

02 December 2024

India | Equity Research | Company Update

Sapphire Foods

Consumer Staples & Discretionary

CXO 1x1: Sanjay Purohit, Group CEO – relentless focus towards reviving growth

We met Sanjay Purohit, Group CEO, Sapphire Foods. Takeaways: (1) Focus is back on core products, expanding occasions, improving value proposition, driving consumer experience given near-term demand headwinds for KFC and Pizza Hut (PH) India while creating higher awareness for PH India through continued higher ad-spends and innovations. (2) Cautious approach towards near-term store expansion for PH while KFC is likely to continue its expansion trajectory (ADS trajectory of new stores vs. system average is a key monitorable). (3) Incremental focus on building lunch dine-in and late-night occasions through launch of attractive combos. (4) Operating margins to be under pressure in the near term given cost inflation (raw material, labour etc.) and operating deleverage with a focus on revival of growth-led (operating leverage) margin recovery. Maintain ADD.

Three pillars to drive growth: Customers, experience and accessibility

Given the current subdued demand scenario, management is focused on three pillars to drive growth – 1) customers; 2) experience; and 3) accessibility.

Customers: Focus back on core to drive consumer franchisee

A large set of Sapphire’s customers has awareness of its brands but experienced these brands infrequently. Therefore, its focus is back on core products to help expand consumer franchisee while innovation shall be relatively moderated. Secondly, the company sees it important to continue expanding consumption occasions through innovation (snacking, lunch, late-night delivery). Further, it shall focus on providing value (INR 99/INR 149 price points) across three different price points (including core products as well and not limited to add-on products) of snacking, individual meals and group meal occasions.

Frictionless experience

Sapphire aims to improve its consumer experience throughout the customer’s journey. The idea is to make customer interactions with its brands as frictionless as possible through multiple interventions across the consumer journey – through digital self-ordering kiosks, mobile app and partnering with aggregators – while having relentless focus on operational excellence (customer ratings, time take on delivery, etc.).

Financial Summary

Y/E March (INR mn)	FY23A	FY24A	FY25E	FY26E
Net Revenue	22,656	25,943	30,807	36,790
EBITDA	4,284	4,613	5,498	7,072
EBITDA Margin (%)	18.9	17.8	17.8	19.2
Net Profit	2,334	528	754	1,474
EPS (Rs)	3.7	0.8	1.2	2.3
EPS % Chg YoY	402.3	(77.4)	42.9	95.4
P/E (x)	88.8	393.5	275.4	140.9
EV/EBITDA (x)	47.8	44.7	37.5	29.1
RoCE (%)	13.9	10.3	13.0	19.0
RoE (%)	20.7	4.1	5.5	9.9

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Market Data			
Market Cap (INR)	104bn		
Market Cap (USD)	1,236mn		
Bloomberg Code	SAPPHIRE IN		
Reuters Code	SAPI BO		
52-week Range (INR)	401 /259		
Free Float (%)	73.0		
ADTV-3M (mn) (USD)	4.2		
Price Performance (%)	3m	6m	12m
Absolute	2.0	15.4	16.4
Relative to Sensex	4.8	8.3	(2.8)
ESG Score	2022	2023	Change
ESG score	57.0	59.4	2.4
Environment	25.0	32.4	7.4
Social	58.0	60.2	2.2
Governance	78.5	76.5	(2.0)

Note - Score ranges from 0 - 100 with a higher number indicating a higher ESG score.  
Source: SES ESG, I-sec research

Previous Reports  
29-10-2024: [Q2FY25 results review](#)  
31-07-2024: [Q1FY25 results review](#)

It has achieved >4.0 ratings at aggregate level across Swiggy, Zomato and Google. Further, implementation of Dragon Tail (kitchen planning tool) resulted in further improvement in customer service metrics.

**Accessibility: Store expansion trajectory to continue for KFC; being cautious for PH** Sapphire KFC count as on Sep'24 of 461 stores is on track to double its store presence as compared to Dec'21, with ~85% and ~50–60% of new stores being in towns of population >1mn and top metros, respectively. KFC is likely to continue its store expansion trajectory while being slightly cautious if demand conditions further worsens (ramp-up of average daily sales of stores being opened vs. system average shall be a key monitorable).

Store expansion trajectory for PH will likely be cautious, as management continues to invest in the brand (higher ad-spend, innovation etc.) and plans to open ~20–25 stores in FY25.

### **KFC impacted by near-term demand headwinds**

KFC had a weak SSSG performance in H1FY25 due to demand headwinds witnessed across the industry. That said, SSSG decline increased to -8% in Q2FY25 vs. -6% in Q1FY25 (largely due to seasonality shift), which has likely reverted back to a mid-single-digit SSSG decline for now.

In the medium-term, the holy grail of QSR business continues to be followed with a focus on delivering 5–7% SSSG in the medium term with aggressive retail expansion while maintaining margins (expansion might be dialled up or down in the short-term depending on SSSG and margin delivery).

### **Focus on revival of PH India through higher ad-spends and innovation**

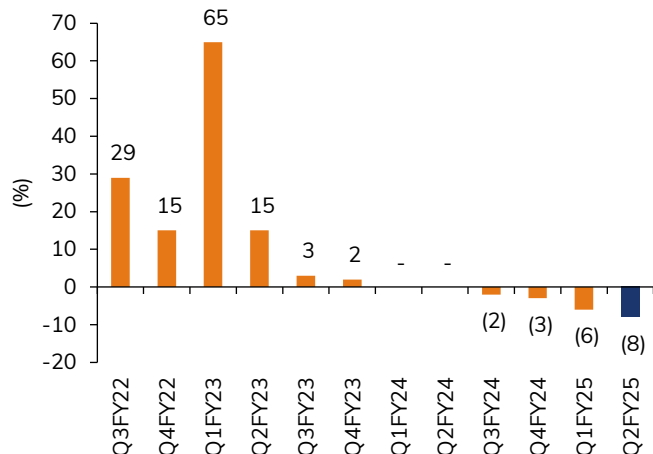
Pizza Hut (PH India) being the challenger brand has been impacted higher than market leader in pizza category given the slowdown in the industry. It continues to maintain its ADS levels at ~50k, having witnessed sequential improvement in Q1FY25 with the launch of Melts. It has further re-introduced Momo Mia range of appetizers and pizzas in Oct'24. While overall awareness for PH India is good, it needs to improve on top-of-mind awareness and consideration. Therefore, the company continues to spend more on ad-spends (higher-than-mandated).

