

Sapphire Foods India | BUY



Near term challenging, long-term story intact

Sapphire's performance over the past few quarters has been a mixed bag - SSSG trend has been weak while gross margin has risen steadily QoQ led by a benign input cost environment. In the near term, we don't see these trends changing materially – SSSG is likely to remain muted with demand challenges continuing for PH and Q2 being a seasonally weak quarter for KFC. That said, the company has undertaken initiatives (value offerings to ensure transaction growth, new launches in premium range, increased marketing spend) to improve brand accessibility/relevance, which, along with the upcoming festive season, should help revive growth in PH. On the positive side, KFC's (c.65% of sales) brand strength and profitability remain intact; the overall raw material scenario is also stable, which, along with a favourable mix, should support margins. In our previous report, we had highlighted Sapphire's superior execution ([link](#)) and said there was headroom for the discount to Devyani (c.40% on pre-IND AS EV/EBITDA) to narrow over time. Any volatility in the stock should thus be used as an opportunity to add. BUY.

- PH – demand recovery not yet visible:** Same store sales and average daily sales (ADS) are likely to remain muted in the near term, as the demand scenario remains challenging in the Pizza category amidst weak macro and high competitive intensity. Given the inflationary environment, consumers are down-trading to value offerings (Flavor Fun range) while the premium range is yet to see a recovery. As a result, the average pay cheque has declined, impacting overall same store sales and restaurant-level EBITDA. Both the Yum franchises have responded by intensifying their efforts (portfolio expansion and marketing spend) to improve brand relevance, which along with upcoming festive season & favorable base should aid growth from H2FY24. Also, store expansion in this format is likely to see some moderation in FY24 (vs. run-rate seen in FY23), although medium- to long-term guidance (doubling of stores in 3-4 years vs. CY21 levels) on store expansion is intact.
- KFC- long-term flavour intact:** KFC's performance has been relatively resilient vs. PH, and among the two franchisees, Sapphire's execution has been quite commendable - absolute ADS, SSSG and ADS CAGR are higher vs. Devyani over FY19-23. SSSG is unlikely to see a recovery in 2Q, given that it's a seasonally weak quarter owing to various festivities (in July/August) because of which non-vegetarian consumption is lower, especially in Sapphire's territories (viz., North/West). From the medium-term perspective, the management remains confident about 5-7% SSSG. Also, KFC's brand equity in the chicken segment is extremely strong and its differentiated chicken offering provides it an edge over the competition. Hence, store expansion is expected to be higher in this format vs. PH. Further, the raw material environment is stable to benign and the benefit was visible in 1Q, so, barring seasonal moderation in 2Q, achieving c.20%+ restaurant EBITDA margin should not be a challenge in this format.

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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	1,630
Upside/(Downside)	12.1%
Previous Price Target	1,550
Change	5.2%

Key Data – SAPPHERE IN

Current Market Price	INR1,454
Market cap (bn)	INR92.5/US\$1.1
Free Float	47%
Shares in issue (mn)	63.5
Diluted share (mn)	63.5
3-mon avg daily val (mn)	INR231.6/US\$2.8
52-week range	1,574/1,102
Sensex/Nifty	67,597/20,133
INR/US\$	83.3

