Initiating Coverage

Devyani International Ltd.

Nov 30, 2022

RETAILRESEARCH

Devyani International Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
QSR	Rs 186	Buy in the band of Rs 184-188 & add more on dips to Rs 164-168 band	Rs 205	Rs 220	2-3 quarters

HDFC Scrip Code	DEVYANILTD
BSE Code	543330
NSE Code	DEVYANI
Bloomberg	DEVYANI IN
CMP Nov 29, 2022	186
Equity Capital (Rs cr)	120.5
Face Value (Rs)	1
Equity Share O/S (cr)	120.5
Market Cap (Rs cr)	22,408
Book Value (Rs)	6.8
Avg. 52 Wk Volumes	3624171
52 Week High	215.0
52 Week Low	135.5

Share holding Pattern % (Sep 2022)	
Promoters	62.8
Institutions	15.8
Non Institutions	21.4
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst
Hemanshu Parmar
hemanshu.parmar@hdfcsec.com

Our Take:

Devyani International Ltd (DIL) is the largest franchisee of Yum Brands in India. It is among the largest operators of quick service restaurants chain in India operating 1096 stores as of Sep 30, 2022. As the franchise partner of Yum Brands, the company operates their iconic brands KFC and Pizza Hut in India as well as in Nigeria and Nepal. DIL has also franchisee rights for the Costa Coffee brand stores in India. In addition, the company has established in-house brands such as Vaango and Food Street. The company has been consistently expanding its store network. Stores in Core Brands grew at CAGR of 21% over FY19-22 to 832 stores as at March'22. DIL plans to add 250 outlets per annum with a cluster-based approach. Its strong association with Yum Brands coupled with large addressable population in KFC states (>80% non-vegetarian) and exclusivity for Pizza Hut delivery only stores provides significant growth opportunities in India's growing QSR market.

DIL has been riding on the strong business momentum in core brand business. KFC is on strong footing in terms of operating metrics and store economics, whereas Pizza Hut performance is seeing some green shoots from various turnaround measures. Leveraging on their Core Brands, increasing brand recognition of Other Business, innovative product offerings, improving digital and delivery capabilities and robust supply chain management system; DIL is poised to improve its positioning. Yum Brand franchisees have reduced the store size of all new stores for both KFC and Pizza by 30-40% thereby reducing capex and related operational cost. The shift to smaller stores has not hurt average daily sales per store for either brands. Lower capex with improving store-level economics aided in quicker payback for new stores. Continuous food innovation and value proposition (Pizza Hut) would enhance its unit-level performance by driving order frequency and order ticket size, thereby improving SSSG and profitability of existing stores.

DIL has shifted its focus from opening large dining-focused stores to smaller-sized, delivery-focused stores. The company will work diligently to improve its delivery performance and plans to establish synergies between Core Brands stores and delivery services by leveraging its broad store network. Rollout of delivery format stores for both Pizza Hut and KFC would reduce the delivery time. Furthermore, the company plans to expand its collaboration with delivery aggregators to capitalize on the rising online delivery segment. DIL has plan to aggressively expand its store network by opening 1000 stores in next 4 years (250 stores per annum). The company looks to open new stores for KFC and Pizza Hut in close proximity to one another that allows them to reduce capital costs incurred on construction and logistics costs towards supply of raw materials to both stores. We expect store addition to gain momentum supported by under-indexed Pizza Hut stores compared to Dominos in key states, its exclusive rights for delivery format stores and larger addressable chicken market (compared to Sapphire). Although this aggressive store expansion could limit SSSG marginally due to store splits; but overall additions with greater emphasis on the delivery model would improve unit-level profitability.

Valuation & Recommendation:

A strong recovery in the out-of-home consumption, rising traction for branded products, aggressive store expansion plans, value proposition through an innovated menu and widening delivery reach will help DIL's revenues clock a CAGR of 36% over FY22-24E (~23% increase due to store count). Accelerated store expansion with improving unit metrics for KFC & Pizza hut led by store size reduction; and steady increase in SSSG would drive EBITDA/PAT growth of 37.6%/46.7% CAGR over FY22-24E. Improving profitability and lower capex/store should also lead to a significant improvement in returns ratios. **We think the base case fair value of the stock is Rs 205 (28x FY24E EV/EBITDA) and the bull case fair value is Rs 220 (30x FY24E EV/EBITDA) over the next two-three quarters. Investors can buy the stock in the band of Rs 184-188 (26x FY24E EV/EBITDA) and add more on dips to Rs 164-168 band (23x FY24E EV/EBITDA).**

Financial Summary

Particulars (Rs cr)	Q2FY23	Q2FY22	YoY-%	Q1FY23	QoQ-%	FY20	FY21	FY22	FY23E	FY24E
Total Operating Income	747.4	516.1	44.8	704.7	6.1	1,516.4	1,134.8	2,084.0	3,098.8	3,852.6
EBITDA	166.4	128.1	29.9	164.7	1.0	174.4	234.6	476.0	709.6	901.5
PAT	56.8	46.6	22.0	74.8	-24.0	-121.4	-63.0	155.1	276.5	333.9
Adjusted PAT	58.8	45.7	28.6	73.8	-20.4	-121.4	-55.2	156.3	278.0	334.9
Diluted EPS (Rs)	0.5	0.4	28.6	0.6	-20.4	-1.1	-0.5	1.3	2.3	2.8
RoE-%						93.6	146.6	39.1	33.7	29.6
P/E (x)						NA	NA	143.3	80.6	66.9
EV/EBITDA (x)						21.1	97.0	49.6	33.2	25.9

(Source: Company, HDFC sec)

Q2FY23 Result Review:

Devyani International Ltd (DIL) reported healthy topline of Rs 747.4cr (+44.8%/6.1% YoY/QoQ) mainly on the back of accelerated store additions in the recent quarter. DIL delivered a healthy performance across its core brands in a seasonally soft quarter. The company opened a record 88 net new stores during the quarter, taking the total operational stores to 1,096 as of Sep'22. Store count grew 38.5%/9% YoY/QoQ. Gross margins declined ~90bps QoQ owing to raw material inflation (upward revision in RM sourcing contracts which happens with a lag). The company reported EBITDA of Rs 166.4cr (+30%/flat YoY/QoQ). EBITDA margin came in at 22.3% (down ~255bps/110bps YoY/QoQ) marginally below expectation due to higher employee costs. Adjusted EBITDA (Pre-Ind AS 116) stood at 15.1% compared to 16.1% in the previous quarter. It posted PAT of Rs 58.8cr (+28.6%/-20.4% YoY/QoQ). The company's profitability was impacted on account of exceptional loss from currency fluctuations (for subsidiary operating in Nigeria) of Rs 11.3cr.

KFC revenue grew +47%/4.2% YoY/QoQ to Rs 443cr; with SSSG growth of 13% YoY (mainly price driven). KFC added 32 new stores and reached a mark of 423 stores at the end of the quarter. Average daily sales (ADS) was at Rs 121,000, down 4.7% QoQ (usual seasonality due to lower non-veg food consumption during 'Shravan'). Gross margin stood at 67.9% vs 69% in Q1FY23. Brand contribution margin stood at 21.5% (down 94bps/90bps YoY/QoQ). Off-premise sales continue to remain strong at 36% of its revenue.

Pizza Hut posted revenue of Rs 181.2cr (+36%/9.8% YoY/QoQ) and it added 30 stores taking the count to 466. Its ADS improved marginally to Rs 45,000 on sequential basis, with a SSSG at 2.9% YoY. Higher input prices and change in product mix impacted the gross margins which came in at 74.5% compared to 76.2% in the previous quarter. Brand contribution margins were 17%, down ~50bps QoQ mainly due to contraction in gross margin while operating leverage benefits arrested further fall. On-premise consumption remained steady for Pizza Hut at 45%.

Costa coffee reported robust revenue of Rs 22cr, +134%/25% YoY/QoQ. SSSG continued to remain healthy (50.7% YoY), on the back of recovery of footfalls at its stores. Store count stood at 88 (+95.6%/27.5% YoY/QoQ). ADS was down 14% QoQ at Rs 31,000, reflecting dilution due to new store additions. Gross margin came in at 79.5% vs 81.8% in Q1FY23. Brand contribution margin shrunk to 19.5% compared to 30.7% in the previous quarter; this was mainly due to significant addition of new stores during the quarter.

