

August 05, 2022

Sapphire Foods India Limited: Ratings upgraded, outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term - Term Loan	126.18	70.68	[ICRA]A; Upgraded from [ICRA]BBB+, Outlook revised to Stable from Positive.
Long-term – Non-Fund Based	-	50.36	[ICRA]A; Upgraded from [ICRA]BBB+, Outlook revised to Stable from Positive.
Unallocated amount- Short-term and Long-term	73.82	78.96	[ICRA]A/[ICRA]A2+; Upgraded from [ICRA]BBB+/[ICRA]A2, Outlook revised to Stable from Positive.
Total	200.00	200.00	

*Instrument details are provided in Annexure-1;

Rationale

The rating upgrade of Sapphire Foods India Limited's (SFIL/the company) bank facilities factors in the significant increase in scale of operations and margins both at operating and net levels on the back of robust rebound in Average Daily Sales (ADS) reaching almost pre-Covid levels for both the franchisees, Kentucky Fried Chicken (KFC) and Pizza Hut (PH) amid gradual relaxation in lockdowns and commencement of dine-in operations. The consolidated revenues grew by 69% in FY2022 to Rs. 1,721.6 crore from Rs. 1,019.6 crore in FY2021. Given the high operating leverage nature of business, the rise in scale of operations has translated into improvement in the OPBDITA margins to 17.8% in FY2022 over 12.3% in FY2021, while the PAT margins improved significantly to 2.7% in FY2022 from -9.8% in FY2021. ICRA also notes the comfortable capital structure aided by lower reliance on external debt for store expansion and working capital needs. The sizeable equity infusion into the company in FY2022 to the tune of about Rs. 474.2 crore has led to significant strengthening of its net worth and also provided impetus towards growth capital for the aggressive expansion plans in the near to medium term. The rating continues to take into account the established presence of the PH, KFC and Taco Bell brands in the local and global markets as well as the group's diversified presence across India. The ratings also derive comfort from the reputed promoter profile of reputed private equity (PE) entities and an experienced management team.

The ratings, however, remain constrained by the company's subdued return on capital employed (RoCE) considering the company is in its growth phase albeit turning positive in FY2022. The ratings also factor in the ongoing macro-economic instability in Sri Lanka, leading to weakening of Lankan Rupee (LKR) vis-à-vis the Indian Rupee (INR) and inflationary pressures in Sri Lanka whereby the company has exposure through its step down subsidiary Gamma Pizzakraft Lanka Private Limited (GPLPL), operating 90 PH and 5 Taco Bell stores, with the business contributing about 17% to the consolidated revenues of the company in FY2022. The topline and margin in INR terms is expected to be impacted in the current fiscal given the depreciation in LKR along with any decline in revenue due to country specific issues, however expected growth in its major market in India is expected to drive the topline growth in FY2023. The margin for India business is also expected to be under pressure due to inflationary input cost scenario, though adequate hike in prices for its portfolio so as to protect its overall margin will be a key rating monitorable in the near term. ICRA also notes that the company has signed an amendment to the development agreement in H2FY2022 with Yum! for both PH and KFC whereby it needs to open a target number of stores in the medium term. 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 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 (poultry), which may impact both the supply as well as the consumption of chicken and its related products. Risks pertaining to any severe subsequent waves of Covid and its impact there on the business will also be an ongoing monitorable.

The Stable outlook on [ICRA]A rating reflects ICRA's opinion that the momentum of recovery and improvement in ADS to sustain or grow in near to medium term which are likely to support the scale of operations in the near term. Infusion of sizeable equity is also positive from the perspective of the availability of growth capital and negates any probable risk of debt funded capex in the 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– The Group (SFIL and Subsidiaries) 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 about 54,000 restaurants in more than 150 countries and territories, with about 98% outlets owned and operated by franchisees, licensees and affiliates. SFIL operated 263 KFC stores in West, North, South and Central India and 212 PH outlets in western, southern and central India as on March 31, 2022. The company also operates seven PH stores in Gurugram (Haryana, India), 90 PH and five Taco Bell outlets in Sri Lanka and two outlets (PH and KFC each) in the Maldives through its subsidiaries/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 a reputed investor profile such as affiliates of Samara Capital, Goldman Sachs, CX Partners, Creador and Edelweiss. Certain investors, including the promoters made a partial exit through Initial Public Offering (IPO) in November'2021. In the FY2022, 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. During FY2015-FY2020, the investors had infused about Rs. 681.93 crore as equity and Rs. 224.99 crore as compulsorily convertible preference shares (CCPS).

Financial profile characterised by robust revenue growth, comfortable capitalisation and coverage indicators and low working capital requirements– SFIL witnessed sharp rebound in sales from FY2022, thereby its overall financial profile posted sharp rebound, with monthly run rate of sales surpassing pre-covid levels. The margins 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 consolidated revenues have grown by 69% to Rs. 1721.6 crore in FY2022 from Rs. 1019.6 crore in FY2021. 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.

