SapphireFoods

Date: November 10, 2022

To,

National Stock Exchange of India Limited	BSE Limited
Exchange Plaza, Block G, C/1, Bandra Kurla Complex, Bandra (E), Mumbai – 400051	Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai – 40001
Symbol: SAPPHIRE	Scrip Code: 543397

Dear Sir/Madam,

Subject: Earnings Call Transcript – Q2 FY23

Pursuant to the Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, please find enclosed herewith the transcript of earnings call held on Thursday, November 3, 2022, in relation to the financial results of the Company for the quarter and half year ended September 30, 2022.

The said Earnings Call Transcript is also available at the website of the Company (https://www.sapphirefoods.in/investors-relation/financials) under FY 2022-23 Quarter 2 section.

Request you to kindly take the same on record.

Thanking you,
For Sapphire Foods India Limited

SACHIN TUKARAM DUDAM

Digitally signed by SACHIN TUKARAM DUDAM
Date: 2022.11.10 17:37:56 +05'30'

SAPPHIRE FOODS INDIA LIMITED MUMBAI

Sachin Dudam
Company Secretary and Compliance Officer

Encl: a/a

Sapphire Foods India Limited
(*formerly known as Sapphire Foods India Private Limited*)
CIN: L55204MH2009PLC197005

+91 022 67522300
info@sapphirefoods.in
www.sapphirefoods.in
702, Prism Tower, A-Wing, Mindspace, Link Road, Goregaon (W), Mumbai- 400062

"Sapphire Foods India Limited

Q2 FY2023 Earnings Conference Call"

November 03, 2022

MANAGEMENT: **MR. SANJAY PUROHIT – GROUP CHIEF EXECUTIVE OFFICER & WHOLE TIME DIRECTOR – SAPPHIRE FOODS INDIA LIMITED**
MR. VIJAY JAIN – CHIEF FINANCIAL OFFICER – SAPPHIRE FOODS INDIA LIMITED
MR. NACHIKET KALE – ORIENT CAPITAL

Moderator: Ladies and gentlemen, good day and welcome to the Sapphire Foods India Limited's Q2 FY2023 Earnings Conference Call. As a reminder all participants are in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please press "*" then "0" on your touchtone telephone to signal for an operator. Please note this conference is being recorded. I would now like to turn the conference over to Mr. Nachiket Kale from Orient Capital. Thank you and over to you Mr. Kale!

Nachiket Kale: Good evening everyone and welcome to Sapphire Foods' Q2 and H1 FY2023 Earnings concall. The management today is represented by Mr. Sanjay Purohit, Group CEO and whole time director along with Mr. Vijay Jain, CFO. I hope everyone had a chance to go through the investor presentation and earnings press release. Before we begin just a reminder that this call may contain some forward looking statements which do not guarantee future performance and involves unforeseen risks. With that I would like to hand over to Mr. Sanjay Purohit to take over.

Sanjay Purohit: Good afternoon ladies and gentlemen. Welcome to our Q2 highlights. I will talk very briefly about the numbers and then I will give you a color on the quarter. In the quarter we delivered a strong performance. Our revenue was highest ever at Rs.560 Crores, our EBITDA was at Rs.103 Crores at 18.4% up 350 basis points year-on-year and our adjusted EBITDA was about Rs.62 Crores at 11.1% up 490 basis points year-on-year. PAT stood at Rs.27 Crores 4.8% of revenue up 600 basis points year-on-year. Our India restaurant EBITDA grew by 40 basis points year-on-year; however, due to the adverse Sri Lanka impact consolidated restaurant EBITDA of 16.8% was actually lower by 50 basis points and all of this I am looking at versus our normalized EBITDA of Q2 FY2022 and if you remember last year we were painstakingly calling out that our EBITDA was actually lower than what we had received in that period because of one time incentives that we have got on our store openings so against the normalized EBITDA numbers India grew by 40 basis points but on a consolidated level we dropped by 50 basis points.

At the beginning of the quarter we thought it is going to be a challenging quarter. One KFC revenues especially for the Sapphire markets are especially impacted because of the higher festival vegetarian days that we see and I will say this year the extent of drop that we see on vegetarian days has gone back to 2018, 2019 levels so there has been quite a severe drop versus say last year but in line with what we have seen perhaps in the earlier years so that was one potential negative impact. The second potential negative impact was that inflation peaking and on both the brands we were seeing mid teens inflation levels. Therefore at the start of the financial year along with Yum we have consciously taken a call to have price increases not in line with inflation but lower price increases so as to ensure that our transaction volumes are maintained and that has worked really well for us from a demand perspective so we are really happy with how the quarter has gone from a demand perspective. If you look at our same store sales growth had been really strong, our year-on-year ADS levels have been sustained in spite of 176 stores that we have added in the last one year so I think the fact that SSSGs are strong, transaction growth has been maintained in spite of our price increases I think that bodes well for us. So if you look at KFC now we delivered a 15% same store sales growth and a 36% increase in overall transaction. When we look at a channel level actually dine in was quite strong and their transactions also grew on a year-on-year basis but because our price increase which we had taken about between 9% to 10% and like I said inflation was in mid teens our gross margins were impacted by 310 basis points, but because of leverage that we got on 15% SSSG and tighter cost management the drop in restaurant EBITDA went to about 80 basis points versus the normalized EBITDA level of 18.7% in Q2 FY2022. You would have heard both Vijay and me talk about Q2 being generally the lowest quarter for us from KFC perspective and it drops versus Q1 and then we hope to recover in Q3 as we go past the festival vegetarian days. Gross margins went down by 310 basis points, our restaurant EBITDA margins just went down by 80 basis points so the SSSG focus as well as the cost management focus helped us to curtail this drop.

