Date: 16th February 2024

To,

National Stock Exchange of India Limited Exchange Plaza, Block G, C/1, Bandra Kurla Complex, Bandra (E), Mumbai – 400051 Symbol: SAPPHIRE	BSE Limited Phiroze Jeejeebhoy Towers, Dalal Street, Mumbai – 400001 Scrip Code: 543397

Dear Sir/Madam,

Subject: Earnings Call Transcript – Q3 FY24

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 Friday, 9th February 2024, in relation to the financial results of the Company for the quarter and nine months ended 31st December 2023.

The said Earnings Call Transcript is also available at the website of the Company (https://www.sapphirefoods.in/investors-relation/financials) under FY 2023-24 Quarter 3 section.

Request you to kindly take the same on record.

Thanking you,
For Sapphire Foods India Limited

Sachin Dudam
Company Secretary and Compliance Officer

Encl: a/a

"Sapphire Foods India Limited Q3 & 9M FY-24 Earnings Conference Call"

February 09, 2024

MANAGEMENT: **MR. SANJAY PUROHIT – GROUP CEO & WHOLE-TIME DIRECTOR, SAPPHIRE FOODS INDIA LIMITED**
MR. VIJAY JAIN – CFO, SAPPHIRE FOODS INDIA LIMITED
MR. RAHUL KAPOOR – HEAD, INVESTOR RELATIONS, SAPPHIRE FOODS INDIA LIMITED

MODERATOR: **MR. BHAVYA SHAH – ORIENT CAPITAL**

Moderator: Ladies and gentlemen, good day and welcome to the Sapphire Foods India Limited Q3 and nine-months FY24 Earnings Conference Call of organized by Orient Capital.

As a reminder all participant lines will be 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 call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Bhavya Shah from Orient Capital. Thank you and over to you sir.

Bhavya Shah: Good evening, everyone. Welcome to the Q3 and Nine Months FY24 Earnings Con-Call for Sapphire Foods India Limited.

From the Management we have with us Mr. Sanjay Purohit – Group CEO and Whole-Time director, Mr. Vijay Jain – CFO and Mr. Rahul Kapoor – Head, Investor Relations.

I hope everybody had a chance to go through the results and investor presentation which was uploaded on the exchange earlier today. Before we proceed a reminder that his call may contain some of the forward-looking statements which do not guarantee future performance and involve unforeseen risks. A detailed disclaimer has also been published in the presentation.

I will hand over the call to Sanjay. Over to you sir.

Sanjay Purohit: Good afternoon, everybody. Thank you for joining our investor call.

Let me start off; our Quarter 3 FY24 consolidated restaurant sales were 664 crores, and this grew by 12% YOY and EBITDA at 123 crores grew by 5%. Now these numbers seem to suggest that the quarter continues to be tough from a demand perspective. Indeed, when you look at most consumer product categories, we can see that demand conditions are tough and then when you look at the rest of the QSR industry, again you will see demand conditions the growth generally being muted. But in the light of competitor highlights that have been given out, this performance still is relatively a strong performance driven by KFC which is doing quite well, Sri Lanka being stable and Pizza Hut continuing to be a challenging quarter.

In the quarter we added 36 restaurants, 25 KFC, 8 Pizza Hut in India and 3 Pizza Hut in Sri Lanka, taking a total restaurant count to 850. Our consolidated restaurant EBITDA margin; EBITDA was flat Y-on-Y and margin was down to 16%, 210 basis points lower than last year. Our consol EBITDA post Ind-AS was 123 crores or 18.4% and this grew year-on-year by 5%, though down by 120 basis points. Our adjusted EBITDA was 72 crores or 10.9% and this declined Y-on-Y by 2% or by 155 basis points.

I'm now going to jump to the KFC slide, which is Slide #18 and talk about what we are trying to drive on the KFC brand. Like I said in general, we are seeing growth being challenging in the

QSR space. However, on KFC our biggest priority is to be able to grow the fried chicken relevance. We have taken two occasions of lunch and snacking, and we are starting to blow this up. This is both through product menu innovation and then advertising both digital as well as mass media television advertising to back these initiatives. So, you would have seen snacking as a continuing theme from last couple of quarters and lunch is an occasion that we have started backing from this quarter onwards. Like I said both of them come with a variety of options at attractive price points and we are advertising to create demand.

From an operational perspective, our customer scores and our operating scores continue to improve. For example, our Google ratings, our Swiggy ratings, our Zomato ratings on the basis of which consumers make a choice between brands have never been higher than what they are today. That's on account of the rigor in operational initiatives that we drive at the front end. So, that's doing really well.