Notable improvement in ADS witnessed for both the franchisee, enabling strong growth in top-line as well as margins with positive PAT for FY2022

The ADS for PH and KFC has improved on a YoY basis and has almost reached pre-covid levels (FY2020- levels). The ADS for KFC stood at Rs. 130,000 in FY2022 as against Rs. 106,000 in FY2021 and Rs. 130,000 in FY2020. The ADS for PH stood at Rs. 57,000 in FY2022 over Rs. 48,000 in FY2021 and Rs. 58,000 in FY2020. The Same Store Sales Growth (SSSG) stood at 31% in FY2022 for KFC and 42% for PH albeit on a low base year of FY2021. Given the high operating leverage nature of business, the increase in scale of operations has translated into improvement in the OPBDITA margins to 17.8% in FY2022 over 12.3% in FY2021, while the PAT margins have turned positive for the first time to 2.7% in FY2022 from -9.8% in FY2021.

Credit challenges

Inflationary pressures and macro-economic instability in Sri Lanka to keep margin under pressure at consolidated level in the near term; RoCE continues to be at subdued levels– The company's margins are expected to be under pressure in the near term owing to the prevailing inflationary pressures in India and the macro-economic instability in Sri Lanka. Although the Sri Lankan business has shown robust growth (in both INR and LKR) in FY2022 on the back of improvement in ADS to Rs. 108,000 as against Rs. 94,000 in FY2021 and Rs. 92,000 in FY2020 while the SSSG grew by 31% in FY2022 (INR terms; 42% in LKR terms), the company is expected to face headwinds in the medium term with respect depreciation of LKR against INR resulting in impact on topline at the consolidated level. The margin for India business is also expected to be under pressure on account of inflationary input cost scenario, though adequate prices hikes to offset any such rise will be critical to protect the overall margins. The company has taken price hikes in the current fiscal both in India as well as Sri Lanka market to counter rise in input costs. The consolidated RoCE which turned positive in FY2022, albeit still continues to remain at subdued level given the aggressive store expansion plan for the company. The store expansion is expected to remain aggressive in the medium term as per the capex plans and expansion of RoCE will be contingent on ability to profitably scale up the new stores while maintaining the growth momentum for the existing ones and will remain a rating monitorable.

Compliance with terms and conditions of development agreement with Yum! and timely execution of future capex remains critical – SFIL has plans to open a pre-determined number of KFC and PH stores as per the amended development agreement with Yum!. The compliance on the same to achieve the revised capex plans in the medium term, 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 bird flu, which may impact both supply as well as consumption of chicken and its related products.

Liquidity position: Adequate

SFIL's liquidity position is **adequate**. The company had a liquid balance of ~Rs. 445 crore (including fixed deposits and current investments) as on March, 2022, 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 20 crores for the period FY2023.

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 indicators 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 a rating downgrade. Any unanticipated debt-funded capex resulting in leveraged capital structure and moderation in debt coverage indicators marked by interest coverage ratio of below 3.5x on a sustained basis 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 SFIL. The subsidiaries of SFIL as of March 31, 2022, 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 (QMT), 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's IPO was consummated in November' 2021 where by promoters and certain set of investors had a partial exit through an offer for sale.

The company operated 263 KFC stores and 219 Pizza Hut stores in India as on March 31, 2022. In addition, it operates 95 stores in Sri Lanka, two in Maldives and seven in Gurugram (India) through its subsidiaries. As on March 31, 2022, the company held 99% stake in Gamma Pizzakraft (Overseas) Private Limited, an investment company, and has subsidiaries operating in Gurugram, Sri Lanka and the Maldives.

Key financial indicators (Audited)

Consolidated- SFIL	FY2021*	FY2022*
Operating Income (Rs. crore)	1019.6	1721.6
PAT (Rs. crore)	-99.9	46.0
OPBDITA/OI (%)	12.2%	17.8%
PAT/OI (%)	-9.8%	2.7%
Total Debt [^] /OPBDIT (times)	5.2	2.6
Interest Coverage (times)	1.6	3.9

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.

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History				
		Type	Amount Rated	Amount Outstanding as of Jun 30, 2022	Date & Rating in FY2023	for the past 3 years				
			(Rs. crore)	(Rs. crore)	5-Aug-22	Date & Rating in FY2022		Date & Rating in FY2021		Date & Rating in FY2020
						1-Nov-21	16-Apr-21	4-Mar-21	30-Jul-20	13-Feb-20
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	70.68	51.81	[ICRA]A (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)	-
3	Bank Guarantee	Long Term	50.36	50.36	[ICRA]A (Stable)					
4	Unallocated Limits	Long-term and Short-term	78.96	-	[ICRA]A (Stable)/[ICRA]A 2+	[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
Long Term Non-Fund based facilities – Bank Guarantee	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: www.icra.in

Annexure-I: 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	6.50%	February 2024	44.01	[ICRA]A(Stable)
NA	Term Loan II	February 24, 2021	6.50%	October 2026	17.16	[ICRA]A(Stable)
NA	Term Loan IV	June 11, 2021	6.50%	June 2027	9.50	[ICRA]A(Stable)
NA	Bank Guarantee	-	-	-	50.36	[ICRA]A(Stable)
NA	Unallocated amount	-	-	-	78.96	[ICRA]A(Stable)/ [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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