

Sapphire Foods

Favourable risk reward

We upgrade Sapphire Foods to ADD from Reduce with TP of INR 1600 (25x FY26 Pre IND-AS EV/EBITDA) as we expect it to deliver Revenue and EBITDA CAGR of 18/19% over FY23-26 on the back of (a) mgmt. priority on course correction i.e., improving profitability over store expansion for its low-margin Pizza Hut brand, (b) KFC margins expected to improve further with newer stores (KFC stores have multiplied from 203 stores in FY21 to 429 in FY24) once they achieve maturity, (c) macro-economic stability for Sri Lankan business as reflected in FY24 numbers (Revenue/EBITDA growth of 25/16% respectively in INR terms of YoY basis). Moreover, reasonable valuations (17x FY26 Pre Ind-AS EV/EBITDA) provide enough margin of safety. Overhang of stake sale by PE funds (promoters own 30.84% stake as on 31st March 2024) has moderated significantly, as promoters have perpetual lock in for its 26% stake.

- 4Q results—disappointing show:** 4QFY24 results were below consensus estimates owing to brand building initiatives undertaken for Pizza Hut brand and weaker than expected performance of KFC brand. SSS for Pizza declined 15%+ for 3rd consecutive quarter courtesy weak macro and intense competition, whereas KFC SSS declined 3%, impacted to some extent by boycott of American brands on account of ongoing geopolitical issues and customers downgrading to value options.
- Con call takeaways:** 1) Action plan **for Pizza Hut** – a) Intends to go in for cautious expansion in FY25 till there is improvement in profitability. Mgmt. will start thinking of store expansion only once it achieves restaurant margin of 8-10% from 5% achieved in FY24. b) Launching value for money “Melts” range and has been aggressively marketing the same. Incrementally, launched the thin crust pizza, revamped pasta range, and activated Lunch Day in March 2024 with the intent to improve SSS. c) Dragon Tail software rolled out in all restaurants, thereby leading to reducing delivery timelines and improving customer experience as seen in higher aggregators customers ratings. d) Focus on late night deliveries (90% of stores). 2) **KFC** – Sapphire will prefer to go for store expansion rather than stretching restaurant margin beyond 20%. Further, business was impacted in April due to festivities (Choti Navratri) in North and West India. 3) **International business** – margins were impacted (down 190bps YoY) during 4QFY24, courtesy elevated store cost inflation. Mgmt. expects profitability to improve in FY25 on the back of improving macroeconomic environment and it intends to go aggressive on store expansion once it achieves mid teen margin (down 110bps to 13.7% in FY24). 4) **Gross margin** at consolidated level for FY25 is likely to remain at similar levels as seen in FY24.

Quarterly/annual financial summary

(INR mn)	Q4 FY24	Q4 FY23	YoY (%)	Q3 FY24	QoQ (%)	FY22	FY23	FY24	FY25E	FY26E
Net Sales	6,317.0	5,604	12.7	6655.6	(5.1)	17,154	22,571	25,845	31,593	37,120
EBITDA	1,029.5	981	4.9	1217.46	(15.4)	1,615	2,647	2,716	3,584	4,486
APAT	24.3	1,356	(98.2)	101.38	(76.1)	457	1,402	786	1,510	1,891
EPS (INR)	0.4	21	(98.2)	1.60	(76.1)	7	22	12	24	30
P/E (x)						190.2	62.0	110.5	57.6	46.0
EV / EBITDA (x)						51.7	31.9	30.7	22.4	17.1
RoCE (%)						8.3	15.3	(3.1)	14.0	22.6

Source: Company, HSIE Research

ADD

CMP (as on 10 May 2024) INR 1,417

Target Price INR 1,600

NIFTY 22,055

KEY CHANGES	OLD	NEW
Rating	REDUCE	ADD
Price Target	INR 1100	INR 1600
EPS %	FY25E	FY26E
	n.a	n.a

KEY STOCK DATA

Bloomberg code	SAPPHIRE IN
No. of Shares (mn)	64
MCap (INR bn) / (\$ mn)	90/1,082
6m avg traded value (INR mn)	315
52 Week high / low	INR 1,700/1,213

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	2.7	9.0	8.2
Relative (%)	1.2	(3.0)	(9.1)

SHAREHOLDING PATTERN (%)

	Dec-23	Mar-24
Promoters	31.30	30.84
FIs & Local MFs	31.69	32.39
FPIs	29.98	29.95
Public & Others	7.03	6.82
Pledged Shares	0.00	0.00

