Date: May 17, 2023

To,

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

Dear Sir/Madam,

Subject: Earnings Call Transcript – Q4 FY23

Pursuant to the Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, please find enclosed herewith the transcript of earnings call held on Friday, May 12, 2023, in relation to the financial results of the Company for the quarter and year ended March 31, 2023.

The said Earnings Call Transcript is also available at the website of the Company (https://www.sapphirefoods.in/investors-relation/financials) under FY 2022-23 Quarter 4 section.

Request you to kindly take the same on record.

Thanking you,

For Sapphire Foods India Limited

SACHIN TUKARAM DUDAM

Digitally signed by SACHIN TUKARAM DUDAM
Date: 2023.05.17 13:16:19 +05'30'

SAPPHIRE FOODS INDIA LIMITED MUMBAI

Sachin Dudam
Company Secretary and Compliance Officer

Encl: a/a

“Sapphire Foods India Limited

Q4 FY '23 Earnings Conference Call.”

May 12, 2023

MANAGEMENT: MR. SANJAY PUROHIT – GROUP CHIEF EXECUTIVE OFFICER AND WHOLE-TIME DIRECTOR – SAPPHIRE FOODS INDIA LIMITED
MR. VIJAY JAIN – CHIEF FINANCIAL OFFICER – SAPPHIRE FOODS INDIA LIMITED

MODERATOR: MR. NACHIKET KALE – ORIENT CAPITAL

Moderator: Ladies and gentlemen, good day, and welcome to the Q4 FY '23 Earnings Conference Call of Sapphire Foods India Limited 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 star, then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Nachiket Kale from Orient Capital. Thank you and over to you, Mr. Kale.

Nachiket Kale: Hello. Good evening, everyone. Welcome to the Q4 and FY '23 earnings concall for Sapphire Foods India Limited. Representing the management on call, we have with us Mr. Sanjay Purohit, Group CEO and Whole-Time Director; accompanied by Mr. Vijay Jain, CFO.

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

I would now like to hand over the call to Mr. Sanjay Purohit to take over. Over to you.

Sanjay Purohit: Good evening, all of you. Thank you for joining this call. This is our second annual results presentation since the IPO. And therefore, firstly, we wanted to place our 2 years score card in front of you and then we will talk about the quarter 4 performance.

I'm referring to Page number 6 on our deck. FY '23 has seen our best-ever annual performance. So, we delivered our highest revenue and in a growing company, I understand we will always deliver ever highest revenue every single year. So, INR22.6 billion is the revenue that we delivered for the full year, but also from an adjusted EBITDA sense, we delivered INR2.6 billion and our highest margin of 11.7%.

The same thing is with respect to our adjusted PAT. And we had a deferred tax credit of INR125 crores this quarter. But removing that, we delivered our highest-ever adjusted PAT of INR1.4 billion at 6.2% PAT margin. We also had our highest ever new restaurants addition of 164 new restaurants, KFC, Pizza Hut and in Sri Lanka. It was the best ever year for KFC and Pizza Hut India, both from a revenue and from a restaurant EBITDA percentage.

And even in Sri Lanka, despite all the challenges that the country has faced, we were able to grow revenue in Lankan Rupee terms by 48%. And despite 100% inflation, our restaurant EBITDA remained flat in LKR terms. And today, we continue to remain the number 1 QSR brand in the country.

Now talking about our quarter 4 numbers. Our quarter 4 consolidated sales of INR5.59 billion. We grew it by 13% year-on-year. India restaurant sales within that grew robustly at 23%. And therefore, the Lanka business contributed to the gap between 23% and 13%.

Same-store sales were, however, challenged, as we have continued to experience post Diwali '22. And you would have read that our GDP growth rate dropped from 7%-plus in April in the first half to 4.4% in October-December.

I'm quoting these numbers just to indicate that at a macro level, demand conditions were tough, but we believe that these such conditions are actually opportunities for us. What do I mean by that? Generally, consumers revert to trusted brands in a tough macroeconomic condition. And we believe that the 2 power brands that we have got, KFC and Pizza Hut, we can gain differential momentum if we launch a robust marketing and activation calendar.

So starting April itself, both brands have launched both a strong product innovation -- strong product innovation as well as increased marketing investments, and I'll talk about that in a minute or 2 minutes. Consol restaurant EBITDA remained flat year-on-year in absolute terms. Margin was 16.2%, down 210 basis points over last year. Again, primarily due to the adverse Sri Lanka impact, India restaurant EBITDA grew in absolute terms by 19% and margin was 16.5%, down 50 basis points primarily due to Pizza Hut.

Our consol EBITDA post IndAs was INR1.03 billion or 18.4% and that declined Y-o-Y by 1% down 260 basis points. Our consol adjusted EBITDA was INR56 crores or 10.1%, which declined year-on-year by 11%, and largely on account of the Sri Lanka impact. Consol PAT came in at INR136 crores or 24.2%, due to a deferred tax credit of INR125 crores in this quarter. Consol adjusted PAT before this DTC, Deferred Tax Credit, is INR187 million or INR19 crores, 3.3% in quarter 4 of FY '23.

While consumer demand, like I said, in India has remained a little muted over the last few months, we believe that this is a near-term concern only and we have continued our pace of expansion in quarter 4 FY '23 with a total addition of 28 restaurants, 16 KFC and 12 Pizza Hut and none in Sri Lanka, where we are adopting a more cautious approach on our new restaurant expansion in the next 12 months.

