March 04 2021

Sapphire Foods India Private Limited: Ratings reaffirmed and Outlook revised to Stable; Issuer rating placed on notice of withdrawal

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Rating	0.00	0.00	[ICRA]BBB; Reaffirmed, Outlook revised to Stable from Negative; Placed on notice of withdrawal
Long-term - Term Loan	71.25	71.25	[ICRA]BBB; Reaffirmed, Outlook revised to Stable from Negative
Unallocated amount- Short-term and Long-term	128.75	128.75	[ICRA]BBB/[ICRA]A3+; Reaffirmed, Outlook revised to Stable from Negative
Total	**200.00**	**200.00**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook to Stable follows the sharp recovery witnessed in Sapphire Foods India Private Limited's (SFIPL) operations and thereby its financial profile from Q3 FY2021 onwards due to steady ramp up in sales with gradual relaxation on lockdown and commencement of dine-in operations. The company saw an adverse impact on sales and subsequent profitability in H1 FY2021. However, the standalone operations witnessed recovery in H2 FY2021 and reported an operating income of Rs. 618.10 crore during 10M FY2021 (unaudited) and operating profit in 10M FY2021 against an operating loss in Q1FY2021. Additionally, the relaxation in targets and incentives offered by Yum! Brands Inc. for CY2020 and CY2021 is also expected to provide some comfort, going forward. At a consolidated level, operations in the Gamma Group (subsidiary of SFIPL) were not impacted considerably. The Gamma Group reported YoY sales decline in the range of 10 to 12% in 10M FY2021. ICRA also takes note of the company's comfortable capital structure and low working capital intensive nature of operations. In addition, the ratings take into account the established presence of the Pizza Hut and the KFC brands in the local and global markets as well as Group's diversified presence across India, Sri Lanka and the Maldives through a chain of KFC and Pizza Hut outlets. The ratings drive comfort from substantial investments made by reputed venture capital funds and an experienced management team.

The ratings, however, remain constrained by the company's continuing losses at the net level and its negative return on capital employed (RoCE) since its inception. In addition, ICRA notes that compliance with the terms and conditions laid out in the development agreement for ongoing operations and a prudent funding plan for launching targeted outlets going forward, will remain critical from the credit perspective. The ratings also take into account the increasing competition from players in the organised and the unorganised markets. Furthermore, ICRA notes that KFC's sales are exposed to the inherent industry risk of a disease outbreak in case of birds (chicken), which may impact both the supply as well as the consumption of chicken and its related products.

The issuer rating of SFIPL has been placed on one month notice of withdrawal at the request of the company, in accordance with ICRA's policy on withdrawal and suspension of credit rating.

Key rating drivers and their description

Credit strengths

Established brand presence in local and global markets and geographically diversified presence in India and Sri Lanka– The Group operates as one of the two largest franchisees of the Pizza Hut and KFC brands (owned by Yum!) in India, along with its presence in Sri Lanka and Maldives. Yum! Brands Inc. has established over 49,000 restaurants in more than 145 countries and territories, with about 98% outlets owned and operated by franchisees, licensees and affiliates. SFIPL operated 199 KFC stores in West, North, South and Central India and 155 Pizza Hut outlets in western, southern and central India as on January 31, 2021. The company also operates seven Pizza Hut stores in Gurugram (Haryana, India), 64 Pizza Hut and three Taco Bell outlets in Sri Lanka and two outlets in the Maldives through its subsidiaries/Gamma Group.

Substantial investments made by reputed venture capital funds and experienced management team – SFIPL's daily operations are looked after by a management team with more than a decade's experience in the industry. The company is promoted by QSR Management Trust, which is owned by Samara Capital. Sapphire Foods Mauritius Limited (owned by Samara and IDE Emerging Markets), Goldman Sachs, CX Partners and the Edelweiss Group are the other investors in the company. The investors have infused Rs. 681.93 crore as equity and Rs. 224.99 crore as compulsorily convertible preference shares (CCPS) during the past five financial years. Furthermore, the investors infused Rs. 40.8 crore in Q2 FY2021, through rights issue to support the liquidity position.

Speedy recovery witnessed in financial profile from Q3 FY2021 – SFIPL witnessed speedy recovery in sales from Q3FY2021, thereby its overall financial profile posted sharp rebound compared to H1FY2021 performance. SFIPL (standalone) sales stood at Rs. 618.10 crore during 10M FY2021. Furthermore, the company achieved turnaround in 10M FY2021 and reported an operating profit against an operating loss in Q1 FY2021 on the back of management's attempts to optimise its expenses coupled with high operating leverage in the business. ICRA expects the company to report operating profit for FY2021 on the back of healthy sales in Q4 FY2021. At a consolidated level, operations in the Gamma Group (subsidiary of SFIPL) were not impacted considerably and YoY revenue decline has remained in the range of 10-12% in 10M FY2021.

