Devyani International Ltd

Price Band ₹ 86-₹ 90

SUBSCRIBE

IPO Review

ICICI Securities – Retail Equity Research

August 4, 2021

Devyani International (DIL) is among the earliest and largest operators of quick service restaurants (QSRs) in India. The company is the largest franchisee of Yum brands in India and operates brands KFC & Pizza Hut under its banner. In addition, DIL is also a franchisee of Costa Coffee in India. Core brands (KFC, Pizza Hut and Costa Coffee) contribute ~94% to its topline while the rest comes from international operations and other business (own brand such as Vaango & Food Street). The core brands store counts grew at a CAGR of ~14% in the last two years to 605 stores by March 2021. The store count reached 645 by June 2021 as DIL continued its focus on adding core brand stores amid pandemic. The company is looking to expand its core brands in existing and new cities as the QSR industry is likely to grow at ~12% CAGR over the next five years (higher than historical CAGR of 5.5%), supported by rising urbanisation and per capita income.

India's QSR to grow at ~12% over next five years

The Indian QSR industry has grown at a CAGR of 3% in the last five years to US$40 billion (bn) in 2020. Further, it is likely to grow at a higher rate of ~10% to become ~US$65 bn industry by 2025. Rapid growth in QSR will be aided by increased urbanisation supported by a younger population with rising income levels and excess disposable income. Also, QSR is expected to experience a rise in number of transactions and average transaction amount due to the short service time at an affordable price offered by QSR.

Biggest franchise of KFC in India

DIL is the largest franchisee of KFC in India, contributing ~57% to its overall topline. The segment has recorded strong revenue CAGR of ~18% in FY19-21 to ₹ 644 crore, despite pandemic led disruption. The segment's gross profit also increased at a CAGR of 19% and recorded one of its best gross profit margin (of ~68%) in FY21. On the cost front, while all marketing expenditure of KFC is managed by Yum Inc, DIL pays 6% of its gross revenue as fixed royalty. While the company has future plans to expand more stores under the KFC and Pizza Hut brands, the company is focused on increasing innovative product offerings under the same head.

Key risks & concerns

- Localised lockdowns, low consumer confidence
- Not exclusive India franchisee & termination of franchisee
- Competition risk

Priced at 7x price/sales (post issue) FY20 on upper band

We believe DIL would be able to capture the growth owing to metro lifestyle and outside food habits. This, coupled with the company's cost rationalisation initiatives will help drive profitability in future. We recommend **SUBSCRIBE** to the issue.

DEVYANI INTERNATIONAL LIMITED

Particulars

Issue Details	
Issue Opens	4th August 2021
Issue Closes	6th August 2021
Issue Size*	₹ 1838 crore
Fresh Issue	₹ 440 crore
Price Band	₹ 86-90
No. of shares on offer (in crore)	15.5
QIB (%)	75
Retail (%)	10
Minimum lot size (no of shares)	165

*based on upper price band of ₹ 90 per share

Shareholding Pattern (%)

	Pre-Issue	Post-Issue
Promoter Group	75.8	65.2
Public	24.2	34.8

Objects of issue

Objects of the Issue	₹ crore
Repayment/prepayment of all or certain of our borrowings	324.0
General corporate purposes	116
Fresh Issue	**440**
Offer for sale	**1395**

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Key Financial Summary

₹ crore	FY19	FY20	FY21	CAGR FY19-21 (%)
Total Revenues	1310.6	1516.4	1134.8	-6.9
EBITDA	254.2	251.6	196.7	-12.0
EBITDA Margins (%)	19.4	16.6	17.3	
PAT	-59.3	-78.7	-63.5	NM
EPS (₹)	-10.7	-11.7	-8.6	
P / Sales	8.3	7.1	9.5	
RoE (%)	0.5	0.3	-0.9	
RoCE (%)	-70.2	-79.4	-2.5	