Source : BSE

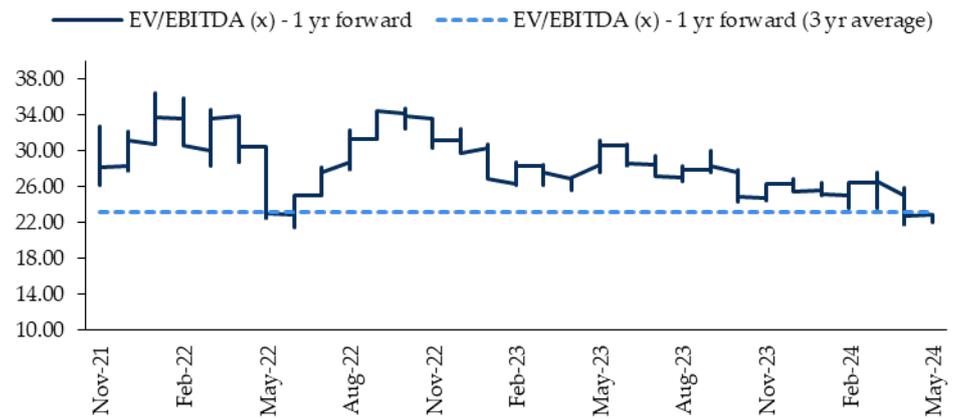
Pledged shares as % of total shares

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EV/EBITDA is trading at 22x on 1 year forward.

SSSG trend

SSSG	FY22	FY23	FY24	FY25E	FY26E	FY27E
KFC	52%	15%	-1%	3%	3%	3%
Pizza Hut	42%	12%	-16%	0%	5%	5%
Sri Lanka	42%	-40%	2%	3%	5%	5%

Store count

KFC	FY22	FY23	FY24	FY25E	FY26E	FY27E
Total Store count	263	341	429	499	569	639
Net Store addition	60	78	88	70	70	70

Pizza Hut	FY22	FY23	FY24	FY25E	FY26E	FY27E
Total Store count	219	286	319	339	379	419
Net Store addition	57	67	33	20	40	40

Sri Lanka	FY22	FY23	FY24	FY25E	FY26E	FY27E
Total Store count	97	114	120	130	140	150
Net Store addition	27	17	6	10	10	10

Consolidated Pre IND-AS P&L (INR mn)

Year End	FY23	FY24	FY25E	FY26E	FY27E
Net Revenues	22,571	25,845	31,593	37,120	43,149
Growth (%)	31.6	14.5	22.2	17.5	16.2
Material Expenses	7,407	8,109	9,889	11,544	13,419
Employee Expense	2,929	3,456	4,169	4,818	5,569
Rent Expense	2,280	2,885	3,474	4,003	4,555
Other expenses	7,393	8,778	10,589	12,398	14,344
EBITDA	2,647	2,716	3,584	4,486	5,410
EBITDA Growth (%)	63.9	2.6	32.0	25.2	20.6
EBITDA Margin (%)	11.7	10.5	11.3	12.1	12.5
Depreciation	1,366	1,635	1,923	2,261	2,660
EBIT	1,282	1,081	1,661	2,225	2,751
Other Income	311	334	342	376	414
Interest	74	13	13	13	13
PBT	1,519	1,402	1,990	2,588	3,152
Tax	(5)	(1,795)	480	697	925
RPAT	1,403	3,197	1,510	1,891	2,226
adjustment	-	-	-	-	-
Adjusted PAT	1,402	786	1,510	1,891	2,226
APAT Growth (%)	206.6	(43.9)	92.0	25.3	17.7
Adjusted EPS (Rs)	22.1	12.4	23.8	29.8	35.0

Source: Company, HSIE Research

Consolidated Balance Sheet (INR mn)

Year End	FY23	FY24	FY25E	FY26E	FY27E
SOURCES OF FUNDS					
Share Capital - Equity	635	635	635	635	635
Reserves	11,924	12,618	14,044	16,112	18,858
Total Shareholders' Funds	12,559	13,254	14,680	16,747	19,494
Minority Interest	(20)	(20)	(20)	(20)	(20)
Long Term Debt	209	209	209	209	209
Short Term Debt	234	234	234	234	234
Total Debt	443	443	443	443	443
Net Deferred Taxes	(1,184)	(1,184)	(1,184)	(1,184)	(1,184)
Long Term Provisions & Others	7,820	9,417	10,675	12,184	13,693
TOTAL SOURCES OF FUNDS	19,617	21,909	24,592	28,169	32,425
APPLICATION OF FUNDS					
Net Block	15,621	16,925	16,975	17,186	16,926
CWIP	565	565	565	565	565
Other Non-current Assets	1,988	1,988	1,988	1,988	1,988
Goodwill	1,622	1,622	1,622	1,622	1,622
Total Non-current Assets	19,795	21,099	21,149	21,360	21,100
Inventories	993	1,062	1,298	1,525	1,773
Debtors	179	212	260	305	355
Other Current Assets	890	890	890	890	890
Cash & Equivalent	2,864	4,057	6,958	10,581	15,378
Total Current Assets	4,926	6,221	9,406	13,302	18,396
Creditors	2,170	2,478	3,029	3,559	4,138
Other Current Liabilities & Provisions	2,933	2,933	2,933	2,933	2,933
Total Current Liabilities	5,103	5,412	5,963	6,493	7,071
Net Current Assets	(177)	810	3,443	6,809	11,325
TOTAL APPLICATION OF FUNDS	19,617	21,909	24,592	28,169	32,425

