

Sapphire Foods India | BUY

Navigating challenging times through focused format strategy

For the QSR industry, the operating environment has been challenging so far in FY24; however, the issues are more cyclical in nature and the penetration-led story is intact. We like Sapphire's format strategy to deal with the challenging/volatile situation by a) fortifying KFC's presence in the chicken segment through aggressive store expansion, b) calibrating store expansion in Pizza Hut (PH) and taking steps to improve brand recall and drive transactions and cost efficiencies, and c) bridging portfolio gaps (KFC Snackers, late night delivery in PH) to enhance play across dayparts for both brands. Domestic business apart, weakness in the Sri Lanka (SL) business (which was a drag in FY23) is bottoming out vs. peers whose overseas operations (Devyani – Nigeria) are either seeing challenges or still work in progress (RBA). Resilient KFC margins and recovery in SL profitability should help Sapphire offset some impact of the weakness in PH. We continue to believe in Sapphire's superior execution ([link](#)), and forecast 19%/24% sales/EBITDA (pre-Ind AS) CAGR over FY23-26E. Current valuations (21x/17x FY25/26E pre-IND AS EV/EBITDA) are not demanding; there is headroom for the discount (c.35-40%) to Devyani to narrow over time. We reiterate BUY.

- KFC - Fortifying presence in chicken segment; well ahead of competition:** Regional competition is not a threat in this category and no formidable No. 2 brand has emerged despite the entry of large QSR peers. In our view, apart from getting unit economics right, creating top-of-the-mind brand recall, getting the right location and building back-end supply chain (important for fresh chicken-based QSR) are not easy and happen over the long haul. This is visible from Popeye's pace of expansion since launch (JUBI is looking at 250 stores over next 4 -5 years vs KFC sapphire/Devyani at 381/540 stores currently). We have seen the first-mover advantage that Domino's (in Pizza), and Westlife (in Burger) enjoy even today despite scale-up by No. 2 players in those categories. We believe KFC is far ahead of competition & enjoys similar advantages in the chicken segment. Sapphire's execution here has been impressive, providing assurance on the runway for growth. We forecast a strong 20%/21% sales/ROM CAGR for KFC over FY23-26E.
- PH remains a focus; favourable base apart, several initiatives underway that should aid gradual ADS recovery:** Category has seen aggressive scale-up by competitors; however, some of them have adopted the sub-franchisee route, which enables faster expansion in a shorter time. But maintaining quality standards becomes a challenge while dealing with multiple franchisees. This could potentially impact consumer experience/product quality in the long run, in our view. We have seen PH struggling in the past due to the multiple franchisee model, and post consolidation to two franchisees it did see a significant turnaround. While PH has been able to get the store format right, more work needs to be done on strengthening brand recall. Several initiatives have been undertaken – a) increased marketing spends, b) ramp-up in innovations, c) integration of Dragontail technology to enhance consumer experience, which, along with a soft base, should aid ADS recovery.



Mehul Desai

mehul.desai@jmfl.com | Tel: (91 22) 66303065

Sumanyu Saraf

sumanyu.saraf@jmfl.com | Tel: (91 22) 66303077

Richard Liu

richard.liu@jmfl.com | Tel: (91 22) 66303064

Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	1,600
Upside/(Downside)	12.6%
Previous Price Target	1,520
Change	5.3%

Key Data – SAPPHERE IN

Current Market Price	INR1,421
Market cap (bn)	INR90.6/US\$1.1
Free Float	58%
Shares in issue (mn)	63.5
Diluted share (mn)	63.5
3-mon avg daily val (mn)	INR217.9/US\$2.6
52-week range	1,568/1,102
Sensex/Nifty	69,929/20,997
INR/US\$	83.4