### **Near-term margins to be under pressure; operating leverage may drive margin expansion over time**

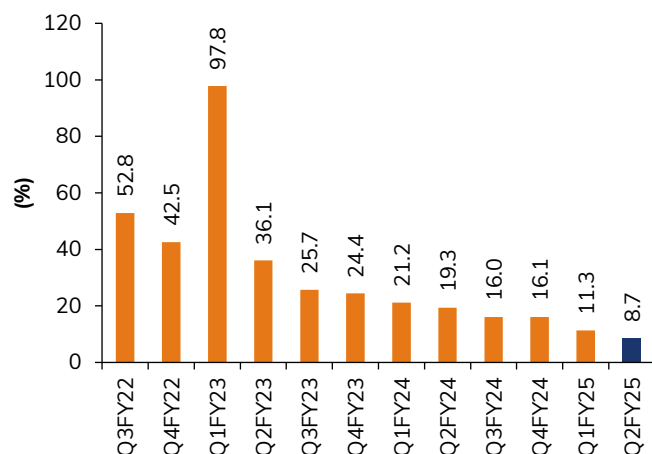
Operating margin will likely remain under pressure in the near-term given the high-cost inflation (input cost, labour, power etc.) and SSSG decline. Operating leverage in Pizza Hut India through improvement in store-throughput and operating leverage on corporate overheads are the key drivers for margin expansion over medium-term. It plans to recover store operating margins of ~20% in KFC business with a focus on growth (SSSG and retail expansion).

### **Valuation and risks**

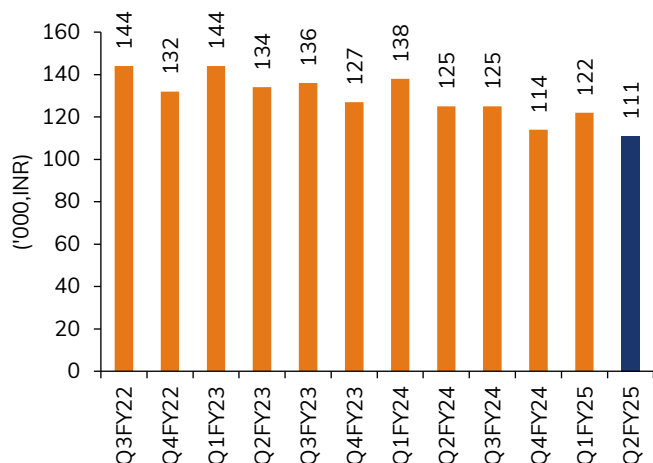
We maintain our estimates, modelling revenue and EBITDA CAGRs of 19% and 24%, respectively, over FY24-FY26E. Maintain **ADD** with a DCF-based unchanged target price of INR 360. Key risks: (1) Irrational competition due to increased store expansion, (2) failure to turnaround Pizza Hut business and (3) deterioration in macroeconomic conditions in Sri Lanka.