Quarterly Performance

KFC	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Revenue (Rs cr)	125.1	221.1	254	202.9	301.4	362.1	352.6	425	443
No of Stores	214	240	264	284	309	339	364	391	423
Average Daily Sales (Rs)	68,517	1,12,237	1,18,498	92,136	1,16,380	1,24,000	1,13,000	1,27,000	1,21,000
SSSG (%)	-51.60%	-13.0%	19.6%	158.0%	72.0%	23.8%	3.0%	63.6%	13.0%
Gross Margin (%)	65.9%	67.1%	69.6%	69.4%	69.1%	69.3%	69.3%	69.0%	67.9%
Brand Constribution Margin (%)	12.9%	19.1%	22.6%	16.0%	22.4%	23.0%	21.8%	22.4%	21.5%
On-Premise	56%	67%	68%	35%	56%	64%	59%	65%	64%
Off-Premise	44%	33%	32%	65%	44%	36%	41%	35%	36%

Pizza Hut	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Revenue (Rs cr)	63	95.1	103.6	96.5	133.3	155.6	146.4	165.1	181.2
No of Stores	258	273	297	317	351	391	413	436	466
Average Daily Sales (Rs)	26,456	40,464	41,788	38,411	45,000	47,000	41,000	44,000	45,000

SSSG (%)	-37.3%	-11.0%	13.4%	216.1%	73.5%	24.7%	2.3%	31.5%	2.9%
Gross Margin (%)	71.6%	74.0%	76.2%	75.9%	75.5%	75.6%	75.5%	76.2%	74.5%
Brand Constribution Margin (%)	10.3%	16.2%	15.2%	14.1%	15.8%	16.8%	17.6%	17.5%	17.0%
On-Premise	39%	46%	48%	20%	38%	42%	41%	46%	45%
Off-Premise	61%	54%	52%	80%	62%	58%	59%	54%	55%

Costa Coffee	Q2FY21	Q3FY21	Q4FY21	Q1FY22	Q2FY22	Q3FY22	Q4FY22	Q1FY23	Q2FY23
Revenue (Rs cr)	4	7.6	8.5	3.7	9.4	14.3	13.7	17.6	22
No of Stores	55	45	44	44	45	50	55	69	88
Average Daily Sales (Rs)	12,255	20,706	24,592	16,060	27,000	37,000	30,000	36,000	31,000
SSSG (%)	-78.7%	-55.9%	-24.9%	344.9%	225.9%	101.2%	24.0%	206.8%	50.7%
Gross Margin (%)	75.0%	76.3%	80.0%	78.4%	79.8%	79.7%	81.8%	81.8%	79.5%
Brand Constribution Margin (%)	-30.0%	35.5%	30.6%	16.2%	33.0%	32.2%	29.9%	30.7%	19.5%

(Source: Company, HDFC sec)

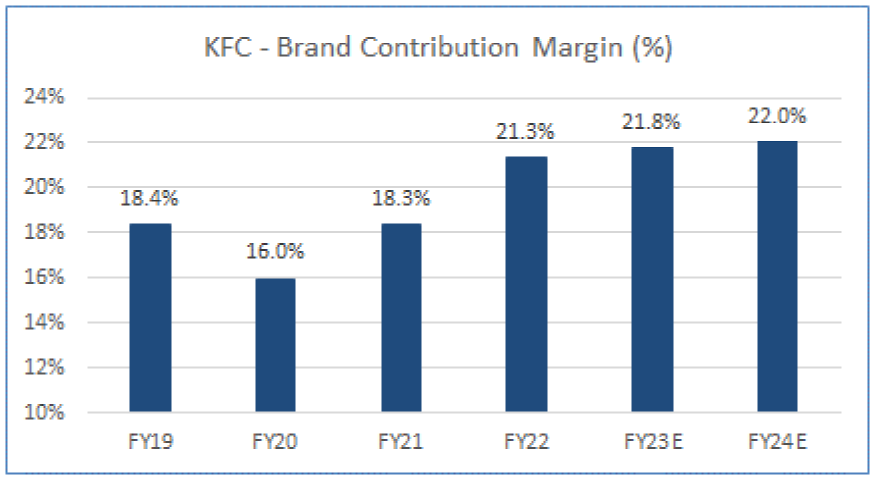
Key Triggers:

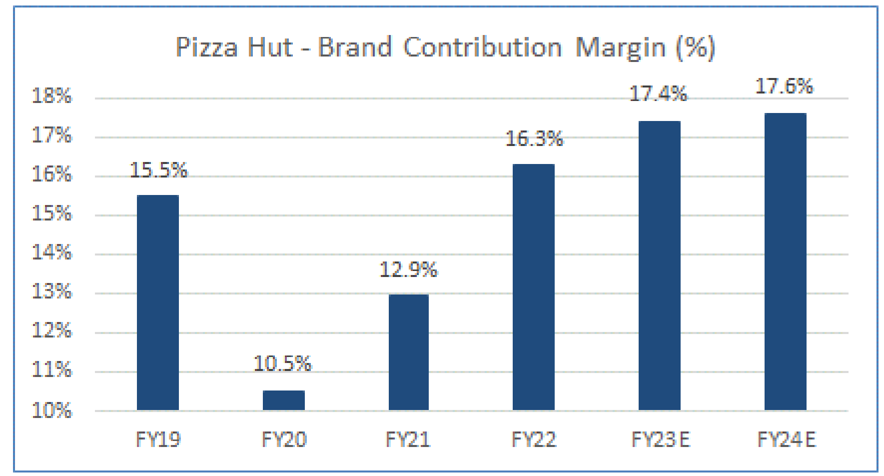
Portfolio of well recognized global brands offering variety of options:

Devyani International operates iconic global QSR brands – KFC (a global chicken restaurant brand, with over 26,500+ outlets in over 149 countries), Pizza Hut (restaurant chain specialising in the sale of ready-to-eat pizza products with over 18,250+ restaurants across 111 countries), Costa Coffee (a global coffee shop chain with over 4,000 coffee shops in over 41 countries). Their multi-brand portfolio offers variety of cuisine options catering to varied customer preferences. Their in-house band (Vaango and The Food Street) further expands its product offerings. The company's offerings include burgers, pizzas, South-Indian food and street food and serves in different formats – dine-in, delivery formats, drive through, cafes. The company works closely with Yum Brands and Costa Coffee International in menu innovation, operations and marketing which would further consolidate their leadership position in India's QSR industry. DIL has been riding on the strong business momentum in core brand business which saw 21% CAGR store growth during FY19-22. KFC is on strong footing in terms of operating metrics and store economics, whereas Pizza Hut performance is seeing some green shoots from various turnaround measures. Leveraging on their Core Brands, increasing brand recognition of Other Business, innovative product offerings, improving digital and delivery capabilities and robust supply chain management system; DIL is poised to improve in positioning.

(Source: Company, HDFC sec)

Store format rationalization and focus on improving unit level profitability:
DIL continues to focus on improving the quality of operations, enriching customer experience and strategically expanding store network in India while efficiently managing unit-level economics and attaining economies of scale. Store expansion and high density of stores in particular area will reduce the costs associated with transporting raw material to stores and other fixed overheads (spread across number of outlets), thereby improving EBITDA margins and store level profitability. Effective cost management will help manage profitability at the brand level.





(Source: Company, HDFC sec)

DIL has been able to rationalize store operations. Yum Brand franchisees have reduced the store size of all new stores for both KFC and Pizza by 30-40% thereby reducing capex and related operational cost. The shift to smaller stores has not hurt average daily sales per store for either brand. Lower capex with improving store-level economics aided in quicker payback for new stores. This store economics has given credence for network expansion in Tier 2-3 cities. Pizza Hut brand which was earlier seen as dine-in brand for casual dining has been rebranded to QSR brand with more rollout of delivery format stores. Reduced store size, improving ADS, high delivery sales mix and higher store-level profitability (RoCE) has improved Pizza Hut's brand contribution. KFC brand has further strengthened its positioning with remodeled store formats and generating better profitability. We expect KFC and Pizza Hut brand contribution margin to increase to 22% in FY24E (21.3% in FY22) and 17.6% in FY24E (16.3% in FY22); on the back of store size rationalization, change in employee hiring (flexi pay model) and operating leverage benefits kicking in from cross brand synergies.

Menu innovation with larger play in the value segment:
Devyani Internationals leverages its core menu items and works with Yum Brands to introduce innovative menu items to meet evolving consumer preferences and local tastes, drive customer engagement and continue to broaden the brand appeal. Menu innovation with larger focus on value proposition, especially for Pizza Hut, which was known as more premium brand is a step to go head-to-head with Dominos and other regional pizza chains. It launched Fun Flavour Pizzas at affordable prices of Rs 79 in Q1FY23. Some of the recent launches include Momo Mia Pizza and San Francisco Style. In KFC, DIL launched Biryani bucket in place of Rice bowl; peri-peri chicken which saw encouraging customer response. The company has added various innovative food items in the menu and introduced combo meals (affordable pricing), which have helped in improving average transaction size for the company. Continuous food innovation and value proposition would enhance its unit-level performance by driving order frequency and order ticket size, thereby improving SSSG and profitability of existing stores.

(Source: Company, HDFC sec)

Aggressive Store Expansion with focus on delivery channel format for Core Brands:

DIL has plan to aggressively expand its store network by opening 1000 stores in next 4 years (250 stores per annum). 100 stores each of KFC and Pizza Hut every year and the balance will come from the rest of the brands. Currently, DIL operates a total of 1096 stores in India and International market. It expanded footprint to nearly 50 new cities in FY22. Store network is being consistently expanded to consolidate its presence in existing cities and growing its presence in new market. It follows a cluster based expansion approach which optimizes supply chain and drives cost efficiencies. The company looks to open new stores for KFC and Pizza Hut in close proximity to one another that allows them to reduce capital costs incurred on construction and logistics costs towards supply of raw materials to both stores. More stores in a particular area allows the company to capitalize on economies of scale. DIL has strategically opened 48% of the core brand stores in eight metro cities. The company has been able to address demand in high-potential domestic markets (non-metro contribution within core brands has gone up to 52%). DIL remains positive on expanding in non-metro markets which have higher profitability compared to metro markets due to lower rentals, staffing costs and utilities. Geographically, DIL has a stronger presence in north and south India, which represented 74% of core brand stores as of Sep'22. The company's expansion is driven by its ability to keep costs low and implement economies of scale through operational leverage.