We have overall implemented digital kiosks. This is Slide #20 in about 130 restaurants and that's going well. From an accessibility perspective, we used to call out that on an overall basis we should be able to double our restaurant count in 3 to 4 years. On KFC at least we think that we should be able to call out that we will double this restaurant count in 3 years' time. Quickly let me hand it over to Vijay to take us through the numbers part.

Vijay Jain: Thank you, Sanjay. Just to clarify on the previous slide; doubling the count we meant December '21 as the base. We are on track to double it by the end of Calendar Year '24.

Slide #22; dining mix was 43%, delivery came at 38%, 200 basis points higher than last year. In terms of SSSG were at (-2%) with overall revenue growth of 16%. ADS of 125,000 include 25% new store additions. So, we added 81 stores over the last calendar year. So, that impact is there in the ADS of 125. Overall gross margin grew by 190 basis points and sequentially it improved by 50 basis points. This combined with the cost efficiencies meant that we were able to deliver a very strong EBITDA of 20.1%. And even if you look at our nine-month performance, 19% revenue growth with a 20% restaurant EBITDA this is the highest ever restaurant EBITDA for Sapphire KFC for a nine month period.

Moving to Slide #25; it gives you a 4-year trend and five quarter trend. Now that we have the benefit of looking at the results of all of the QSR players, we can safely say that the last nine months performance of KFC and especially the Sapphire KFC.

I would like to underline this "Sapphire KFC is by far the best in the industry considering the scale growth and the margins which we are able to deliver."

Sanjay Purohit: While KFC has been a shining star in our overall portfolio, Pizza Hut continues to face a challenging situation on the back of quite severe competitive pressures. Last time we had tried to distill out everything that we are doing into really three simple buckets, and we had called out specific actions that we are taking under each of these initiatives and here we are giving you a

summary update. Now given the nature of the decline that we have had on the brand, I must say there are no silver bullets to rejuvenating the brand. This is going to be a medium-term task and to be able to change perceptions on the brand. So, the first action that we have called is how do we revive customer interest in the brand by building the brand and both product innovation and enhanced marketing investments are the specific actions. You should be able to see innovation starting to roll out in the next two quarters and we will be putting in a higher level of marketing monies to back this innovation. Then we'd said we've got through operational initiatives how do we grow both dine in and home service. We have now implemented the Dragontail kitchen planning tool in 100% of our restaurants and most importantly because this is a delivery forward kitchen planning tool, for it to be effective we needed to integrate with the aggregator platforms, that is also complete. So, now our simple premise is that if we are able to deliver pizza within 20 minutes to a customer as soon as it comes out of the oven then it is hot and fresh. We are now seeing month on month improvement in these metrics of the number of orders that we are able to serve within these 20 minutes. That's resulted in our higher ratings on Google, on Swiggy and on Zomato. So, across the platform we are close to a 4 rating on Zomato, and this has seen a substantial improvement and above 4 on Swiggy.

Further building occasions like KFC is an important initiative. Both lunch as well as late night deliveries are the two areas that we are focusing on. The lunch day part activation has been rolled out and over 90% of our stores now are open for late night deliveries. So, this also we think will give us an upside.

And finally, we've talked about our philosophy on capital allocation and given that the brand right now has had a challenging couple of quarters on profitability, we've said that we will do 3% to 5% portfolio corrections in the next two quarters. We will slow down on our rate of expansion, but we will continue to invest in refurbishments so that the customer experience is really maintained. So, like I want to underline here, brand revival will take a few quarters but the actions we believe we are taking are fundamental in nature and it's just persistence that will definitely drive and deliver results.

Vijay Jain: Moving to Slide #32; dining mix came at 35% and delivery is at 49%. Largely stable quarter-on-quarter and even for the last nine months in the similar range. Overall SSSG for the brand was (-19%) and even the overall revenue decreased by 4%. ADS came at 45,000 ADS. Again, in terms of last 1-year additions we roughly added 15% of stores in last 1 calendar year.

Moving to the gross margins; 75.7%, up by 130 basis points. Although gross margins improved, the operating deleverage on account of negative SSSG meant that our restaurant EBITDA came down at 4.6%. Slide #35 which gives you the 4-year trend and five quarter trend, clearly shows that the brand is facing challenging times. However, Pizza Hut continues to be important second leg for Sapphire and we're confident that it will emerge stronger in the medium term.

Sanjay Purohit: Very quickly on the Sri Lanka business performance; Sri Lanka has been quite steady. On a YTD basis we are seeing 1% SSSG. The operating conditions are quite steady. I think this is the

period where with cost stabilizing, with the country's economic and political scenarios stabilizing, we should look at an improvement in the growth outlook towards the latter part of the year. We still believe strongly that there is good growth potential in this market and for the brand Pizza Hut, there is still a long runway for expansion and growth here. We will continue to be careful. We opened 7 stores last year and we will continue to be in that vicinity until we see an uptick in the overall macros and then we should be able to accelerate. The brand continues to be the #1 QSR brand in the country.