**Exhibit 1: Same-store sales growth (SSSG) – KFC**

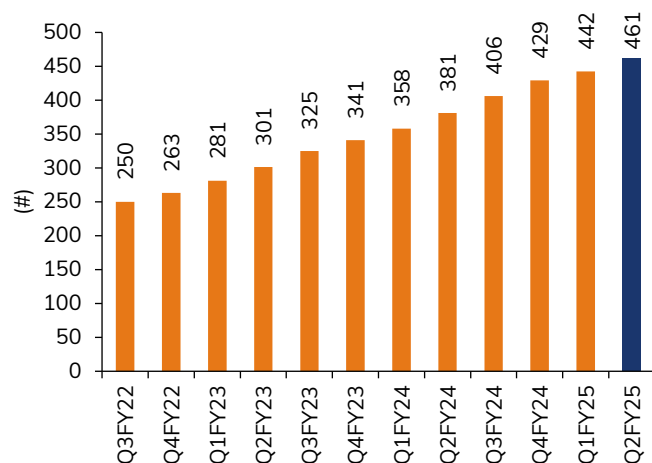
Source: Company data, I-Sec research

**Exhibit 2: Revenue growth – KFC**

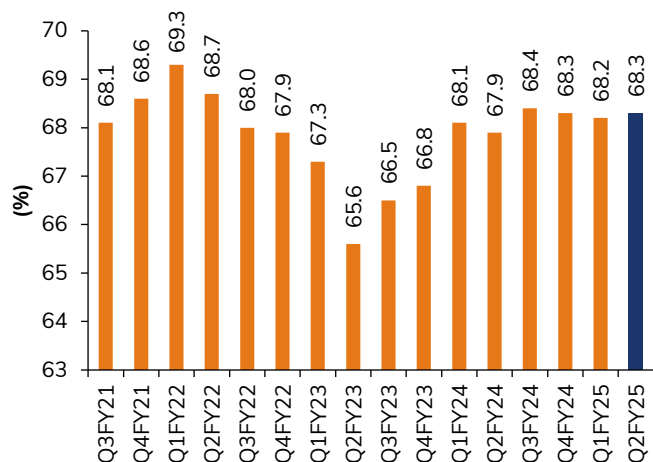
Source: Company data, I-Sec research

**Exhibit 3: Average daily sales (ADS) – KFC**

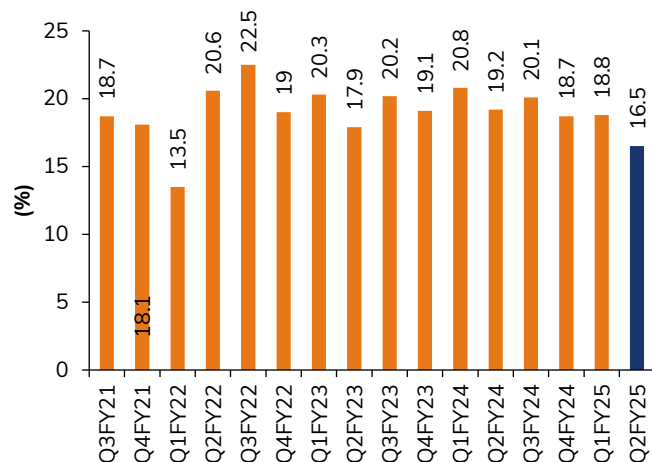
Source: Company data, I-Sec research

**Exhibit 4: Number of stores (EoP) – KFC**

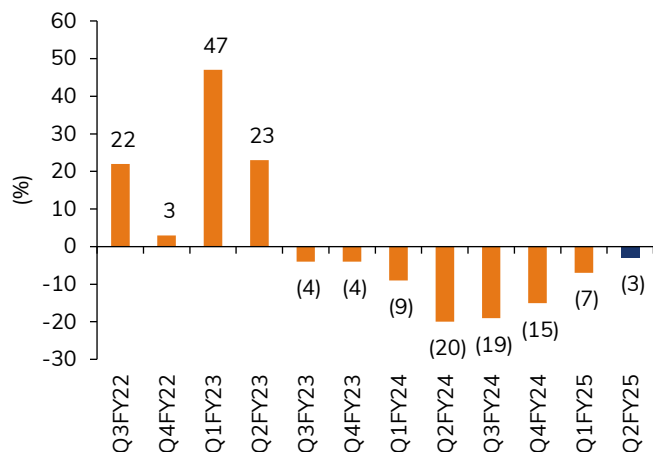
Source: Company data, I-Sec research

**Exhibit 5: Gross margin – KFC**

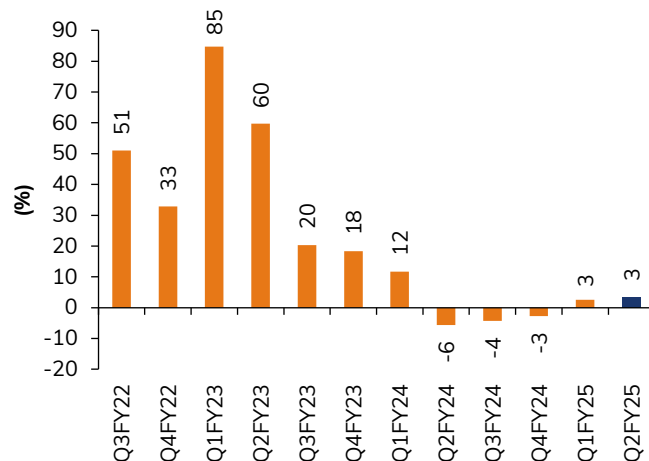
Source: Company data, I-Sec research

**Exhibit 6: Restaurant EBITDA margin – KFC**

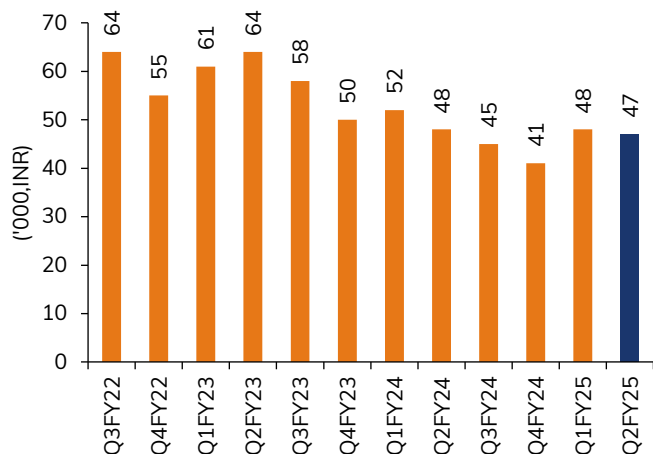