Price Performance

%	1M	6M	12M
Absolute	9.4	4.1	2.5
Relative*	1.5	-6.8	-8.9

* To the BSE Sensex

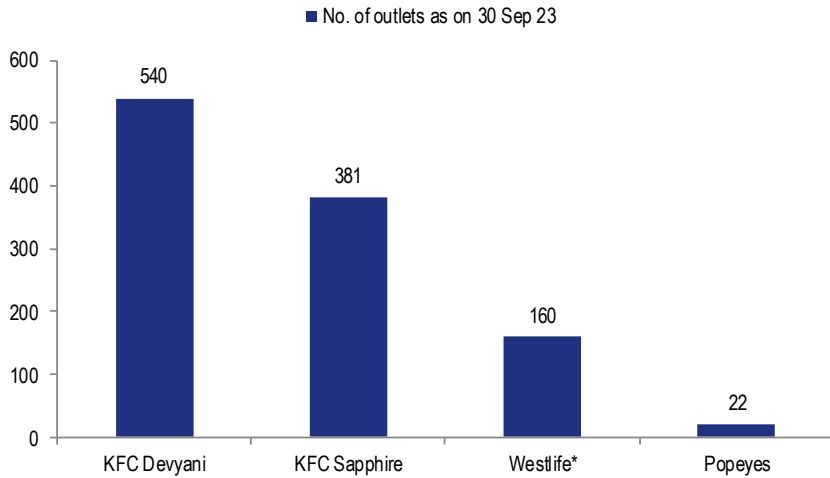
Financial Summary					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Sales	17,154	22,571	27,175	32,805	38,433
Sales Growth (%)	68.8%	31.6%	20.4%	20.7%	17.2%
EBITDA	3,050	4,284	5,120	6,507	7,754
EBITDA Margin (%)	17.8%	19.0%	18.8%	19.8%	20.2%
Adjusted Net Profit	465	2,329	816	1,297	1,665
Diluted EPS (INR)	7.3	36.6	12.8	20.4	26.2
Diluted EPS Growth (%)	-146.2%	400.3%	-65.0%	59.0%	28.4%
ROIC (%)	9.1%	13.9%	10.4%	14.0%	15.7%
ROE (%)	6.3%	20.6%	6.3%	9.2%	10.7%
P/E (x)	NA	38.8	NA	69.6	54.2
P/B (x)	9.0	7.2	6.8	6.2	5.5
EV/EBITDA (x)	28.5	20.5	17.1	13.3	11.0
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, JM Financial. Note: Valuations as of 11/Dec/2023

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

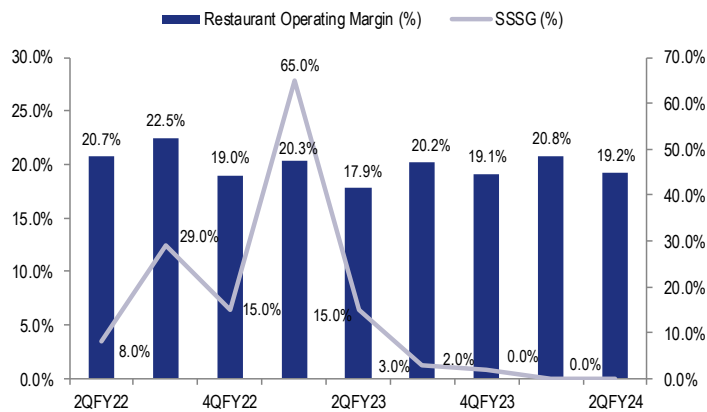
Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Exhibit 1. KFC far ahead of competition in terms of store network in chicken segment



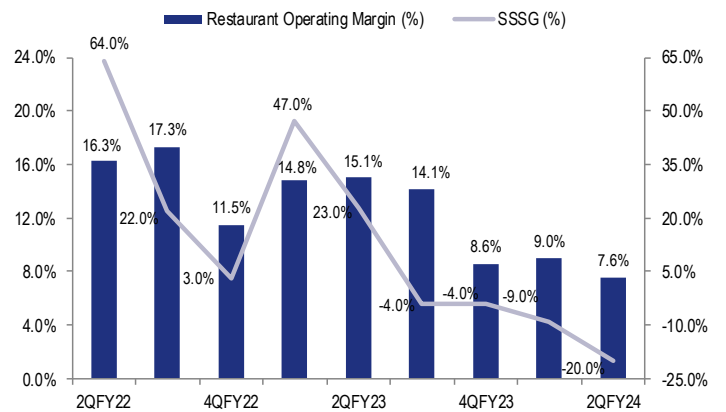
Source: Company, JM Financial
 *Outlets serving bone-in chicken offerings

Exhibit 2. KFC: Resilient operating performance in tough scenario



Source: Company, JM Financial

Exhibit 3. PH: High competitive activity impacts performance

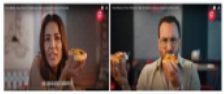


Source: Company, JM Financial

Exhibit 4. Pizza Hut: Several initiatives for the next 6-12 months to drive gradual recovery in ADS