Now we will cover the business or the performance of our 3 business verticals. And I'll first start off with KFC. I'm referring to Slide number 20, where we wanted to give you an idea of what are the brand priorities that we are driving -- what are the brand priorities that we are driving.

Firstly, I'd like to say that these are the brand priorities that we drive jointly with YUM. And our first priority is to enhance fried chicken category relevance. While KFC is synonymous with fried chicken, we would like to grow its relevance with Indian consumers, and this is largely a marketing and communication task. Among all related QSR brands, KFC scored the highest on taste. And therefore, enhancing up our, what we internally call, craveable taste credentials is an important priority.

While core product innovation remains the largest contributor, we also look at other innovations, and I'll give you examples that we have run through the day. So Chizza is a core innovation, whereas we have done a chicken popcorn with Maggi or popcorn Nachos in the year that has gone by.

Thirdly, value is absolutely key in the QSR industry, both entry value and abundant value. And while our bucket options offer the consumer abundant value, we are very, very excited with the launch of chicken rolls in April. This price point starts from INR99 onwards, and we have seen very good traction behind this launch in April. We are sure that it will contribute to driving transactions on the brand and increasing our snacking day part.

The fourth priority is to ensure that the customer has as frictionless an experience as possible. And we are making a big play with our digital kiosks that we piloted in about 16 restaurants last year. But this year, we will be upping that significantly.

I have spoken about our operational excellence initiative of 7 minutes or free chicken. Our scores are in the high 90s here, which means that we are -- and this is an important driver of customer satisfaction.

And finally, we believe that accessibility is also critical to driving demand. And we continue to implement towards our ambition of doubling the store count in 3 to 4 years' time. This year, we have launched -- this year, we have opened a record 78 stores of KFC in the year.

Vijay Jain, our CFO, will now take us through the KFC numbers.

Vijay Jain: Yes. I'm starting on Page 28. With SSSG of 2% in quarter 4 was partly impacted by the soft demand conditions, which continued post Diwali and also partly by the fact that Navratra festival, this time shifted to March vis-à-vis last year was in April.

This 2% in SSSG has also come on the back or with additions of 78 additions in restaurant count, that is 30% additions in the last 1 year. Overall revenue grew by 24% to INR369 crores. And annually, we delivered approximately INR1,450 crores revenue on the brand, which is growth of 40%.

Gross margin for the quarter, while it dropped by 110 basis points, there was a sequential improvement of 30 basis points on gross margin. And if you compare to quarter 2 of this financial year, the total gain sequentially has been 120 basis points on gross margin. So definitely, we have seen some cooling off on inflation and that improvement in gross margin over the last 6 months shows it.

Restaurant EBITDA was at 19.1%, despite a low SSSG of 2%. This is on back of cost efficiencies that we were able to deliver 10 basis points improvement vis-à-vis last year. And overall, on KFC, we had the best ever year with 78 store additions that's highest ever, revenue growth of 40% and highest ever EBITDA percentage of 19.4%, which is up by 70 basis points.

Sanjay Purohit: Going now forward to Pizza Hut. We had an excellent first half on Pizza Hut. And with the slowdown that we have seen post Diwali, perhaps it impacted Pizza Hut slightly more. Our SSSG is negative. However, importantly, our SSTG, same-store transaction growth, is positive because we believe because of the big value play that we have made. But I'll talk about that in a minute or so.

I think importantly, when we look --so I was saying we had an excellent first half on Pizza Hut, and we believe that we've got all the levers of the consumer proposition on Pizza Hut in place and the brand competes well in the category. And while the last 6 months have been slow, we are quite confident about the prospects of this brand.

So our first task on Pizza Hut is to build top-of-mind awareness. We find that -- so apart from digital advertising, we have -- first time we are on mass entertainment television also. And we intend to sustain this marketing presence for the -- we intend to sustain this marketing presence going forward.

The marketing campaign, which you can see in Slide number 35, employing 2 celebrities, Saif Ali Khan and Shehnaaz Gill, broke on April 20 with the launch of our 10 new pizzas. And that's the second priority that I wanted to talk about that Pizza Hut has Taste leadership in this category. And with the rise of competition, I think it's extremely important to reinforce what a great pizza tastes like.

And therefore, the launch of 10 new pan pizzas in April, new -- 2 new pastas, we have expanded our garlic bread range with a keema garlic bread. Also, the new pizzas are very flavorful, very moist and again, consumer reactions are positive on this.

Value, like I said earlier, is also important and flavor fun continues to do well. And today, we - - today, Pizza Hut offers as good, if not the best value in the pizza category. And therefore, it goes back to -- with taste leadership and value, it goes back to the first priority that we have to enhance the top of mind awareness of the brand as we go forward. And invest in both television, digital and higher marketing spends.

Frictionless customer experience is our next priority. So apart from the native Pizza Hut app launch, which happened earlier in FY '22, we also launched a self-ordering QR code-based dine-in digital solution, which has also got good response from consumers. Operational excellence is our fifth priority, and we are using technology to simplify our back-end operations.