DIL has shifted its focus from opening large dining-focused stores to smaller-sized, delivery-focused stores. The company will work diligently to improve its delivery performance and plans to establish synergies between Core Brands stores and delivery services by leveraging its broad store network. Accelerated rollout of delivery format stores for both Pizza Hut and KFC would reduce the delivery time. Furthermore, the company plans to expand its collaboration with delivery aggregators to capitalize on the rising online delivery segment. Also, smaller store sizes with attractive metrics offer opportunity to penetrate deeper. We expect store addition to gain momentum supported by under-indexed Pizza Hut stores compared to Dominos in key states, its exclusive rights for delivery format stores and larger addressable chicken market (compared to Sapphire). Although this aggressive store expansion could limit SSSG marginally due to store splits; but overall additions with greater emphasis on the delivery model would further improve unit-level profitability.

Cross brand synergies leading to operating leverage:

DIL has been able to leverage operating synergies across the brands that they operate. The company has streamlined business processes from conceptualization of the stores to execution of daily operations. The company's sourcing, warehousing and distribution of raw materials is centralized for particular regions and across the Core Brands Business; this reduces the storage space required at stores, thereby helping DIL minimize store operating costs, without incurring significant additional expenses at the commissary level. The vehicles deployed for the delivery of raw materials to the stores are common across the core brands business and also for stores of brands that form part of other business. Company's policy of centralized sourcing from an optimal number of vendors further facilitates cost efficiencies and reducing costs. DIL is able to obtain competitive rates for raw materials given that it taps a common pool of suppliers and ensure consistency in service and delivery standards. The presence of multiple brand stores in specific location helps to increase efficiencies of its supply chain and also allows negotiate competitive lease rentals. Apart from this, DIL is able to launch and operate smaller brands such as Vaango as they benefit from operating leverages derived from operating a wider brand portfolio. Cross-brand synergies & cluster focused expansion with a focus on bringing cost efficiencies at each level; the company is able to achieve consistent growth in margins and earn higher brand contribution.

Focus on technology and digital capabilities:

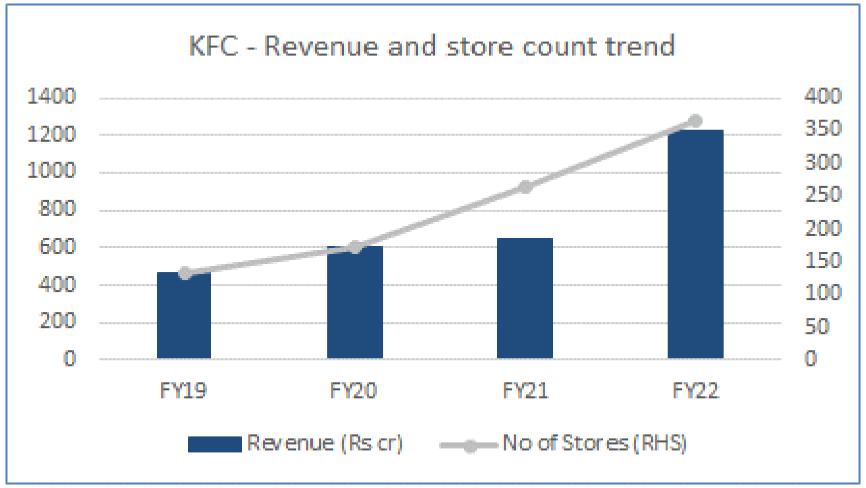
Devyani continues to invest in technology to improve its digital and delivery capabilities. Most of the stores across KFC and Pizza Hut have been integrated with the online channel, enabling a greater number of customers. It has also upgraded its online order-taking platform to serve a greater number of customers across a larger store base. DIL plans to increase investment in end-to-end digitalization, automation, artificial intelligence and machine learning, to effectively connect online traffic with offline assets. The company is working with Yum to improve its technology platform and further integrate its systems with Yum's platform to ensure greater operational efficiency. Going forward, the company will continue to optimize its delivery service by adopting innovative technologies and developing new delivery service concepts.

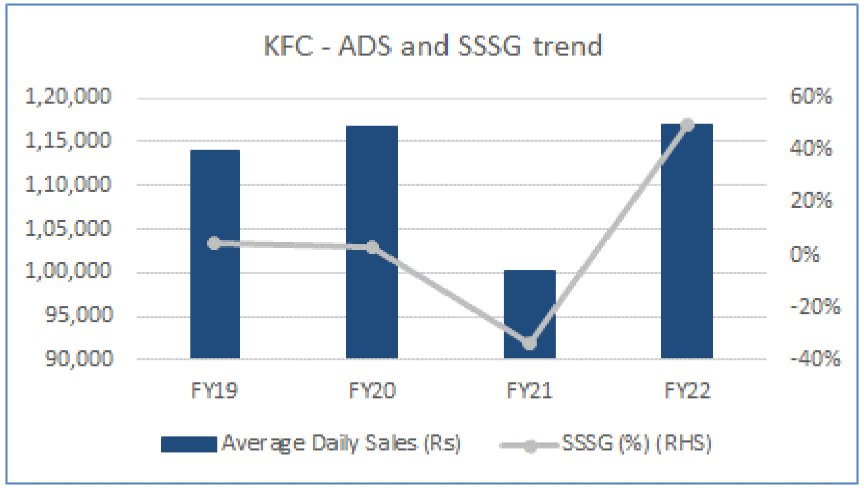
Understanding portfolio offerings and its triggers:

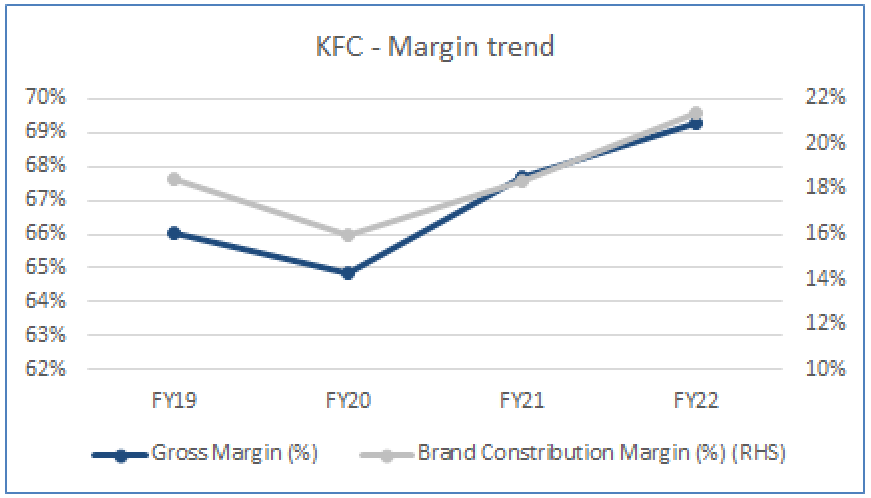
KFC – on a strong footing, serving large addressable under-penetrated market and; improving unit profitability

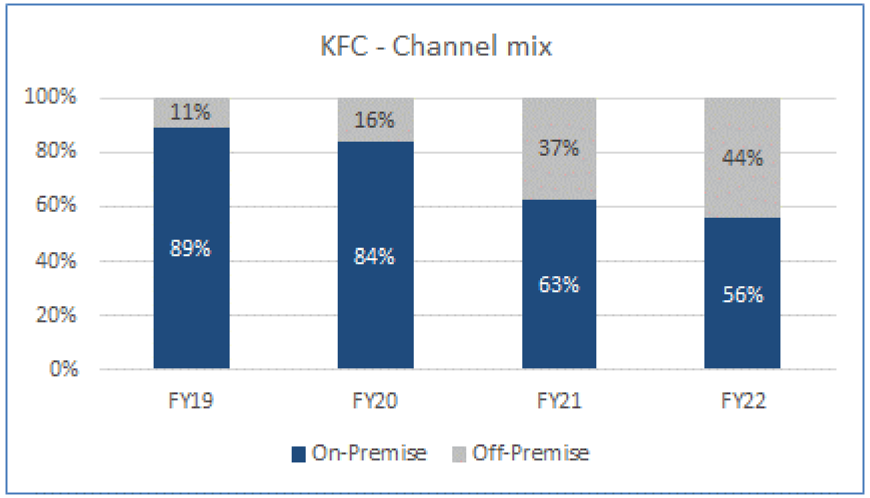
DIL opened the first KFC store in India in 2005 at Kolkata. As of Sep'22, it operates 423 KFC stores across India. Contributing ~58% of the topline, it reported strong revenue growth of 38% CAGR over FY19-22 mainly on the back of robust store expansion (230 net store additions). KFC stores in India are generally located in neighborhood markets in urban areas, such as high-street locations, shopping malls and food courts, business hubs, drive-thrus, and transit locations such as airports. It operates in two formats – larger format with full service dining in capacities and small-store formats to cater to delivery/ take-away orders with limited seating. Incrementally, the company is focused on opening smaller outlets ranging from 1,500-1,700 sq. ft of retail space.

KFC stores have an extensive menu featuring fried chicken buckets and allied chicken products, grilled chicken, burgers, rice bowls, and beverages. KFC is dominant market leader in chicken QSR space and remains relatively under-penetrated (compared to Dominos). DIL has strategically acquired stores in South, east and northeast territories, which are larger addressable population (>80% non-vegetarian) compared to Sapphire. Apart from aggressive store expansion, the company is focused on delivery-focused omnichannel stores aligned with the structural customer demand shift towards delivery from dine-in. Also, roll-out of stores has increased brand density and facilitated faster delivery to customers. Its share of off-premise sales has increased from 11% in FY19 to 44% FY22, which is received bump-up due to covid pandemic.









