November 01, 2021

# Sapphire Foods India Limited: Ratings upgraded and outlook revised to Positive from Stable

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Long-term - Term Loan | 71.25 | 126.18 | [ICRA]BBB+; Upgraded from [ICRA]BBB, Outlook revised to Positive from Stable. |
| Unallocated amount- Short-term and Long-term | 128.75 | 73.82 | [ICRA]BBB+/[ICRA]A2; Upgraded from [ICRA]BBB/A3+, Outlook revised to Positive from Stable. |
| Total | **200.00** | **200.00** | |

**Instrument details are provided in Annexure-1*

## Rationale

The rating upgrade factors in the sizeable equity infusion into the company in the current fiscal to the tune of about Rs. 474.2 crores which has led to significant strengthening of its net-worth and has also provided impetus towards growth capital needed for the aggressive expansion plans in the near to medium term. The recovery in top-line is also visible in the current fiscal for Sapphire Foods India Limited's (SFIL; erstwhile Sapphire Foods India Private Limited) as reflected by steady ramp up in sales with gradual relaxation in lockdown and commencement of dine-in operations. The company`s top line and margin were adversely impacted during FY2021 and to some extent on Q1FY2022, on account of disruptions due to Covid-19 pandemic and resultant impact of lock-down. However, the operations witnessed smart recovery in Q2FY2022 with ADS (average daily sales) reaching pre-covid levels. ICRA expects the momentum to continue in term of sales for FY2022 and is expected to surpass pre-covid levels, with better profitability, given the high operating leverage nature of business. However, risk remains in terms of any severe subsequent wave and its impact there on the business, and will be an ongoing monitorable.

ICRA also notes that the company with respect to expansion of stores have to meet certain pre-determined numbers as per last relief agreement signed with Yum! Brands Inc.(Yum) for CY2020 and CY2021 which remains critical for availing financial incentives and thereby strengthen its cost structure. The rating also continues to take into account the established brand presence of the Pizza Hut (PH), KFC and Taco Bell 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 also derive comfort from the 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 an efficient execution for launching its targeted outlets going forward, will remain critical from the credit perspective. The ratings also consider the increasing competition from players in the organized and the unorganized markets. Furthermore, ICRA notes that KFC's sales are exposed to the inherent industry risk of a disease outbreak in case of birds (poultry), which may impact both the supply as well as the consumption of chicken and its related products.

The Positive outlook on [ICRA]BBB+ rating reflects ICRA's opinion that the momentum of recovery and improvement in ADS to sustain or grow in near to medium term which is likely to support the scale of operations and operating margins in the current fiscal. Infusion of sizeable equity is also positive from availability of growth capital perspective and negates any probable risk of debt funded capex in near to medium term.

# 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 PH and KFC brands (owned by Yum!) in India, along with its presence in Sri Lanka and Maldives. Yum! Brands Inc. has established over 50,000 restaurants in more than 150 countries and territories, with about 98% outlets owned and operated by franchisees, licensees and affiliates. SFIL operated 219 KFC stores in West, North, South and Central India and 181 PH outlets in western, southern and central India as on September 30, 2021. The company also operates seven Pizza Hut stores in Gurugram (Haryana, India), 70 Pizza Hut and three Taco Bell outlets in Sri Lanka and two outlets in the Maldives through its subsidiaries/Gamma Group.

**Demonstrated support from promoter-spurred capital infusion over the years, and experienced management team –** SFIL'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 Sapphire Foods Mauritius and QSR Management Trust. The Company has attracted marquee investors such as affiliates of Samara Capital, Goldman Sachs, CX Partners, Creador and Edelweiss. In the H1FY2022, the company received primary equity funding from existing as well as new PE investors to the tune of Rs. 474.2 crores for growth capital purpose. Furthermore, the investors infused Rs. 40.8 crore in FY2021, through rights issue to support the liquidity position amid the impact of the pandemic. In the past, the investors have infused about Rs. 681.93 crore as equity and Rs. 224.99 crore as compulsorily convertible preference shares (CCPS) between FY2015-FY2020.

**Financial profile characterised by, comfortable capitalisation, further supported by capital infusion in the current fiscal and low working capital requirements –** SFIL witnessed sharp rebound in sales from Q2FY2022, thereby its overall financial profile posted sharp rebound in 5MFY2022, with monthly run rate of sales reaching pre-covid levels. The margins (including one-time expenses-without IndAs) for the period has also improved compared to pre-covid levels owing to increase in scale of operations, thereby leading to better absorption of fixed costs.  The company's capital structure too remained comfortable aided by steady equity infusions shoring up the net-worth base, lesser reliance on debt in funding the capex and comfortable working capital cycle. The company's working capital cycle is negative as the sales are made on cash basis and faster inventory turnover. ICRA expects the capital structure to be comfortable factoring in the liquidity cushion available following the equity infusions, which is adequate to meet any shortfalls in funding the capex requirement in the near term.