Source: Company data, I-Sec research

**Exhibit 7: Same-store sales growth (SSSG) – PH India**

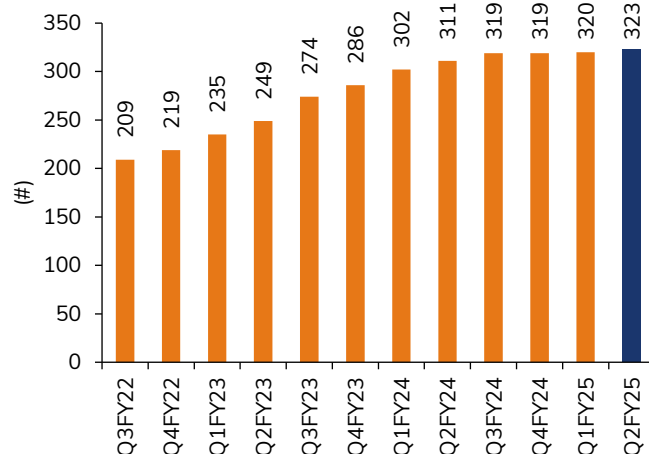
Source: Company data, I-Sec research

**Exhibit 8: Revenue growth – PH India**

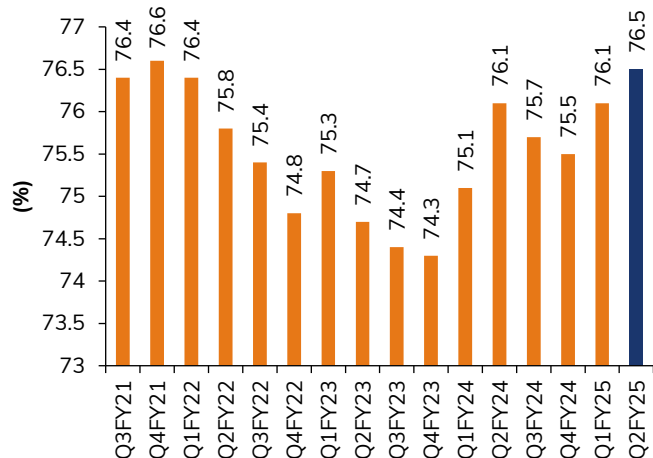
Source: Company data, I-Sec research

**Exhibit 9: Average daily sales (ADS) – PH India**

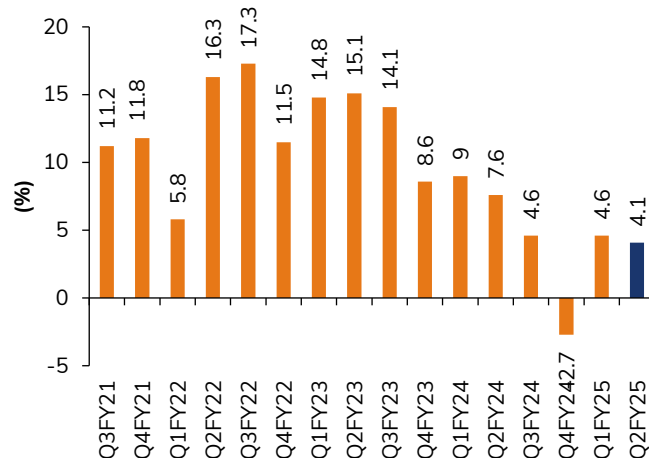
Source: Company data, I-Sec research

**Exhibit 10: Number of stores (EoP) – PH India**

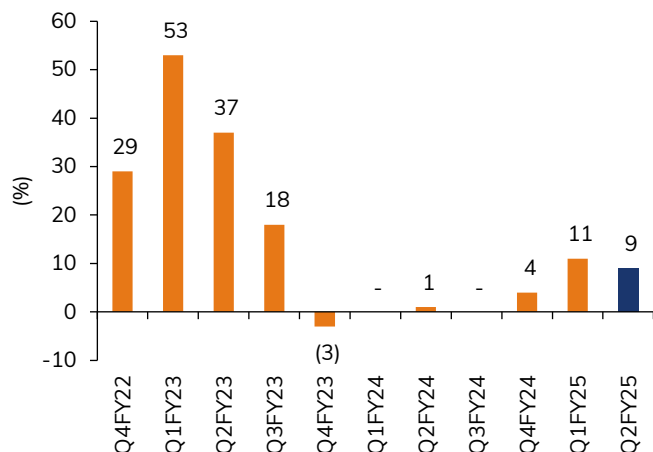
Source: Company data, I-Sec research

**Exhibit 11: Gross margin – PH India**

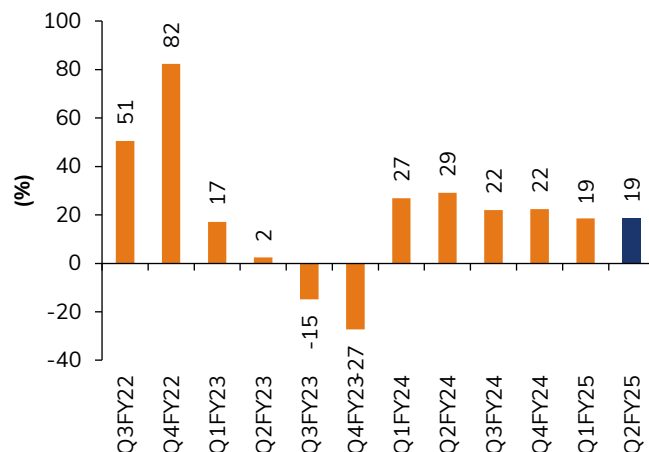
Source: Company data, I-Sec research

