October 07, 2024

Sapphire Foods India Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Term Loan	32.49	15.82	[ICRA]A (Stable); reaffirmed
Long-term – Non-Fund Based	77.73	60.00	[ICRA]A (Stable); reaffirmed
Unallocated amount- Short-term and Long-term	89.78	124.18	[ICRA]A (Stable)/ [ICRA]A2+; reaffirmed
Total	**200.00**	**200.00**	

**Instrument details are provided in Annexure-I*

Rationale

The reaffirmation of the ratings reflects ICRA's expectation that the credit profile of Sapphire Foods India Limited (SFIL) will remain comfortable, supported by its strong business position as one of the national franchisee for Kentucky Fried Chicken (KFC) and Pizza Hut (PH) in India, Sri Lanka and the Maldives. SFIL has demonstrated healthy revenue growth over the past few fiscal years, reaching Rs. 2,594.27 crore in FY2024 (up 15% YoY), bolstered by significant store expansions, particularly for its KFC chain. The company also benefited from the stabilisation of economic and political conditions in Sri Lanka in FY2024, which led to the Sri Lankan currency's recovery against the INR, improving its consolidated performance. SFIL maintains a comfortable capital structure due to its limited reliance on external debt for store expansion and working capital requirements. Additionally, the ratings consider the Group's diversified international presence, operating PH and KFC brands in India and the Maldives, as well as PH and Taco Bell in Sri Lanka. Further, the ratings are supported by an experienced management team and the favourable long-term demand for the quick service restaurants (QSR) industry.

However, the ratings remain constrained by the company's subdued return on capital employed (RoCE), as SFIL is still in its growth phase. The RoCE declined in FY2024, driven by margin pressures due to softening consumer demand amid intense competition especially in the Pizza segment, which impacted average daily sales (ADS). Given the notable store additions planned in the near-to-medium term, ICRA expects the recovery of return indicators to be gradual, hinging on the timely capex execution for store additions and successful ramp-up of operations. ICRA will continue to monitor margin trends and the subsequent impact on return indicators, with a focus on a meaningful recovery in ADS, especially of the Pizza segment, in the near term.

ICRA also notes that the company has signed an amendment to the development agreement in FY2022 with Yum! Brands for both PH and KFC, as SFIL intends to launch its targeted number of stores in the medium term. Compliance with the terms and conditions laid out in the development agreement for ongoing operations and efficient execution for launching its targeted outlets going forward will be key monitoring factors. KFC's sales are exposed to the inherent industry risk of a disease outbreak in birds (poultry), which may impact both supply and chicken consumption, along with its related products.

The Stable outlook on [ICRA]A rating reflects ICRA's opinion that the company will continue to capitalise on its strong brand profile, improving penetration through store additions and limited external borrowing levels except for lease liabilities.

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 ~59,000 restaurants in more than 155 countries and territories, with ~98% of outlets owned and operated by franchisees, licensees and affiliates. SFIL operates 442 KFC stores in western, northern, southern and central India and 320 PH outlets in western, southern and central India as on June 30, 2024. The company also operates 111 PH and nine Taco Bell outlets in Sri Lanka and four outlets (two each of PH and KFC) in the Maldives through its subsidiaries/group.

Demonstrated support from promoter towards capital requirements over the years and experienced management team – SFIL has benefited from strong promoter support for its capital requirements over the years. The company is promoted by Sapphire Foods Mauritius and QSR Management Trust, with a notable investor base that includes Samara Capital, Creador, and other prominent foreign and domestic institutional investors. Some investors, including the promoters, partially exited through the initial public offering (IPO) in November 2021, followed by a series of subsequent open-market sales. The company is managed by experienced professional management, who have proven industry expertise and steered SFIL to its present scale and size with healthy profitability levels.

Financial profile characterised by healthy revenue growth, comfortable capitalisation and coverage indicators – Over the years, the company has witnessed an uptick in sales, with operating income rising to Rs. 2,594.27 crore from Rs. 1,340.41 crore in FY2020, representing a CAGR of 18%, driven by healthy store expansions over the years. The company's capital structure remained healthy, supported by consistent equity infusions until its IPO in FY2022. The subsequent profits have strengthened its net worth, with minimal reliance on debt for capex and a comfortable working capital cycle. SFIL operates with a negative working capital cycle, as sales are made on a cash basis and faster inventory turnover. ICRA expects that the capital structure will remain strong, with adequate liquidity to cover any potential funding gaps for capex in the near term. However, the company's on-book liquidity is expected to moderate over the medium term due to the planned expansion of stores.