On Pizza Hut I think we have had best ever quarter. Our same store sales growth grew by 23%. There was a very strong transaction growth in excess of this SSSG and the ADS growth both over the corresponding quarter and the sequential quarter and therefore even when gross margins dropped by 110 basis points our restaurant EBITDA was our highest ever at 15% up by 440 basis points compared to our normalised restaurant EBITDA of 10.7% in Q2 FY2022. So here I am happy to say that a combination of our Omni channel strategy where dine in, takeaway and delivery all three come, we are able to maximize revenue out of our store through all three channels combined with all the work that we have done on cost management as well as the innovation on Pizza Hut the same store sales growth has been very strong at 23%.

Our Sri Lanka business also had a strong quarter and we grew SSSG to the tune of 37%. Now this has largely been on the back of price increases so the transaction growth has been just about positive in this quarter. Inflation has continued to rise and therefore our gross margins have got significantly impacted and therefore restaurant margins also dropped to about 550 basis points to 15% versus our normalised restaurant EBITDA of 20.5% last year Q2. Absolute value EBITDA grew by 23% in Lankan rupee terms but in Indian rupee terms declined by 25% with currency translation impact. Largely if you see in Q1 we delivered in Indian rupees sense roughly about Rs.7 Crores in this quarter also we have delivered similar roughly 10% to 11% mix of our corporate EBITDA. We are also happy to say that our restaurant expansion pace has been steady. We opened 42 restaurants in Q2, 20 KFC, 14 Pizza Hut in India and 7 Pizza Hut and a Taco Bell in Sri Lanka. So given all the macroeconomic conditions that we are seeing many consumer products company is showing lower transaction growth, lower volume growth our inflation being quite high, the fact that we consciously took lower price increases in the hope that we will be able to maintain transaction growth I think this quarter has been actually a very strong quarter for us and we are quite happy at the way that it has panned out coupled with our restaurant expansion that means that we are in a reasonably good space. Q3 is generally better than Q2 and we expect some marginal amount of gross margin improvement towards the end of Q3 perhaps beginning Q4 but inflation continues to be at the same level so there is no drop in inflation level so that is the overview.

When I look at page seven the consolidated financials you will see as I am repeating myself here Rs.560 Crores up 36%, adjusted EBITDA Rs.62 Crores up 144%, Rs.62 Crores translates into 11.1% adjusted EBITDA margin, EBITDA was Rs.103 Crores at 18.4% and PAT Rs.27 Crores at 4.8%. We ended the quarter with 658 stores, 301 KFC, 249 Pizza Huts in India and 106 Pizza Hut and Taco Bell in Sri Lanka and two stores in Maldives so totally 658 stores. I will now quickly hand it over to Vijay who will talk about the specific financial highlights.

Vijay Jain: Good afternoon everyone. I will move on to slide number nine consolidated financial highlights. Slide number nine so we clocked sales of Rs.560 Crores our highest ever revenue growth of 36%, gross margins we dropped by 310 basis points, we will deep dive into this at each business level.

Moving on to slide number 10, slide number 10 is a bit busy at times when you do over disclosures it can have this kind of effect so I will take a bit of time on this particular slide.

If you look at numbers in brackets which are given for last year corresponding quarters those indicate normalized restaurant EBITDA numbers taking aside onetime benefit which we received from Yum on account of COVID additional incentives which we received. We had called out this last time as well in Q3 financials when we released so on a comparison to our normalized restaurant EBITDA of last year of 17.2% we delivered 16.8% this year, a drop of 50 basis points. If you look at the below the graph it says Indian restaurant EBITDA grew by 40 basis points versus last year so after excluding the Sri Lanka business where we have seen a big drop on Sri Lanka the India restaurant business grew by 40 basis points in spite of a 300 basis points drop what we have seen at overall level. On adjusted EBITDA at 11.1% it was up by 750 basis points over the last year compared to a normalized EBITDA for Q2 which was 3.6% last year. In terms of value we delivered Rs.62.4 Crores, Q1 for us was around Rs.73 odd Crores.

Slide number 11 overall EBITDA of Rs.103 Crores 18.4% up by 610 basis points versus last year's normalized EBITDA of 12.3% and PAT of 4.8% at Rs.27 Crores up by 860 basis points over the last year. Last year we were negative on PAT. On YTD basis if you look at we delivered a PAT of Rs.65 Crores is close to 6% up by almost 1000 basis points versus last year. Sanjay would take over on the KFC section.

Sanjay Purohit: When we look at channel contribution we will find that dine in has continued to increase in overall contributions so in Q2 it was at 44% whereas delivery was at about 36% and takeaway was about 20%. We had product launches chicken peri peri, we had chocolate lava, a lot of branding and promotions around both chicken peri peri and chocolate lava. Our digital activation continues and the use of celebrities. Our new store launches we have given you some pictures. Finally we were able to launch a Colaba store. Recently in October we launched a store near fort and then we have launched a store in Central Mumbai also near Dadar. You can see the Faridkot, Punjab store, some of the stores in Punjab are really beautiful big stores with full drive through and it is an integrated retail development with lot of food players, apparel players, entertainment, so the brand does really well here and you can see a picture of the Jalna Road, Aurangabad store.