Vijay Jain: I will cover from the financials of Lanka, slide #40; the dining mix came at 27%, delivery was at 37% again, largely in line with the last year. SSSG was 1% in LKR, in terms of overall revenue growth 7% in LKR, 22% in Indian rupees and while gross margins improved by 450 bps, cost inflations on other lines meant that restaurant EBITDA came at 14.2%, again largely in line with the last few quarters. Also, our absolute restaurant EBITDA grew by 4% in LKR term. So, that's again another heartening part that now we are able to grow our restaurant EBITDA. So, over last 1 year over past few quarters we lost out on our restaurant EBITDA and absolute basis. We are again seeing the growth happening on an absolute EBITDA basis. So, 4% for the quarter, 2% on YTD basis in LKR terms and 19% for the quarter in INR terms and 19% on YTD basis as well.

Slide #44 gives out the 4-year trend and five quarter trend. As you can see the last few quarters have been quite steady in terms of our performance in terms of profitability and as macroeconomic recovery continues. As mentioned by Sanjay, we expect improvement in this starting from next financial year.

Moving on to Slide #45; very pleased to inform that Sapphire Foods is now rated by S&P on ESG parameters. Our DJSI ratings, we were rated as 42 in terms of score. We are highest or first amongst the QSR brands in India, 95th percentile amongst the global QSR companies. The key areas of impact have been human capital development, business ethics and customer relationship management. With this we hand it over back Anuja to you. We can open the forum for questions.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Nihal Mahesh Jham from Nuvama Wealth Management Limited.

Nihal Mahesh Jham: Two questions from my side. Starting off with Pizza Hut, over the last six quarters there's been a significant deceleration in the performance, which you also highlighted. So, is this totally related to the competitive intensity or maybe from a brand perspective also some choices or some aspects have not worked out right? Because if you look at the history there was revival which the brand saw but it's just surprising in terms of the kind of deceleration the specific brand has taken versus some of the other pizza players.

Sanjay Purohit: So, I think part of the issue is the competitor intensity and perhaps that's affected Pizza Hut a little more than other brands. So, that's what the numbers point out towards, Nihal. Having said that I think we recognize that in a highly competitive space at this moment, we've got to start upping the ante. The brand still means a lot to consumers. All our consumer research still shows

that the brand retains a top-of-mind awareness, consideration. And yet in the face of like I said competitive pressures, we have lost out on growth despite our higher expansion. So, the answer really lies in how do you revive consumer interest behind the brand and to do that it's a combination of how much marketing that you put behind the brand and through both innovation as well as value attract consumers and back that up with very strong operations to deliver a great experience to consumers when they either come to the store or when they order in their home.

Nihal Mahesh Jham: A related question here was that we've been very aggressive with product launches in Pizza Hut over the last 2 years. When we are incrementally looking at launching further products, what is going to be different versus say launching those 10 unique Pizzas which I think just happened 6 months back?

Sanjay Purohit: Very well. So, if I just look at our last say perhaps 2 or 3 years what really worked on the brand was about 2 years ago when we launched the Momo Pizza, that seemed to work on the brand. When we launched Flavor Fun for a period of 6 to 9 months, we saw significant upside on the brand. Brand ADS started to move up, the core Pizza Refresh which was the 10 new pizzas and branded as 'What's your mood Pizza', perhaps did not have as much of impact as it should have because you're changing around toppings and not offering the consumer anything significantly new. So, that's a lesson that we are perhaps taking out. So, whereas when I look at the first two innovations that I talked about both Momo as well as on Flavor Fun, I think one recognition is that we should have been able to support these innovations for a longer period of time through heightened marketing. Given the size of the brand and the costs of media today, we thought that if we support these initiatives for a one quarter basis or so that will be enough. I don't think that's enough. I think those are our learnings out of what we have launched in the past and we should take that into our future launches.

Nihal Mahesh Jham: In case of KFC, it has obviously been a much better performer as you said. Is there a possibility in that category also online competition come up and just become an issue in the future, there are 1-2 brands who obviously launched specific chicken offerings? So, just your view on that.