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



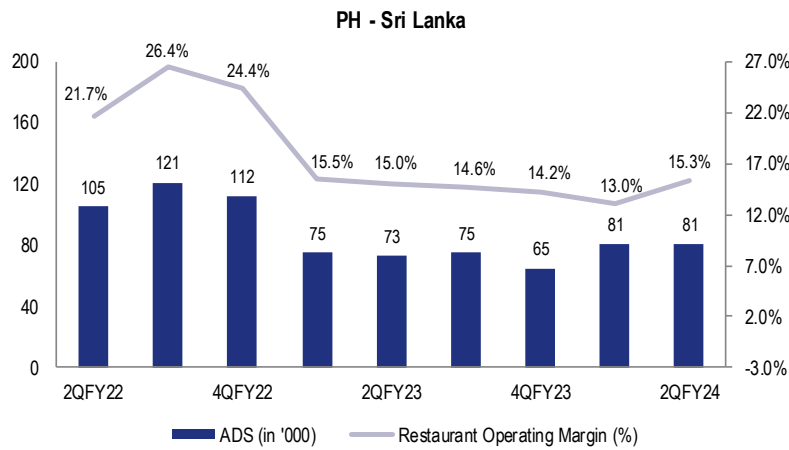
Real Estate Strategy (existing/new restaurants)

- **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



Source: Company, JM Financial

Exhibit 5. International business - worst seems to be behind for Sri Lanka business



Source: Company, JM Financial

Exhibit 6. 12-month DCF based price target works out to INR1,600/share

(INR mn)	(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	32,928	38,570	44,628	50,983	57,636	64,532	71,690	79,198	87,225	95,802	104,964
yoy growth		12.3%	-23.9%	68.8%	31.6%	20.4%	20.7%	17.1%	15.7%	14.2%	13.1%	12.0%	11.1%	10.5%	10.1%	9.8%	9.6%
Comparable EBITDA (Pre Ind As 116)	435	662	382	1,808	2,647	3,184	4,201	5,039	5,903	6,904	7,912	9,020	10,095	11,249	12,497	13,843	15,295
EBITDA margin %	3.6%	4.9%	3.7%	10.5%	11.7%	11.7%	12.8%	13.1%	13.2%	13.5%	13.7%	14.0%	14.1%	14.2%	14.3%	14.4%	14.6%
Comparable EBIT	-309	-357	-728	703	1,281	1,501	2,229	2,765	3,322	4,020	4,726	5,535	6,323	7,197	8,166	9,239	10,423
EBIT margin %	-2.6%	-2.7%	-7.1%	4.1%	5.7%	5.5%	6.8%	7.2%	7.4%	7.9%	8.2%	8.6%	8.8%	9.1%	9.4%	9.6%	9.9%
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%
NOPAT	-314	-353	-737	630	2,755	1,110	1,660	2,060	2,475	2,995	3,521	4,124	4,711	5,362	6,084	6,883	7,765
Depreciation	744	1,019	1,110	1,105	1,366	1,684	1,972	2,274	2,581	2,884	3,186	3,485	3,772	4,052	4,330	4,604	4,872
Capex	-6,871	-1,165	-426	-2,221	-3,693	-2,992	-3,252	-3,616	-3,773	-3,967	-4,251	-4,423	-4,586	-4,892	-5,212	-5,547	-5,898
Net working capital investment	3,528	-2,979	23	-312	73	282	55	81	98	85	101	88	110	109	120	122	136
Free Cash Flow	-2,913	-3,478	-30	-798	501	84	435	798	1,381	1,997	2,557	3,273	4,007	4,631	5,322	6,062	6,875
YoY Growth - %						-83.2%	417.5%	83.5%	73.0%	44.6%	28.0%	28.0%	22.4%	15.6%	14.9%	13.9%	13.4%
Discounting Factor						1.00	0.98	0.88	0.80	0.72	0.65	0.59	0.54	0.48	0.44	0.40	0.36
Present Value of FCF						84	424	705	1,103	1,444	1,673	1,938	2,147	2,245	2,335	2,407	2,471
Fade period forecast	FY36E	FY37E	FY38E	FY39E	FY40E	FY41E	FY42E	FY43E	FY44E	FY45E							
FCF	7,753	8,693	9,692	10,743	11,839	12,971	14,129	15,299	16,468	17,621							
Discounting Factor	0.33	0.29	0.27	0.24	0.22	0.20	0.18	0.16	0.15	0.13							
Present Value of FCF	2,521	2,559	2,581	2,589	2,583	2,561	2,524	2,473	2,409	2,333							
12M Forward Equity Valuation																	
PV of Cash Flow - Explicit Period	18,893																
PV of Cash Flow - Fade Period	25,134																
PV of Terminal Value	54,958																
Enterprise Value	98,984																
Debt - Mar'23	221																
Cash - Mar'23	3,053																
Net Debt	-2,832																
Equity value	101,816																
Mn no of shares	64																
12M Target (DCF value) - Rs per share	1,600																