Vijay Jain: Moving on to slide 20 on financials very strong SSSG of 15% in the quarter for KFC, very healthy ADS of 134, this ADS is in spite of the 82 restaurant additions which have happened over the last one year so it includes all the new restaurants as well. On restaurant EBITDA of slide 21 on gross margins just let me cover the gross margins first. Restaurant revenue first, on restaurant revenue we clocked Rs.350 Crores up by 36%, additions of 20 stores which took the count part to 300 mark for us in KFC in the last quarter. On gross margins we dropped by 310 basis points, two reasons over here and one prime reason that inflation picked in Q2. Q1 while inflation was there we were also carrying old inventories. Inflation picked in Q2 that was a major impact. A marginal impact also on account of delivery mix compared to last year, last year it was 42% now it is 36% so small impact also on account of delivery relaxation. Our delivery prices are generally higher than our dine in and takeaway prices; however, in spite of gross margin reduction we were able to curtail the restaurant EBITDA drop to 80 basis points if you compare to a normalized EBITDA of last year of 18.7 we delivered 17.9%. This was possible because of healthy SSSG which Sanjay spoke about that we were able to drive because of lower price increase than inflation combined with the cost control we were able to limit the drop to 80 basis points in the quarter. Overall it is a very soft quarter expectedly soft quarter from a festival point of view, but from an overall demand and SSSG point of view it was a strong quarter for us and the cost management ensured we were able to restrict the impact to 80 basis points. Going forward Sanjay mentioned that as we move into Q3 we expect a recovery in demand to pick up because of the vegetarian festival days are over. Gross margin point of view we expect marginal recovery to happen in the end of Q3 and the beginning of Q4 and the higher ADS or higher revenue should enable us to drive greater restaurant EBITDA margins.

Sanjay Purohit: From a Pizza Hut perspective the channel sales contribution is quite similar to Q1 where 35% came out of dine in and about 15% to 16% comes out of takeaway, so deliveries today about 49% to 50% of our total business. A lot of our branding and promotions was focused on flavour fun that we launched on in the end of July nationally. You can see some of our new restaurant launches and we launched about 14 in the quarter so you can see Alwal, Gandhidham, and Avadi where we have got KFC and Pizza Hut in the same premise and Dighi in Pune and now Vijay will just talk about the numbers.

Vijay Jain: Slide 28 on Pizza Hut our overall SSSG was 23% and as Sanjay mentioned that it was on the back of strong transaction it was really heartening to see. In terms of the ADS we were at 64000 which was not only a growth on sequential quarter but as well as corresponding quarter as well and this is in spite of 61 store additions which happened over the last one year in case of Pizza Hut. Restaurant revenue grew by 60% at Rs.140 Crores with 14 additions during the quarter from the overall tally 249 restaurants. On gross margins we dropped by 110 basis points on account of churn in our price increase generally been lower than the inflation; however, our restaurant EBITDA when compared to a normalized EBITDA of last year at 10.7% we delivered 15.1% which is up by 440 basis points so this was best ever quarter for Pizza Hut in terms of revenue as well as in terms of restaurant margins and within 15.1% if you guys remember last time we called out that stores which have opened from April 18, 2022 onwards over the last four years those are delivering mid to high teens level of profitability and stores prior to April 18, 2022 while they are converted to Omni channel because of their insufficient size they deliver lower double digit restaurant EBITDA.

Sanjay Purohit: Our Sri Lanka business in an economy that is still impacted continues to do well. The highest or the greatest impact of all the disturbances came in perhaps towards the end of June, July and August but now things are stabilizing from an operations perspective, it is easier to get fuel. There is less number of electricity outages, imports again been allowed so we are able to get our imported products also in time, cheese, etc., which is very important so operating wise the business at least I would say 85% to 90% at a normal level. Inflation when we look at the first half would anyway close to about 75% to 80% we would have taken price increases in the region of about 40% and therefore gross margins here have dropped but ADS at a Sri Lanka level SSSG grew by 37% and our store openings continue. We opened 7 Pizza Huts and one Taco Bell. We are also seeing reasonably good traction on Taco Bell even though it is just 7 stores today, but potentially at some point in time it could be another driver of growth in Sri Lanka. Our new products continue to do well so the brand is in a strong position and when I look at October so improvement in operating conditions; however, inflation is still there and given that wage inflation is not in line with the general inflation there will be pressure on consumer discretionary categories and from a transaction level I feel that we will see pressure as we go forward. The quick financials Vijay will talk about.