Source: Company, HSIE Research

Consolidated Cash Flow (INR mn)

Year End	FY23	FY24	FY25E	FY26E	FY27E
Reported PBT	1,084	928	1,906	2,764	3,671
Non-operating & EO Items	117	-	-	-	-
Interest Expenses	666	-	-	-	-
Depreciation	2,642	3,000	3,397	3,868	4,339
Working Capital Change	(669)	206	268	257	281
Tax Paid	(21)	(234)	(480)	(697)	(925)
OPERATING CASH FLOW (a)	3,818	3,900	5,091	6,193	7,366
Capex	(3,842)	(4,304)	(3,448)	(4,079)	(4,079)
Free Cash Flow (FCF)	(23)	(404)	1,643	2,114	3,287
Investments & Acquisition	-	-	-	-	-
Non-operating Income	1,806	-	-	-	-
INVESTING CASH FLOW (b)	(2,036)	(4,304)	(3,448)	(4,079)	(4,079)
Debt Issuance/(Repaid)	(192)	-	-	-	-
Interest Expenses	(864)	-	-	-	-
FCFE	(1,080)	(404)	1,643	2,114	3,287
Share Capital Issuance	-	-	-	-	-
Dividend	-	-	-	-	-
Others	(892)	1,597	1,258	1,509	1,509
FINANCING CASH FLOW (c)	(1,948)	1,597	1,258	1,509	1,509
NET CASH FLOW (a+b+c)	(166)	1,193	2,901	3,623	4,796
EO Items, Others	583	444	1,638	4,539	8,162
Closing Cash & Equivalents	417	1,638	4,539	8,162	12,958

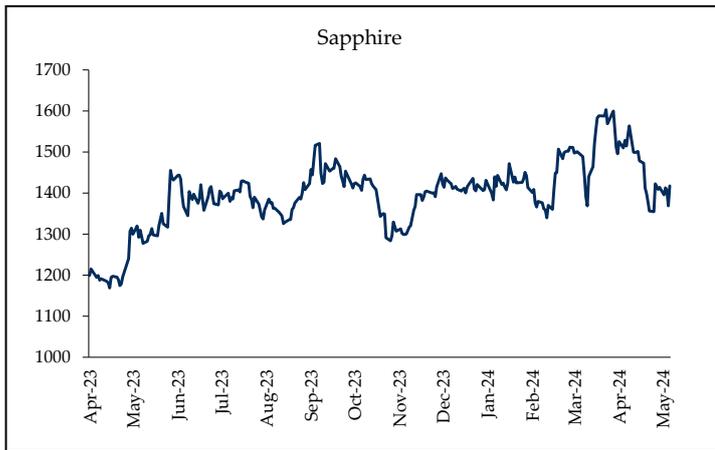
Source: Company, HSIE Research

Ratios

Year End	FY23	FY24	FY25E	FY26E	FY27E
PROFITABILITY (%)					
GPM	67.2	68.6	68.7	68.9	68.9
EBITDA Margin	11.7	10.5	11.3	12.1	12.5
EBIT Margin	5.7	4.2	5.3	6.0	6.4
APAT Margin	6.2	3.0	4.8	5.1	5.2
RoE	12.4	6.1	10.8	12.0	12.3
RoIC (or Core RoCE)	15.3	(3.1)	14.0	22.6	36.9
RoCE	12.3	5.8	10.5	11.7	12.0
EFFICIENCY					
Tax Rate (%)	0.4	128.0	25.0	25.0	25.0
Fixed Asset Turnover (x)	1.1	1.0	1.1	1.1	1.2
Inventory (days)	16.1	15.0	15.0	15.0	15.0
Debtors (days)	2.9	3.0	3.0	3.0	3.0
Other Current Assets (days)	14.4	12.6	10.3	8.8	7.5
Payables (days)	35.1	35.0	35.0	35.0	35.0
Other Current Liab & Provs (days)	23.6	20.6	16.9	14.4	12.4
Cash Conversion Cycle (days)	(25.4)	(25.1)	(23.6)	(22.6)	(21.8)
Net D/E (x)	(0.2)	(0.3)	(0.4)	(0.6)	(0.8)
PER SHARE DATA (Rs)					
EPS	22.1	12.4	23.8	29.8	35.0
Dividend	-	-	-	-	-
Book Value	197.7	208.6	231.0	263.6	306.8
VALUATION					
P/E (x)	62.0	110.5	57.6	46.0	39.0
P/BV (x)	6.9	6.6	5.9	5.2	4.5
EV/EBITDA (x)	31.9	30.7	22.4	17.1	13.3
EV/Revenues (x)	3.7	3.2	2.5	2.1	1.7
OCF/EV (%)	4.52	4.68	6.33	8.07	10.23
FCF/EV (%)	(0.03)	(0.48)	2.04	2.75	4.57
FCFE/Mkt Cap (%)	(1.3)	(0.5)	2.0	2.8	4.6
Dividend Yield (%)	-	-	-	-	-

Source: Company, HSIE Research

1 Yr Price Movement



Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: > 10% Downside return potential

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