(Source: Company, HDFC sec)

Strong brand positioning and constant menu innovation with adoption of local flavours aids in driving SSSG (average 5.9% over FY19-22). Its innovation pipeline continues to be strong; it launched Biryani Bucket, peri – peri chicken. KFC also launched the popcorn nachos an innovative blend of tender chicken popcorns served on a bed of crunchy nachos. Adding more products in the value for money segment (such as KFC Zinger, Double Down) would increase the customer acceptability and then gradually shift them towards premium offerings.

The company plans to add 100 KFC stores per annum in the coming years. The store opening drive will likely be largely driven by smaller-format stores. Rationalising store size would further boost profitability over the years. Despite reducing the store size in the recent years, DIL's KFC stores have been able to maintain ADS and margins. The company saw improvement in gross margin from 66% in FY19 to 69.3% in FY22. Store level profitability also improved; with brand contribution margin increasing from 18.4% in FY19 to 21.3% in FY22. The company is piloting KFC smart restaurants with self-ordering kiosks and a futuristic store design.

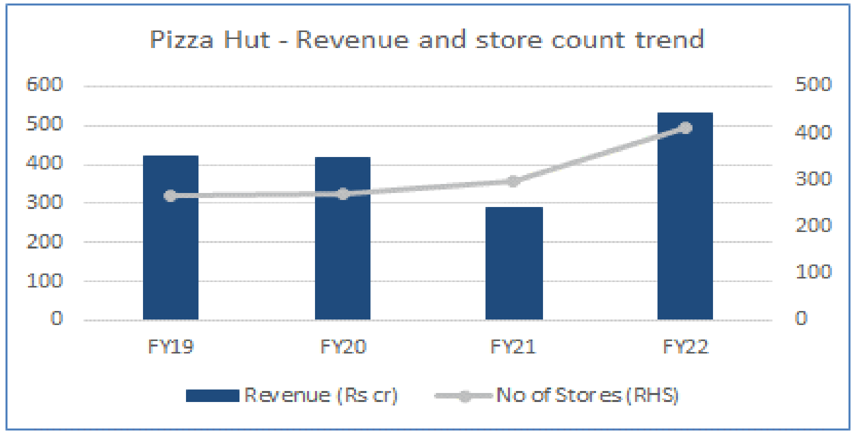
The KFC brand franchise has been on a relatively strong footing, with steady expansion and high-teens store margins. Rationalization of stores, variable employee cost structure and benefits of operating leverage would improve their margins. We expect KFC's revenue to grow at CAGR of 36.3% over FY22-24E on accelerated store expansion and expect margin to reach 22% in FY24E. We are positive on the growth despite the increasing competition in the chicken QSR industry. Entry of McDonalds in this segment with selective rollout and Jubilant Foodworks securing franchise rights of Popeyes; would not have meaningful impact in the medium term due to large opportunity in underpenetrated space.

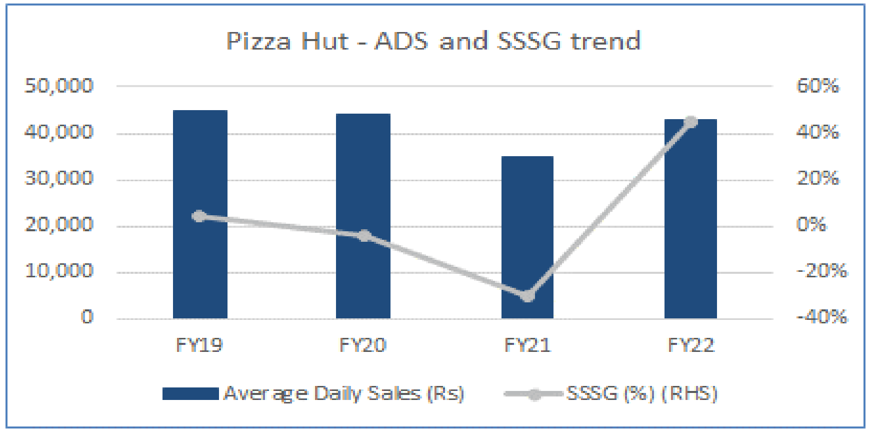
Pizza Hut – potential turnaround (addressing gaps in terms store network, delivery experience, value focused menu and store economics)

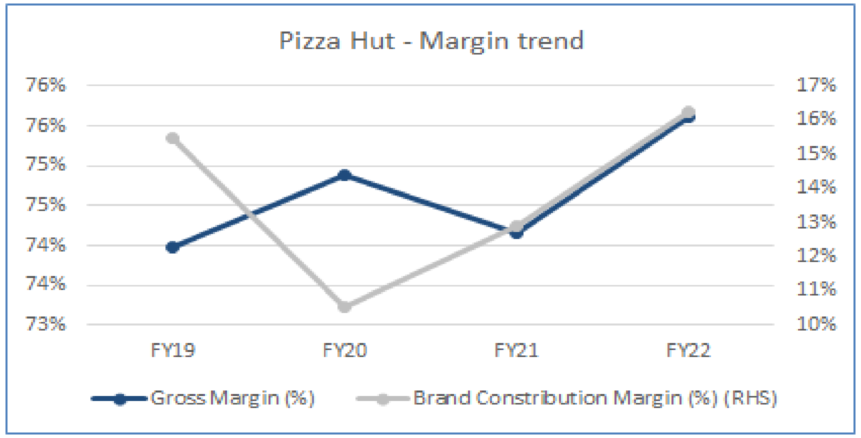
Devyani opened the first Pizza Hut store in India in 1997 at Jaipur. It operates 466 Pizza Hut stores as of Sep'22. Yum brands have two categories of franchise rights for Pizza Hut – Dine-in format and Delivery format. The former is larger format omni-channnel restaurant (with capacity of 50-100 seats) while dine-in area are more focused to address delivery needs but it has limited seating (20-30 capacity). DIL has dine-in format rights for North and East India and has almost pan-India opportunity of opening delivery-led Pizza Hut stores (except Tamil Nadu). DIL's Pizza Hut reported revenue CAGR of 7.9% mainly driven by aggressive store expansion. It added net 145 stores in last three fiscals taking the count to 413 stores as at Mar'22. It is consolidating its presence in existing markets and foraying into smaller towns.

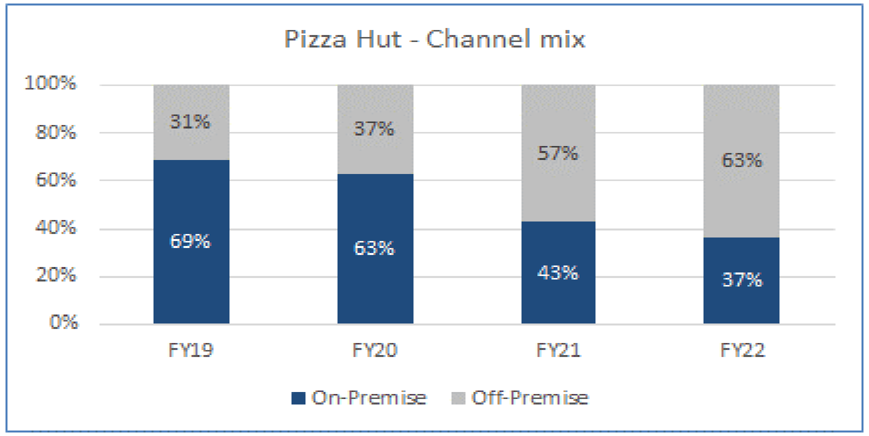
The market leader – Dominos – has attractive unit economics (lower breakeven sales level), value positioning, strong delivery focus and strong brand equity. Pizza Hut lags Dominos in terms of store network, ADS, product portfolio, pricing value equation, delivery experience. Pizza Hut was more dine-in focused, with large formats, leading to high costs and lower sales than Domino's, which had poor delivery offering. In the recent years, Pizza Hut has taken few initiatives to address these gaps.

DIL has accelerated store additions; in FY22 as it added net 116 stores. Even after scaling up operations and replacing large format stores with smaller format, its ADS were maintained. Maintaining ADS at similar levels, despite cutting down the store size, has reduced its payback period. The company is planning to add ~100 stores per annum in the medium term. Devyani has an advantage as it has exclusive rights to open smaller sized omnichannel 'Delivery' format stores. Also store expansion would delivery time due to better store density and strengthen brand equity. Compared to Dominos, Pizza Hut stores are less penetrated providing opportunity to scale up. The company is pivoting from dine-in format to a delivery focused format. These delivery focused omni-channel stores have better unit economics than a typical dine-in-focused store. Off-premise share increased from 31% in FY19 to 63% in FY22. DIL along with Yum brands are working on improving the delivery experience by leveraging technology and working closely with food aggregators.









(Source: Company, HDFC sec)

Pizza Hut's constant menu innovations and affordable pizza offerings make it a strong competitor in the Indian QSR industry, driving consumption of pizza as a regular meal. It launched San Francisco Style Pizza; and its product innovation Momo Pizza saw strong adoption by customers in the East and Northeast. Pizza Hut launched Fun Flavour Pizzas at affordable prices of Rs 79 in Q1FY23 to bridge the gap with the market leader. The launch is a step towards value brand proposition of Pizza Hut which was perceived to be a more expensive brand. Filling portfolio gaps and adding value-for-money products in the menu would drive SSSG (average of ~4% over FY19-22).