So we have invested in 2 technologies**:** Dragontail and HutBot to help us drive operational excellence. And like on KFC, accessibility is very important. We are on track to double our store count in 3 or 4 years. And what is going to aid us in this process is the launch of a 1,000 square foot model with the same number of covers as a 1,200 square foot model, which means that we have tightened the back end. And this, we believe, can work to increasing density of our stores in the larger towns.

I'll hand it over to Vijay for the Pizza Hut numbers.

Vijay Jain: Yes. I'm on Slide 42, on average daily sales. So SSSG was minus 4% for the quarter. And as Sanjay mentioned, the SSTG, the same-store transaction growth, continued to remain positive. And -- so that's the happening part.

67 store additions in the last 1 year, that's 30% on a previous year's base. Overall revenue grew by 18% to INR122 crores for the quarter, and gross margins dropped by 50 basis points. That's also a sequential drop of 10 basis points.

Our restaurant EBITDA came at 8.6%, which is a drop of 290 basis points over previous year. This was largely on account of the negative leverage or the operating deleverage we get because of the lower or negative SSSG.

However, having said that, the overall year, while H2 was soft -- H1 was great for the Pizza Hut, H2 was slightly softer. But overall, we still had the best ever year for Pizza Hut with highest ever store additions of 67, revenue growth of 41% and highest ever restaurant EBITDA margin of 13.3%, which is up by 190 basis points over last year.

Sanjay Purohit: A quick note on the Sri Lanka business. Today, operational constraints are few and far between in Sri Lanka. So from an ability to import cheese to availability of utilities, all operating conditions have largely normalized. The economy is also gained because of the IMF loan being sanctioned, India rolling over credit. So things have stabilized in the country.

Actually, foreign -- actually, the dollar rate has also -- the Sri Lankan Rupee has also appreciated marginally versus the dollar. So it used to operate at LKR 360 to $1, now it's operating anywhere between LKR 320 and LKR 330. So the signs on Sri Lanka are positive from that perspective.

However, the impact has been very high on customer wallets, and we are seeing big transaction drops on the brand. We have lost transactions definitely. But with our omnichannel presence, with our delivery capabilities, with the kind of stores footprint that we have got, we continue to be the number 1 QSR brand in the country.

And Vijay will now quickly take us to the Sri Lanka financial.

Vijay Jain: Yes. So Slide 49, SSSG for the quarter was minus 3%. We had 19 store additions in last 1 year, that's 20% on the previous year's base. Overall revenue grew by 10% in Sri Lanka Rupees. In Indian Rupees all translation effect, it degrew by -- declined by 27% for the quarter.

The gross margin dropped by 390 basis points year-on-year and overall restaurant EBITDA was 14.2%. So while the SSSG has been challenging, what you can see, the settling down of the restaurant EBITDA in and around that 14% mark over the last 3 quarters, which makes us feel that this is probably the bottom what we are seeing in that country on the business performance at the restaurant EBITDA level.

From here onwards, we hope that over a period of time, we should be able to go somewhere around that 20% restaurant EBITDA mark, which we used to get a year back. So hopefully, over 12 months' time to 24 months' time, we should be able to go back to that particular level.

Overall, 48% revenue growth in Lankan Rupees. And in spite of all the challenges, which Sanjay spoke about, the Lanka EBITDA in absolute terms has remained largely flat year-on-year. So that's the happening side. And we continue to remain the number 1 QSR player in that particular country.

Sanjay Purohit: So while closing, I want to say that we've had a tough last 6 months, but this is what the entire industry has seen, and there are overall weak consumer demand conditions. In the past, I have noticed that consumer behavior is such conditions always favors the trusted large brands, and they tend to do better in these conditions. And therefore, actually, we are looking at this situation as an opportunity.

Both KFC and Pizza Hut are quite well placed to perform differentially in this environment. All our consumer proposition levers are in place. And we have doubled down on both innovation as well as on marketing starting end of March and in April. The launch of chicken rolls for KFC and the launch of 10 new pizzas and appetizers along with flavor fun and the television campaign is really an indicator as to how we believe that we can perform well even in market conditions like this.

That's all from us. We will now open it up to questions. Thank you so much.

Moderator: The first question is from the line of Jay Doshi from Kotak Securities Limited.

Jay Doshi: Sanjay, my first question is on the weakness we're seeing in pizza category. In the past cycles, we've not seen the kind of divergence between different QSR categories that we are seeing this time between KFC, Pizza Hut maybe even Domino's and burger. So what is your reading? What do you think is the problems of the category are?

Sanjay Purohit: Yes. So while the SSSGs are different, KFC is 2% SSSG and Pizza Hut is negative. From a transaction perspective, actually, it is a little opposite where KFC is negative transaction and Pizza Hut is positive. So I'm not sure whether that is -- that hypothesis actually bears out, Jay, that pizza category is doing either worse off or other categories are doing better off. We don't know what the other pizza brands will come in at.

But at this moment, I think it is largely secular slowdown that we believe is happening. And then when you factor in new store additions across different QSR brands, if you see the total system growth also you have to compare, because if one brand has perhaps opened less number of stores, it will impact positively on same-store sales growth. And in our case, over our base of last year, we've opened nearly 30% more stores, and therefore, we've always called out that our SSSG ambitions would be in the region of 5% to 7%. So I think it's not that pizza is doing worse off than other categories, is my submission.