Sanjay Purohit: I guess the overall competitive pressure in food has increased. If I even just break up this competitive pressure, we are not seeing so much of pressure coming from brick and mortar and or omni restaurants. So, people who are putting up stores as well as being online. The competitive intensity there is I would say normal but not heightened where it seems to be coming out is in the form of cloud kitchens. Now each one of them whether they are making money or not is a secondary question. But at least in the initial stages it's quite easy, there are lower costs of setup. Continuing costs of being able to make money is a different question. But therefore, you see a burgeoning of what I think are cloud kitchen brands and, in this space, also pizza is a little easier than perhaps KFC. So, could it happen on KFC? Yes, it could happen on KFC. It could happen on any brand really. Hence again how do you continuously build consumer interest on the brand, is really the answer only to counter such competition.

Moderator: The next question is from the line of Jay Doshi from Kotak Institutional Equities.

Jay Doshi: I have just one question. With such strong store growth over the last couple of years and SSSG decline in KFC, you're still able to hold on to a margin of 20%. So, what are the steps you've taken over the past couple of years to improve efficiency at store level and do you think this is a sustainable margin assuming that the demand environment remains weak?

Vijay Jain: So, again Jay at (-2%) SSSG this was possible because we also got a benefit of gross margins. Having said that a lot of work has gone on the cost efficiency side as well. If I give you a few examples and I've called out this on previous forums, the pace setter exercise which we follow internally where you bucket the similar revenue stores in cohorts of 15 and 20 and then you try and compare one cost versus the other and challenge the less performing stores to deliver the cost parameters as per the greater performing stores or better performing stores is a continuous exercise. So, that exercise actually cuts across whether it is labor hours, whether it is electricity unit consumption, whether it is gas cylinder consumption, whether it is wastage across the stores. So, this is a continuous program which we have developed in house and over the last 3 years have been giving us quite a bit of joy. Having said that if the pressure on SSSG continues, I don't think the gross margin there is further scope of improvement. If we're able to hold onto these ADS levels, I think yes it's possible to hold onto margin in this particular range. But if the ADS level goes down and if the SSSG goes even further down, then it becomes difficult to hold onto this level of margin. Having said that while we have taken various measures on the cost front just to clarify not at the cost of the customer. So, our customer metrics are at all-time high in terms of whether it is Swiggy ratings, Zomato ratings, the Google ratings, our guest experience scores, the ratings which we measure internally on operating and brand standards. So, they are at all-time high. So, these efficiencies are driven not at the cost of experience.

Jay Doshi: A follow up there, you had about 250 KFC stores 2 years back December 2021 quarter. You have (+150) stores that are less than 2 years old. What would be the profitability gap between the stores that are 2 years and above maturity wise and the stores that are less than 2 years? What would be the differential in this margin?

Vijay Jain: Jay, we typically don't give out vintage wise profitability. However, what I can tell you is that typically it takes 3 years for the store to mature in terms of revenue levels and in terms of coming to the profitability near the brand average. So, if it's 2 years yes, it's short of the brand average in terms of both revenue and profitability. It takes closer to 3 years to reach the brand level in terms of the ADS and the profitability.

Jay Doshi: But is it a big drag on overall profitability or not so much?

Vijay Jain: I would not look at those as being drag. This is like you're building it for the future growth. It's a natural course which it is to traverse over 3 years. It's profitable in year 1. We break even almost in Quarter 1. In year 1 the profitability will be in double digits. In year 3 it will move towards the brand average. So, while it will be shorter of the brand average, after 3 years it becomes rolling cycle. The stores which I opened 3 years ago now are adding to the profitability. I will again add new stores. So, it's a continuous cycle and that's why we have said that we are

very happy to target ourselves to deliver a margin which is in the range of in and around 20%. We don't want to really have a scenario where this goes beyond 20% and if it goes beyond 20%, we will invest even more aggressively on the brand by opening even more aggressively. So, that's the approach. If it goes down considerably below 20%, we will have to relook at our expansion plan. So, that's the simple approach we apply. You have seen that already on Pizza Hut, that moment the profitability got impacted, we have called out first in the industry to go slow on our expansion plan. If you look at the last two quarter numbers on Pizza Hut, we have slowed down in single digit our store expansion.

Jay Doshi: Your KFC profitability is very resilient and impressive in context of what we are seeing across the space. One last thing you talked about Pizza's turnaround, but steps and you have a slide there. But my question is that look there are three stakeholders here, yourself the other franchisee and Pizza Hut India. If the interests of all three are not aligned then is it possible for any one stakeholder to **(Inaudible) (30.35 mins)** around the brand and do something? And in this case is there an equal level of commitment you see from the other franchise as well as Pizza Hut to actually fix this issue?