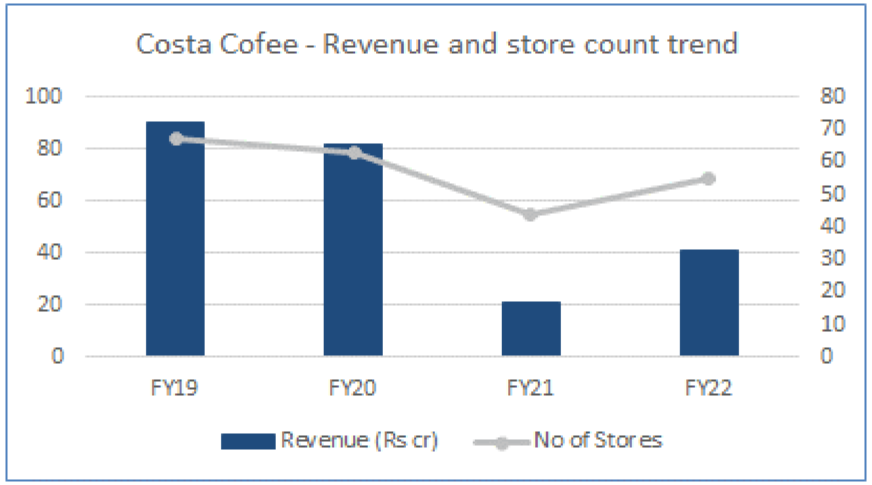
Reduced store size and improving unit metrics (especially in delivery format) could narrow the gap with the market leader in the next few years. Exclusive rights to open delivery format stores offer higher expansion opportunity to go deeper in the market (in Tier 2/3 cities) and increase Pizza Hut presence. We expect Pizza Hut revenues to grow at CAGR of 31.7% over FY22-24E (ADS to grow at CAGR of 10-12%). Improving store economics and ADS would consistently improve brand contribution margins in the coming years and we expected to reach 17.6% level.

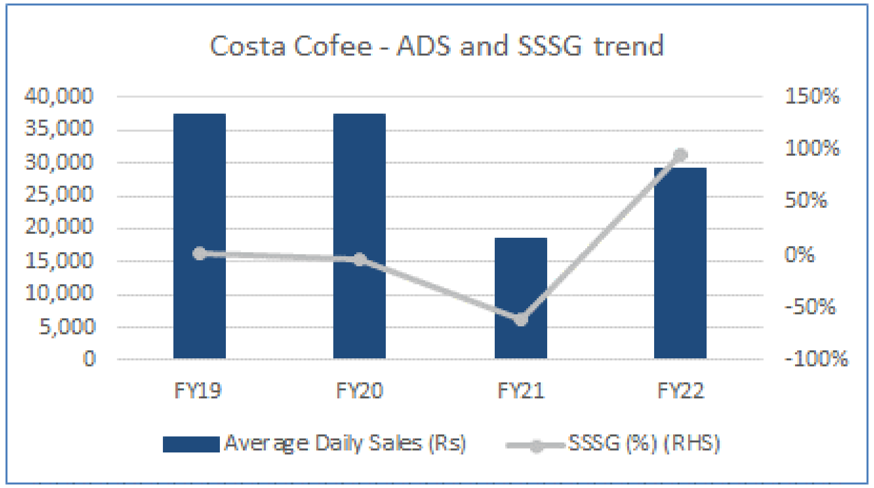
Costa Coffee – faster scaling up of operations in cards:

Costa Coffee contributes ~2% of revenue in FY22 and operates 88 stores in India. It operates in two format - full retail stores at high-street locations and malls, and branded kiosks at airports, hospitals and food courts at highways. Costa Coffee stores have an extensive menu featuring coffee, sandwiches, wraps, Indian snacks, desserts, and other beverages. Costa coffee's revenue saw de-growth during FY19-22 impacted by Covid and store closures. It posted high gross margins (80.3% in FY22) despite its low scale of business and not-so -premium positioning compared to Starbucks. Its brand contribution margin improved from 20.2% in FY19 to 30.4% in FY22.

DIL extended partnership with Costa Coffee parent in Aug 2021, and under the revised agreement, it has been granted development rights for pan-India in a phased manner. Devyani will be the sole franchisee for Costa coffee, and this gives them the edge to design and recreate the brand. The company's focus is on adding new stores, launching new products, driving brand engagement. Compared with Starbucks, Costa's pricing is lower and more affordable. DIL will continue to focus on smaller sized outlets in contrast to Starbucks' strategy of opening large format stores. The beverage segment is expected to grow at higher rate on the back of rising demand from the young population, rapid urbanization, business culture, and western lifestyle.

Revenues of Costa Coffee brand is expected to grow at CAGR of 101.4% over FY22-24E as we expect ramp up in store additions after the revised development agreement. Margins have improved in recent quarters for Costa and we expect gross margin to hover around 79-80% and brand contribution margin of ~28% in FY24E.





(Source: Company, HDFC sec)

International & Others Business – modest growth opportunity; revenue share to remain at current levels

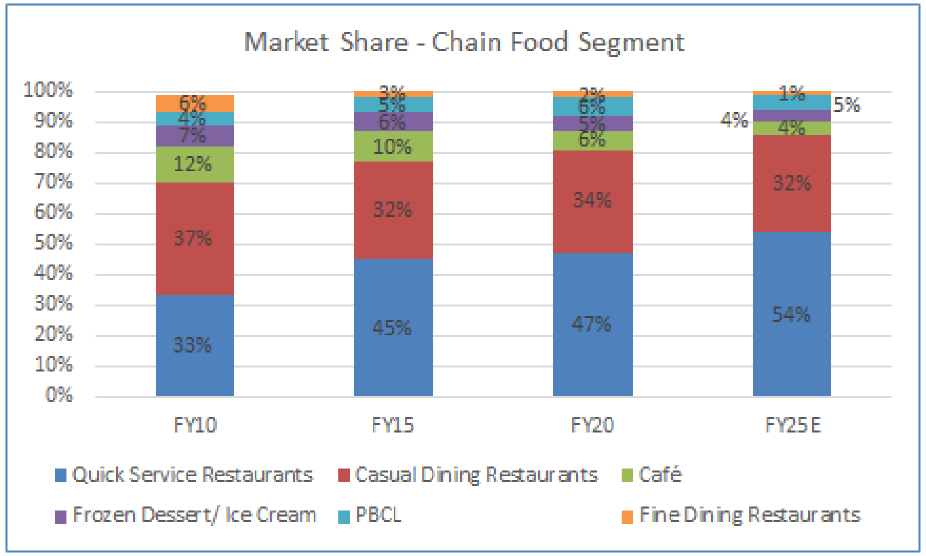
DIL operates KFC and Pizza Hut stores in Nepal, and KFC stores in Nigeria. Contributing ~9% of the topline, it has 29 KFC stores in Nigeria and 20 KFC & Pizza Hut stores in Nepal. The business segment reported ~20% CAGR growth over FY19-22, exhibiting decent brand contribution margins in the range of 14-15%. The international business is profitable and cash-generating, the funds are re-invested in capex for store expansion (7-9 stores per annum) in the respective markets. Although Nepal is not a huge market, there is greater market opportunity in Nigeria. We expect modest business growth with revenue CAGR of 21.4% and expect brand contribution margin to hover around 23% levels.

Devyani operates own brands such as Vaango, The Food Street which contributes ~5% of the topline. Vaango is a one stop destination for all South Indian food lovers serving pure vegetarian meals. Food Street offers its consumers variety and depth in menu under one roof. These brands are located within larger food courts in malls, shopping complexes and airports. Fall in footfalls at airports and malls impacted its revenue share (15%+ in FY19). These in-house brands under Other Business have been a drag on their overall profitability. We expect the revenue mix to remain in similar range given the company's focus on its core brand portfolio.

Industry Insights:

The organised foodservice market provide a multi-year growth opportunity. The organised foodservice market (comprising chains and standalone outlets) is expected to grow ~15% CAGR over FY20-FY25 (market size increasing from Rs 1.6 tn to Rs 3.2 tn in FY25) and its share in the total food services market is expected to increase to 51% in FY25 from 37% in FY20, surpassing unorganised market. Rising population of youth, higher income levels, changing lifestyles with greater frequency of eating out, wider internet penetration, growth of online food delivery & food tech and growing acceptance in smaller towns drives the growth of organised food service in India.

The QSR (Quick Service Restaurant) segment is focused on service speed, affordability and convenience. It includes dine-in, takeaways, delivery, drive-thru and on-the-go sub formats. The QSR industry clocked 19% CAGR over FY15-20 and has added outlets at a healthy CAGR of ~9% over FY15-20. QSR segment comprises 22% of the organised foodservice market and is expected to grow at 23% CAGR over FY20-25E, outpacing all other chain food segments. The headroom for expansion remains very large with low penetration beyond Top-8 cities as these cities contribute ~85% of chain industry revenues currently. Also, restaurant chains currently address <15% of overall population, indicating significant room for penetration increase.



(PBCL - pub, bar, café and lounge; Source: Sapphire RHP, HDFC sec)

Segment-wise growth – Chain Food Segment

Format	FY 2010-15 CAGR	FY 2015-20 CAGR	FY 2020-25E CAGR
Quick Service Restaurants	29%	19%	23%
Casual Dining Restaurants	18%	19%	19%
Café	16%	8%	10%
Frozen Dessert/ Ice Cream	15%	16%	17%
PBCL	25%	22%	16%
Fine Dining Restaurants	5%	3%	2%

Big QSR players have been proactive in their product offerings, omni-channel focus, menu innovation, competitive pricing strategy (low entry pricing) and aggressive expansion (especially in smaller towns & cities). Moreover, the pandemic led the shift from unorganized to organized due to health and hygiene concerns. Post Covid, QSR's have recovered faster and are better geared to drive growth through convenience channels and digital initiatives. The pandemic led to growing digital adoption, ordering-in habits and acceptance of delivery fees. QSRs have used the crisis to improve economics by optimizing their cost structures, store networks and store designs. These along with several closures of other chain restaurants is likely to drive faster growth and share gains in favour of established QSR players.