Jay Doshi: Okay. Let me ask you one more on the same thing. What do you pick up when you talk to the aggregators, Yum being the largest partner for both Zomato and Swiggy. I believe you would be getting some color or intelligence on overall what they are seeing for this category on that platform? Is there a similar level of sort of weakness or softness on food aggregator platforms also? Or do you think there is some competitive -- change in competitive landscape with a lot of new brands eating into?

Sanjay Purohit: Yes. So in general, there is a softness that we see even on the aggregator platform and on aggregated deliveries. So in general, we see that. Specifically, there might be some brands with a higher level of discounting that might do a little better in the short term. And if we are consistent on our discounting, then there might be a little up and down. But I think, again, we are seeing this softness even with our aggregator partners.

Jay Doshi: But is that for Pizza Hut brand or is that -- you're referring to softness for the entire category?

Sanjay Purohit: At least on both our brands, we see that.

Jay Doshi: Understood. One bookkeeping question there. What percentage of your delivery orders are now delivered within 30 minutes? Can you give us some color around it in terms of how delivery metrics have improved over time?

Vijay Jain: Right now for Pizza Hut, around 85% of our orders gets delivered within the 30 minutes' time.

Sanjay Purohit: Yes. And about 93%, 94% gets delivered under 40.

Jay Doshi: Understood. That's pretty impressive. Second question is, can you call out -- give us some color on your store opening guidance for FY '24 and capex guidance as well?

Vijay Jain: So again, Jay, we have refrained from giving our annual store opening guidance. As we have called out previously, we could double the count on the base of December '21 over 3 to 4 years, that remains we are on track, which converts to annual number of anywhere between 130 to 160 per year. So we are on track for that particular number.

As Sanjay said previously that we believe the softening is near term, so our expansion plans continue. If we see that this softer demand continues for a longer time or a longer period, at that point in time, we'll definitely recalibrate our approach. But at this point in time, we are on the track for that 130 to 160 range.

Jay Doshi: And what will be the capex for the year?

Vijay Jain: So again, as I said, we have not given out the total capex guidance for the next year. But for a per store basis, KFC is in the range of INR2 crores. It used to be INR1.9 crores with the inflation. It's now more around INR2 crores for KFC. Pizza Hut used to be around INR1.4 crores, now it's more around INR1.5 crores per store.

Jay Doshi: Right. So when I look at your FY '23 numbers and the store additions versus overall capex of INR380 crores. Ballpark, I get that about INR70 crores to INR80 crores is spent on refurbishment or some upgradations. So, is that being sort of a higher number than the normalized number or is that something that we should expect every year?

Vijay Jain: So roughly and again, I'm giving approximate number, roughly INR40-odd crores would have got spent on the refurbishment and the resizing and there would be included some major refurbishments as well. The balance will also be the maintenance capex as well as the IT capex, which we would incur and even the warehouse capex. So it's the combination of all those, but the refurbishment capex would be in the range of INR40-odd crores.

Jay Doshi: Understood. But is this something that we should model in or bake in every year or was FY '23 a year where this number...

Vijay Jain: Initially for the -- I think the next couple of years probably, yes, because these are the refurbishment capex of our legacy stores, some of the old stores, which were sized in the range of 2,500 to 3,000 square feet. But post that, we have been opening the tighter format stores. So we expect, as we move around 2 years, 3 years down the line, the per store refurbishment capex will certainly come down. Yes.

Sanjay Purohit: Also, Jay, our legacy stores are much older stores, and they have come up for their major refurbishment after 10 years. And that's why perhaps our per store costs are slightly higher. Our newer stores, we will see this cycle a minor refurbishment cycle, which is much lower in terms of capex per store as we go forward. But I think in the next 1 or 2 years, there is also a significant -- so once you do a significant upgrade, there is also an upgrade that you get on sales. So it does pay for itself over a period of time.

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

Tejash Shah: A couple of questions from my side. Sanjay, you spoke about the divergence on trend between KFC and Pizza Hut. And you said that there's nothing specific to consumer sentiment, but when we just look at the way broaden number, like a country in Sri Lanka -- country in distress like Sri Lanka, having an SSSG of minus 3% and India having minus 4, obviously, on a low base, Sri Lanka is there, but still don't you think that somewhere either the resilience of our brand in pizza in Sri Lanka is much better or perhaps the distress that we are seeing on pizza as a category is much louder in India. How do you read that?

Sanjay Purohit: So Sri Lanka, the first half of Sri Lanka because of the pricing that we've got was because of pricing that we took. So we would have taken nearly 50%, 60% pricing and in response to inflation, which was about 90%. And therefore, SSSG is minus 3%. Transaction decline is in high double digits.

So I don't think the parallels that you are drawing between Sri Lanka and India doesn't exist. The Sri Lanka business has got impacted much more significantly from a transaction basis than India.

Tejash Shah: Very clear. And you spoke about SSG being negative in Pizza Hut but our STG has been in positive territory. Does it mean that down-trading has actually played a very major role and you briefly touched upon it, but if you can elaborate, how should we think about that dynamic playing out in FY '24 going ahead?

Sanjay Purohit: So I think -- so this has been one of the key pillars of the Pizza Hut strategies, which was to pivot towards QSR kind of pricing. It first started off by us stopping our high low -- stopping our high, low discounting strategy in April'19 going to everyday value, then to meal options and finally, culminating in the launch of flavor fun.

Today, the kind of pricing and the average order value that we see on Pizza Hut is what we expect to continue as we go forward.