Source: Company, JM Financial

Exhibit 7. Peer comparison

Company	Sales (INR mn)				EBITDA (INR mn)				EBITDA (Pre-IND AS INR mn)			
	FY23A	FY24E	FY25E	FY26E	FY23A	FY24E	FY25E	FY26E	FY23A	FY24E	FY25E	FY26E
Westlife	22,782	25,830	29,884	34,374	3,740	4,425	5,256	6,289	2,864	3,426	4,108	4,980
RBA (Standalone)	14,397	17,652	21,566	26,420	1,654	2,528	3,731	4,871	362	985	1,896	2,683
Sapphire	22,571	27,175	32,805	38,433	4,284	5,120	6,507	7,754	2,647	3,184	4,201	5,039
Devayani	29,728	35,131	44,555	54,529	6,551	7,211	9,691	12,236	4,348	4,498	6,431	8,263

Source: Company, JM Financial

Exhibit 8. Valuation metrics

Company	CMP (INR)	EV/EBITDA (x)				EV/Sales (x)				EV/EBITDA (Pre-IND AS)			
		FY23A	FY24E	FY25E	FY26E	FY23A	FY24E	FY25E	FY26E	FY23A	FY24E	FY25E	FY26E
Westlife	847	35.4	29.6	24.8	20.5	5.9	5.1	4.4	3.8	46.3	38.3	31.7	25.8
RBA (Standalone)	117	34.0	22.4	15.3	11.8	3.9	3.2	2.7	2.2	155.2	57.4	30.2	21.4
Sapphire	1,422	20.5	17.1	13.3	11.0	3.9	3.2	2.6	2.2	33.2	27.5	20.6	16.9
Devayani	186	34.2	31.0	22.9	17.9	7.5	6.4	5.0	4.0	51.5	49.7	34.5	26.5

Source: Company, JM Financial

Financial Tables (Consolidated)

Profit & Loss Statement					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Sales	17,154	22,571	27,175	32,805	38,433
Sales Growth	68.8%	31.6%	20.4%	20.7%	17.2%
Other Operating Income	61	85	97	124	137
Total Revenue	17,216	22,656	27,272	32,928	38,570
Cost of Goods Sold/Op. Exp.	5,278	7,407	8,520	10,255	11,952
Personnel cost	2,740	2,929	3,604	4,271	4,977
Other expenses	6,148	8,036	10,028	11,895	13,887
EBITDA	3,050	4,284	5,120	6,507	7,754
EBITDA (%)	17.8%	19.0%	18.8%	19.8%	20.2%
EBITDA Growth (%)	145.2%	40.4%	19.5%	27.1%	19.2%
Comparable EBITDA	1,808	2,647	3,184	4,201	5,039
Comparable EBITDA (%)	10.5%	11.7%	11.7%	12.8%	13.1%
Depn & Amort	2,135	2,642	3,244	3,864	4,502
EBIT	915	1,642	1,876	2,642	3,253
Other Income	380	311	266	308	398
Finance Cost	781	869	1,040	1,209	1,415
PBT before Excep & Forex	514	1,084	1,102	1,741	2,235
Excep & forex Inc/Loss(-)	0	0	0	0	0
PBT	514	1,084	1,102	1,741	2,235
Taxes	54	-1,248	287	444	570
Extraordinary Inc/Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	5	2	0	0	0
Reported Net profit	465	2,334	816	1,297	1,665
Adjusted Net Profit	465	2,329	816	1,297	1,665
Net Margin (%)	2.7%	10.3%	3.0%	4.0%	4.3%
Diluted share capital (mn)	63.5	63.5	63.5	63.5	63.5
Diluted EPS (Rs)	7.3	36.6	12.8	20.4	26.2
Diluted EPS Growth	-146.2%	400.3%	-65.0%	59.0%	28.4%
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	14,672	16,338
Share capital	635	635	635	635	635
Reserves & Surplus	9,436	11,924	12,740	14,037	15,702
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
Total - Equity & Liab	10,754	11,798	12,392	13,578	15,188
Net Fixed Assets	6,944	9,269	9,956	10,460	10,884
Gross Fixed Assets	11,978	15,433	18,425	21,677	25,293
Intangible Assets					
Less: Depn. & Amort.	4,329	5,458	7,142	9,114	11,388
Capital WIP & Net lease asset	-705	-706	-1,327	-2,102	-3,020
Investments	1,525	659	659	659	659
Current Assets	5,890	5,607	6,234	7,766	9,827
Inventories	652	993	1,117	1,348	1,579
Sundry Debtors	141	179	223	270	316
Cash & Bank Balances	2,546	2,204	2,394	3,130	4,396
Loans & Advances	2,131	1,578	1,902	2,296	2,690
Other Current Assets	420	653	598	722	846
Current Liab. & Prov.	3,605	3,738	4,457	5,307	6,183
Current Liabilities	3,429	3,561	4,248	5,067	5,910
Provisions & Others	176	177	208	240	273
Net Current Assets	2,285	1,870	1,777	2,459	3,645
Application of Funds	10,754	11,798	12,392	13,578	15,188