Price Performance

%	1M	6M	12M
Absolute	9.4	22.3	-0.1
Relative*	5.1	5.0	-12.6

* To the BSE Sensex

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

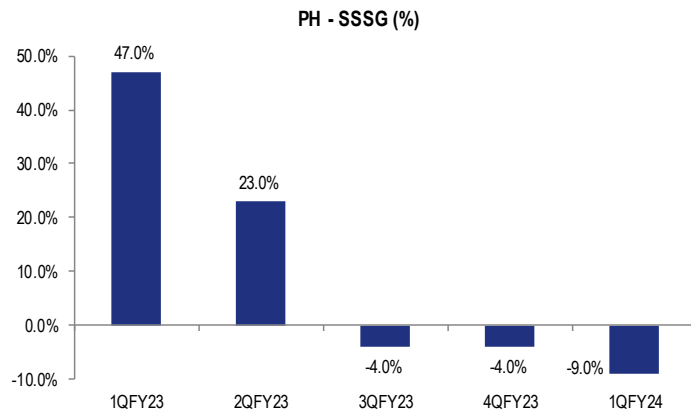
Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Financial Summary					(INR mn)
Y/E March	FY21A	FY22A	FY23A	FY24E	FY25E
Net Sales	17,154	22,571	27,898	33,392	39,163
Sales Growth (%)	68.8%	31.6%	23.6%	19.7%	17.3%
EBITDA	3,050	4,284	5,369	6,752	8,094
EBITDA Margin (%)	17.8%	19.0%	19.2%	20.2%	20.7%
Adjusted Net Profit	465	2,329	1,029	1,497	1,893
Diluted EPS (INR)	7.3	36.6	16.2	23.6	29.8
Diluted EPS Growth (%)	-146.2%	400.3%	-55.8%	45.4%	26.5%
ROIC (%)	9.1%	13.9%	12.0%	15.3%	17.4%
ROE (%)	6.3%	20.6%	7.9%	10.4%	11.8%
P/E (x)	NA	39.7	89.8	61.7	48.8
P/B (x)	9.2	7.4	6.8	6.1	5.4
EV/EBITDA (x)	29.2	21.0	16.7	13.1	10.8
Dividend Yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company data, JM Financial. Note: Valuations as of 18/Sep/2023

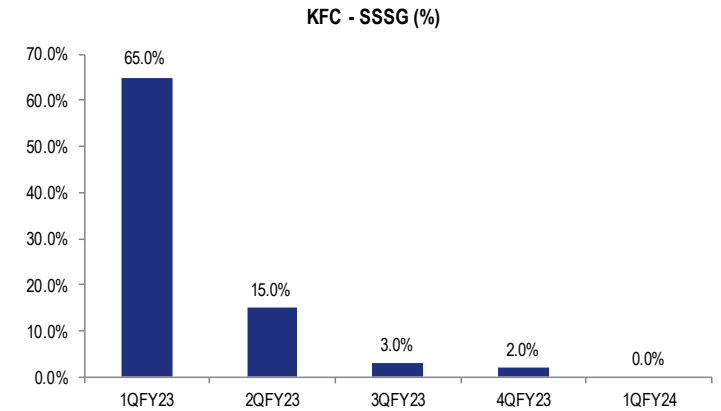
- **Gradual recovery in Sri Lanka to continue:** The operating environment in Sri Lanka is stabilising and demand weakness is likely bottoming out with moderation in inflation. This is visible from the improvement in ADS in 1QFY24 and this trend is likely to continue in the coming quarters. On the profitability front too, raw material prices are stable and the management expects no further increase in prices in the upcoming quarters with inflation now in single digits. This, along with further recovery in ADS will, we believe, help improve overall profitability in the country.

Exhibit 1. PH: Challenging demand visible from sharp moderation in same store sales in past 3 quarters