Vijay Jain: So, while it can be difficult but not an impossible one as long as the interests and the objectives are aligned which they are. Over the years we have seen that all the three partners have come together on the platform, and we have been able to arrive at a way forward which is aligned across all the three parties. That's what happened when April '19, if I may recall we complete redid the menu card, brought in the everyday low pricing. That's what happened when we did the meal options. That's what happened when we did Flavor Fun and even the going forward plan, when we are calling out that we are going to heighten the level of marketing investments and product innovations. Heighten the level of marketing investments not just by Sapphire, other partner franchisee as well and not just other partner franchisee even Yum! themselves will put additional money towards that. So, yes, our interests are aligned. As I said as long as the objectives are aligned, we are able to figure out the way. Three partners on the table can also mean the three-thinking people. So, the idea can come from any one of the three. As long as it's good for the brand there is no harm in accepting that idea and moving forward.

Sanjay Purohit: I will add my two bits also here Jay. So, unequivocally yes, we are aligned between Devyani, between us and between Yum!.

Jay Doshi: I never had doubt about alignment, it's about commitment. The level of investment that each one of you would be willing to put in.

Sanjay Purohit: Alignment without commitment is useless. I would say in my book, so it is alignment with commitment. And at this moment you just have to take me at face value perhaps but hopefully this will play out in the next couple of months.

Moderator: The next question is from the line of Tejash Shah from Avendus Spark.

Tejash Shah: My question is an extension of what Jay asked, on resilience on KFC margins. So, interestingly we were at 65% SSG 1Q last year and we delivered 20.3% margin, and we are at (-2%) this quarter and still we are at 20.1%. So, understandably as you explained that in that period you would have kind of reinvested into it into the brand and hence, we did not kind of overrun on the operating leverage part that period. But I'm just wondering if those investments were done at that point and immediately it is followed by such a weak period of demand in SSG, how should we think about that operating leverage not allowing to come through in the margins and investing? And how do you calculate or how do you track ROI of such investments when the tailwind is in your favor, you don't allow margins to go up and then headwinds are not under our control? So, just wanted to understand the mindset or philosophy over here.

Vijay Jain: You were referring to which quarter if you can just come again, which quarter you are referring to?

Tejash Shah: 1Q FY23 when we had a low base, our restaurant EBITDA in KFC was 20.3% with SSG of 65%. Then even 3Q last year on 3% we are at 20.2%. So, we have been very resilient on this point on EBITDA margin. I was just wondering if things have to improve.

Vijay Jain: I was just wanting to understand which quarter you were referring to. When you're looking at that 65% SSSG growth, Tejas that's not really comparable or normalized SSSG because Q1 FY23 it's getting compared with Q1 FY22 which is the second wave or the peak of second wave of COVID. So, it comes across from a really low base. What you need to look at is what were the ADS levels at those point in times. And our ADS levels have been in the range of I would say anywhere between 120 to 140. Those are the kind of ADS levels range we have been hovering around. So, those ADS levels would determine what kind of restaurant EBITDA I'm able to hold on. Having said that my new stores also come at a lower ADS. When we say we will invest back in the business, we never meant invest back in the business through increasing the level of promotions or marketing. Those are at a standard level of 5% as per the agreement with the Yum!. What we meant by investing back in the business is by opening or increasing the pace of our expansion. So, if you are able to go faster and take the market by adding more stores that's the preferred route or the strategic route which we are choosing, growth with profitability rather than just trying to pocket the profitability and then have a lower growth. That's what we meant. So, it's not that when the tailwinds are there, we are not wanting to pocket the profitability.

Tejash Shah: Second Sanjay in his opening remarks called out that pace of expansion will be relooked perhaps in more in Pizza Hut and we will also go down on some store corrections. So, if you can assign some number to this comment of yours for both the brands, you have a target of doubling on CY21. But we are almost at the back end of that for KFC as well. So, if you can give some color on how should we think about next 3 years for both the brands?

Vijay Jain: When we gave out the CY21 number, so CY21 if I put all the three verticals together, we had 550 restaurants and we said we could double it to 1100 restaurants in 3 to 4 years' time. We

again gave a range of 3 to 4 years because we know in India shift can happen, it's happening for us right now in one of our brands. So, that's the reason we gave out a range of 3 to 4 years. Within that while we said we could largely double, yes one brand can be 2.1x, other brand can be 1.8x, 1.9x. We never wanted to get into a year by year or quarter by quarter targets. What it meant was that we could be in the range of 130 to 160 restaurants opening all verticals put together. For the last 2 years we have been on track on that. What we called out today specifically was that while we gave a range of 3 to 4 years, increasingly it looks like for KFC we would be able to meet that target of doubling in 3 years' time. So, probably within the range of 3 to 4 lower end of the range. In the case of Pizza Hut, we called out that probably within the range of 3 to 4, we would go on the higher end of the range which was 4. As of today, if the brand is delivering (-19%), I would not want to get into a conversation on how many stores. I think the immediate priority for the next 6 months is let's see whether we can get some growth back on the brand and then we can try and do discussion on what the numbers looks like. It will continue to be slow. Right now, the numbers are single digit. We are opening 8 stores. For the next two quarters probably, you may even see a lower number as well. But the annual numbers the target for next 2 years I can call out, it looks like more towards 4 years rather than 3 years. But I think it would be prudent to park the conversation for the next 6 months at least and let's focus on getting the growth back.