Credit challenges

Losses at net level and negative RoCE since inception – SFIPL's net margin has remained negative since its inception due to a modest operating profit margin and high depreciation expense. The consolidated RoCE continues to remain negative given the under-absorption of overheads and ongoing capital expenditure to set-up new outlets.

Compliance with terms and conditions of development agreement with Yum! and judicious funding plan for future capex will remain critical – SFIPL (standalone) had plans to open a pre-determined number of KFC and PH stores as per the arrangement with Yum!. While the company has revised its capex plans for CY2020 and CY2021 based on the relief agreement, its ability to set up the targeted number of stores and avail maximum benefit under the arrangement, will remain a key monitorable. Furthermore, a prudent funding pattern; with limited reliance on debt to fund the expansion plans will remain crucial from the credit perspective. Adherence to the developmental agreement for both Pizza Hut and KFC will be an ongoing monitorable parameter and will be a key rating sensitivity.

Increasing competition from organised and unorganised markets – SFIPL faces intense competition from unorganised as well as organised QSR players like Dominos, McDonald's and Burger King. The company's ability to sustain its growth and improve its profit margin amid intense competition will remain critical.

Exposed to inherent industry risk of disease outbreak in case of birds (chicken), which may impact both supply as well as consumption of chicken and its related products – As SFIPL generates most of its revenues from KFC, its sales are exposed to uncontrollable factors like outbreak of diseases such as Avian Influenza (bird flu), which may impact both supply as well as consumption of chicken and its related products.

Liquidity position: Adequate

SFIPL's (standalone) liquidity position is **adequate**. The company had a free cash balance of ~Rs. 76.38 crore (unaudited) as on January 31, 2021. While the operational cash flows remained under stress due to losses reported by the company during H1FY2021, the turnaround in operations in 10M FY2021, remains a source of comfort. SFIPL plans to incur a sizable capex for next two fiscals, which is expected to be funded through internal accruals and term loan. At a consolidated level, the company has repayment obligations in the range of Rs.12.50 crore to Rs.55.00 crore for next three years.

Rating sensitivities

Positive factors – ICRA could upgrade SFIPL's rating if there is: a) continued increase in its revenues on the back of a continuous business expansion, as planned; b) Improvement in the profit margin thereby leading to improvement in coverage indicators could also lead to a rating revision.

Negative factors – Lower-than-expected sales growth coupled with a delay in stabilisation of new stores leading to lower than expected profitability can lead to a rating downgrade. Any unanticipated debt-funded capex resulting in leveraged capital structure and moderation in debt coverage indicators could also result in rating downward pressure.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the consolidated financials of SFIPL. The subsidiaries of SFIPL as of March 31, 2020, are enlisted in Annexure-2.

About the company

Incorporated in November 2009 as Samarjit Advisors Private Limited, the entity was renamed as Sapphire Foods India Private Limited in 2015. SFIPL is a franchise partners of Yum. for Pizza Hut and KFC brands. It was promoted by QSR Management Trust, which is owned by Samara Capital. In FY2016, QMT's stake diluted to 7.24%, pursuant to fresh investment by Sapphire Foods Mauritius Limited (owned by Samara and IDE Emerging Markets), Goldman Sachs and CX Partners. The Edelweiss Group subscribed to CCPS and joined the company as an investor in FY2019.

The company operated 199 KFC stores and 155 Pizza Hut stores in India as on January 31, 2021. In addition, it operates 64 stores in Sri Lanka, two in Maldives and seven in Gurugram (India) through its subsidiaries. As on March 31, 2020, the company held 99% stake in Gamma Pizzakraft (Overseas) Private Limited, an investment company, and has subsidiaries operating in Gurugram, and in Sri Lanka and the Maldives.

In FY2020, SFIPL (consolidated) reported a net loss of Rs. 132.98 crore (consist of exceptional loss of Rs.94.39 crore) on an OI of Rs. 1,340.41 crore compared to a net loss of Rs. 44.66 crore on an OI of Rs. 1,193.82 crore in the previous year.