Source: Company, ICICI Direct Research

Company background

Devyani International (DIL) is a well-established QSR player in India with operating rights for KFC, Pizza Hut & Costa coffee. The company also operates with its own brands (Vaango, Food Street, Masala Twist, Ile Bar, Amreli & Ckrussh Juice) in the country. Apart from India, the company also has exclusive rights for operating KFC & Pizza Hut stores in Nepal and Nigeria. DIL was incorporated in 1991 and partnered with YUM brand of the US in 1997 to first bring Pizza Hut to India. Later, it introduced KFC as well. The company also got franchise rights for operating the Costa Coffee brand in India. DIL operates around 696 stores across 166 cities including 284 KFC stores, 317 Pizza Hut stores and 44 Costa Coffee outlets as of June 2021. DIL is the largest franchisee amongst the three for YUM brands in India, the other two being Sapphire Foods & Burman Hospitality. However, the operating rights are defined exclusive to their respective states and territories for each partner. Globally, YUM Brands Inc. has a very well recognised presence with brands like KFC, Pizza Hut & Taco Bell with more than 50,000 restaurants in over 150 countries as of December 31, 2021.

Exhibit 1: Presence of KFC stores across states in India

KFC territorial operational rights with DIL in India.

284 stores across 107 cities in 21 states & 2 UTs.

Rights for all major metros except Mumbai (only airport rights in Mumbai).

Source: RHP, ICICI Direct Research

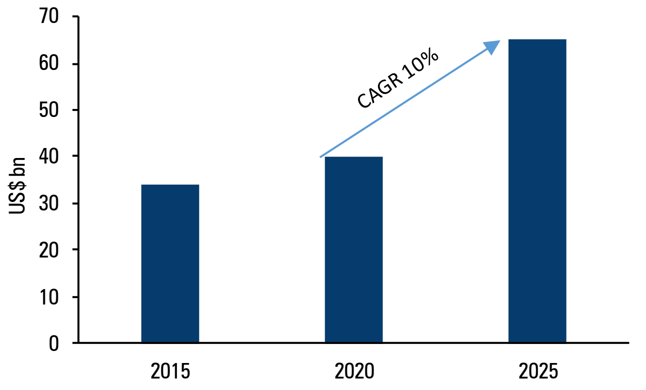
The company is planning on cluster expansion by opening small in area and delivery focused stores along with its plan to expand in Tier II & III cities while creating resources and supply chain to open multiple stores in one cluster. This will help DIL to reduce capex and opex per store and improve realisations, therefore improving the payback time. The IPO proceeds will mainly be used towards paying off debts and general corporate procedures.

Although the Covid-19 crisis has somewhat adversely affected the ability to open new restaurants and expand restaurant network temporarily, the company continues to evaluate expansion possibilities of its restaurant network and aims to increase the pace of growth when the Covid-19 crisis subsides.

Industry background

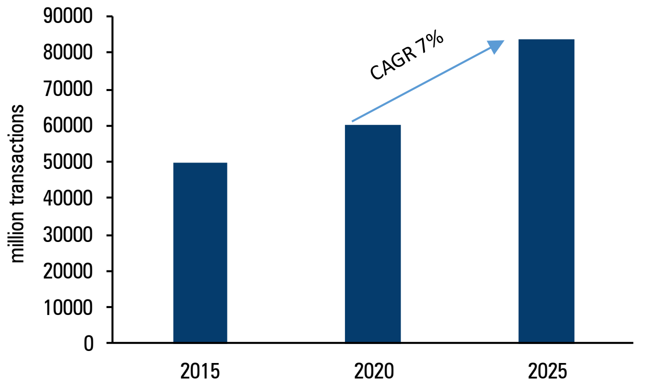
The Indian QSR industry has grown at a CAGR of 3% in the last five years to US$40 bn in 2020. Further, it is likely to grow at a higher rate of 10% to become ~US$65 bn industry by 2025. Rapid growth in QSR will be aided by increased urbanisation supported by a younger population with rising income levels and excess disposable income, which can be spent on eating food outside. The growth will also be augmented by the pick-up in take away and home deliveries, which was the preferred option during the pandemic as people could not step out. Also, QSR is expected to experience a rise in the number of transactions and the average transaction amount on account of the short service time at an affordable price offered by QSR.