Tejash Shah: And whatever these 3 or 4 years whenever you're comfortable giving, this you are referring to net addition and not gross?

Vijay Jain: Net additions and on the base of December '21.

Moderator: The next question is from the line of Arnab Mitra from Goldman Sachs.

Arnab Mitra: My first question was actually on the store expansion in KFC where you seem to be, obviously you're bringing down your target to 3-year doubling. So, the macro environment is still bad for food, KFC has of course been more resilient. So, just wanted to understand what's giving you the confidence that you could actually accelerate KFC addition. Is there a risk that we overdo KFC addition in an environment which is really bad and that puts us in a troubled spot? If you could put some light on the last three-four quarters the new store openings, how have those new stores done qualitatively versus where you normally expect it to be? Have they been significantly worse or more or less in line, so broadly the thought process on this acceleration in this weak environment?

Vijay Jain: So, while we call it acceleration, I think we are trying to say we are largely maintaining the pace right. We opened 80 stores this calendar year as well. So, it's not going to go dramatically higher than that and still we will be able to closely hit that doubling the count in 3 years. So, first of all, we are not saying we will go extremely further aggressive from the current pace of expansion. The current pace of expansion actually leads us to or results into that 3-year doubling count on KFC. Secondly the approach we have always called out Sapphire's approach on capital allocation. We would not get swayed by saying that if we can double it 3-4-5 years. It's based

on a simple approach that if you're opening the stores and those stores which you have opened are able to hit the strike rates or hurdle rates which gives us the required or desired payback of 3 years or so, it gives us the desired level of profitability. It means whatever you're doing it's working and if it's working, you can continue with your pace of expansion. If it's not working you have to reduce the pace of expansion. That's what exactly we are doing. On KFC, whatever we are opening right now, you can see overall margins in the range of 20% which means the new stores are not big drag on our profitability. Those are working, they are able to follow largely the cycle of getting us the payback of 3 years or so. Over 3 years they are able to mature and hit the profitability which is of brand level average. So, as long as we're able to hit that profitability mark, it gives us an indication that you can continue the pace of expansion. The moment we fall on the SSSG even further or the moment we fall on the benchmark even further on the profitability, it gives us an indication immediately that this is a time to relook at your numbers. We relooked at Pizza Hut numbers. Nothing will stop us from relooking or revisiting the KFC numbers as well because capital allocation will be of prime importance. Having said that on Pizza Hut, we did not revisit the numbers on the very first quarter when the numbers went southwards. We always said these are conversations or decisions which cannot be taken on quarters data. We waited for three quarters for Pizza Hut before calling out yes, three quarters, nine months is long enough, and this warrants a store expansion approach which is more cautious. So, if anything of that sort happens in KFC yes, you will have to wait for 6-9 months to come up with what the new approach of the management would be.

Arnab Mitra: My second question was on Pizza Hut, at this SSSG level and the margin level it is the exceptional circumstances right now. So, is there not a strong case to completely pause expansion temporarily till your initiatives that you've highlighted come in and the store economics improve? If such a measure has to be taken does Yum! have to be in agreement with the pause in store expansion or is that something you can take on your own based on the circumstances? Is there like a red line of margins that you take a call that this is just too bad, we need to stop and get our economics back in the existing store?

Vijay Jain: So, while I answer your question specifically first just to overall strategy on Pizza Hut, for us it's a very important second leg for Sapphire. And while we are right now in challenging times, even in these challenging times our second leg, which is Pizza Hut, is way ahead than any other competitor's second leg. A few of our competitors don't even have a second leg. So, that's an important point to remember that it's a very important part of our portfolio in the medium term, in the long term. Yes, currently we are facing challenging times. We have already tapered down our expansion. If you can see it's 8-8 stores vis-à-vis what we used to, our run rate used to be 15-20 stores almost per quarter prior to that. The stores which you put are again an independent decision. So, while the current SSSG may not be great, there could be few opportunities, few pockets, few trade areas which could be completely not served by the existing stores, existing channels. Which means there could be opportunity, there could be good real estate available, there could be a great rental deal. So, you don't want to completely go into a situation where you are not able to capture those things. Also, there would be few stores which we have already signed in terms of the pipeline. If those are at great commercials you may want to open that. So,

completely pausing may not be an approach. But if it comes to that situation yes, you are right. This requires a conversation with Yum!. Having said that thrice we had a conversation with Yum! over the last 7 years or so on the Pizza Hut store expansion and thrice we have been successful to renegotiate our development agreements in terms of store expansion. So, if this warrants any conversation yes, we can have those conversations. And as long as those conversations are with common sense and business sense, we have been able to confidently pull that off as well.