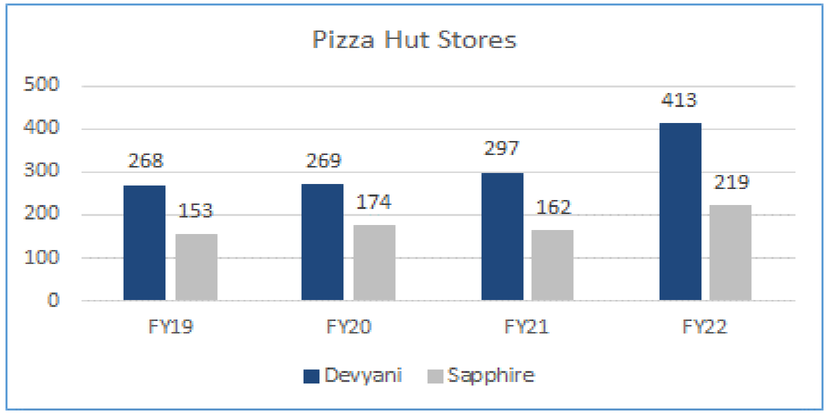
Economies of established QSRs brands improved, especially after covid. Aggressive review of cost structure, closure of non-performing store, rental negotiations (linked to revenue), focus on omni-channel (delivery + takeaway). All these measures improve unit-level cost structure and economics; which would go long way in improving the return ratios. Also, the pandemic triggered lower discounting and higher delivery fees by aggregators. Cloud kitchens, especially new entrants and weaker players, which earlier thrived on subsidized delivery costs and discounts/promotion of food aggregators saw some slowdown. So, the value proposition for western QSRs has improved versus restaurants/cloud kitchens. The evolution of delivery ecosystems and gradual improvement in economics provides an opportunity for QSRs to step-up the pace of expansion.

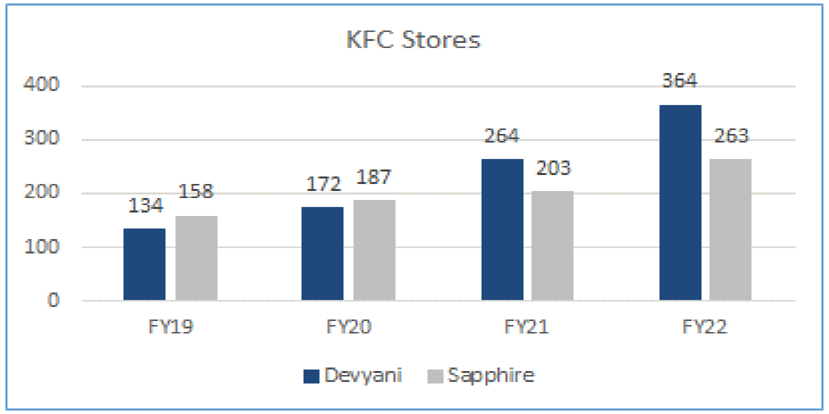
Given the prevailing opportunities in QSR industry, we expect both Yum brands franchisees – KFC and Pizza Hut are well poised for growth led by rapid store expansion. Both brands have adopted various initiatives – store size reduction, cost rationalising, menu innovations and network expansion - to expand market share and improving store efficiency.

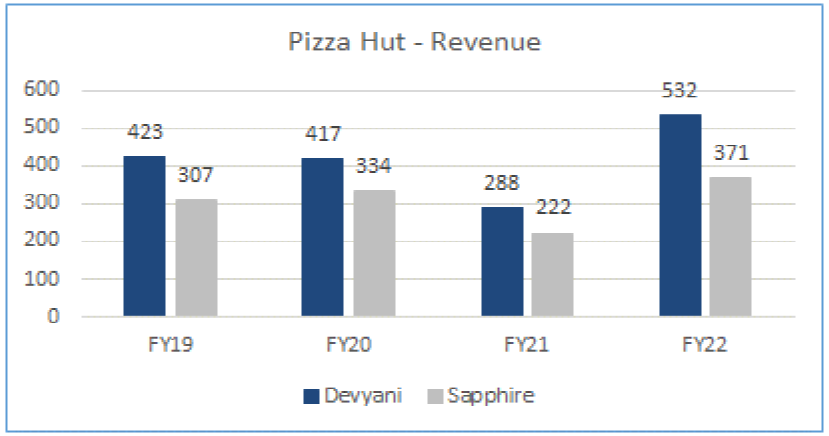
Devyani vs Sapphire

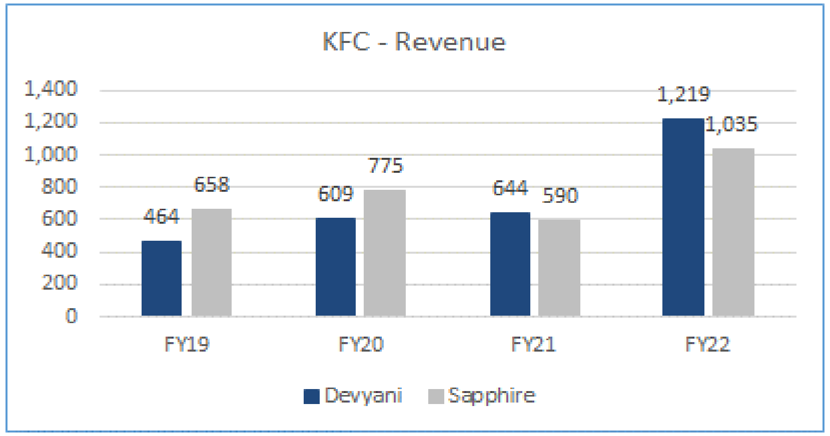
Sapphire Foods is a leading YUM franchisee operator in the Indian subcontinent with presence in India, Sri Lanka and Maldives. Sapphire Foods started operations in September 2015, by the acquisition of about 270 KFC and Pizza Hut Stores in India and Sri Lanka, by a group of leading Private Equity firms and is managed by a team of professionals. The company owns and operates 301 KFC and 249 Pizza Hut restaurants in India, 99 Pizza Hut and 7 Taco Bell restaurants in Sri Lanka and 1 KFC and Pizza Hut each in Maldives as of Sep 30, 2022.

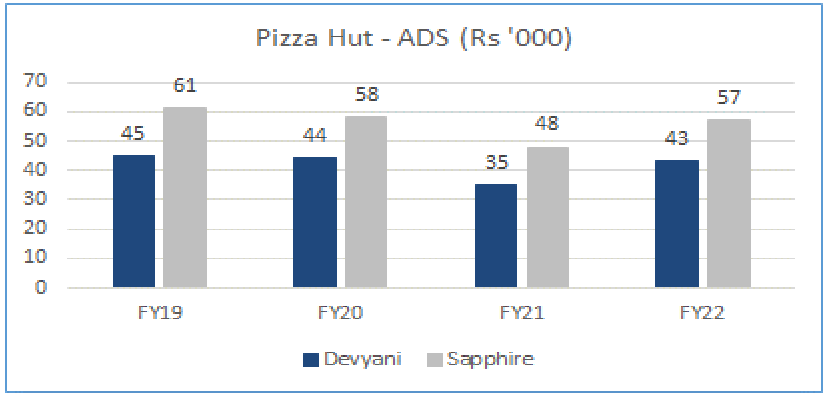
	Devyani	Sapphire
KFC	South (except Tamil Nadu), east, and northeast territories (high non-veg easting population)	West, North India, Tamil Nadu (core markets - Mumbai, Delhi, Pune, Chennai)
Pizza Hut	Dine-in: North & East	Dine-in: South & West
	Delivery: Pan India (except Tamil Nadu)	Delivery: Tamil Nadu

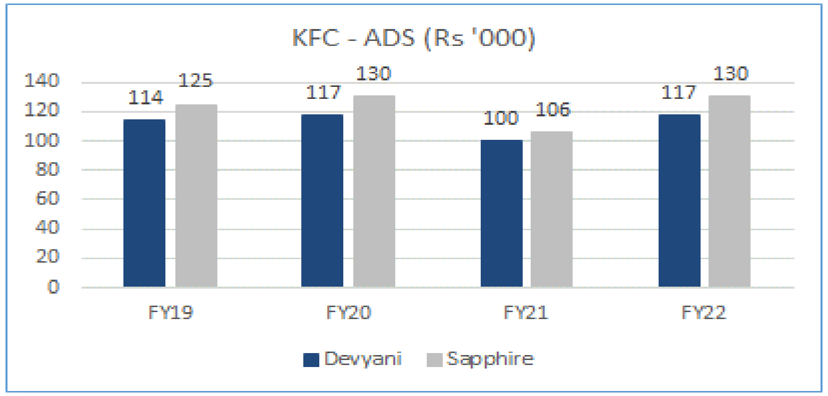

Pizza Hut Stores
500
400
300
200
100
0
268
153
269
174
297
162
413
219
FY19
FY20
FY21
FY22
Devyani
Sapphire