**Exhibit 12: Restaurant EBITDA margin – PH India**

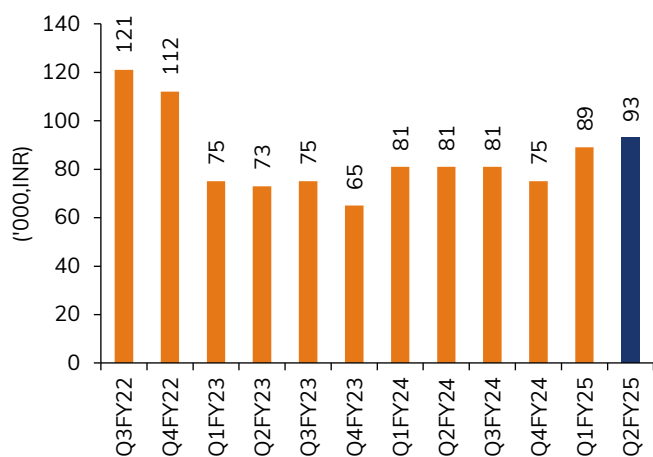
Source: Company data, I-Sec research

**Exhibit 13: Same store sales growth (SSSG) – PH SL**

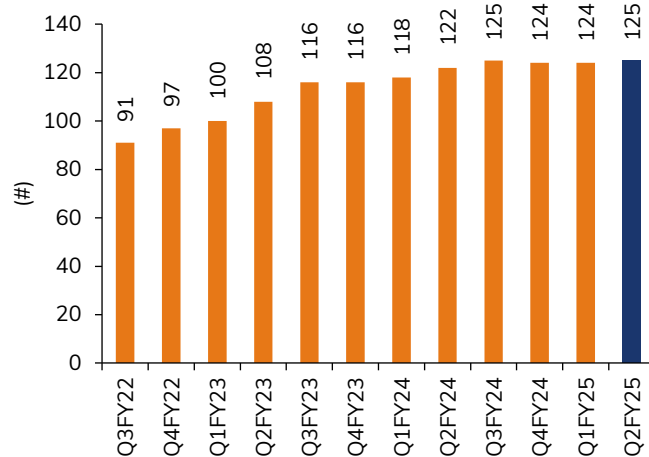
Source: Company data, I-Sec research

**Exhibit 14: Revenue growth – PH SL**

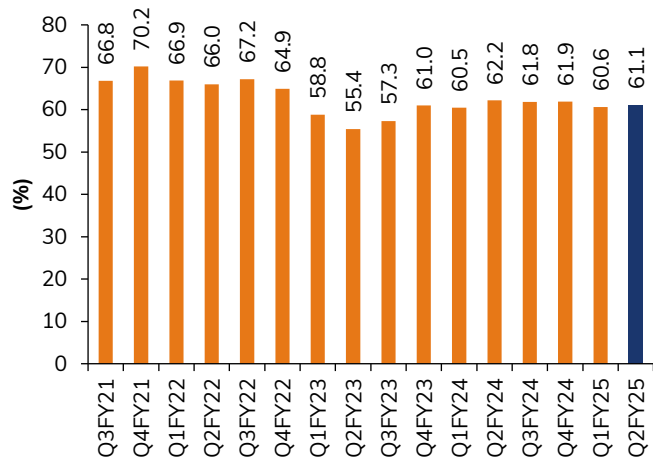
Source: Company data, I-Sec research

**Exhibit 15: Average daily sales (ADS) – PH SL**

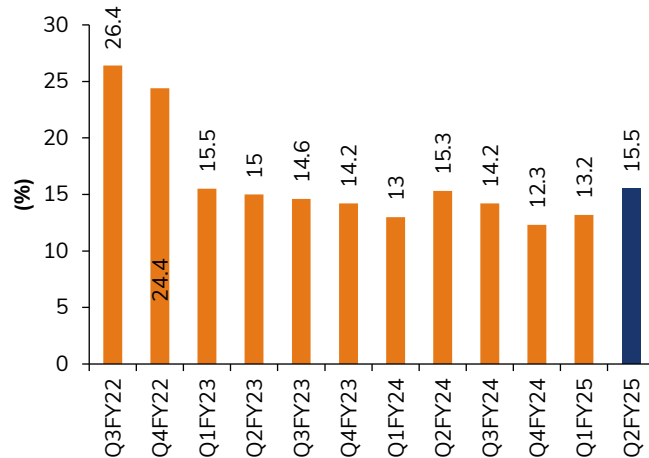
Source: Company data, I-Sec research

**Exhibit 16: Number of stores (EoP) – PH Sri Lanka\***

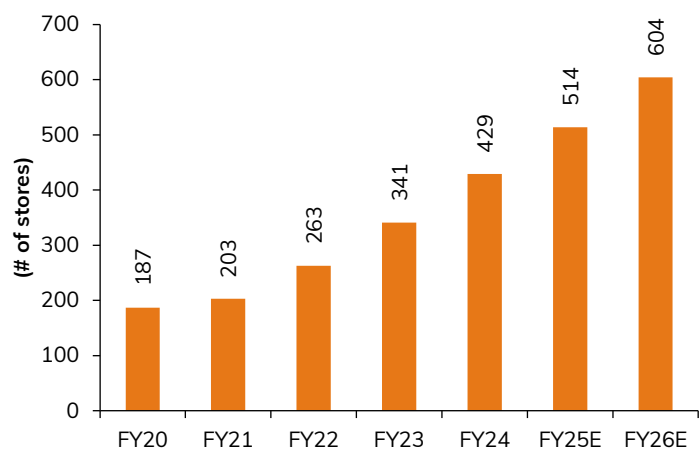
Source: Company data, I-Sec research \*includes Maldives