Exhibit 2: Indian QSR industry growth trend



Source: McKinsey, ICICI Direct Research

Exhibit 3: QSR transactions



Source: McKinsey, ICICI Direct Research

Internet penetration, expansion of food delivery companies;

With changing lifestyle and increase in disposable incomes, the demand for eating out is increasing significantly. However, in recent years, internet & simultaneous smart phone penetration, expansion of food delivery companies and ease of payments methods through digital transactions have also worked in favour of increasing volumes of QSRs through deliveries & takeaways. Internet in India had a reach of over 53.5 crore users in FY18 and is expected to exceed 70 crore users by the end of FY20. Smartphone penetration is growing at a similar pace, with an estimated 34 crore users in FY18 and is expected to exceed 49 crore by the end of FY20. Internet penetration and increased smartphone usage paired with demonetisation implemented in November 2016 boosted an increase in digital transactions. Digital wallets like Paytm, Mobikwik and PhonePe fuelled the growth of digital transactions across different sectors. The rise of digital commerce, innovation in payments, real time payment and mobile point of sale have contributed to growth of digital payment across the food services market. Further, food delivery companies (Zomato, Swiggy) have increased the delivery proportion of most QSRs, which resulted in higher assets turnover for these restaurants.

Exhibit 4: Internet & smartphone penetration in India

Category	FY 2017	FY 2018	FY 2019
Internet Users (in cr)	45.5	53.5	62.7
Smartphone Users (in cr)	10.0	34.0	40.8

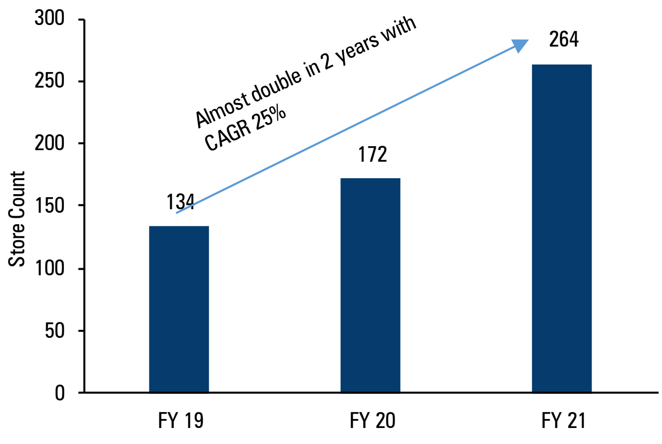
Source: Burger King RHP, ICICI Direct Research

Investment Rationale

Biggest franchise of KFC in India

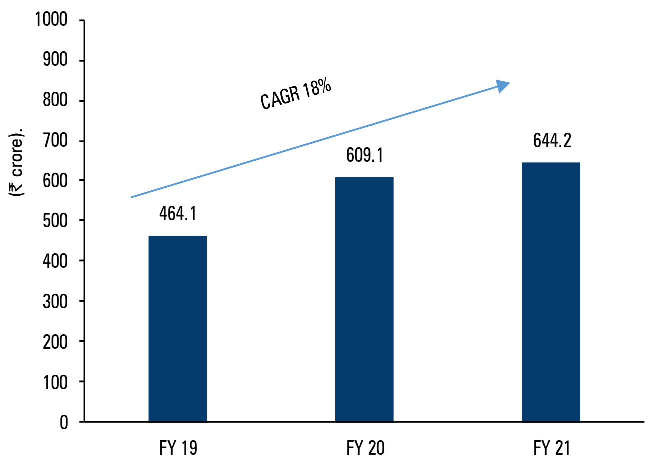
DIL is the largest franchisee of the Yum brands in India, with rights to develop, establish, operate and franchise KFC & Pizza Hut branded outlets in its licensed territories in India. DIL would be paying 6% fixed royalty for the use of the brands, technical, marketing & operational expertise. We believe the approach of focusing on delivery focused restaurants under the brands and cluster expansion is the right approach and opens up a bigger opportunity for the company to grow for a sustainable period of time. Moreover, it also has exclusive rights for KFC, Pizza Hut in Nepal and Nigeria, which is an additional benefit the company enjoys. DIL would be able to leverage expansion of food delivery companies and increase the proportion of delivery only kitchen. This would reduce the store size and increase the asset turnover, which is in line with its ongoing transition plans. Its sub-franchise rights also provide the additional flexibility to sub-franchise restaurants in locations where access to direct ownership of restaurants may be restricted due to the type of location i.e. airports and certain shopping malls where one party directly owns all the outlets. Also, apart from Yum Brands, the company also holds the rights for Costa Coffee brand and owns brands like Vaango & Food Street, which are well recognised and can be leveraged to advantage of company as and when the opportunity arises.