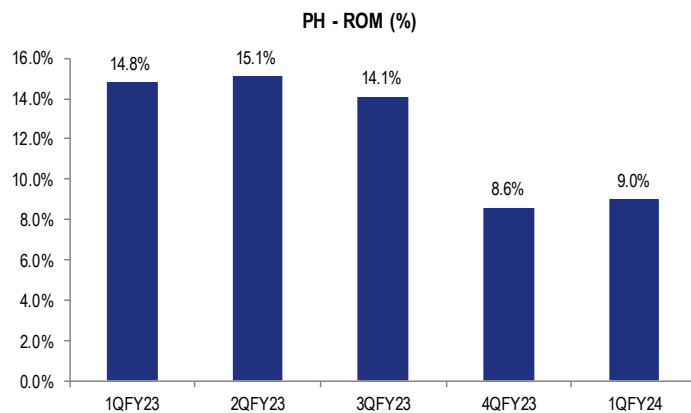
Source: Company, JM Financial

Exhibit 2. KFC on the other hand has been relatively more resilient



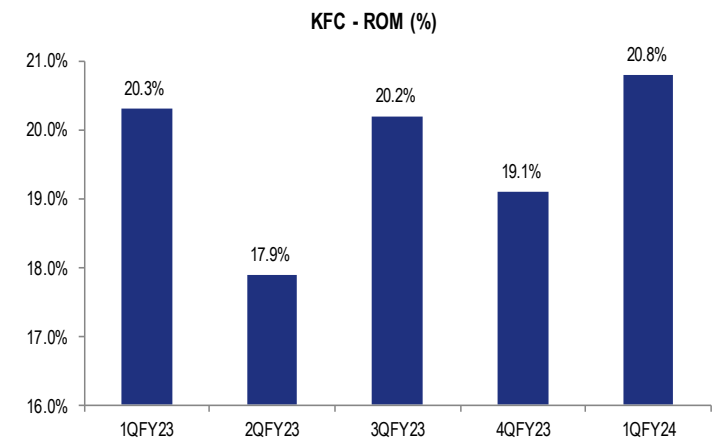
Source: Company, JM Financial

Exhibit 3. PH: ROM under pressure amidst weak macro and high competitive intensity