**Exhibit 17: Gross margin – PH SL**

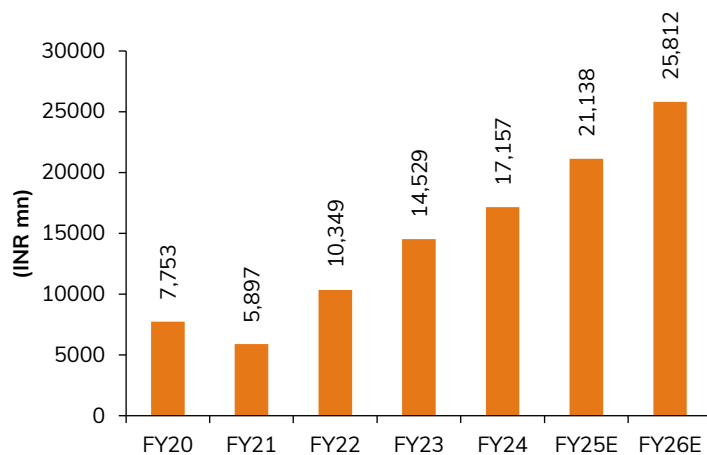
Source: Company data, I-Sec research

**Exhibit 18: Restaurant EBITDA margin – PH SL**

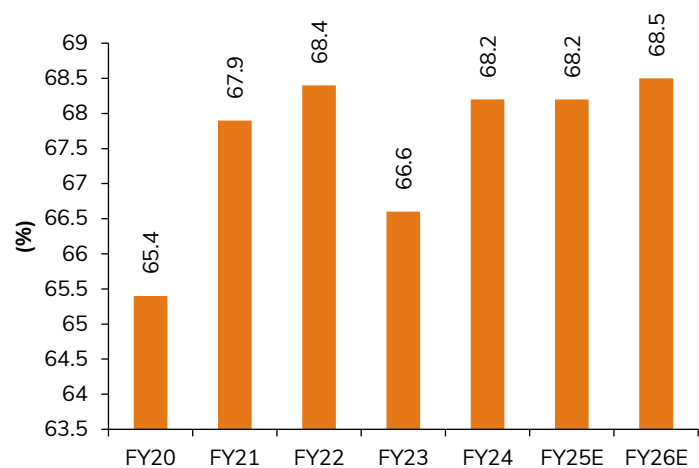
Source: Company data, I-Sec research

**Exhibit 19: Store footprint – KFC**

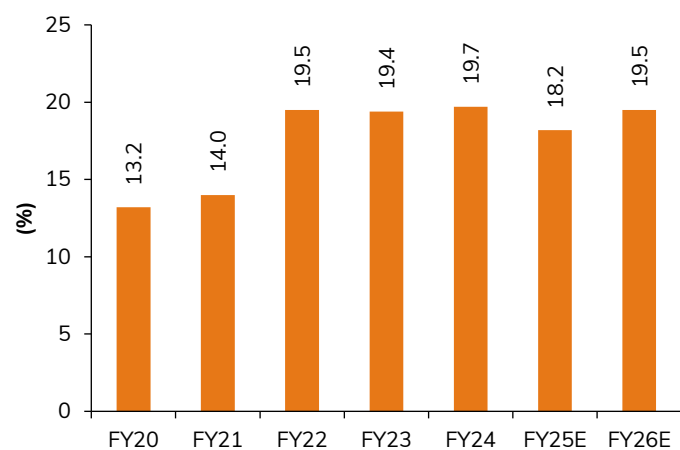
Source: Company data, I-Sec research

**Exhibit 20: Brand revenue – KFC**

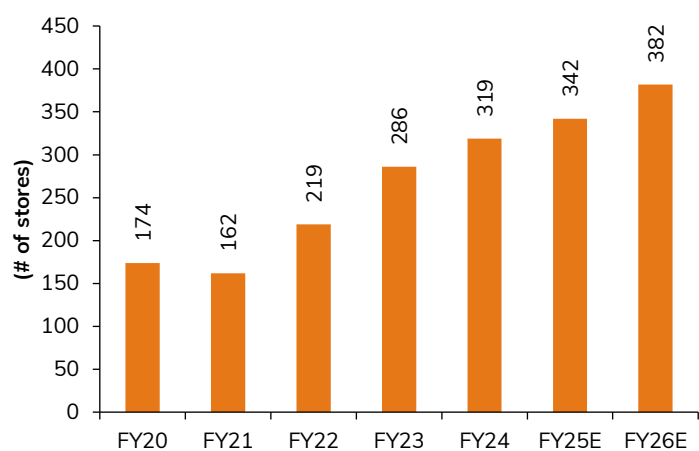
Source: Company data, I-Sec research

**Exhibit 21: Gross margin – KFC**

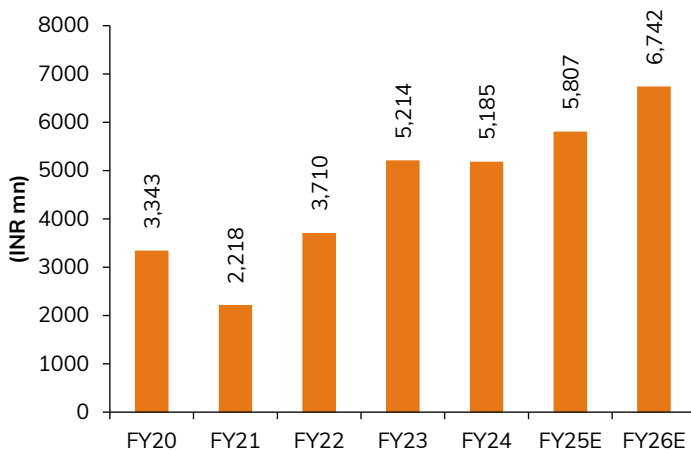
Source: Company data, I-Sec research

**Exhibit 22: EBITDA margin – KFC**

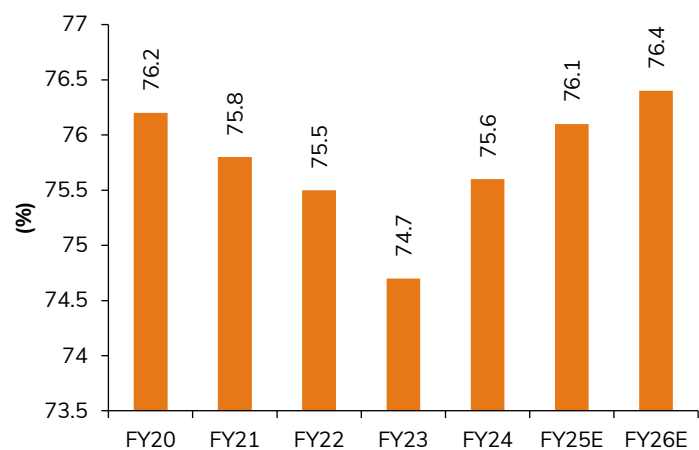
Source: Company data, I-Sec research

**Exhibit 23: Store footprint – PH India**

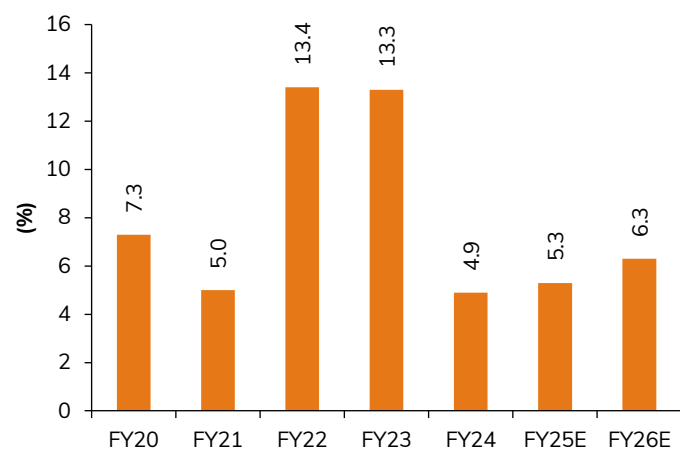
Source: Company data, I-Sec research

**Exhibit 24: Brand revenue – PH India**

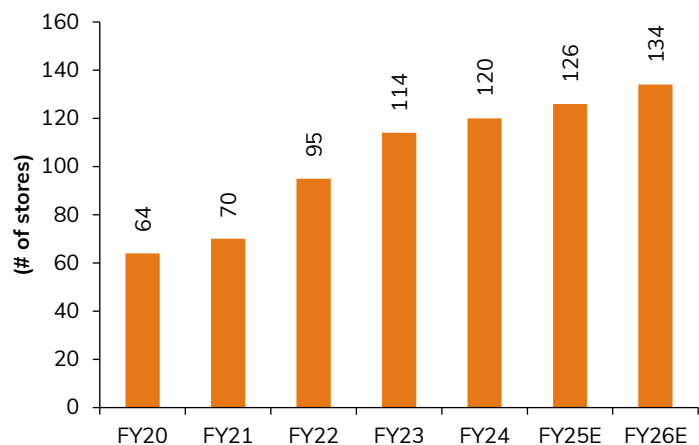
Source: Company data, I-Sec research

**Exhibit 25: Gross margin – PH India**

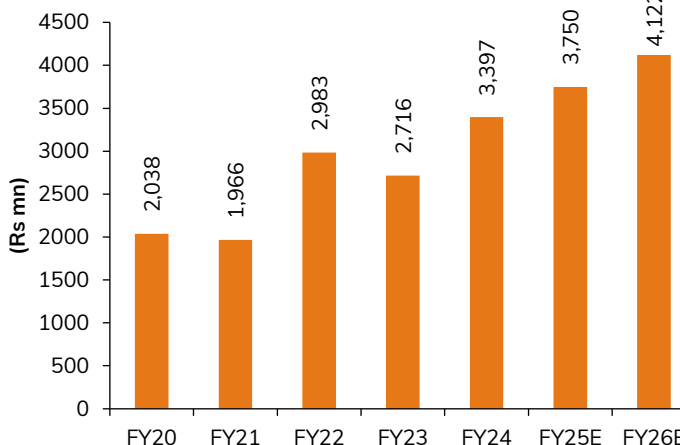
Source: Company data, I-Sec research

**Exhibit 26: EBITDA margin – PH India**

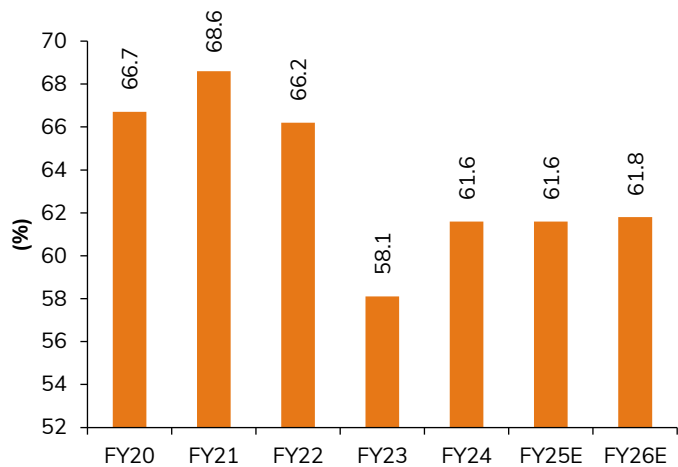
Source: Company data, I-Sec research

**Exhibit 27: Store footprint – PH SL**

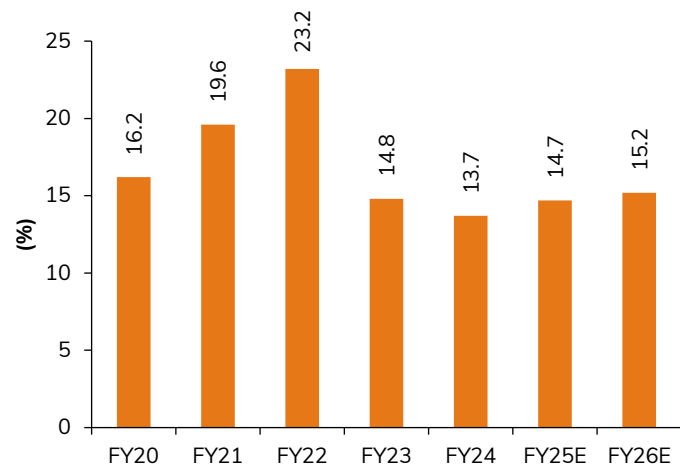
Source: Company data, I-Sec research

**Exhibit 28: Brand revenue – PH SL**

Source: Company data, I-Sec research