Vijay Jain: Page 36 overall SSSG 37% with ADS in Lankan rupees at Rs.335000. If you look at the Indian rupees, impacted by translation of currency of almost 40% impact or depreciation. In terms of revenue in Sri Lankan rupees Rs.312 Crores revenue for the quarter up by 76% in Indian rupees it is Rs.67 Crores up by 2% so still positive even though a big impact on translation of currency. At gross margins a drop of 1000 basis points as we saw even in Q1 there was drop of close to 900 to 950 basis points impacted by inflations. Sanjay spoke about the uprising figure is in the range of 40% while the inflation was in the range of 75% to 80%. Absolute margin still grew by 23% in LKR terms while the percentage margin dropped by 550 basis points when you compare with normalized EBITDA of last year so it has clocked 15% so overall things are more stable in terms of as Sanjay said operating conditions be it for availability, be it supply chain management, be it power and fuel and as indicated earlier this year we expect probably the overall year where revenue to grow by 20% to 30% in Lankan rupees. We would be happy if we are able to hold or marginally grow our EBITDA at Lankan level. In LKR terms of course we will have a depreciation impact of 40%, which means at a corporate EBITDA level on annual basis there would be an impact of Rs.15 Crores to Rs.20 Crores in Indian rupees. Having said that the India business has more than able to cover for a deficit on the Lanka business and this now comes only 10% to 11% of mix at corporate EBITDA level. That is it guys. Thank you. I will hand it over to Vikram for the Q&A session.

Moderator: Thank you very much Sir. Ladies and gentlemen we will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. The first question is from the line of Sameer Gupta from India Infoline. Please go ahead.

Percy Panthaki: My question is on the margins you mentioned there is a 300 basis points hit on gross margins so what is the plan to counter that, is it that you see the commodities coming down and that itself will take care of it and if so to what extent and do you think any more price increases are necessary that is the first part of the question and the second part of the question is that assuming that you recover this 300 basis points over the next two to three quarters does that mean that your EBITDA margin also versus the 11% to 11.5% you have done this quarter does it mean it goes up to 14% plus when that happens or it does not translate that way?

Sanjay Purohit: I just let me take KFC example, I think we have got one balancing act to do between pricing and the impact of the pricing on consumer demand therefore we have taken 9% versus inflation of mid teens been able to still hold on to very strong SSSGs and despite 310 basis points in gross margins EBITDA margins just dropped by 80. Now we do another calculation and let us take mid teens price increase and if it leads to a very poor SSSGs then the leverage impact will vanish and therefore it can have a detrimental impact on restaurant EBITDA so this is something that along with Yum we are monitoring at a close level. We are not seeing commodity prices coming down at an overall level significantly. Some places it is coming down for example oil has come down but for both the brands inflation versus last year continues to be at this level. Now are there opportunities to take price increases I think we will be very cautious about some of the price increases so I will say gross margins perhaps will see some marginal improvement towards end of Q3 and beginning of Q4 but would not see any dramatic improvement in gross margins. Having said that restaurant EBITDA in Q3 because of better sales compared to Q2 we will see some leverage coming out of that and I am hoping that the restaurant EBITDA margins improve.

Vijay Jain: Just to add to that Percy we have always called out that our focus is more at a restaurant EBITDA margins level and we always try and take the impact in our stride on gross margins and still deliver, sustain and improve upon restaurant EBITDA margins so that journey will still continue where while you may not see a full recovery on gross margins and marginal recovery but our cost management and the SSSG which will gives us leverage will help us move towards that restaurant EBITDA margins the ideal margin which we are looking for.

Percy Panthaki: If the interest costs comes off in future do you think you would retain that benefit or in one way or the other not through MRP but through extra promotions or something like that a large part of that would get passed through to the consumer?

Sanjay Purohit: Let us wait and watch if it comes down Percy and it will be all combination of what SSSGs and what growths we are seeing at that point in time and based on that we will take a call Percy.

Percy Panthaki: One small question I had was on corporate expenses, the corporate expenses that I am deriving for this quarter are about 5.6% of sales versus in Q1 it was 5.1% of sales so there is a 50 basis points operating deleverage on a sequential basis so am I reading too much into this or do you think there is scope for this corporate expenses itself to be like over the next six to eight quarters can be 100 basis points driver of margins or something like that?

Sanjay Purohit: We will not comment on a specific line and give specific line guidance. Having said that Q2 corporate cost is also impacted by the ESOPs grant which happened towards the latter half of Q1 so Q1 did not see probably the full impact of that so that has probably contributed 30 basis points in this. Yes marginal impact has also happened on account of leverage on account of lower sales. As the revenue builds up happen our corporate cost which is a combination of corporate cost and regional team will definitely grow lower than the revenue growth so you will see some leverage happening quarter-on-quarter or more logically year-on-year on corporate cost because on quarter-on-quarter seasonality also plays out so you will see some leverage I will not put that leverage.

Percy Panthaki: This ESOP cost of 30 basis points does it continue into the coming quarters as well?

Sanjay Purohit: Q2 is now representative of the ESOP cost so it is full ESOP cost which have got built in. in fact what may happen is after March 2023 when some ESOP gets vested it may come down slightly in fact.

Percy Panthaki: Okay that is all from my side. Thank you.

Moderator: Thank you. We have the next question from the line of Nihal Jham from Nuvama. Please go ahead.

Nihal Jham: Thank you so much and good evening to the management. Sir a couple of questions. First on the KFC part because you were highlighting the seasonality generally what is the impact from Q1 to Q2 in ADS that happens because of as you said higher instance of vegetarian in the areas we operate?

Vijay Jain: Nihal very difficult to put an exact ratio because what happens is the religious festivals the days can move between Q2 and Q3 and then last two years COVID has actually played havoc with trends analysis so very difficult to put actual number. For example even this quarter you saw Navratri part of Navratri coming in September last week whereas last year the entire Navratri was in October so very difficult to put. What I can say is that this year the dip which we are seeing is similar to the dips which we have seen in pre COVID times.

