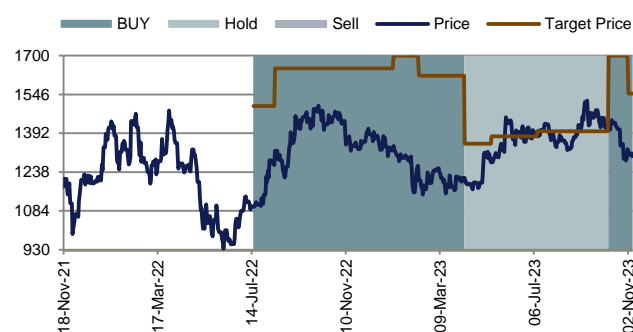
SAPPHIRE FOODS

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
02-Nov-23	1,319	1,550	Buy	Devanshu Bansal
08-Oct-23	1,425	1,700	Buy	Devanshu Bansal
03-Aug-23	1,337	1,400	Hold	Devanshu Bansal
10-Jul-23	1,400	1,400	Hold	Devanshu Bansal
21-May-23	1,298	1,380	Hold	Devanshu Bansal
13-May-23	1,277	1,380	Hold	Devanshu Bansal
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

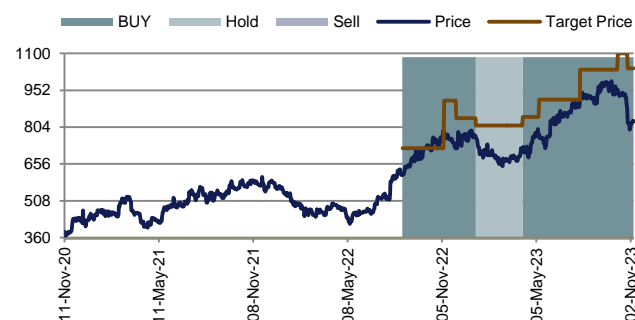
WESTLIFE FOODWORLD

RECOMMENDATION HISTORY - DETAILS

Date	Closing Price (INR)	TP (INR)	Rating	Analyst
27-Oct-23	820	1,040	Buy	Devanshu Bansal
08-Oct-23	955	1,100	Buy	Devanshu Bansal
28-Jul-23	940	1,035	Buy	Devanshu Bansal
10-Jul-23	861	915	Buy	Devanshu Bansal
21-May-23	739	915	Buy	Devanshu Bansal
10-May-23	774	915	Buy	Devanshu Bansal
09-Apr-23	720	845	Buy	Devanshu Bansal
31-Jan-23	735	810	Hold	Devanshu Bansal
09-Jan-23	761	810	Hold	Devanshu Bansal
02-Dec-22	720	840	Buy	Devanshu Bansal
09-Nov-22	781	910	Buy	Devanshu Bansal
21-Aug-22	611	720	Buy	Devanshu Bansal

Source: Company, Emkay Research

RECOMMENDATION HISTORY - TREND



Source: Bloomberg, Company, Emkay Research

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