Key financial indicators (Audited)

	FY2019	FY2020*
Operating Income (Rs. crore)	1193.82	1340.41
PAT (Rs. crore)	-44.66	-132.98
OPBDIT/OI (%)	3.44%	4.89%
PAT/OI (%)	-3.74%	-9.92%
Total Outside Liabilities/Tangible Net Worth (times)	0.53	0.46
Total Debt/OPBDIT (times)	2.34	1.09
Interest Coverage (times)	2.34	5.61

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
**Audited Results adjusted for INDAS 116*
All the figures mentioned in the above table are as per ICRA's computation
Note: All the figures mentioned in the rationale for FY2021 are unaudited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)					Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jan 31, 2021 (Rs. crore)	Date & Rating in		Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
					4-Mar-2021	30-July-2020	13-Feb-2020	-	-
1	Issuer Rating	-	-	-	[ICRA]BBB (Stable); Placed on notice of withdrawal	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	-	-
2	Term Loan I	Long-term	51.25	46.23	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	-	-	-
3	Term Loan II	Long-term	20.00	19.33	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	-	-	-
4	Unallocated Limits	Long-term and Short-term	128.75	-	[ICRA]BBB (Stable)/[ICRA]A3+	[ICRA]BBB (Negative)/[ICRA]A3+	-	-	-

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Issuer Rating	-	-	-	-	[ICRA]BBB(Stable); Placed on notice of withdrawal
NA	Term Loan I	June 2018	9.80%-10.70%	August 2023	51.25	[ICRA]BBB(Stable)
NA	Term Loan II	July 1, 2020	14%	September 2023	20.00	[ICRA]BBB(Stable)
NA	Unallocated amount	-	-	-	128.75	[ICRA]BBB(Stable)/[ICRA]A3+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Subsidiary Companies		
Gamma Pizzakraft Overseas Private Limited	100%	Full Consolidation
Gamma Pizzakraft Private Limited	100%	Full Consolidation
Gamma Pizzakraft Lanka Private Limited	100%	Full Consolidation
French Restaurants Private Limited	100%	Full Consolidation
Gamma Island Food Private Limited	51%	Full Consolidation

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About ICRA Limited:

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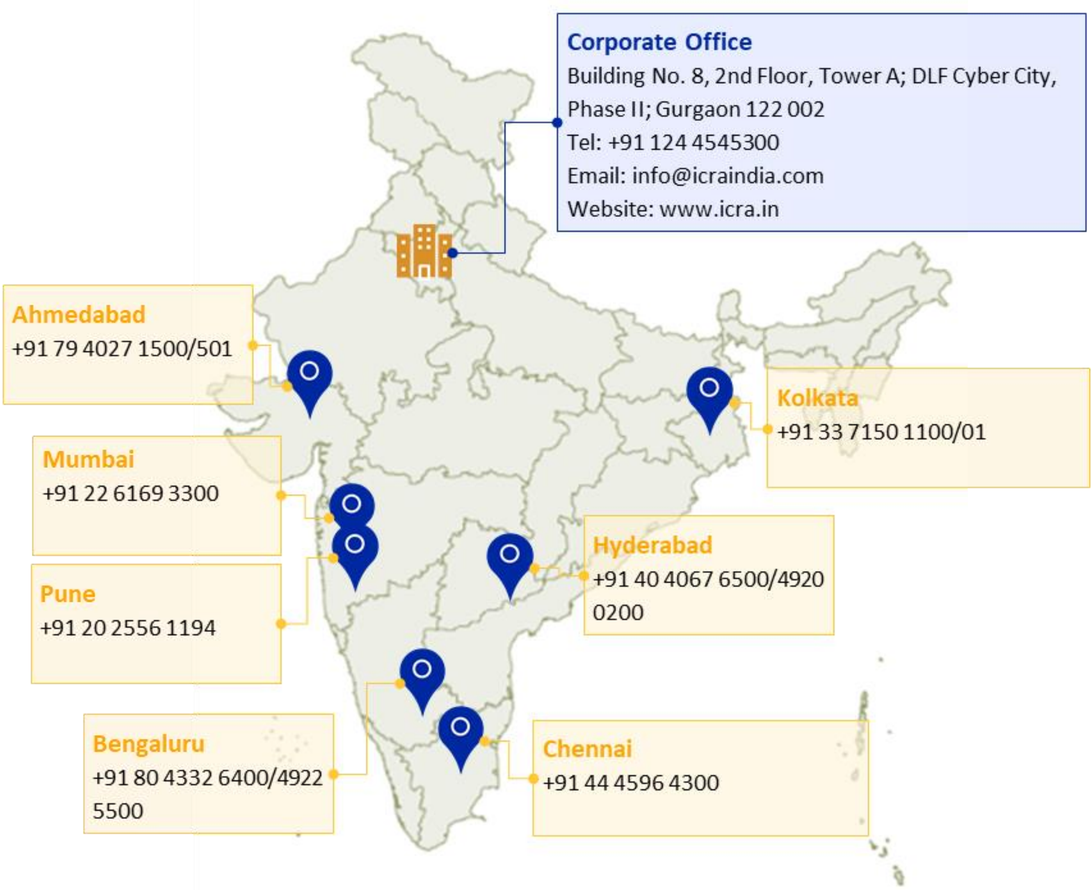

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