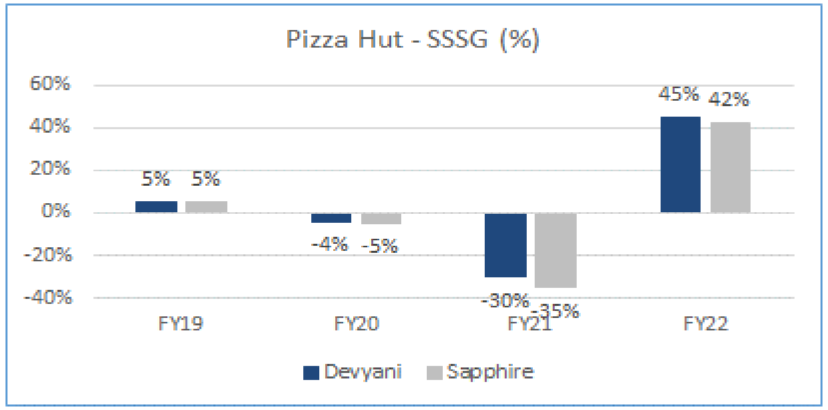

KFC Stores
400
300
200
100
0
134
158
172
187
264
203
364
263
FY19
FY20
FY21
FY22
Devyani
Sapphire

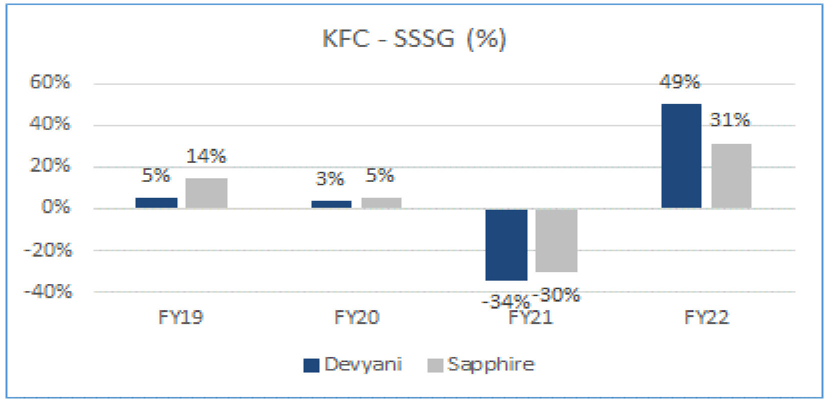

Pizza Hut - Revenue
600
500
400
300
200
100
0
423
307
417
334
288
222
532
371
FY19
FY20
FY21
FY22
Devyani
Sapphire

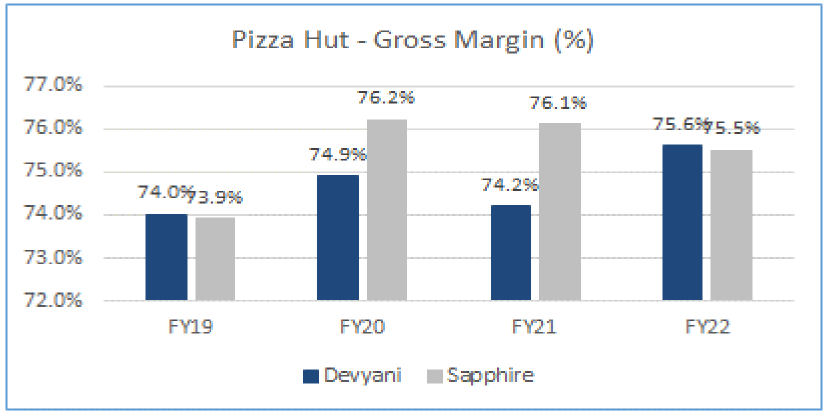

KFC - Revenue
1,400
1,200
1,000
800
600
400
200
0
464
658
609
775
644
590
1,219
1,035
FY19
FY20
FY21
FY22
Devyani
Sapphire

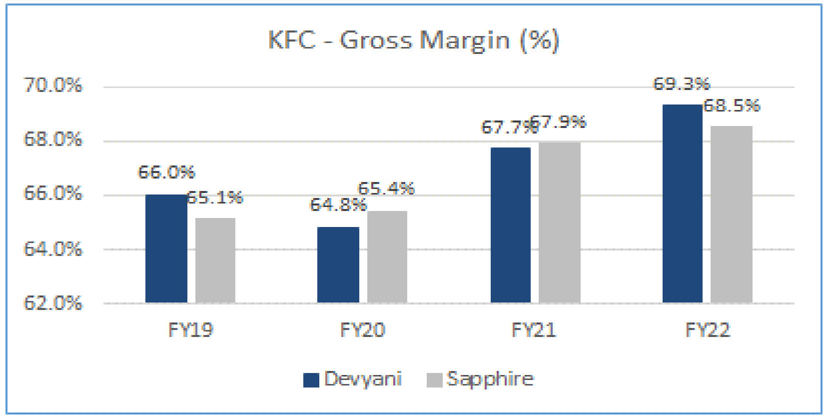

Pizza Hut - ADS (Rs '000)
70
60
50
40
30
20
10
0
45
61
44
58
35
48
43
57
FY19
FY20
FY21
FY22
Devyani
Sapphire

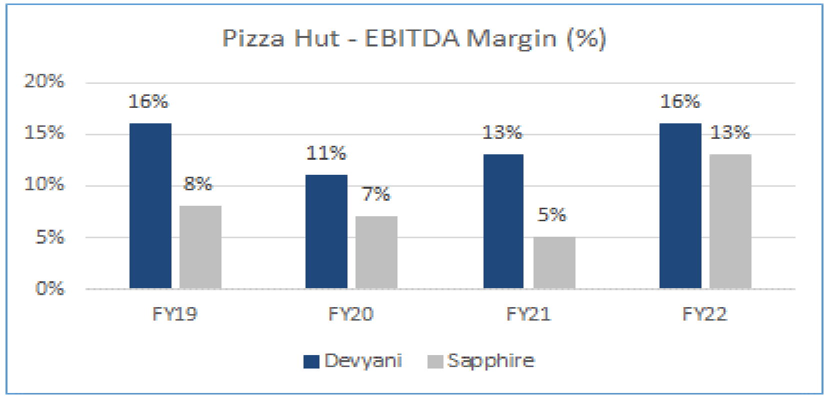

KFC - ADS (Rs '000)
140
120
100
80
60
40
20
0
114
125
117
130
100
106
117
130
FY19
FY20
FY21
FY22
Devyani
Sapphire

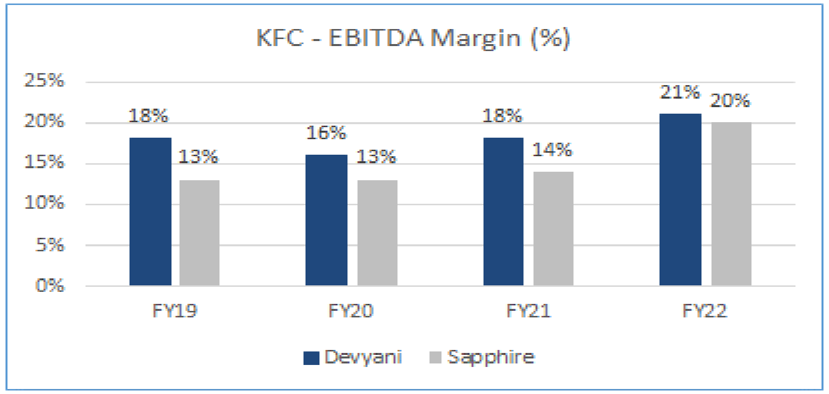












(Source: Company, HDFC sec)

Concerns:

Weak execution and lower than expected SSSG: The company is set its plans to aggressively expand its Core business brands. Although a large part of DIL's revenue would be driven by store expansion, lower than expected SSSG (especially for Pizza Hut) could impact its operational performance. Slow SSSG growth could be because of slowdown in discretionary spends or higher impact from store expansion due to store splits.

Increased Competition: QSR players continue to see increased competition intensity from unorganised small players. Burgeoning number of players are added in the market every year and many face closedowns due to stressed economics. Apart from unorganized player, DIL's KFC face increasing competition from McDonalds and Jubilant's Popeyes. Pizza Hut has direct competition with the market leader Dominos and other regional pizza chains. Moreover, growth of cloud kitchen format restaurants also could dampen revenue growth of established players. But the rise in delivery costs and lower discounting by aggregators, especially post the pandemic, have impacted the value proposition of some cloud kitchen brands and also strained economics.

Food inflationary pressures: Although DIL has a well-integrated vendor supply management, it is vulnerable to high food inflation. Sharp increases in raw material costs and inability to pass on prices to consumers could impact profitability.

Increased dependence and bargaining power of food aggregators: Food aggregators has seen rapid expansion and acceptance, especially after the Covid. Growing digital adoption, ordering-in habits and acceptance of delivery fees have strengthened their foothold. Given the company's plan to expand into smaller cities & towns, dependence on food aggregators would increase. Although the company is making strides with its own delivery apps, support of food aggregators would be vital.

Disruption in supplies for key ingredients: Typically franchisees rely on third party logistics/ registered suppliers for supply, warehousing and transportation of ingredients and packaging materials. Disruption to the supply chain due to transportation of resources, non-compliance with license and quality requirements, could impact the supply of key ingredients and adversely impact operations.