Sanjay Purohit: Having said that Q1 our overall ADS was in the region of 144, our overall ADS in Q2 is 134 so there is a 7% give or take because new store impact from quarter-to-quarter would not be high so that is the kind of impact we see over the full quarter Nihal.

Nihal Jham: Understood. The only reason I am asking because you have highlighted inflation so if there was exaggerated impact of footfalls or something but I will take the number that you are giving that this is represented.

Sanjay Purohit: I called out and that was one worry that we had that with inflation and with vegetarian days would it impact transactions but we are really happy with the kind of SSSG growth that we have seen because dine in has been strong their transaction growth has been strong and we have also seen it translates into SSSG growth also.

Nihal Jham: Understood. Taking two questions on Pizza Hut and first is if you could again highlight on the flavour fun which you highlighted from July have been promoting and the second is if you could separately call out the margins for a new format stores if that is the right term I will be done with? Thank you.

Vijay Jain: The second question is first. We have said that the stores which have opened from April 18, 2022 onwards and it is not a new format it is all way operative Omni channel stores whether it is old or new. The April 18, 2022 onwards are more compact ones compared to the size which we were operating earlier which we inherited in legacy so the compact ones are delivering anywhere from mid to high teens.

Sanjay Purohit: On flavour fun the response has been very positive and loathe to call out a specific number on flavour fun because it is just really too early days and while we always say that there is a seasonality impact on KFC there is also some seasonality impact that happens in Pizza Hut also so I think we should wait for three to four quarters and look at how this specific innovation goes. Undoubtedly it is leading to transaction growth and from an anecdotal basis the kind of customers we are seeing coming to our stores and ordering is definitely these consumers might not have come in the past so that value layer under Rs.100 like we called out even in the last earnings call is the important future driver of growth. I hope we answered your question Nihal.

Nihal Jham: Very much thank you so much. I will come back in the queue.

Moderator: Thank you Sir. We have the next question from the line of Devanshu Bansal from Emkay Global. Please go ahead.

Devanshu Bansal: Thanks for the opportunity. Sir I just wanted to check what is the typical growth trend in ADS from Q2 to Q3 because Q2 generally is a weak quarter for KFC so if you can just help me with the historical trends it would be helpful?

Vijay Jain: ADS is also a function of how many new stores you are opening. When you look at a historical trend we were not expanding so much so it may not be the representative. The new store additions do dilute to some extent the overall ADS. Having said that we have seen a drop of 5% to 7% vis-à-vis Q1 something of in that range it could be anywhere between that 4% to 8% so I would not put a specific number to it but that could be the range on Q3 versus Q2.

Sanjay Purohit: Devanshu Sanjay here I just want to interrupt. I think I heard Vijay say decrease in Q3 versus Q2 actually it is between 4% to 8% increase in Q3 versus Q2.

Devanshu Bansal: Yes Sir I got that. I understood it as an increase only Yes Sir.

Vijay Jain: We just wanted to clarify for the benefit of everyone.

Sanjay Purohit: There are 260 people on the call so there should not be 260 minus Devanshu all of them freezing and saying my God this quarter we are going to be lower than Q2 so I just clarify for that sake. Go ahead with your question again please Devanshu.

Devanshu Bansal: Yes Sir so I was indicating that Pizza Hut has seen a very encouraging performance with 23% SSSG this quarter I wanted to check if there was any sort of a low base element for you last year for Pizza Hut format due to operating conditions, etc.?

Sanjay Purohit: I would say there was very marginally lower base. I would say malls were at say 90% recovery last year versus what they would normally be but I think it is minimal so base is not the issue.

Vijay Jain: So marginally it is a small impact and may be a pocket territory like Maharashtra where the conditions got slightly more favorable in operating from October onwards September towards the end of September but then that is a marginal impact in the base.

Devanshu Bansal: Lastly Sir if you can talk about the trends in terms of SSSG for the festive season it would be very helpful for both the formats?

Sanjay Purohit: The festive season is over so we have given you the SSSG numbers the quarter numbers are you talking about Q3 or what are you talking about?

Devanshu Bansal: Yes festive season in Q3 some outlook if you can provide then it will be very helpful.

Sanjay Purohit: We can predict our business but we are not soothsayers here and therefore what Vijay said roughly we have seen 4% to

8% increase over Q2 I think that is about as much that I am able to perhaps predict.

Vijay Jain: That is for KFC just to call out clarify again Pizza Hut does not get so impacted by seasonality anyway so Q2 was the best ever quarter so the ADS of Pizza Hut which was 64000 in Q2 does not have any seasonality impact so we hope we continue on the same trajectory for Pizza Hut.

Devanshu Bansal: Got it Vijay. That is it from mine. Thank you.

Moderator: Thank you Sir. We have the next question from the line of Kapil Jagasia from Edelweiss Broking. Please go ahead.

Kapil Jagasia: First of all congratulations for a great set of numbers Sir.

Sanjay Purohit: Kapil you are the first person who has congratulated us normally Percy is the first person who says good set of numbers but this time Percy for some reason was very muted so thank you Kapil.

Kapil Jagasia: Sure. Sir the store opening run rate has been very healthy in H1 so would we be eligible for incentives from Yum this year too and what would be the quantum?