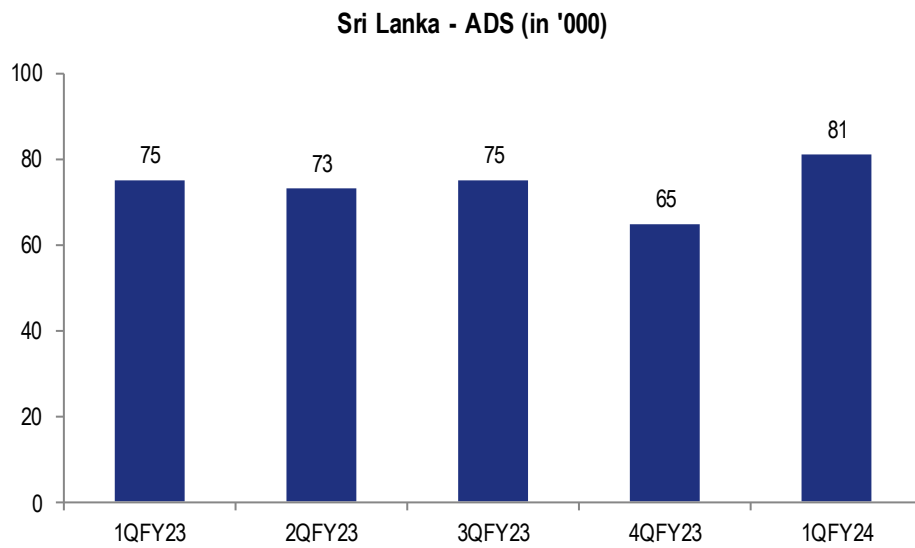
Source: Company, JM Financial

Exhibit 4. KFC: Performance has been relatively resilient



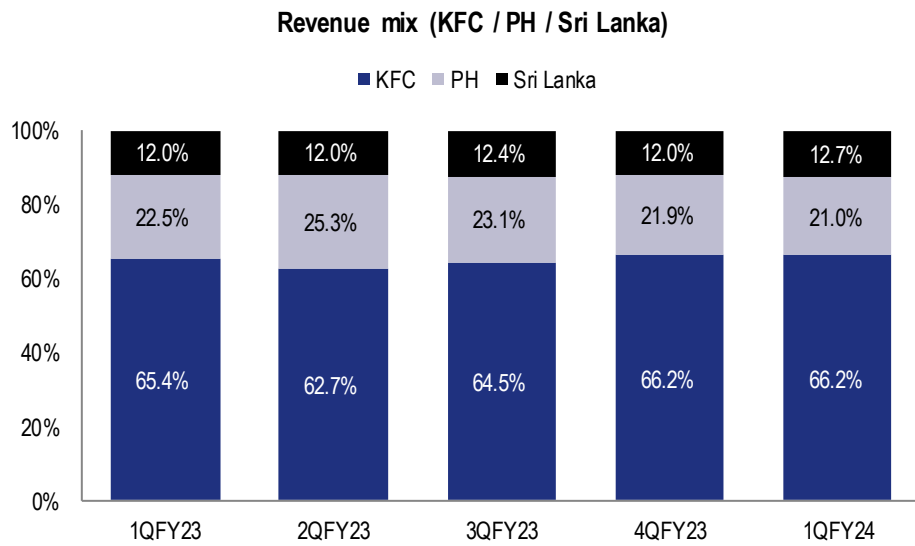
Source: Company, JM Financial

Exhibit 5. Sri Lanka business seeing gradual recovery



Source: Company, JM Financial

Exhibit 6. Favorable revenue mix with higher growth in better margin KFC format



Source: Company, JM Financial

Exhibit 7. 12-month DCF based price target works out to INR1,630/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	27,998	33,518	39,303	45,322	51,563	58,138	65,045	72,319	79,949	88,105	96,822	106,134
yoy growth		12.3%	-23.9%	68.8%	31.6%	23.6%	19.7%	17.3%	15.3%	13.8%	12.8%	11.9%	11.2%	10.6%	10.2%	9.9%	9.6%
Comparable EBITDA (Pre Ind As 116)	435	662	382	1,808	2,647	3,412	4,416	5,358	6,274	7,209	8,223	9,310	10,425	11,600	12,866	14,229	15,695
EBITDA margin %	3.6%	4.9%	3.7%	10.5%	11.7%	12.2%	13.2%	13.6%	13.8%	14.0%	14.1%	14.3%	14.4%	14.5%	14.6%	14.7%	14.8%
Comparable EBIT	-309	-357	-728	703	1,281	1,728	2,439	3,074	3,693	4,341	5,065	5,859	6,688	7,582	8,570	9,659	10,858
EBIT margin %	-2.6%	-2.7%	-7.1%	4.1%	5.7%	6.2%	7.3%	7.8%	8.1%	8.4%	8.7%	9.0%	9.2%	9.5%	9.7%	10.0%	10.2%
Tax Rate	-1.6%	1.1%	-1.2%	10.5%	-115.1%	25.5%	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	1,287	1,817	2,290	2,752	3,234	3,773	4,365	4,982	5,648	6,385	7,196	8,089
Depreciation	744	1,019	1,110	1,105	1,366	1,684	1,977	2,284	2,581	2,868	3,158	3,451	3,738	4,018	4,295	4,569	4,837
Capex	-6,871	-1,165	-426	-2,221	-3,693	-2,994	-3,349	-3,610	-3,579	-3,842	-4,117	-4,406	-4,569	-4,874	-5,194	-5,528	-5,879
Net working capital investment	3,528	-2,979	23	-312	73	271	49	70	88	92	95	92	108	110	122	125	140
Free Cash Flow	-2,913	-3,478	-30	-798	501	248	495	1,034	1,842	2,353	2,909	3,501	4,258	4,902	5,608	6,362	7,187
YoY Growth - %					-50.4%	99.0%	109.2%	78.1%	27.7%	23.6%	20.4%	21.6%	15.1%	14.4%	13.4%	13.0%	13.0%
Discounting Factor				1.00	1.00	1.00	0.95	0.86	0.78	0.71	0.64	0.58	0.52	0.47	0.43	0.39	0.35
Present Value of FCF				-798	501	248	470	890	1,435	1,659	1,856	2,022	2,225	2,318	2,400	2,464	2,519
Fade period forecast	FY36E	FY37E	FY38E	FY39E	FY40E	FY41E	FY42E	FY43E	FY44E	FY45E							
FCF	8,076	9,027	10,036	11,098	12,206	13,351	14,525	15,715	16,909	18,092							
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	2,562	2,591	2,607	2,609	2,597	2,571	2,531	2,478	2,413	2,337							
12M Forward Equity Valuation																	
PV of Cash Flow - Explicit Period	20,260																
PV of Cash Flow - Fade Period	25,295																
PV of Terminal Value	55,038																
Enterprise Value	100,593																
Debt - Mar'23	221																
Cash - Mar'23	3,162																
Net Debt	-2,940																
Equity value	103,534																
Mn no of shares	64																
12M Target (DCF value) - Rs per share	1,630																