## Credit challenges

**Significant decline in operating income in FY2021 owing to government's measures towards containment of Covid-19 pandemic; Losses continues at net level coupled with suppressed RoCE** – The company's top line slipped by 24% in FY2021 as most of SFIL's outlets across the country have been closed since March 24, 2020, following the nationwide lockdown announced by the GoI. The company reported a drop in operating margins following higher fixed overheads in the form of employee costs and rentals. At net level it posted a loss of Rs. 99.9 crore which also factored in the impact of impairment on certain assets.  SFIL'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 in negative territory 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 timely execution of future capex remains critical –** SFIL (standalone) had plans to open a pre-determined number of KFC and PH stores as per the arrangement with Yum!. The compliance on the same to achieve the revised capex plans for CY2020 and CY2021 based on the relief agreement in light of the Covid-19 pandemic, remains critical in terms of incentive perspective. Its ability to set up the targeted number of stores and avail maximum benefit under the arrangement, will remain a key monitorable. Furthermore, ability of the company to timely execute the aggressive expansion plans in terms of store expansion in near to medium term with limited reliance on debt will remain crucial from the credit perspective. Adherence to the developmental agreement for both PH and KFC will be an ongoing monitorable parameter and will be a key rating sensitivity.

**Increasing competition from organised and unorganised markets** – SFIL 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 SFIL 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

SFIL's (standalone) liquidity position is **adequate**. The company had a liquid balance of ~Rs. 502 crore (unaudited) as on September 30, 2021, however the same is expected to be used for growth capital going forward SFIL has plans to incur a sizable capex for medium term, which is expected to be funded through a mix of internal accrual with any shortfall in funding is expected to be funded by the available cash balance. At a consolidated level, the company has repayment obligations of Rs. ~Rs 9 crores for the period H2FY2022 and ~Rs.49 crores in the next two financial years.

### Rating sensitivities

**Positive factors** – ICRA could upgrade SFIL'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 as well as return indicators could also lead to a rating revision.

**Negative factors**– Lower-than-expected sales growth coupled with a delay in stabilization of new stores leading to lower than expected profitability can lead to the outlook being revised to stable. Any unanticipated debt-funded capex resulting in leveraged capital structure and moderation in debt coverage indicators could also result in revision of the outlook.

### 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 SFIL. The subsidiaries of SFIL as of March 31, 2021, 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. SFIL 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 219 KFC stores and 181 Pizza Hut stores in India as on September 30, 2021. In addition, it operates 73 stores in Sri Lanka, two in Maldives and seven in Gurugram (India) through its subsidiaries. As on March 31, 2021, 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.

### Key financial indicators (Audited)

| | FY2020* | FY2021* |
|---|---|---|
| Operating Income (Rs. crore) | 1340.41 | 1019.62 |
| PAT (Rs. crore) | -159.24 | -99.89 |
| OPBDITA/OI (%) | 13.8% | 12.2% |
| PAT/OI (%) | -11.9% | -9.8% |
| Total Debt^/OPBDIT (times) | 3.5 | 5.2 |
| Interest Coverage (times) | 2.6 | 1.6 |

*PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation. * as per IndAs; ^includes Lease Liability. All the figures mentioned in the above table are as per ICRA's computation. Note: All the figures mentioned in the rationale for FY2022 are unaudited.*

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| | Instrument | Current Rating (FY2022) | | | | | 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 FY2022 | | Date & Rating in FY2021 | Date & Rating in FY2021 | Date & Rating in FY2020 |
| | | | | | 01-Nov-2021 | 16-Apr-2021 | 4-Mar-2021 | 30-July-2020 | 13-Feb-2020 |
| **1** | Issuer Rating | - | - | - | - | [ICRA]BBB (Stable); Withdrawn | [ICRA]BBB (Stable); Placed on notice of withdrawal | [ICRA]BBB (Negative) | [ICRA]BBB (Stable) |
| **2** | Term Loan | Long term-Term Loan | 126.18 | 63.13 | [ICRA]BBB+ (Positive) | [ICRA]BBB (Stable) | [ICRA]BBB (Stable) | [ICRA]BBB (Negative) | - |
| **3** | Unallocated Limits | Long-term and Short-term | 73.82 | - | [ICRA]BBB+ (Positive)/ [ICRA]A2 | [ICRA]BBB (Stable)/[ICRA] A3+ | [ICRA]BBB (Stable)/[ICRA]A3+ | [ICRA]BBB (Negative)/[ICRA]A3+ | - |

## Complexity level of the rated instrument

| Instrument | Complexity Indicator |
|---|---|
| Long Term Fund based facilities – Term Loan | Simple |
| Unallocated | Not Applicable |

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: Click Here

## 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 | Term Loan I | February 24, 2021 | 8.30% | February 2024 | 44.01 | [ICRA]BBB+(Positive) |
| NA | Term Loan II | February 24, 2021 | 8.30% | October 2026 | 17.16 | [ICRA]BBB+(Positive) |
| NA | Term Loan III | September 23, 2021 | 8.30% | NA- Term Loan yet to be drawn | 55.50 | [ICRA]BBB+(Positive) |
| NA | Term Loan IV | September 23, 2021 | 8.00% | June 2027 | 9.50 | [ICRA]BBB+(Positive) |
| NA | Unallocated amount | - | - | - | 73.82 | [ICRA]BBB+(Positive)/ [ICRA]A2 |

***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 |

***Source:*** *Company*

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## About ICRA Limited:

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