Sanjay Purohit: So just to clarify I think you are referring to the incentives which we actually had last year so as per our contract every year incentives we have been getting incentives over the last five years we will continue to get incentives over the next five years as well that is not going to change, what we called out last year was there was an additional component on account of COVID, because of COVID our targets were revised and we were given some additional incentives that is all we have called out. Those current set of numbers are representative in terms of incentive calculations you will not see a reduction in terms of incentives, you will not see increase in terms of incentives.

Kapil Jagasia: That is very much there and just wanted to understand your takeaway channel because if I just see in terms of during COVID probably people might be sitting in and taking away the pizza or KFC items but now with nothing there no restriction is there would it clearly a dine in or a delivery channel because I am just trying to understand why the takeaway still at 20% of sales like what is like any drivers for it or how do you see this channel growing going forward?

Sanjay Purohit: Takeaway has always been a double digit channel for us even in the past and proximity to store enables this takeaway, in many of our malls format stores and drive through stores, we say that when a person purchases in the drive through that comes under takeaway. Having said that

I think now I will just refer to a global trend that we are seeing and perhaps that will play out in India sometime. If you look at globally delivery now delivery prices are substantially higher than either dine in or takeaway prices and apparently there is a global trend where consumers look at these delivery prices and if they are in the vicinity of the store preferred to come and take away because it is little more economical perhaps something like that we are seeing in India because our takeaway portions are slightly better than what has been there in the past but again compared to what happened during COVID it is not better than what happened during COVID so it has reduced a little bit so I think it has traditionally been a strong double digit contributing channel for us and the behavior that started during COVID period when takeaway increased that sort of continues even when COVID is off and neighborhood restaurants and access to a restaurant drives really takeaway.

Vijay Jain: Just to add to that our Omni channel strategy where all the three channels are available actually puts us in a strong position that you can take advantage of one channel versus the other. All the three channels are available in the fire formats be it Pizza Hut it is Omni channel and be it KFC it is Omni channel.

Moderator: Thank you. We have the next question from the line of C Kishore from Chola MS. Please go ahead.

C Kishore: Good evening. Thanks a lot for taking my questions. I just want to understand what is the average size of the new stores that you are opening and I want to understand going forward would it be safe to assume that the future would be towards let us say smaller store sizes so that the unit economics actually work out better? Thank you.

Vijay Jain: So our sizes for KFC are in the range of 1500 square foot to 1600 square foot, Pizza Hut in 1200 square foot. The reductions in sizes have happened over the last five to six years that I want to call out it is not just a COVID phenomenon that we have cut down the sizes it happened with calculations in terms of the covers, table turns, and with the advent of delivery channels, partnering with aggregators meant that we can be a more Omni channel player so that is how the decision has happened. While the reduction in sizes happen again just to clarify will not impact our capacity to serve customers so the ADS throughput can be considerably higher than what we delivered right now. At the levels where we are we do not expect in the medium term or dramatic or a further reduction in the sizes as we move forward because you require X amount of capacity sitting capacity for your dine in channel to be relevant, any cut downs from here on would compromise that particular channel.

C Kishore: Fair enough. Thank you so much.

Moderator: Thank you. We have the next question from the line of Ashish Kumar from Infinity Alternatives. Please go ahead.

Ashish Kumar: Thank you Sir and congratulations for a good set of results. Sir if you compare our pace of store addition while we have kind of comment significantly from where we were last year the question which I have is that when we compare to our peer group they seem to be opening almost double this number of stores on the KFC plus Pizza Hut India do you think we have a part to kind of get to catch up with them in terms of the same store sales because from GDP perspective we kind of split the GDP 50:50 right?

Sanjay Purohit: I think the pace of our expansion is in line with what we have said consistently over the last one year that we hope to double our restaurant base of about 550 stores at the end of December 2021 and that gives us roughly in the region of 130 to 160 stores between these numbers and all three businesses Pizza Hut, KFC and Sri Lanka will be roughly be able to deliver this kind of pace for expansion. Now this is what we are happy and comfortable with. I think this is a factor when you look at pace of expansion it is pace of expansion into the ADS that you are able to get out of a new store and if you look at I do not think we have compromised in any way with respect to our peers.

Vijay Jain: So just to add Sanjay said you mean doubling in three to four years time vis-à-vis the numbers which we had in December 2021 and again our guiding factor would not be what Pizza Hut is doing our guiding factor would be our levels, our strike rates, our paybacks that is our internal measures which we use and that is why we feel we are comfortable with doubling the count over three to four years. On the point which you just made the GDP wise the territory distribution is 50:50 I would like to clarify the territories which KFC operates for us they contributes 56% to India's GDP, for Pizza Hut the territories which we operate is roughly 57% of India's GDP.

Ashish Kumar: Which is where I was coming from and maybe yes you are right that this is in line with the guidance that you have given but given the fact that we are seeing an environment where in the shift towards branded players like yourselves is significantly higher if I were to say does it make sense to it and we have a balance sheet with very healthy cash accruals and healthy internal accruals does it make sense to kind of exercise the pace of rollout given the fact that you have a higher footprint of the country it is a question of if you do not do it then somebody like Popeyes may come and kind of capture the space it is a question of land grab?

