

Company Overview

Sapphire Foods which was incorporated in 2009 is YUM's (One of the world's largest fast food restaurant Operator) largest franchisee operator in the Indian Sub Continent. As per their franchisee agreement they own non exclusive rights to operate under 3 of YUM's leading brands called KFC (World's largest QSR Chicken Brand), Pizza Hut (Asia's largest Pizza chain) and Taco Bell (Largest Mexican inspired restaurant chain) while leveraging YUM's system and System property. They are also Sri Lanka's largest QSR chain. As of September 2021, they own and operate 220 KFC, 260 Pizza Hut and 2 Taco Bell Restaurants in the western and southern regions of India. Sapphire foods has a dedicated business development and projects team and well defined new restaurant roll out process including a "Development Agreement" with YUM which specifies the number of restaurants to be opened each year. The management has indicated that they have identified that "Omni Channel" model (combined model of dine in, take away and delivery) of new restaurants is the best way to fulfill their advancement plans going forward.

Objects of the issue

The IPO proceeds shall be used towards the following purposes;

- ⇒ Carry out the offer for sale of up to 17,569,941 equity shares by the selling shareholders,
- ⇒ Achieve the benefits of listing the equity shares on the stock exchanges, and
- ⇒ Enhancement of company's brand name amongst existing and potential customers and creation of a public market for equity shares in India.

Investment Rationale

Ability to leverage Omni-channel model and operational efficiency across multiple revenue channels to derive efficiency

As Sapphire foods is an Omni channel player, they are able to optimize their restaurant assets across multiple revenue channels, such as delivery and take away while delivering differentiated product offerings consistent with global standards. This has also helped them to survive the pandemic and still earn 18.9% EBITDA pre ESOP in FY21, one of the highest in the industry. As a evidence of the operational excellence the company has initiated a robust internal 'PACE SETTER' program that enables continuous benchmarking of key cost lines amongst cohorts of restaurants, thereby improving financial performance at the restaurant level.

Industry trends in favor of the company

As a result of various factors which includes the pandemic, the food service industry has accelerated the transition from unorganized to organized sector, which is expected to grow at a CAGR of 15% over next 5 years (Technopak report). Of this QSR segment is expected to obtain a share of 54% in FY25 (Technopak report) as they can assure consumers of consistent great tasting products, food safety, hygiene, great value and easy accessibility across dine-in, takeaway and delivery channels. The company plans to take advantage of this trend (as evidenced by Capital raised of INR 4.7 Bn through Preferential allotment in Aug 2021) to build their restaurant network using a cluster strategy, where they would launch their brands from flagship locations in high traffic and high visibility locations in key metropolitan areas and cities and then develop new restaurants within that cluster.

Valuation and Outlook

Sapphire Foods is relatively young company with excellent and experienced professional management and institutional financial backers which in short amount of time has established themselves as one of the premier food service industry player. They also enjoy strong relationship with YUM being its largest franchisee operator in India and Sri Lanka. On the upper end of the price band, the issue is valued at 7.35x Price/ Sales based on FY21 financials which is reasonably priced when compared to its listed peers (Devyani International-14.5x, Jubilant Foodworks-14.9x, Burger King-12.4x and Westlife Development-9.3x). While the QSR industry was hit by the pandemic driven nationwide lockdowns, it has boosted digital orders & delivery and has shifted preference towards quality & safety, thus providing tailwinds for stronger brands. There is underlying risk of stiff competition in the market, but considering factors such as differentiated product offering, operational efficiency, experienced management and strong industry triggers, we give a "SUBSCRIBE" rating on this issue.

Issue Details	
Offer Period	9 th Nov- 11 th Nov 2021
Price Band	INR. 1120 to INR. 1180
Bid Lot	12
Listing	BSE&NSE
Issue Size (no. of shares in mn)	17.57
Issue Size (INR. in bn)	20.73
Face Value	INR. 10

Issue Structure	
QIB	75%
NIB	15%
Retail	10%
BRLM	JM Financials, BofA Securities, ICICI Securities, IIFL Securities
Registrar	Link Intime India Pvt. Ltd.