Tejash Shah: Yes. And if this trend has to continue, would you revisit -- so you spoke about that perhaps if this weakness continues for a longer period, you will revisit your store expansion guidance. But how long will it be that monitoring period? Will it be 6 months, 1 year or will you like -- will you respond a bit earlier on the store expansion guidance?

Sanjay Purohit: So it is important to note, Tejash, that the machinery on new stores is not a switch on, switch off machinery. And many of the calls that we take have been baked in earlier. And hence, we are saying that we have to project calmness in this scenario. So we're -- I think over the next 6 to 9 months is when we would take a call on what we need to do from a store addition perspective.

Vijay Jain: Tejash, the current marketing plan and the new launches, which we have done will start playing out the results or we can start seeing the results over the next 3 to 4 months. And I think that's the time that how those marketing initiatives and the new product initiatives has gone through and maybe that's the time if the softness still remains, that's the time to probably rethink.

Moderator: The next question is from the line of Nihal Jham from Nuvama.

Nihal Jham: Two questions. First was on the Pizza Hut and KFC, you highlighted that while you've seen transaction growth in Pizza Hut, there has obviously been a fall in the average bill value, and is the opposite way, which is paid out for KFC and you've taken price hikes of around 9% to 10%. As things improve or revive, which of these 2 would end up catching up faster or reviving further?

Sanjay Purohit: Which of these 2 from a...

Vijay Jain: Revive faster.

Sanjay Purohit: SSSG or transaction? I think...

Nihal Jham: SSSG perspectives, overall. Because there is a divergence in terms of how the SSSG stayed out for the 2 formats is different. One has seen a fall in the footfall, whereas the other one has seen a fall in the transaction value.

Sanjay Purohit: Yes. So if you look at the answer to that lies in the kind of price increases that we expect from going forward from here. On both the brands we are seeing inflation having cooled off, and therefore, pricing today will be very modest. And I think from here onwards, both SSSG and transactions will start to go in the same direction.

In KFC also the launch of our value -- entry value innovation, which is chicken rolls will help us in our transaction growth. In one simple adage that we try and follow is that transaction growth finally is the important barometer for a brand. And it's not only same-store transaction growth, but overall transaction growth also because our number of stores that we have opened also is quite high.

As long as transactions are growing, the brands are in good health. And going forward, with inflation, cooling of pricing, then reverting to the kind that we have had in the past, I think both will start to see upward trajectory.

Nihal Jham: Just one follow-up to Sanjay, that in case of KFC, there are launches maybe at the value range of -- with the INR99 roll launch and all. That going forward, is there a case of the transactions come back and maybe similar to Pizza Hut the ADS maybe contrast a little or maybe the SSSG stays flat, irrespective of how the market turns out?

Sanjay Purohit: Yes. So I think it's -- you've got to do both, Nihal. You've got to have innovations that are aimed at the brand loyalists and therefore, things like Chizza worked with the brand loyalists and you have to look at customer acquisition innovation. So chicken rolls perhaps do a bit of both. They talk to the brand loyalists and give them one more reason to come to KFC.

But also because of their attractive price points, so they'll attract a new consumer. So I think we should see both SSSG and SSTG move up now through this launch. So it's not one versus the other.

Nihal Jham: Just one final question was on the store sizes for Pizza Hut. Ideally, you used to target 1,500 square feet kind of omni store sizes. Are the 1,000 square feet either -- despite, say, the lowest space on kitchen food serving, the purpose in terms of giving the omni experience, which, in a way, differentiated us, say, from our sister brand -- sorry, our sister company, which is opening more delivery focused?

Sanjay Purohit: Yes. So we are not doing 1,500 square foot stores, Nihal, first of all. We have done 1,200 square foot stores right across. This 1,000 square foot format does not compromise one bit on the front-of-house, it's dine-in experience. What we have seen is that because -- in the larger cities, through increased delivery cycles, we are able to crunch the back-of-house kitchen and a large portion of the back-of-house kitchen goes into storage, both chilled, as well as frozen as well as dry. That we are able to crunch because we are in the large cities. So this format won't work if you're going to a slightly more remote city. So this is only to enable us to increase density.

Moderator: Next question is from the line of Percy Panthaki from India Infoline.

Percy Panthaki: First question on innovations. These innovations which you have written in terms of popcorn pizza, -- sorry, Chicken Popcorn with Maggi, Popcorn Nachos and Chizza, these few months or weeks back were visible on Zomato, but now they are not. So have you withdrawn these launches? And if so, why?

Sanjay Purohit: Secondly, to answer your question, these are limited time offers typically, Percy. So there are some innovations that come and stay as part of our menu forever. And there are innovations that we run for a limited period of time. So chicken popcorn with Maggi and nachos was a limited time offer.

Vijay Jain: And for example, chicken roll is a permanent addition to the menu. So there are LTOs as we call internally, LTOs are a limited time offers, and there are some permanent additions to the menu.

Sanjay Purohit: Yes. So chicken rolls is a permanent addition to the menu.

Percy Panthaki: And what parameters or metrics do you use to determine whether it will be a permanent or a limited time offering?

Sanjay Purohit: Yes. So during the process of new product innovation, we would have tested with consumers, and there are parameters that we use for acceptability, is there a new occasion of consumption and what need does it serve. After looking at much of these parameters, then we decide whether it is a limited time offer or a permanent offer.