Source: Company, JM Financial

Exhibit 8. Peer Comparison

Company	Sales (INR mn)				EBITDA (INR mn)				EBITDA (Pre-IND AS INR mn)			
	FY23E	FY24E	FY25E	FY26E	FY23E	FY24E	FY25E	FY26E	FY23E	FY24E	FY25E	FY26E
Westlife	22,782	26,279	30,476	34,873	3,740	4,607	5,477	6,505	2,879	3,612	4,320	5,175
RBA (standalone)	14,397	18,449	22,293	27,028	1,654	2,601	3,930	5,056	362	1,009	2,040	2,832
Sapphire	22,571	27,898	33,392	39,163	4,284	5,369	6,752	8,094	2,647	3,412	4,416	5,358
Devyani	29,728	37,362	46,490	56,517	6,551	8,276	10,449	12,972	4,348	5,512	7,108	8,898

Source: Company, JM Financial

Exhibit 9. Valuation metrics

Company	CMP (INR)	EV/EBITDA (x)				EV/Sales (x)				EV/EBITDA (Pre-IND AS)			
		FY23E	FY24E	FY25E	FY26E	FY23E	FY24E	FY25E	FY26E	FY23E	FY24E	FY25E	FY26E
Westlife	984	41.2	33.1	27.6	23.0	6.8	5.8	5.0	4.3	53.5	42.2	35.0	28.9
RBA (standalone)	128	37.3	23.8	15.9	12.3	4.3	3.4	2.8	2.3	170.2	61.3	30.6	21.9
Sapphire	1,464	21.2	16.8	13.2	10.8	4.0	3.2	2.7	2.2	34.2	26.4	20.2	16.4
Devyani	210	38.6	30.4	23.9	18.9	8.5	6.7	5.4	4.3	58.2	45.6	35.1	27.6

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	27,898	33,392	39,163
Sales Growth	68.8%	31.6%	23.6%	19.7%	17.3%
Other Operating Income	61	85	100	126	140
Total Revenue	17,216	22,656	27,998	33,518	39,303
Cost of Goods Sold/Op. Exp.	5,278	7,407	8,786	10,486	12,245
Personnel cost	2,740	2,929	3,611	4,293	5,004
Other expenses	6,148	8,036	10,232	11,987	13,959
EBITDA	3,050	4,284	5,369	6,752	8,094
EBITDA (%)	17.8%	19.0%	19.2%	20.2%	20.7%
EBITDA Growth (%)	145.2%	40.4%	25.3%	25.7%	19.9%
Comparable EBITDA	1,808	2,647	3,412	4,416	5,358
Comparable EBITDA (%)	10.5%	11.7%	12.2%	13.2%	13.7%
Depn & Amort	2,135	2,642	3,206	3,838	4,484
EBIT	915	1,642	2,164	2,913	3,610
Other Income	380	311	226	265	347
Finance Cost	781	869	1,008	1,169	1,416
PBT before Excep & Forex	514	1,084	1,382	2,009	2,541
Excep & forex Inc/Loss(-)	0	0	0	0	0
PBT	514	1,084	1,382	2,009	2,541
Taxes	54	-1,248	352	512	648
Extraordinary Inc/Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	5	2	0	0	0
Reported Net profit	465	2,334	1,029	1,497	1,893
Adjusted Net Profit	465	2,329	1,029	1,497	1,893
Net Margin (%)	2.7%	10.3%	3.7%	4.5%	4.8%
Diluted share capital (mn)	63.5	63.5	63.5	63.5	63.5
Diluted EPS (Rs)	7.3	36.6	16.2	23.6	29.8
Diluted EPS Growth	-146.2%	400.3%	-55.8%	45.4%	26.5%
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	13,589	15,085	16,979
Share capital	635	635	635	635	635
Reserves & Surplus	9,436	11,924	12,953	14,450	16,343
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	12,606	13,992	15,830
Net Fixed Assets	6,944	9,269	10,050	10,747	11,203
Gross Fixed Assets	11,978	15,433	18,427	21,776	25,386
Intangible Assets					
Less: Depn. & Amort.	4,329	5,458	7,142	9,120	11,404
Capital WIP & Net lease asset:	-705	-706	-1,235	-1,909	-2,779
Investments	1,525	659	659	659	659
Current Assets	5,890	5,607	6,445	7,960	10,227
Inventories	652	993	1,147	1,372	1,609
Sundry Debtors	141	179	229	274	322
Cash & Bank Balances	2,546	2,204	2,502	3,241	4,693
Loans & Advances	2,131	1,578	1,953	2,337	2,741
Other Current Assets	420	653	614	735	862
Current Liab. & Prov.	3,605	3,738	4,548	5,374	6,259
Current Liabilities	3,429	3,561	4,340	5,133	5,985
Provisions & Others	176	177	209	241	274
Net Current Assets	2,285	1,870	1,896	2,586	3,967
Application of Funds	10,754	11,798	12,606	13,992	15,830