**Exhibit 29: Gross margin – PH SL**

Source: Company data, I-Sec research

**Exhibit 30: EBITDA margin – PH SL**

Source: Company data, I-Sec research

Exhibit 31: Shareholding pattern

%	Mar'24	Jun'24	Sep'24
Promoters	30.8	30.8	26.2
Institutional investors	62.3	63.1	68.7
MFs and other	27.5	27.4	32.9
FI/Banks	0.0	0.0	0.0
Insurance Cos.	3.5	2.9	2.9
FII's	31.3	32.8	32.9
Others	6.9	6.1	5.1

Source: Bloomberg, I-Sec research

Exhibit 32: Price chart



Source: Bloomberg, I-Sec research



## Financial Summary

### Exhibit 33: Profit & Loss

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Net Sales	22,656	25,943	30,807	36,790
<b>Operating Expenses</b>	<b>18,372</b>	<b>21,330</b>	<b>25,309</b>	<b>29,717</b>
EBITDA	4,284	4,613	5,498	7,072
<b>EBITDA Margin (%)</b>	<b>18.9</b>	<b>17.8</b>	<b>17.8</b>	<b>19.2</b>
Depreciation & Amortization	2,642	3,239	3,647	4,107
EBIT	1,642	1,374	1,851	2,966
Interest expenditure	869	1,009	1,174	1,365
Other Non-operating Income	311	334	327	381
Recurring PBT	1,084	699	1,004	1,981
<b>Profit / (Loss) from Associates</b>	-	-	-	-
<b>Less: Taxes</b>	<b>(316)</b>	<b>180</b>	<b>258</b>	<b>509</b>
PAT	1,400	520	746	1,472
Less: Minority Interest	2	9	8	2
Extraordinaries (Net)	932	-	-	-
Net Income (Reported)	2,332	528	754	1,474
<b>Net Income (Adjusted)</b>	<b>1,400</b>	<b>528</b>	<b>754</b>	<b>1,474</b>