Exhibit 5: KFC store addition trend



Source: RHP, ICICI Direct Research

Exhibit 6: KFC revenue growth trend



Source: RHP, ICICI Direct Research

Focus on delivery channels for core brands

In the wake of Covid-19 pandemic, the company has been aggressively focusing on the delivery aspect of its core brands Pizza Hut and KFC. As a result of increased focus on aggregators like Swiggy and Zomato in which DIL has a considerable presence, the revenue generated from delivery sales reached 70.2% of operational revenue in FY21 from 51.2% in FY20. To further facilitate this strategy, the company intends to open additional delivery focused stores of Pizza Hut and KFC, going forward. It is important to note that though the company also has its own delivery channels, it is focusing mainly on food aggregators to rope in additional revenue growth and they are an important part of DIL's strategy, going forward.

Addition of small size store to improve profitability

DIL is cutting back on its area of stores considering that smaller sized stores have lower capex and operational expenses. Also, the company was able to maintain its sales with smaller size stores. We believe the ongoing transition in DIL with respect to smaller stores is certain to benefit the company in the long run as there would be better realisations & shorter payback periods per store. Both KFC (14-16%) & Pizza Hut (17-19%) had better per store EBITDA margins than McDonalds (13-15%) & Burger King (12-14%) though lower than Domino's (21-23%) & Subway (20-22%) on an average as per data of FY20. Going forward, the company is expected to further improve these margins with the help of this ongoing transition strategy.

Exhibit 7: Competitive edge to small stores with higher proportion of deliveries sales

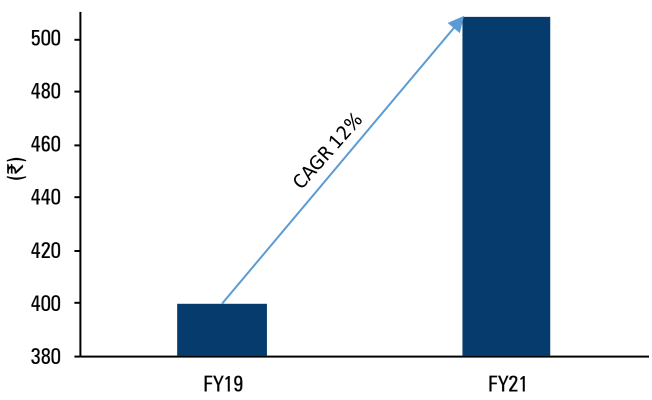
Heads	Domino's	McDonald's	KFC	Subway	Burger King	Pizza Hut
Format	QSR	QSR	QSR	QSR	QSR	CDR
Business Model	Master Fran.	Master Fran.	Master Fran.	Master Fran.	JV	Master Fran.
Outlet Count	1,354	311	454	541	261	431
APC*** (INR)	200-225	225-250	200-225	175-200	200-225	400-450
Average Ticket Value (INR)	500-550	550-600	500-550	250-300	500-550	1,450-1550
COGS	22-23%	34-36%	34-36%	32-34%	35-36%	25-26%
Gross Margins	77-78%	64-66%	64-66%	66-68%	64-65%	74-75%
Advertisement	4-5%	5-6%	6-7%	4-5%	~5%	4-5%
Royalty	3-4%	4-5%**	7-8%	7-8%	4-5%	7-8%
Store EBITDA	21-23%	13-15%	14-16%	20-22%	12-14%	17-19%
Capex for Initial Build and Opening	150-200 L	350-400 L	300-350 L	40-50 L	200-250L	200-250 L
Avg. Store Size (in sq.ft.)	1400-1600	2600-3200	2500-3000	750-1000	1300-1400	2600-3200
Average sales /Day***	0.75-0.80 L	1.2-1.3 L	1.2-1.3 L	0.30-0.35 L	1.1-1.2 L	0.7-0.8 L