Sanjay Purohit: I will just add here Arnab. Finally, we are all taking business decisions from a single lens, and I can't see any reason why Yum! should not back us. And in fact, they should be the first people who will tell us that go slow on expansion, let's get the brand right, let's get profitability right because they know that a profitable franchisee anywhere in the world is more than willing to put in further capital. But if you're not being able to get your returns, then what is the point in expanding for the sake of expansion. I think the conversations are fairly logical and fairly business forward.

Moderator: The next question is from the line of Devanshu Bansal from Emkay Global Financial Services Limited.

Devanshu Bansal: My question is specific to dine-in or on-premise channel for KFC. The numbers suggest that performance has been sort of relatively much better versus peers in this quarter. We have reported a 6% to 7% sequential growth in our dining channel versus flattish to negative trends for other formats. So, what is working well for us here? Is it new launches, the KFC launched Wednesday offer or the store modernization that we have done? So, if you could just throw some light on this.

Vijay Jain: So, yes, a lot of our current offers are focused on actually encouraging dine-in consumers to come in, dine-in and takeaway. So, our lunch offer is one of such examples which is focused on dine-in consumers. There's another offer which is currently going on, on crispy which is again dine-in and takeaway focus. So, yes, the efforts are there which actually try and get the consumer on the premise vis-à-vis just having it on the delivery platform. That's one. Secondly if you look at the mix and the quarterly mix also plays a role. Typically, if you look at Quarter 3 being a festival quarter, dine-in is definitely better in this quarter compared to the other quarters. So, entirely looking at sequential performance may not be the right way. When you compare it last year quarter the mix for dine-in has slightly gone down as well.

Devanshu Bansal: So, Vijay I was comparing it across players. So, those things play out for other players also. From a gross margin point of view, Vijay indicated that for KFC at least there is not much room to improve there. But the other franchisee is still (inaudible) at 100- 150 bps (48.25mins) higher. So, is it just because of channel difference or can you throw some light there?

Vijay Jain: So, first of all, on the gross margin I said there's not much of a room there, what I meant was again from an inflation point of view. We are fairly at a steady state over last couple of quarters.

So, whatever upside we had and whatever the gross margin we lost a year or so back because of high inflation, we have been able to largely pull back. Hence, I meant there's not much headroom available over there and we're quite steady, both for KFC as well as Pizza Hut. When you try and compare with the gross margins of Devyani, unfortunately we will not have a breakup or details available and this number over the period, over the last couple of years have gone up and down. So, frankly I would not have a specific answer. Having said that…

Sanjay Purohit: Just look at the restaurant margin here.

Vijay Jain: Having said that there are two or three reasons which can lead to different gross margins across both the franchisee. The first the buying mix, so while we negotiate at a one system Yum! level on key raw materials and vendors, the buying pattern could be very different. I would buy from a vendor who is nearer to me vis-à-vis vendor who is far away from me but cheaper because the transportation cost could make it quite expensive. So, buying mix could be quite different. The sales mix could be quite different. So, those are the mix which can be at play. Having said that if you look at the overall P&L profitability to restaurant EBITDA and even if you look at nine months profitability because sometimes quarterly numbers, there could be skewness and it may not do justice. On a nine-month basis KFC Sapphire is now at 20% restaurant EBITDA, the highest in the industry and Devyani if I remember number correctly is 19.8%. So, we are 20 bps higher than them. Traditionally I used to answer questions where that why are you 2% lower than Devyani on KFC? And we have called out that some of the territories which they operate in north, northeast, they have a cost advantage in terms of lower rentals, lower utility cost, lower cost of even wages. So, if right now we have been able to bridge and overtake I think it's a fantastic performance by Sapphire.

Devanshu Bansal: No doubt about that Vijay, very good performance on the margins front. Just last two bookkeeping questions from my end. This depreciation expense has seen an increase in Q3. Is this expected to normalize or what is the reason for this?