Finally, also importantly is while we will do all of this testing, performance in the marketplace is really important. And we might -- so that's the final determinant.

Percy Panthaki: Okay. Also on the same topic of innovation, just something I noticed was that a company like McDonald's, most of the innovation in recent times are towards the premium and their gourmet burger variants are actually what is driving the SSSG in a meaningful way now. Whereas, I see that our innovations are largely towards democratization, affordable price points like chicken roll at INR99, flavor fun pizza, et cetera.

So just wanted to understand why the differential thought process? And does this really help in this kind of an environment where, for example, flavor fun pizza, whatever gain you've got in terms of attracting new users or transactions the detriment in terms of down trading has actually more than offset that. That explains the negative SSSG at a net level.

So just wanted to understand if probably this could have been launched at some other time when the situation was more normal and not stressed like this?

Sanjay Purohit: So first of all, Percy, innovation is a long game. So this is not a quarter-on-quarter gain. And at a period of time, you are seeing both the brands launching value innovation. So this is coincidental. This is, like I said, a period of time that you've seen this innovation. There's no grand plan that either both of these brands will only launch value innovation. So that's the first thing that I would want to say.

In fact, the April innovations on Pizza Hut, and it's just not a topping -- I'd invite you to go and try the product out, but mouth feel, et cetera, has substantially improved. There's much more moistness in the pizzas. And so while we are saying 10 new pizzas, actually, this is our core range that has got completely re-done.

So -- and again, brands have different objectives at different times. Largely, you're trying to appeal to the brand loyalists and when you're appealing to the brand loyalists, premiumization is an important factor. So Chizza, for example, does really well with the premiumization aspect that we want to drive with the KFC brand loyalists.

And at times, you also want to expand the consumer base, and therefore, rolls plays a good role. It also plays a very important role in expanding the usage occasions for the same KFC brand lines. So give him or her an occasion to come, say, between 3 and 6 and snack on our products and so on.

Percy Panthaki: Right. Got it. And finally, just wanted to get some idea on this Pizza Hut margins. So this time, we had a negative 4% SSSG and the margin is around sort of 8.5%. Assuming that -- I mean, in the near term, for the next 2, 3 quarters, if let's say our SSSG comes to a 0% kind of a level, what kind of margin range we'll be looking at? Will it be like 10% to 11% will be a fair number to look at for the next 2 to 3 quarters under an assumption of 0 SSSG?

Vijay Jain: So again, Percy, I would not comment on the next 2 or 3 quarters percentage. But yes, if your negative SSSG comes to flat or starts going to positive, we should come back to double-digit restaurant EBITDA.

Sanjay Purohit: It's also a factor of ADS, Percy, that it went down to 50 ADS. So it's also a factor of that.

Vijay Jain: But yes, SSSG becomes neutral or positive, it will be on the last year's SSSG in H1, which was pretty healthy ADS. So you are right, if you are able to get it neutral or positive, it will come back to the double-digit restaurant EBITDA levels.

Moderator: Next question is from the line of Saurabh Kundan from Goldman Sachs.

Saurabh Kundan: So when you set out into this quarter or maybe you were in the middle of the quarter, were your expectations lower than what you've actually delivered, especially on the Pizza Hut side? So in other words, has March, despite the difficult base, has March surprised you slightly positively? And if you could also comment on how 1Q has been until now, that will be very helpful?

Sanjay Purohit: So I don't think March was any better or any worse on Pizza Hut. I think it continued in the same tradition in the same manner. Quarter 1 generally sees an uplift in absolute terms from the Jan-March quarter, and we have seen an uplift. But I'm not going to -- it's really too early to talk about quarter 1.

But the general movement that we see from Jan, March into April, May, June, is what we have noticed this year. But on the base that we were delivering in -- we are delivering in April, May, June. In the case of KFC, March was muted because 9 days of Navratra and Ramadan, all impacted us in March significantly.

Saurabh Kundan: Right. Second, very quick question. What is the non-cash component of corporate overheads this time or for the whole year?

Sanjay Purohit: Sorry, just repeat that.

Saurabh Kundan: What is the non -- what is ESOP part of the corporate overheads this quarter or for the whole year?

Vijay Jain: ESOP cost for the year would be anywhere between 0.7% to 0.8% of revenue.

Saurabh Kundan: Right. Just a last one, if I can squeeze one in. Another QSR player reported and although the raw material profile is different, but they reported like a very large expansion in gross margin. Can you comment on what drives this difference? For both your formats you've seen a drop in gross margin year-over-year versus like 300 basis points plus increase for the other player.

Sanjay Purohit: So sequentially, KFC has improved. On Pizza Hut also the only pressure is on dairy right now.

Vijay Jain: So again, both the key components of each of our brands. So one is chicken for KFC saw the highest ever inflation in H1, in particular. And since then, we have seen some cooling off and some recovery. Again, oil is a very big component for us and chicken.

On Pizza Hut, dairy probably amongst all commodities and not just for pizza, as a category, but dairy amongst all commodities have seen highest ever inflation. And that's probably the reason for why our -- both the brands would have seen a negative or a drop in gross margins.

Having said that, in spite of a drop in gross margins, as we said, we have reported an improvement in restaurant EBITDA margins year-on-year for both the brands. On the other side, while I should not comment on the other competitor. But we believe the catering business would be high -- typically, catering business is a high gross margin business.