Sanjay Purohit: So I do not think it is a question of land grab Ashish. As I said there are many things that need to be balanced. At this rate the ADS that we get and therefore the new store payback that we get are healthy. Anyone I think will be or there will be few players who can match this rate of expansion, deliver the kind of returns that we are looking at so the short answer is this is the rate of expansion that we are looking at this stage.

Ashish Kumar: Okay and coming back I am sorry I missed a little bit of the call when there was an issue on the gross margin do we believe that we can get back to our historical gross margins in the next couple of quarters?

Sanjay Purohit: So I believe you are referring to KFC in particular?

Ashish Kumar: Absolutely.

Sanjay Purohit: So while again this gross margin drop of 300 basis points happened our restaurant EBITDA dropped by only 80 basis points so that is the way we are focusing. The idea is not to take a price increase in inflation and probably potentially impact our revenue and transaction so we are happy with where the price increase stays right now. Yes marginally we expect the gross margins to come back towards the second half of Q3 and starting Q4 marginally but on improving the restaurant EBITDA which would happen with the improvement in sales which we are anyway sitting in Q3 over Q2 because the vegetarian days are now over in terms of the festivities, but the focus is more on the restaurant EBITDA margin and how do we sustain and drive restaurant EBITDA margins.

Moderator: Thank you. We have the next question from the line of Jignesh Kamani from Gmo. Please go ahead.

Jignesh Kamani: Just with the gross margins front we have seen the milk prices increased by Rs.3 to Rs.4 last month and hence cheese and all the other products so do you think it is still some of the element of the gross margin and raw material still continue to rise and will have further impact on the gross margins in the second half at least for the pizza if not for KFC?

Sanjay Purohit: So I mentioned this right at the beginning that there are some items where prices have come down, some items where as you rightly said milk prices have gone up and therefore potentially over the next three to four months will have an impact on dairy products that we consume also so overall I think inflation will continue at the levels that we have seen in the first half so I am saying the deviation from this will be marginal it is not going to go down dramatically, it is not going to go up dramatically.

Jignesh Kamani: Understood. Second thing on the flavour fun based on the initial experiments are we seeing more downtrading or new customer is taking care of any small downtrading is happening?

Sanjay Purohit: So like I said it is too early to call it on flavour fun it is just that we are getting and I am sure we are getting higher level of transaction growth than we have got earlier so net-net it is positive. We are not going into great specifics on this Jignesh so forgive me for that.

Jignesh Kamani: No issues. Thank you Sir.

Moderator: Thank you. We have the next question from the line of Heeru Tejwani from Motilal Oswal. Please go ahead.

Heeru Tejwani: Good evening Sanjay and Vijay. My question is on a very comprehensive and macro level to Sanjay other than India or Sri Lanka like in the QSR space other peer groups are growing in other countries so it is obviously from the question on increasing stores would you look at strategically introducing any other country in the near future?

Sanjay Purohit: It is too hypothetical a question Heeru at this moment.

Vijay Jain: Having said that we have always called out in terms of our strategy that apart from organic growth in terms of KFC and Pizza Hut restaurant additions in terms of inorganic growth we would love to have a third brand at some point in time. If not in the short term may be in the medium term and that is where we will leave it at. Now whether it could be new territory or new brand in India it is too early to hypothetical to comment.

Sanjay Purohit: I think largely one of the considerations is that it should be able to offer similar kind of growth trajectories as India offers so if anything that is not offering the kind of India's growth trajectory another territory then I think we will be very, very circumspect.

Vijay Jain: The mantras for those identification of brand we have listed in our annual report so if you go page to 35 there are seven mantras which defines where you want to have scale and success both then that would go into our choice of the third brand so you can refer to the page 35 of our annual report as well.

Heeru Tejwani: Sure thank you.

Moderator: Thank you. We have the next question from the line of Kalpit Narvekar from Allianz Global Investors. Please go ahead.

Kalpit Narvekar: Good evening and congrats on the results of the quarter. I had two questions. I want to understand how this essentially if you have done any studies on the demand elasticity say at the young level or for the product categories like KFC and Pizza Hut right so if like how does the prize hike affects volume growth like say in the past in the past cycles if you have done any studies and if you have any sort of color on that?

Sanjay Purohit: So Kalpit actually we are in new territory here, over the last five or six years we have not had an inflation of this level and hence there is very little past data to fall back on. I am just looking at my old consumer product experience that says that in general there is an impact on any discretionary income categories there is an impact when you take severe price increases so the best way to find out actually is to experiment and in general we feel that if we are able to restrict price increases in the region of between 60% and 70% of inflation and then find the economies of scale elsewhere it works well because the product then becomes more affordable over a period of time. I think we have used similar kind of understanding when we have taken price increases this year also, but there is no hard and fast heuristics that shows the demand elasticity. I think we have just got to do something and then see how it plays out. I think the fact that we have kept price increases to the level that we had in Q2 compared to the inflation and it has borne out with SSSG means that at least right now it has worked in the quarter that has gone by.

Kalpit Narvekar: Great Sir. That is helpful and my second question was on the delivery fees so how much of the delivery fees is through our own delivery system and what is the strategy in terms of expansion of our own delivery network?

Vijay Jain: The breakup for both the branches will different KFC would be 90% approximately and I am giving you very approximate numbers 90% through aggregators and the rest delivery Pizza Hut would be 80:20 ratio so our plans for our own delivery in terms of our systems or app, the kind of offers which we have on our platform they continue to be there for the last two to three years and they continue to grow well. What is happening at the same time aggregator continues to pump in money they are growing really well so the mix is not changing. However our own delivery as well as aggregator both the platforms are growing healthily.