*Source: RHP, ICICI Direct Research, IQVIA MAT March 2015-20,*** Pre-covid 19 estimate*

Improvement in unit-level performance

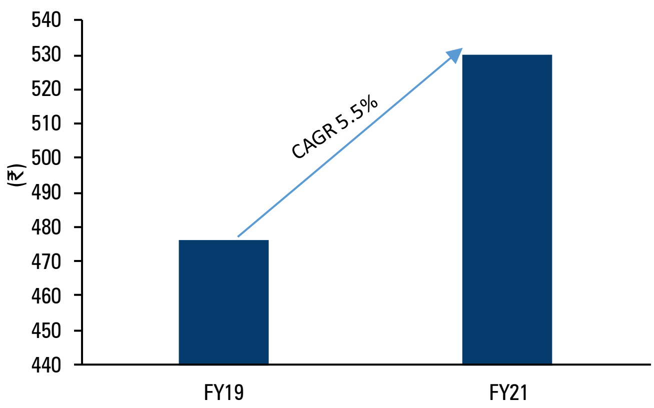
The company has adopted various strategies to achieve economies of scale and drive profitability. DIL will allocate fixed overheads such as brand building and administrative expenses across store networks. With the plan to add new stores, this will, in turn, help improve EBITDA margins. The company has added various innovative food items in the menu, which have helped drive average transaction size for the company. The average transaction size of KFC and Pizza Hut has grown at a CAGR of 12% and ~6%, respectively, in FY19-21. This, along with rationalising loss making stores will help the company improve EBITDA margins, going forward.

Exhibit 8: Growth trend in average transaction of KFC



Source: RHP, ICICI Direct Research

Exhibit 9: Growth trend in average transaction of Pizza Hut



Source: RHP, ICICI Direct Research

Several unorganised smaller joints close down

With the grave impact of lockdown on the restaurant industry, the smaller unorganised restaurants have been negatively impacted by adverse working conditions, increased operational cost and trust deficit with smaller restaurants. Hence, many smaller restaurants have closed down in the past year. According to an estimate, ~25-30% of restaurants and hotels have permanently closed. This would eventually benefit the branded QSR chains, in general, and DIL branded outlets, specifically, mainly on account of its established presence, brand recognition and expansion at new locations.

Key risks and concerns

Localised lockdown, low consumer confidence; short to medium term impact

The outbreak of the Covid-19 pandemic and subsequent lockdowns both nationalised & localised had a substantial impact on restaurant operations across India in the past 15 months. Though things have started returning towards normal with a few localised lockdowns happening as per increased local cases, there is uncertainty on a spurt in Covid-19 cases on a larger specifically in some states & geographies. This can be seen in the recent spike in cases in Kerala and Maharashtra, among others. The possibility of a third wave having a major impact similar to that of the second wave also cannot be completely ruled out. We believe any localised lockdown or movement restriction would somewhat continue to adversely impact the restaurants and QSR businesses in the medium term though restaurants have taken appropriate supply chain measures and stocked the needed inventories at local levels. Restrictions still remain at local levels and some outlets of DIL may not be operational at times here and there.

Negative advertisement of junk food

Burger, pizzas, French fries and other related products with QSRs are generally perceived as junk food. Fried chicken offerings from a QSR also is not an exception. These food habits are generally the target of negative advertisement. With increasing health caution, parents restrict their kid's food habits to healthier options. The negative advertisement can further create adverse perception of QSR brands and could impact the long-term growth for the industry in general and DIL, in particular. We all have witnessed how a small act can impact a product at "EURO 2020" though the impact may not be direct & immediate and how it can go against the image made by marketing campaigns.

Not exclusive India franchisee & termination of franchise

Yum has a three-way franchise model in India, though with separately marked territories. If DIL fails in any adverse situation or on its commitments, Yum US can terminate the franchise agreement. Also, DIL's sole dependency on brands from Yum for its majority revenue can be risky. As we have seen, Yum has given exclusive franchise rights to Burman Hospitality for its famous brand "Taco Bell" in India. Going forward, the franchise model does hold some risk for DIL's operations.