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	1,741	2,235
Depn. & Amort.	2,135	2,642	3,244	3,864	4,502
Net Interest Exp. / Inc. (-)	401	558	774	901	1,017
Inc (-) / Dec in WCap.	592	-669	282	55	81
Others	393	225	0	0	0
Taxes Paid	-86	-21	-287	-444	-570
Operating Cash Flow	3,949	3,818	5,115	6,117	7,265
Capex	-2,844	-3,825	-2,992	-3,252	-3,616
Free Cash Flow	1,105	-6	2,123	2,865	3,649
-Inc/dec in investments	-1,184	910	0	0	0
Other current assets	-2,889	879	266	308	398
Investing Cash Flow	-6,916	-2,036	-2,726	-2,944	-3,218
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	-2,326	-2,725
Financing Cash Flow	3,130	-1,948	-2,200	-2,437	-2,781
Inc / Dec (-) in Cash	162	-166	189	737	1,266
Opening cash balance	2,384	2,370	2,204	2,394	3,130
Closing cash balance	2,546	2,204	2,394	3,130	4,396

Source: Company, JM Financial

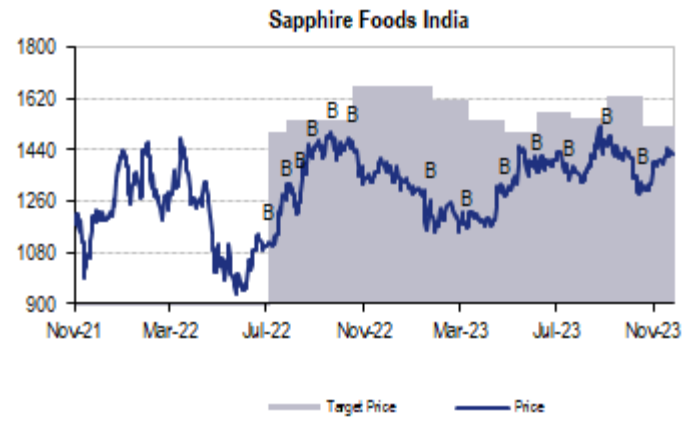
Dupont Analysis					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Margin	2.7%	10.3%	3.0%	4.0%	4.3%
Asset Turnover (x)	2.1	2.0	2.2	2.5	2.7
Leverage Factor (x)	1.1	1.0	0.9	0.9	0.9
RoE	6.3%	20.6%	6.3%	9.2%	10.7%
Key Ratios					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
BV/Share (Rs)	158.5	197.7	210.5	230.9	257.1
ROIC (%)	9.1%	13.9%	10.4%	14.0%	15.7%
ROE (%)	6.3%	20.6%	6.3%	9.2%	10.7%
Net Debt-equity ratio (x)	-0.3	-0.2	-0.2	-0.3	-0.3
PER	NA	38.8	NA	69.6	54.2
PBV	9.0	7.2	6.8	6.2	5.5
EV/EBITDA	28.5	20.5	17.1	13.3	11.0
EV/Net Sales	5.1	3.9	3.2	2.6	2.2
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
3-Nov-23	Buy	1,520	-6.7

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U67100MH2017PLC296081

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

SEBI Registration Nos.: Stock Broker - INZ000163434, Research Analyst - INH000000610

Registered Office: 7th Floor, Cnergy, Appasaheb Marathe Marg, Prabhadevi, Mumbai 400 025, India.

Board: +91 22 6630 3030 | Fax: +91 22 6630 3488 | Email: jmfinancial.research@jmfl.com | www.jmfl.com

Compliance Officer: Mr. Sahil Salastekar | Tel: +91 22 6224 1073 | Email: sahil.salastekar@jmfl.com

Grievance officer: Mr. Sahil Salastekar | Tel: +91 22 6224 1073 | Email: instcompliance@jmfl.com

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Definition of ratings	
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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