And that could be a mix, which would be a play. Also, I heard in the commentary that there was some reclassification by them on some processing charges from the cost of goods sold to other expense line. But again, very difficult to comment on their side.

Moderator: Next question is from the line of Devanshu Bansal from Emkay Global.

Devanshu Bansal: Congrats on big menu revamp and associated marketing. Sir, for KFC, last year ADS was about 145,000 and we have exited Q4 with about 127,000. Similar trends go for Pizza Hut as well. So is it correct to assume that the SSSG outlook that you have mentioned is a combination of declining first half followed up by a strong turnaround in second half?

Vijay Jain: And you're referring to which outlook? I think you're referring to the 5% to 7% comment which Sanjay have made. But that's a comment we would have said, you would have heard Sanjay or me saying over a long-term 3 to 4 years scenario that, that's what we expect with the kind of growth ambitions we have in terms of store additions, which is doubling the count over 3 to 4 years.

We believe a 5% to 7% SSSG over a 3- to 4-year period is a reasonable assumption to go. But this does not indicate in any way what the next or immediate quarter is going to look like.

Devanshu Bansal: No. So even if -- I just want some sense as in last year for Q1, it was 145,000 and Q4 exit is at 127,000. So is this largely because of seasonality or we can see on a sequential basis such kind of a pickup in this quarter, which is going on?

Vijay Jain: ADS has 2 parts to it. So one is seasonality definitely. Also with the new store additions, typically, a new store for us would start anywhere at 75% to 80% of the overall brand average in year 1 and then takes 3 to 4 years to scale up towards brand average. So as you keep adding more and more new stores, which starts at 75% to 80% of the brand average, it impacts the overall ADS. So that's the reason what you have seen. Having said that, Q4, apart from seasonality, has also been impacted by Navratra in March quarter -- in March, month.

Devanshu Bansal: And what is the typical Q4 to Q1 since these are close around quarters? So I guess, what is the typical pickup in Q1 that you see after Q4?

Vijay Jain: Unfortunately, this movement in festival period can make it very difficult to predict at what has been the exact and apart from other than festivals over last 3 years, the COVID impacts from 1 quarter to other quarter, means that there is no specific trend which you can rely upon. However, generally, we could see anywhere between 5% to 15% upliftment in Q1 compared to Q4. But I'm giving you a very broad range and a big range as well. But difficult to say because of the last 3 years trend being marked by various incidents or various reasons.

Devanshu Bansal: And this applies for Pizza Hut as well, Vijay?

Vijay Jain: Yes. Yes. Although Pizza Hut gets slightly less impacted by festival movements unlike KFC, but yes, you see upliftment in given Pizza Hut in quarter 1 compared to quarter 4.

Devanshu Bansal: Okay. And from a gross margin perspective, I just wanted to understand it better, if you could call out on an overall basket basis, so you indicated that dairy is up, while others are down. So on an overall basket basis, what is the current level of inflation that you're seeing in Q1?

Vijay Jain: So we believe that Q4 levels on gross margins, we should be able to sustain on those levels in the near future because the inflation has settled down both for the raw materials for both the brands KFC as well as Pizza Hut.

So I don't see any further impact on the gross margins in the near future. So what we are seeing is inflation in the range of 3% to 5%, but that we should be able to take care manage either through a price increase or other cost efficiencies, hence we should be able to sustain the gross margin levels in the immediate future.

Devanshu Bansal: Okay. Have we taken so far any price increase in…

Vijay Jain: So in KFC, starting this financial year, we have taken a roughly 3.5% price increase starting April.

Devanshu Bansal: Got it. And sir, last small bookkeeping question. So these growth investments toward marketing in this Pizza Hut, many of you've done. And this also lead to some margin impact or this is handled by the master franchisee.

Vijay Jain: So we are definitely increasing the level of marketing investment from the current levels. However, whether this would impact the restaurant EBITDA, we believe if typically, the increase in sales should pay by itself.

Sanjay Purohit: Yes. Is there any -- Devanshu, you said master franchisee -- I'm sure you meant the Yum right?

Devanshu Bansal: Yes, yes, yes.

Sanjay Purohit: Yes. Okay. They're not -- they are the brand owners. Yes.

Devanshu Bansal: Yes. Sorry.

Sanjay Purohit: Yes. Can we move to Shirish, if you're through, Devanshu? Did we answer Devanshu's question? Did we answer your question, Devanshu, I'm sorry?

Devanshu Bansal: No, it was incomplete, sir, sorry.

Sanjay Purohit: It was incomplete, I'm sorry. Let us answer it again.

Vijay Jain: So you will see an increased level of investments, Devanshu. Again, it's a combination where both the brand owners, like Yum and franchisee comes together and will co-invest the increased amount on that marketing front. Having said that, we believe this should pay for itself with the increase in the revenue again, but it's not a short term. You have to sustain it over a period of time.

So while immediately, you may or may not see result, but if you are able to sustain it over 2, 3, 4 quarters, we should -- we believe this will pay for itself.

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

Shirish Pardeshi: Just two questions very quickly. Does that INR99 chicken roll is driven by the scaling up competition and down-trading or is it that it was pre-planned and this one of the one more ammunition to expand the transaction growth?