Particulars	Pre Issue	Post Issue
	%	%
Promoters	51.36%	41.25%
Promoter Group	8.72%	8.72%
Public	39.92%	50.03%
Total	100%	100%

(Assuming issue subscribed at higher band)

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Income Statement (In mn)

Particulars	FY19	FY20	FY21	Q1FY22
Revenue				
Revenue from Operations	11,938	13,404	10,196	3,031
Total Revenue	11,938	13,404	10,196	3,031
Expenses				
Cost of materials consumed	3,946	4,317	3,099	900
Employee benefit expenses	2,063	2,288	1,956	559
Other expenses	4,469	4,943	3,897	1,230
Total Operating Expenses	10,479	11,548	8,952	2,690
EBITDA	1,460	1,856	1,244	341
Depreciation and Amortization Expense	1,547	1,913	2,091	534
Other Income	125	113	616	109
EBIT	37	56	(231)	(84)
Finance Costs	720	722	756	172
Exceptional items	-	944	-	-
PBT	(683)	(1,610)	(987)	(256)
Current Tax	22	13	24	8
Deferred Tax Charge	(11)	(30)	(12)	(0)
Total Tax	11	(17)	12	8
PAT	(694)	(1,593)	(999)	(264)
Diluted EPS	(15.0)	(31.4)	(19.0)	(4.9)

Source: RHP, BP Equities Research

Cash Flow Statement (In mn)

Particulars (Rs in million)	FY19	FY20	FY21	Q1FY22
Cash Flow from operating activities	1,501	2,130	1,541	336
Cash flow from investing activities	(3,351)	(20)	(779)	(237)
Cash flow from financing activities	1,767	(2,081)	(515)	(68)
Net increase/(decrease) in cash and cash equivalents	(83)	29	246	31
Cash and cash equivalents at the beginning of the period	228	145	174	420
Cash and cash equivalents at the end of the period	145	174	420	451

Source: RHP, BP Equities Research



Balance Sheet (In mn)

Particulars	FY19	FY20	FY21	Q1FY22
Liabilities				
Share Capital	431	502	528	528
Other Equity	3,585	4,742	4,271	4,087
Non controlling interests	11	3	(12)	(15)
Net worth	4,027	5,247	4,787	4,599
Lease Liabilities	4,837	5,025	4,905	4,991
Borrowings	651	540	490	686
Deferred tax liabilities (net)	156	117	107	106
Provisions	69	88	98	103
Total Non Current Liabilities	5,713	5,771	5,600	5,887
Borrowings	308	172	267	266
Lease Liabilities	618	719	787	778
Trade Payables	1,142	1,307	1,440	1,615
Other Financial Liabilities	3,631	370	386	336
Other Current Liabilities	159	159.18	158	162
Provisions	78	62	64	69
Total Current Liabilities	5,935	2,789	3,102	3,225
Total Liabilities	15,675	13,807	13,489	13,711
Assets				
Property, Plant & Equipment	3,886	4,346	3,932	3,979
Capital Work in Progress	206	184	213	218
Goodwill	2,539	1,622	1,622	1,622
Other Intangible Assets	767	688	551	622
Right of Use Asset	4,859	4,953	4,739	4,790
Intangible assets under development	4	31	91	-
Other Financial Assets	522	622	722	754
Income Tax assets (net)	23	38	44	47
Other non current assets	251	157	140	267
Total Non Current Assets	13,057	12,640	12,054	12,301
Inventories	381	444	474	504
Investments	-	155	267	119
Trade Receivables	224	46.05	78	142
Cash and Cash Equivalents	222	221	451	470
Bank Balances	1,642	171	50	0
Other Financial Assets	75	54	49	78
Other Current Assets	72	76	68	97
Total Current Assets	2,617	1,167	1,436	1,410
Net Current Assets	(3,318)	(1,622)	(1,666)	(1,814)
Total Assets	15,675	13,807	13,489	13,711

Source: RHP, BP Equities Research

Key Risks

- ⇒ Company reported restated loss for the period / year after tax for the three months ended June 30, 2021 and 2020 and the financials years 2021, 2020 and 2019 and may incur additional losses in the future
- ⇒ The Coronavirus disease (COVID-19) pandemic has substantially affected and may continue to affect the business, results of operations, financial condition, cash flows and reputation in the future.
- ⇒ The company operates restaurants pursuant to the Franchisee Arrangement that imposes certain restrictions and obligations on it with respect to operations, and, which if terminated or limited, could adversely affect the business, results of operations, cash flows and financial condition.

**Disclaimer Appendix****Analyst (s) holding in the Stock : Nil****Analyst (s) Certification:**

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