SSIS

Research

Sapphire Foods India Ltd.

SSIS IPO GRADE 4/5 (Sound Fundamentals)

7th November, 2021

Rating Overview

Since 2014 Sapphire Foods Ltd. (Sapphire) is one of the two YUM franchisee operators in the subcontinent. It operates the franchises of KFC and Pizza Hut across 407 outlets in India across several states. Apart from India, it also operates in Sri Lanka (largest international QSR chain with 73 stores) and Maldives (2 stores).

In addition to KFC and Pizza Hut it also has the franchise rights for the Taco Bell brand for the Sri Lanka geography. The QSR market in India is expected to grow at 23% from INR 188 bn to INR 534 bn over FY20-25. The QSR market is at a nascent stage of growth in India and hence can sustain the high growth over the next couple of decades. At the OFS price of INR 1,180 per share the stock of Sapphire is valued at 17.6X FY24 EV/EBITDA which is at a significant discount of 8.8% to YUM's sister franchisee Devyani International Ltd. (19.3X FY24 EV/EBIDTA), and other QSR peers 23.8% Westlife (23.1X FY24 EV/EBIDTA), and 37.1% Jubilant Foodworks (28.0X FY24 EV/EBIDTA).

Sapphire, leveraging its brand, innovative product offerings, wide footprint, digital and delivery capabilities and a seasoned senior management team, is well positioned to take advantage of this opportunity. We expect Sapphire to roll out 306 additional stores over the next 3 years taking its total tally to 788 stores by FY24. This store expansion should support a robust revenue CAGR of 39.6% to INR 2,774 cr. Due to operating leverage, EBITDA is expected to grow at a faster CAGR of 51.3% to INR 431 cr and EBITDA margin to expand to 15.5% (+330 bps). Net earnings are expected to turn positive by FY24 and scale to INR 46 cr (vs INR 98 cr loss in FY21) with net margin expanding by 1,130 bps to stand at 1.7%. Return ratios ROE and ROCE are expected to expand by 3,500 bps and 760 bps to 5.0% and 12.2% respectively.

Our overall rating of Sapphire Foods is fundamentally sound given its scalability. The ask price is a little higher than our expectations, but participants might reward that in today's primary market frenzy. It's a great long term opportunity in the sector. The only risk for this company is the declining Sri Lankan economy.

Note: The analyst has no plans of subscribing to the offer and does not hold any shares in the company prior to, or at the time of writing this review.

Business Overview

Sapphire Foods India Ltd. (SFIL) is one of YUM's franchisee operators in the Indian subcontinent with revenue from operations of Rs. 1340.41 cr. and Rs. 1019.62 cr. for the financial years 2020 and 2021, respectively. It is also Sri Lanka's largest international QSR chain, in terms of revenue for the financial year 2021 (with revenue of Rs. 1.90 billion representing 35% of the total market revenue), and the number of restaurants operated as of March 31, 2021 (with 68 restaurants representing 39% of the total number of outlets in the market) (Source: Technopak Report).

The company has also established a presence in the Maldives. As of June 30, 2021, it owned and operated 209 KFC restaurants in India and the Maldives, 239 Pizza Hut restaurants in India, Sri Lanka and the Maldives, and two Taco Bell restaurants in Sri Lanka. The company aspires to be India's best restaurant operator by serving customers great food with great experience at a great value. It operates restaurants in high traffic and high visibility locations in key metropolitan areas and cities across India and develops new restaurants in new cities as part of its brand and food category expansion.

Its franchisee arrangement with YUM allows the company to operate, on a non-exclusive basis, under the KFC brand in several states in India and across the Maldives, the Pizza Hut brand in several states in India and across Sri Lanka and the Maldives, and the Taco Bell brand across Sri Lanka.

It has a dedicated business development and projects team and a well-defined new-restaurant roll-out process that enable it to identify new locations, build out restaurants quickly and efficiently operate with optimally trained manpower to achieve the targeted level of sales for restaurants. SFIL's total number of restaurants in the Territories grew from 376 restaurants as of March 31, 2019, to 450 restaurants as of June 30, 2021. It's overall stores tally which was at 437 as of March 31, 2021, stood at 482 as of June 30, 2021.