Vijay Jain: So, two parts to it. First of all, our capacity additions. If you see if our brand is not growing or overall revenue growth is not higher than the store additions, it will impact PBT. So, we have been adding stores in the range of 20%-25% in case of KFC and we are adding stores in the range of 15% in case of Pizza Hut. And the brand growth because of the negative SSSG is not gone beyond 20%. So, as a result there is a deleverage impact. So, depreciation as a percentage would increase as well. So, that's first part, capacity addition and revenue not increasing in line with the capacity addition and especially for new stores revenue comes at 70% to 80% of the brand average. So, that's one thing. But the SSSG actually helps us to set off some of those things in terms of percentage to sales or percentage to revenue for depreciation. Second part, we have also taken a conservative approach and we have accelerated depreciation for some of our Pizza Hut stores which we believe is under watch out list. We called out that there could be a 3% to 5% portfolio correction. So, this is an accounting practice which is more conservative where even before closing the stores we felt that if that's on a watch out list and if they are going to close in the near future, let's take an accelerated depreciation. The impact of this could be

anywhere between 0.7% to 0.9% or 0.7% to 1% of our overall revenue. Whether this would come down I think for the next two quarters or so we believe, we would accelerate some of the stores which are not working out for Pizza Hut. So, you may not see this coming down for the next two quarters or so.

Devanshu Bansal: And the tax rate for coming quarters as well if you could.

Vijay Jain: So, right now, again to clarify on tax we don't have a tax payout. So, the tax expense which you see is deferred tax impact which you are taken in the P&L because if you remember last year Quarter 4, we created a deferred tax asset on all our past losses. We don't have any tax outflow. The rate is that same 25% what you see largely would remain in the P&L but without a corresponding cash outflow. This gets knocked off against the deferred tax assets which we carry in our books.

Moderator: The next question is from the line of Shirish Pardeshi from Centrum Broking.

Shirish Pardeshi: I just have one fundamental question. Sanjay, in your experience, you have been a marketing guru and the reason why I'm asking this question is that candidly the pizza pie is getting shrunk. I have got three observations. One is that either the entire category is getting shrunk, and people are moving away from pizza consumption or it could be a situation that you have been saying that the competition has become aggressive and they are taking share from the organized top 2-3 players or there could be a reason that the traffic is there but the platforms are taking away your traffic and giving it to somebody else. So, what is the realistic thing? Is it a structural decline story or do you think the consumption is still resilient? But I think this time will sell and then people will come back and start eating dine-in.

Sanjay Purohit: Shirish, if it is a long-term structural issue on a country like India, I think it'll be very surprising. I have said this in the past also. Typically, you see sinusoidal growth curves on India. There are periods when growth is fantastic and then there are troughs also. But in general, those sinusoidal curves are pointing upwards. So, it is still growing over a medium to long term perspective. Now having said that on pizza if you speak to the platforms also, they say pizza is growing. When we look at, I can't see any reason why pizza is not growing other categories are growing. So, in many of the year end reports pizza continues to be the #1 and #2 category. I don't think there are any issues with the category itself. Clearly when coming out of COVID when you had a strong momentum on eating out, you will find many people coming in and then whether they are sustainable or not is a different question. Sustainability is really a factor of, can they deliver the required sales and profitability. So, that we will see occurring over the next 1 or 2 years. But everyone or anyone can set up a cloud kitchen today at a much lower level of investment than an omnichannel store of ours. It delivers also significantly lower sales. It is far more difficult to differentiate the brand on an aggregator platform. A pure cloud kitchen brand I would believe will struggle significantly to establish what the brand is about and what its promise is about. But in the short run, a consumer who is willing to experiment will look at the name, will look at what they have to offer and it's quite likely that people will buy once or twice and then go back to

brands that they trust. I think this is what we are seeing on pizza which really leads us to believe that surely our 310-315 stores that we have got and overall say 700-800 stores in the country that we have got on Pizza Hut actually is a big advantage, both from a physical presence, we can get consumers in to dine-in and plus deliver. And therefore, if we change the narrative on the brand build interest, I can't see any reason why we can't come back just as powerfully. There are many similar examples that you would have seen in other countries, for example in the US where there is enormous amount of competitive pressure on coffee how the leading brand came back. I think it's been done before. We are quite confident that through persistence and fundamentally perhaps change a couple of things that we have done in the past learn from what we have done in the past. I talked about what we have learned on innovation plus on marketing and continue the operational excellence. I think we should be able to bounce back.

Moderator: Thank you very much. As there are no further questions, I would now like to hand the conference over to the management for closing comments.

Sanjay Purohit: Thank you very much everybody for joining this call. It's been a tough quarter but relatively when I look at the performance of other players in the industry, we have much to feel proud of. We continue to drive operational efficiencies and customer experience metrics at our end. We believe in the power of the Pizza Hut brand and while in the immediate term we will be a little more cautious from an expansion perspective, we are investing both innovation, in marketing and in customer experience improvement to really revive this brand. Thank you so much.

Moderator: On behalf of Sapphire Foods India Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.