Negative news regarding food incidents: Any negative news regarding the food quality and related incidents would impact its reputation. There is a risk of food tampering incidents or contamination during transport or handling. The occurrence of such events might lead to litigation by customers and fines by food safety regulators.

Devyani International Ltd.

About the company:

Devyani International Ltd (DIL) is the largest franchisee of Yum Brands in India and is among the largest operators of quick service restaurants chain in India and operates 1096 stores across 224 cities as of Sep 30, 2022. As the franchise partner of Yum Brands, the company operates their iconic brands KFC and Pizza Hut in India as well as in Nigeria and Nepal. DIL is also a franchisee rights for the Costa Coffee brand and stores in India. KFC, Pizza Hut and Costa Coffee together comprise its 'core brands' which contributes ~95% of topline. In addition, the company has established in-house brands such as Vaango and Food Street.

KFC contributes ~58% of the topline followed by Pizza Hut and Costa Coffee which contributes ~26% and 2% of the revenue respectively. The company operates 423 KFC, 466 Pizza Hut and 88 Costa Coffee outlets in India; 29 Pizza Hut outlets in Nepal; 20 KFC and Pizza Hut outlets in Nigeria. The company has been consistently expanding its store network. Stores in Core Brands grew at CAGR of 21% over FY19-22 to 832 stores as at March'22. Its strong association with Yum Brands coupled with large addressable population in KFC states (>80% non-vegetarian) and exclusivity for Pizza Hut delivery only stores indicates significant growth opportunities in India's growing QSR market. DIL plans to add 250 outlets per annum with a cluster-based approach in India. DIL's stores are concentrated in North (39%) and South (35%). The company has equal presence in both metro (48%) and non-metro cities (52%). DIL is seeing a strong turnaround and improved unit metrics for KFC and Pizza Hut led by store size reduction, boosting value proposition through innovative menu and focus on delivery with enhanced digital capabilities.

Peer Comparison:

	Mcap (Rs cr)	Revenue			EBITDA Margin (%)			PAT		
		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Devyani International	22,408	2,084	3,099	3,853	22.8	22.9	23.4	156	278	335
Sapphire Foods India	8,652	1,722	2,321	2,907	17.7	19.4	20.5	46	124	172
Jubilant Foodworks	36,031	4,396	5,326	6,284	25.2	24.7	25.1	428	531	681
Westlife Development	11,279	1,576	2,273	2,688	12.0	16.9	17.7	-2	120	171

	RoE (%)			P/E			EV/EBITDA		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Devyani International	39.1	33.7	29.6	143.3	80.6	66.9	49.6	33.2	25.9
Sapphire Foods India	6.2	11.3	13.8	175.0	71.5	51.2	29.6	20.1	15.2
Jubilant Foodworks	24.9	24.0	26.1	84.2	68.5	52.9	34.2	28.9	24.0
Westlife Development	-0.4	22.2	25.3	NA	93.7	62.1	64.6	31.7	25.8

(Source: Bloomberg estimates, Company, HDFC sec)

Financials

Income Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	**1516.4**	**1134.8**	**2084.0**	**3098.8**	**3852.6**
Growth (%)		**-25.2**	**83.6**	**48.7**	**24.3**
Operating Expenses	1342.0	900.2	1608.0	2389.1	2951.1
EBITDA	**174.4**	**234.6**	**476.0**	**709.6**	**901.5**
Growth (%)		**34.6**	**102.9**	**49.1**	**27.0**
EBITDA Margin (%)	**11.5**	**20.7**	**22.8**	**22.9**	**23.4**
Depreciation	223.3	277.5	224.9	271.7	328.5
EBIT	**-49.0**	**-42.8**	**251.1**	**437.9**	**573.0**
Other Income	53.2	82.4	16.1	26.3	32.7
Interest expenses	158.4	149.5	127.0	131.5	159.3
PBT	**-154.2**	**-109.9**	**140.3**	**332.7**	**446.4**
Tax	1.8	-1.1	-32.0	44.9	112.5
RPAT	**-121.4**	**-63.0**	**155.1**	**276.5**	**333.9**
APAT	**-121.4**	**-55.2**	**156.3**	**278.0**	**334.9**
Growth (%)		**-54.5**	**-383.2**	**77.8**	**20.5**
EPS	-1.1	-0.5	1.3	2.3	2.8

Balance Sheet

As at March (Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	106.2	115.4	120.5	120.5	120.5
Reserves	-295.3	-1.6	565.8	843.9	1178.8
Shareholders' Funds	**-189.1**	**113.8**	**686.3**	**964.3**	**1299.2**
Minority's Interest	-39.1	-41.9	-4.7	-6.2	-7.2
Long Term Debt	1516.1	1153.1	1137.9	1267.9	1447.9
Net Deferred Taxes	-7.6	-9.6	-48.2	-68.2	-48.2
Long Term Provisions & Others	17.9	22.8	22.9	30.8	38.2
Total Source of Funds	**1298.3**	**1238.2**	**1794.1**	**2188.5**	**2729.9**
APPLICATION OF FUNDS					
Net Block & Goodwill	1612.9	1327.8	1691.1	1818.4	1856.7
CWIP	13.5	14.3	6.8	6.8	6.8
Other Non-Current Assets	106.4	152.2	180.2	233.3	266.7
Total Non-Current Assets	**1732.9**	**1494.3**	**1878.2**	**2058.6**	**2130.2**
Current Investments	0.0	0.0	0.0	50.0	100.0
Inventories	72.1	62.2	85.5	110.4	137.2
Trade Receivables	17.3	16.9	21.1	25.5	31.7
Cash & Equivalents	16.0	40.5	65.9	301.2	761.3
Other Current Assets	37.8	44.9	163.7	237.7	274.4
Total Current Assets	**143.2**	**164.5**	**336.1**	**724.7**	**1304.6**
Short-Term Borrowings	202.7	182.7	116.3	176.3	216.3
Trade Payables	163.2	161.9	196.4	263.2	306.1
Other Current Liab & Provisions	211.9	76.1	107.5	155.3	182.5
Total Current Liabilities	**577.8**	**420.7**	**420.2**	**594.8**	**704.9**
Net Current Assets	-434.6	-256.1	-84.1	129.9	599.7
Total Application of Funds	**1298.3**	**1238.2**	**1794.1**	**2188.5**	**2729.9**

Cash Flow Statement

(Rs Cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	-119.6	-64.1	123.2	321.4	446.4
Non-operating & EO items	-7.4	-124.0	-17.7	-70.5	-11.5
Interest Expenses	159.4	151.8	118.0	131.5	159.3
Depreciation	246.7	235.7	221.3	271.7	328.5
Working Capital Change	22.3	39.7	16.2	16.6	6.0
Tax Paid	-0.8	0.5	-10.3	-44.9	-112.5
OPERATING CASH FLOW (a)	**300.7**	**239.6**	**450.6**	**625.8**	**816.2**
Capex	-98.8	-133.0	-293.0	-399.0	-366.8
Free Cash Flow	201.9	106.6	157.6	226.8	449.4
Investments	0.0	0.0	0.0	-50.0	-50.0
Non-operating income	7.4	-221.9	-81.8	0.0	0.0
INVESTING CASH FLOW (b)	**-91.4**	**-354.8**	**-374.8**	**-449.0**	**-416.8**
Debt Issuance / (Repaid)	-179.1	-73.9	-369.3	190.0	220.0
Interest Expenses	-43.5	-131.8	-123.0	-131.5	-159.3
FCFE	-20.7	-99.0	-334.7	285.3	510.1
Share Capital Issuance	0.0	347.6	448.6	0.0	0.0
Dividend	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	-14.6	0.0	0.0
FINANCING CASH FLOW (c)	**-222.6**	**142.0**	**-58.4**	**58.5**	**60.7**
NET CASH FLOW (a+b+c)	**-13.4**	**26.7**	**17.5**	**235.3**	**460.1**

One Year Price Chart:

(Source: Company, HDFC sec)

Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
PROFITABILITY RATIOS (%)					
EBITDA Margin	11.5	20.7	22.8	22.9	23.4
EBIT Margin	-3.2	-3.8	12.0	14.1	14.9
APAT Margin	-8.0	-4.9	7.5	9.0	8.7
RoE	NA	NA	39.1	33.7	29.6
RoCE	-3.2	-2.9	14.8	20.1	21.3
Solvency Ratio (x)					
Debt/EBITDA	9.9	5.7	2.6	2.0	1.8
D/E	-9.1	11.7	1.8	1.5	1.3
PER SHARE DATA (Rs)					
EPS	-1.1	-0.5	1.3	2.3	2.8
CEPS	9.6	1.9	3.2	4.6	5.5
Dividend	0.0	0.0	0.0	0.0	0.0
BVPS	-17.8	1.0	5.7	8.0	10.8
Turnover Ratios (days)					
Debtor days	4.8	5.5	3.3	2.7	2.7
Inventory days	15.3	21.6	12.9	11.5	11.7
Creditors days	36.1	52.3	31.4	27.1	27.0
VALUATION					
P/E (x)	NA	NA	143.3	80.6	66.9
P/BV (x)	NA	188.6	32.7	23.2	17.2
EV/EBITDA (x)	21.1	97.0	49.6	33.2	25.9
EV/Revenues (x)	2.4	20.0	11.3	7.6	6.1
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
Dividend Payout (%)	0.0	0.0	0.0	0.0	0.0

(Source: Company, HDFC sec)

HEMANSHU VIJAY PARMAR

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Date: 2022.11.30 08:51:32 +05'30'

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066
Compliance Officer: Murli V Karkera Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No. ARN: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193