Competition risk

Though DIL is a well-established company that is recognised with a presence across multiple decades, the QSR industry in India is competitive. The company primarily competes with international QSR chains operating in India, such as McDonalds, KFC, Domino's Pizza, Subway and Pizza Hut, as well as local restaurants in the QSR segment. The other international QSR chains have been introducing food products that cater to India specific palate while maintaining their core offerings. For example, Domino's now offers wraps and burger chains offer burger pizzas. Burger King is launching a complete café portfolio to complement their main offerings. Pizza Hut is in direct competition with Domino's. Also "Popeyes" is yet to launch from Jubilant's side to compete with KFC. Given the past expansion of other QSRs in different varieties of food, the company can face competition in pizzas and chicken from other established QSRs as well in future, which can restrict the growth prospects of the company.

Financial summary

Exhibit 10: Profit and loss statement (₹ crore)

₹ crore	FY19	FY20	FY21
Net Sales	1310.6	1516.4	1134.8
Raw materials	388.9	460.4	344.7
Employee Cost	191.6	225.5	136.5
Advertisement Cost	57.4	82.4	66.2
Other Cost	418.6	496.5	390.7
Total Cost	1056.4	1264.8	938.1
EBITDA	254.2	251.6	196.7
Other income	13.1	18.7	64.1
EBITDA incl other income	267.3	270.3	260.8
Depreciation	202.8	223.3	229.5
EBIT	64.5	47.0	31.3
Interest	135.6	158.4	152.8
Exceptional Items	-13.1	-34.6	-56.9
PBT	-58.0	-76.9	-64.6
Tax	1.3	1.8	-1.1
PAT	-59.3	-78.7	-63.5

Source: MCA, ICICI Direct Research

Exhibit 11: Cash flow statement (₹ crore)

(Year-end March)	FY19	FY20	FY21
Profit after Tax	-59.3	-78.7	-63.504
Depreciation	225.7	246.7	235.7
Net CF from operating act	277.8	300.7	239.6
Net CF from Investing act	-167.7	-97.4	-358.6
Net CF from Financing Act	-130.5	-222.6	142.0
Net Cash flow	-20.4	-19.3	22.9

Source: ICICI Direct Research estimates

Exhibit 12: Balance sheet (₹ crore)

(₹ crore)	FY19	FY20	FY21
Liablites and Shareholders Fund			
Equity Share Capital	55.2	67.1	73.4
Other Equity	-176.4	-295.3	-1.6
Total Equity	-121.2	-228.2	71.9
Debt	400.2	430.7	380.5
Other Non Current Liablities	1142.0	1193.8	816.5
Trade Payables	136.8	163.2	161.9
Other Current Liablities	249.7	324.1	237.7
Total Liablities	**1807.5**	**1883.6**	**1668.4**
Assets			
Net Block	484.0	478.7	430.7
WIP	11.5	13.5	14.3
Intangible Assets	36.4	57.7	185.5
Non Current Assets	1136.6	1190.5	873.4
Inventories	54.9	72.1	62.2
Trade Receivables	23.0	17.3	16.9
Cash and Reserves	27.1	16.0	40.5
Other Current Assets	34.0	37.8	44.9
Total Current Assets	139.0	143.2	164.5
Total Assets	**1807.5**	**1883.6**	**1668.4**

Source: MCA, ICICI Direct Research

Exhibit 13: Financial ratios

Ratios	FY19	FY20	FY21
Per share data			
EPS (₹)	-10.7	-11.7	-8.6
BV per share (₹)	-22.0	-34.0	9.8
Operating ratios			
EBITDA margin (%)	19.4	16.6	17.3
PAT Margin (%)	-4.5	-5.2	-5.6
Return Ratios			
RoE	0.5	0.3	-0.9
RoCE	-70.2	-79.4	-2.5
Valuation Ratios			
Mcap/sales	8.3	7.1	9.5
Ev/Sales	8.5	7.4	9.8
P/BV	-4.1	-2.6	9.2
Working captial cycle			
Debtor Days	6.4	4.2	5.4
Inventory Days	15.3	17.4	20.0
Creditor Days	38.1	39.3	52.1
Solvency Ratios			
D/E	-3.3	-1.9	5.3
Current Ratio	0.4	0.3	0.4

Source: ICICI Direct Research estimates

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