Source: Company, JM Financial

Cash Flow statement					(INR mn)
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Profit before Tax	514	1,084	1,382	2,009	2,541
Depn. & Amort.	2,135	2,642	3,206	3,838	4,484
Net Interest Exp. / Inc. (-)	401	558	782	905	1,069
Inc (-) / Dec in WCap.	592	-669	271	49	70
Others	393	225	0	0	0
Taxes Paid	-86	-21	-352	-512	-648
Operating Cash Flow	3,949	3,818	5,288	6,289	7,516
Capex	-2,844	-3,825	-2,994	-3,349	-3,610
Free Cash Flow	1,105	-6	2,294	2,940	3,906
-Inc/dec in investments	-1,184	910	0	0	0
Other current assets	-2,889	879	226	265	347
Investing Cash Flow	-6,916	-2,036	-2,768	-3,084	-3,263
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	-2,000	-2,355	-2,746
Financing Cash Flow	3,130	-1,948	-2,222	-2,466	-2,801
Inc / Dec (-) in Cash	162	-166	298	738	1,452
Opening cash balance	2,384	2,370	2,204	2,502	3,241
Closing cash balance	2,546	2,204	2,502	3,241	4,693

Source: Company, JM Financial

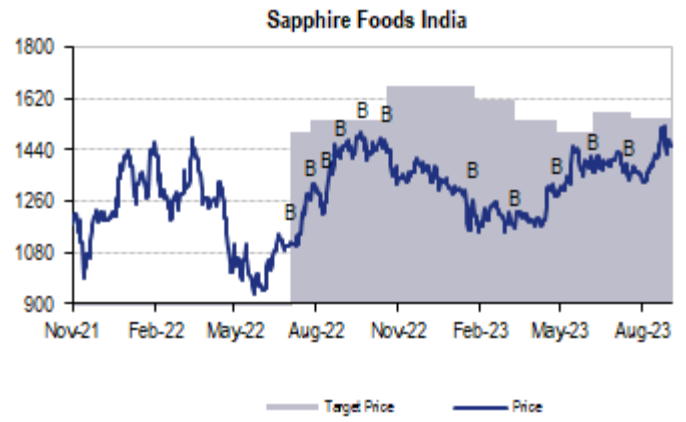
Dupont Analysis					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
Net Margin	2.7%	10.3%	3.7%	4.5%	4.8%
Asset Turnover (x)	2.1	2.0	2.3	2.5	2.6
Leverage Factor (x)	1.1	1.0	0.9	0.9	0.9
RoE	6.3%	20.6%	7.9%	10.4%	11.8%
Key Ratios					
Y/E March	FY22A	FY23A	FY24E	FY25E	FY26E
BV/Share (Rs)	158.5	197.7	213.9	237.4	267.2
ROIC (%)	9.1%	13.9%	12.0%	15.3%	17.4%
ROE (%)	6.3%	20.6%	7.9%	10.4%	11.8%
Net Debt-equity ratio (x)	-0.3	-0.2	-0.2	-0.3	-0.3
PER	NA	39.7	89.8	61.7	48.8
PBV	9.2	7.4	6.8	6.1	5.4
EV/EBITDA	29.2	21.0	16.7	13.1	10.8
EV/Net Sales	5.2	4.0	3.2	2.7	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

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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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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