Source Company data, I-Sec research

### Exhibit 34: Balance sheet

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
Total Current Assets	4,926	3,632	4,494	5,269
of which cash & cash eqv.	2,204	1,676	2,172	2,497
Total Current Liabilities & Provisions	3,631	3,177	3,700	4,336
<b>Net Current Assets</b>	<b>1,295</b>	<b>455</b>	<b>794</b>	<b>932</b>
Investments	-	-	-	-
Net Fixed Assets	8,353	10,337	10,986	11,962
ROU Assets	7,915	9,818	9,818	9,818
Capital Work-in-Progress	565	681	681	681
Total Intangible Assets	1,622	1,622	1,622	1,622
Long Term Loans & Advances	-	-	-	-
Deferred Tax assets	-	-	-	-
<b>Total Assets</b>	<b>22,310</b>	<b>25,224</b>	<b>26,428</b>	<b>27,808</b>
<b>Liabilities</b>				
<b>Borrowings</b>	<b>443</b>	<b>276</b>	<b>726</b>	<b>632</b>
<b>Lease Liability</b>	<b>9,185</b>	<b>11,363</b>	<b>11,363</b>	<b>11,363</b>
Provisions	107	143	143	143
Other Liabilities	36	43	43	43
Equity Share Capital	635	637	637	637
Reserves & Surplus	11,924	12,754	13,509	14,983
<b>Total Net Worth</b>	<b>12,559</b>	<b>13,391</b>	<b>14,146</b>	<b>15,620</b>
Minority Interest	(20)	7	7	7
<b>Total Liabilities</b>	<b>22,310</b>	<b>25,224</b>	<b>26,428</b>	<b>27,808</b>

Source Company data, I-Sec research

### Exhibit 35: Quarterly trend

(INR mn, year ending March)

	Dec-23	Mar-24	Jun-24	Sep-24
Net Sales	6,656	6,317	7,183	6,957
% growth (YOY)	11.6	12.7	9.8	8.3
EBITDA	1,217	1,029	1,242	1,120
Margin %	18.3	16.3	17.3	16.1
Other Income	60	124	53	85
Extraordinaries	-	-	-	114
Adjusted Net Profit	101	24	85	84

Source Company data, I-Sec research

### Exhibit 36: Cashflow statement

(INR mn, year ending March)

	FY23A	FY24A	FY25E	FY26E
<b>Operating Cashflow</b>	<b>1,084</b>	<b>699</b>	<b>1,004</b>	<b>1,981</b>
Working Capital Changes	(672)	(317)	(59)	(79)
Capital Commitments	(3,842)	(3,851)	(2,598)	(3,187)
<b>Free Cashflow</b>	<b>(23)</b>	<b>636</b>	<b>(234)</b>	<b>86</b>
<b>Other investing cashflow</b>	<b>1,789</b>	<b>1,981</b>	<b>327</b>	<b>381</b>
Cashflow from Investing Activities	(2,036)	(1,869)	(2,271)	(2,806)
Issue of Share Capital	-	-	-	-
Interest Cost	(69)	(46)	(50)	(50)
Inc (Dec) in Borrowings	(192)	(209)	450	(95)
Dividend paid	-	-	-	-
Others	(1,687)	(1,870)	-	-
Cash flow from Financing Activities	(1,948)	(2,125)	400	(145)
<b>Chg. in Cash &amp; Bank balance</b>	<b>27</b>	<b>702</b>	<b>492</b>	<b>323</b>
Closing cash & balance	2,204	1,676	2,172	2,497

Source Company data, I-Sec research

### Exhibit 37: Key ratios

(Year ending March)

	FY23A	FY24A	FY25E	FY26E
<b>Per Share Data (INR)</b>				
Reported EPS	3.7	0.8	1.2	2.3
Adjusted EPS (Diluted)	3.7	0.8	1.2	2.3
Cash EPS	7.8	5.9	6.9	8.8
Dividend per share (DPS)	-	-	-	-
Book Value per share (BV)	19.8	21.0	22.2	24.5
Dividend Payout (%)	-	-	-	-
<b>Growth (%)</b>				
Net Sales	31.6	14.5	18.7	19.4
EBITDA	40.4	7.7	19.2	28.6
EPS (INR)	402.3	(77.4)	42.9	95.4
<b>Valuation Ratios (x)</b>				
P/E	88.8	393.5	275.4	140.9
P/CEPS	41.7	55.2	47.2	37.2
P/BV	16.5	15.5	14.7	13.3
EV / EBITDA	47.8	44.7	37.5	29.1
P / Sales	9.1	8.0	6.7	5.6
Dividend Yield (%)	-	-	-	-
<b>Operating Ratios</b>				
Gross Profit Margins (%)	67.3	68.7	69.1	69.4
EBITDA Margins (%)	18.9	17.8	17.8	19.2
Effective Tax Rate (%)	(29.2)	25.7	25.7	25.7
Net Profit Margins (%)	6.2	2.0	2.4	4.0
Net Debt / Equity (x)	(0.2)	(0.1)	(0.1)	(0.1)
Net Debt / EBITDA (x)	(0.6)	(0.3)	(0.3)	(0.3)
Fixed Asset Turnover (x)	1.9	1.7	1.7	1.8
Working Capital Days	(17)	(18)	(18)	(17)
Inventory Turnover Days	18	15	15	15
Receivables Days	3	5	5	5
Payables Days	40	35	35	36
<b>Profitability Ratios</b>				
RoCE (%)	13.9	10.3	13.0	19.0
RoE (%)	20.7	4.1	5.5	9.9
RoIC (%)	21.3	9.5	11.3	16.0

Source Company data, I-Sec research

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**BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return**

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