Sanjay Purohit: Typically we would have stopped our call work for an hour but we are quite happy to continue it if people on the call are also willing to continue so we will take our next call therefore Vikram.

Moderator: Thank you Sir. We have the next question from the line of Harsh Mulchandani from KRIIS PMS. Please go ahead.

Harsh Mulchandani: Thank you for the opportunity. Congratulations Sir for a good set of numbers. I just wanted to understand that do you track the set of repeat customers at your end and how does that number look like on a quarter-to-quarter basis?

Sanjay Purohit: So I do not have those numbers offhand with me I must confess Harsh so if necessary we can get back later but I do not have those have numbers offhand with me.

Harsh Mulchandani: Okay sure no worries and I have another question on the prices so just want to understand that you operate across states so your prices are consistent across states where you operate or they are different?

Sanjay Purohit: Yes we are consistent all India.

Vijay Jain: They will be different across channels so for example delivery channel may have slightly higher prices for KFC in particular, in Pizza Hut even that is not the case, otherwise from state-to-state and territory-to-territory the prices are consistent.

Sanjay Purohit: We also have some premium price stores but that is about difference otherwise pricing is consistent across the country.

Harsh Mulchandani: Got it fair and just to compare it with the price with the other operators for Pizza Hut which operates in India so the prices with them is also similar or you have a different pricing?

Vijay Jain: It is Pan India similar so irrespective of the stores are operated by the sister franchise or by Sapphire the pricing strategy is consistent not just for Pizza Hut even for KFC across all states and all territories.

Harsh Mulchandani: Got it fair. Thank you so much.

Moderator: Thank you. We have the next question from the line of Ameya Gawande from Metaverse Equity Fund. Please go ahead.

Ameya Gawande: Thank you for the opportunity so Sir my question is what growth you are anticipating within the next three years particularly in Sri Lanka?

Vijay Jain: So Sri Lanka as we had called out already this year we are seeing 20% to 30% growth and the macroeconomic situation while it has stabilized continues to remain critical so would be very full heartedly to probably try and predict three years from right now for Sri Lanka. We will take a quarter at a time, let us see in the next six months time where we reach and may be then we can have this conversation.

Ameya Gawande: Sure Sir.

Moderator: Thank you. We have the next question from the line of Pujan Shah from Congruence Advisers. Please go ahead.

Pujan Shah: I just wanted to know what is the advertisement spend we are doing on the percentage basis?

Vijay Jain: So as per the contract with Yum we are required to spend 5% for a national campaign which we contribute to Yum and along with the sister franchise which is used for Pan India marketing and one person for local sales marketing which we spend internally.

Pujan Shah: So as the geographical wise our sister concern and all our companies do we have any segregated advertisement spend or we have collective advertisement spend on the basis of this franchise base?

Vijay Jain: So the segregation is only 1% where it is local marketing where we used to spend into our territories, for the 5% it is a national approved which is used for Pan India marketing.

Pujan Shah: Okay got it. Thank you Sir.

Moderator: Thank you. We have the next question from the line of Dhairya Trivedi from DJT Investments. Please go ahead.

Dhairya Trivedi: I have a couple of book keeping questions what is the likely tax rate for this financial year?

Sanjay Purohit: So this financial year it is unlikely that we will have a tax outflow because we have enough carry forward of losses. I guess we get into the tax sale time next year may be towards second half probably and then going forward a year later we will fall into 25% tax regimen so that is probably couple of years away.

Dhairya Trivedi: Okay got it. Another one on the royalty front what is the royalty that we are paying to the master franchise at the current stage?

Sanjay Purohit: First of all we do not pay to the master we are the master franchise we pay royalty to Yum.

Vijay Jain: As per agreement it is 6.3% but again we have called out there would be waivers depending upon the store opening plan but the base number is 6.3%.

Dhairya Trivedi: Is it likely to go up in the next year or so?

Vijay Jain: So our royalty of 6.3% has been consistent for the last few years, in fact for Yum it has been consistent globally we do not expect this to either come down or go up that is the rate which Yum follows globally for quite a few years across all territories.

Dhairya Trivedi: Okay got it. Thanks.

Moderator: Thank you. Ladies and gentlemen we have reached the end of the question and answer session and I would like to hand the conference back over to Mr. Sanjay Purohit for closing comments. Over to you Sir!

Sanjay Purohit: So first of all thank you all for joining. We had a really good question and answer session. At the end of a quarter where which was potentially challenging but we have been able to navigate these turbulent waters quite well and from a demand perspective both brands were strong in Sri Lanka, also business was strong and our old adage where we said that let us not look at gross margins but see what is the impact of price increases on volume and if we are able to maintain volume and therefore grow same store sales growth we are able to get leverage and that is how it has played out in Q2 and therefore our restaurant EBITDA margins have been quite strong. The drop versus last year quarter on KFC has been quite minimal and the India restaurant EBITDA both brands put together actually went up by 40 basis points. I am quite looking forward to Q3 and Q4 and ending the year also on a strong note. Having said that we will see you at the turn of the New Year and therefore best wishes for the New Year in advance to all of you. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Sapphire Foods India Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.