Financial Performance

On the financial performance front, for the last three fiscals, the company has (on a consolidated basis) it has posted turnover/net profit (loss) of Rs. 1206.28 cr. / Rs. - (69.40) cr. (FY19), Rs. 1351.74 cr. / Rs. - (159.25) cr. (FY20) and Rs. 1081.24 cr. / Rs. - (99.90) cr. (FY21). For the first three months ended on June 30, 2021, of FY22, it has posted a net loss of Rs. - (26.40) cr. on a turnover of Rs. 313.93 cr. against loss of Rs. - (75.17) on a turnover of Rs. 136.18 cr. for the corresponding previous period. Thus it has marked sharp improvement in the top line. According to management, this is due to its aggressive expansion of outlets during this period.

For the last three fiscals, the company has posted an average negative EPS of Rs. - (22.46) and an average negative RoNW of - (24.92%). The issue is priced at a P/BV of 14.63 based on its NAV of Rs. 80.67 as of June 30, 2021, and at a P/BV of 8.38 based on its post-issue NAV of Rs. 140.83 per share (Not clarified as to it is on lower or upper cap).

Its P/E on IPO pricing could not be ascertained due to negative earnings for the reported periods in RHP.

As per offer documents, SFIL has shown Jubilant FoodWorks, Westlife Development, Burger King and Devyani Intl., as its listed peers. They are currently trading at a P/E of 31.72, 00, 00 and 00 (as of November 03, 2021). However, they are not truly comparable on an apple to apple basis. Due to losses posted by Westlife, Burger King and Devyani Intl. their P/E is negative (un-ascertainable).

Summary of financial Information (Restated Consolidated)			
Particulars	For the year/period ended (₹ in millions)		
	31-Mar-21	31-Mar-20	31-Mar-19
Total Assets	13,489.37	13,806.64	15,674.72
Total Revenue	10,812.35	13,517.36	12,062.82
Profit After Tax	(998.97)	(1,592.47)	(694.04)

Issue Details

To avail listing benefits and provide an exit to some of its stakeholders, SFIL is coming out with a maiden IPO of 17569941 equity shares of Rs. 10 each as an offer for sale (OFS) with a book building issue worth Rs. 2073.25 cr. (at the upper cap). The company has fixed the price band of Rs. 1120 - Rs. 1180 per share. The issue opens for subscription on November 09, 2021, and will close on November 11, 2021. Minimum application is to be made for 12 shares and in multiples thereon, thereafter. Post allotment, shares will be listed on BSE and NSE. The issue constitutes 27.65% of the post issue paid-up capital of the company. It has allocated 75% for QIBs, 15% for HNIs and 10% for the Retail investors.

Having issued initial equity at par, the company raised further equity in the price range of Rs. 177.96 to Rs. 12635.23 per share between September 2015 and September 2021. It has also issued bonus shares in the ratio of 70 for 1 in March 2017. The average cost of acquisition of shares by the promoters/selling stakeholders is Rs. 9.36, Rs. 177.96, Rs. 195.38, Rs. 309.09, Rs. 331.86 and Rs. 342.08 per share.

Being secondary offer (i.e. pure OFS), SFIL's post IPO equity capital will remain the same at Rs. 63.54 cr. Based on the upper cap, the company is looking for a market cap of Rs. 7498.02 cr.

Application Dates	Nov 9, 2021 – Nov 11,2021
Issue Type	Book Built Issue IPO
Face Value	₹10 per equity share
IPO Price	₹1120 to ₹1180 per equity share
Market Lot	12 Shares
Listing At	BSE, NSE
Issue Size	[.] Eq Shares of ₹10 (Up to ₹2,073.25Cr)

Issue Timeline

Basis of Allotment Date	Nov 16, 2021
Initiation of Refunds	Nov 17, 2021
Credit of Shares to Demat Account	Nov 18, 2021
IPO Listing Date	Nov 18, 2021

Investment Strategy

While we are witnessing fancy for food chains despite their loss-making operations, many companies have thrown their hats in the fray to encase the ongoing boom. Though all of them have bright prospects ahead and may turn the winds in their favour once the pandemic scare gets over, these investment opportunities are purely meant for the long term rewards. Due to madness seen in the recent past for fancy pricing for loss-making units, such bets may be lapped up by risk seekers/cash surplus investors, others can stay away.

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