Sanjay Purohit: No, this was in the pipeline for quite some time. So typically, our innovation pipelines are anywhere between 12 and 15 months long, because there's quite a robust process of consumer checks, operational checks, then test marketing, operationally test marketing it in a particular area and then only going national. And here, again, there might be new ingredients at play.

So lining up the supplier base for new ingredients is also important. So in this case, the sort of the -- I'm just using an Indian term, the paratha that goes with the roll required -- was a new ingredient and required us to put up a new supply base. So it's been in the offering for some time.

Shirish Pardeshi: Just to follow up on this. This INR99 chicken roll has gone in all 341 restaurants across India and maybe if you can share quick, I'm not saying the growth, but your aspiration is transaction growth has it materially changed in the month of May since the time it is introduced?

Sanjay Purohit: Yes. So I'm not able to give you specifics on this. Let's to say that it has done better than what we have expected and the launch is a national launch. So it's not only restricted to our 341 stores, but all KFCs across the country.

Shirish Pardeshi: No, I'm referring because...

Vijay Jain: Including online.

Shirish Pardeshi: Yes. So the point, Vijay, what I'm asking, is that gone with the other partner also? Because you mentioned that you will start advertising. So is that the thing which is I wanted to check.

Vijay Jain: Yes, yes. So all in fact, not just with this product launch. Any product launch, which happens on KFC, happens with other – even sister franchisees as well. So both the partners do a launch. It's always a pan-India launch because that's where the scale in terms of supply chain, in terms of operational feasibility in terms of marketing plays a role. So it's always a pan-India launch.

Shirish Pardeshi: Okay. My second and last question on the deferred tax credit what we have utilized. Is there anything which is balanced and we will utilize the same in FY '24 also?

Vijay Jain: So we have not utilized as such. We have taken the deferred tax credit. Now it goes on to our balance sheet. It will get utilized in the future when we – out of future profits, we will not require to pay taxes. So to the extent of INR125 crores tax, there will be no cash outflow in the future.

Moderator: Next question is from the line of Amruta from Wealth Managers India.

Amruta: My question is regarding where you mentioned about the store size to be around 1,000 square feet now. So earlier, we had around 1,200 to 1,400 square feet stores. So are we planning to change all those stores step-by-step procedure to 1,000 square feet? And this is for KFC or Pizza Hut or both?

Sanjay Purohit: I'll explain Amruta. We use on Pizza Hut. Our legacy stores are 2,500 square foot. But over a period of time, we have shrunk both the back of house and optimize the front of house, and we were opening 1,200 square foot stores. These 1,200 square foot Pizza Hut stores, we believe in the large cities, 5 – or 6 large cities where we have got warehousing facilities close to the stores can be further crunch to 1,000 square feet.

And because we've got shorter delivery schedules to these stores. And hence, a 1,000 square foot store with the same number of covers is still able to work. Perhaps anywhere between 10% and 15% of our total store base going forward will be in this size. However, it does not mean that we are going to convert our old stores into this.

Amruta: So this is only for the Pizza Hut stores?

Vijay Jain: This is only for Pizza Hut stores, and this is only for stores going forward.

Amruta: Okay. And like what kind of benefit operating-wise do we expect from reduction in these sizes, I mean, in the margin?

Vijay Jain: So again, I would not comment on specific on margins because while we have launched this last year 7 stores we were piloted last year. H2 was a soft period for Pizza Hut. So we will wait till I comment on the margins of this. But from a capex point of view, this could give us anywhere between 5% to 8% capex reduction.

Amruta: And the KFC stores are around 1,200 square feet, right? So that one remain the same?

Vijay Jain: So KFC were always in the range of 1,500-odd square feet. So it would remain in the 1,500 to 1,600 square foot range.

Amruta: My second question is regarding as in, there's lot of strategy going ahead for the Sri Lanka business?

Vijay Jain: So on Sri Lanka business, as we mentioned, the operating conditions have stabilized, so which means the forex availability, the power and fuel availability, the raw material availability, the supply chain, everything has stabilized from that point of view.

Yes, while the demand conditions have impacted those transaction growth, we believe we are at the bottom of it. Hopefully, we believe over the next 12 months, we should start seeing some small amount of recoveries where we can gain our restaurant EBITDA margins back up by a few basis points, if not more.

And hopefully, post 12 months, we expect going back towards that 20% restaurant EBITDA margins. So that could happen from a 12 to 24 months journey point of view on Sri Lanka business.

From a store expansion point of view, we believe the next 12 months, we would be taking a cautious approach and we'll revisit the situation every quarter on how the conditions are improving, whether they are able to pull back our restaurant EBITDA margins. And as we start seeing positive movements, we'll start opening new stores. So that's the strategy on Sri Lanka for next 12 to 24 months.

Moderator: I now hand the conference over to the management for closing comments.

Sanjay Purohit: Like I said, while closing our earnings presentation, the last 6 months have been tough, but we are seeing this general toughness in the macroeconomic demand conditions. But in such conditions, I want to reiterate and underline large trusted brands have the potential of doing better, differentially and differentially. And the marketing program, the product innovation program that we have put on both KFC as well as Pizza Hut backed with our operational execution excellence, we believe can -- will give us dividends even in such market, even in such conditions, and we remain quite optimistic and bullish about both the brands and the future of the QSR category.

Thank you very much, everyone, for participating. Stay safe.

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