Credit challenges

RoCE continues to be subdued, operating margins under pressure amid high inflation - The operating margins at the consolidated level moderated in FY2024 to 17.8% from 19.0% in FY2023 due to muted consumer demand, especially in the Pizza segment. The margins are expected to remain range-bound in the near term, particularly for India operations due to soft consumer demand and inflationary cost scenario. The consolidated RoCE moderated in FY2024 to 7.5%[1] from 10.1%[1] in FY2023, largely due to moderation in the operating margins and the company's aggressive store expansion policy. The expansion is expected to continue in the medium term, and any RoCE improvement is likely to be gradual and will depend on SFIL's ability to profitably scale up its new stores while sustaining growth momentum in its existing outlets and will remain a key rating monitorable.

Compliance with 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!. Compliance with the requirement to achieve the revised capex plans in the medium term remains critical from the incentive 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; exposed to inherent industry risk of disease outbreak in case of birds (chicken) - SFIL encounters intense competition from unorganised as well as organised QSR players like Domino's,

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[1] *As per ICRA calculations*

McDonald's and Burger King. The company's ability to sustain its growth and improve its profit margin amid intense competition will remain critical. 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

Environmental and Social Risks

Environmental considerations: The QSR industry is exposed to environmental protection, food safety, human rights, working and safety conditions among other regulations. Non-adherences to any of these would result in disruptions in business operations and increased costs and compliance-related risks. The QSR industry is also exposed to environmental risks given the use of plastics in packaging, electricity and gas for cooking, and other production functions. The industry is also exposed to significant risks related to the health and safety of customers. While these risks have not resulted in any material implication so far, any breaches in food standards at its outlets could have cost implications for the company. The company has substantially reduced the use of plastics in delivery services by transitioning to sustainable and biodegradable packaging products. SFIL regularly monitors and provides training to employees for food handling and customer service requirements and to ensure adherence to quality standards and norms issued by regulatory authorities. Periodic food safety and quality assessments at restaurants and vendors help ensure operational consistency. The company trains its employees to cultivate a culture of compliance and ethics, ensuring adherence to relevant laws and regulations and reducing environmental impact. The company has also taken many initiatives and has a continuous monitoring and review process towards food safety, energy conservation, waste management and safety procedures.

Social considerations: The QSR industry faces challenges from the evolving healthy food alternatives. Further, as SFIL operates within the labour-intensive segment, a shortage of skilled staff and high attrition can impact the company's operations, which can damage its reputation and customer base. SFIL conducts in-house training for the career enhancement of its employees. It also motivates and retains employees with recognition and performance-based rewards. Fair employment terms, a value-based culture, employee training and employee engagement initiatives for talent development and growth, customer satisfaction surveys, a grievance redressal system and CSR initiatives, which are among the steps that company takes as part of its social considerations.

Liquidity position: Adequate

SFIL's liquidity position is adequate. The company had a liquid cash and bank balance of Rs. 181.11 crore (including fixed deposits) as of March 31, 2024. However, the same is expected to be used for growth capital going forward. SFIL has plans to incur a sizeable capex for the medium term, which is expected to be funded through a mix of internal accruals and available cash balance. The cash accruals are expected to remain healthy in the medium term against minimal debt obligations.

Rating sensitivities

Positive factors – ICRA could upgrade SFIL's rating if its revenue increases on the back of a continuous business expansion, along with the sustenance of healthy profit margins, thereby leading to sustained improvement in coverage indicators as well as profitability metrics.

Negative factors – Lower-than-expected sales growth, along with a delay in the stabilisation of new stores leading to reduced profitability can lead to ratings downgrade. Any unanticipated debt-funded capex, resulting in leveraged capital structure and moderation in debt coverage indicators marked by an interest coverage ratio of below 3.5 times on a sustained basis could also result in downward ratings.

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, 2024, 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 partner 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, 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, whereby promoters and certain set of investors had a partial exit through an offer for sale.

The company is promoted by Sapphire Foods Mauritius and QSR Management Trust. The current investor profile includes Samara Capital, Creador and other high-marquee foreign and domestic institutional investors.

The company operated 442 KFC stores in West, North, South and Central India and 320 PH outlets in western, southern and central India as on June 30, 2024. SFIL also operates, 111 PH and nine Taco Bell outlets in Sri Lanka and four outlets (two each of PH and KFC) in the Maldives through its subsidiaries/group.

Key financial indicators (audited)

SFIL Consolidated	FY2023*	FY2024*
Operating income	2265.57	2594.27
PAT	233.19	51.96
OPBDIT/OI	19.0%	17.8%
PAT/OI	10.3%	2.0%
Total outside liabilities^/Tangible net worth (times)	1.0	1.0
Total debt^/OPBDIT (times)	2.2	2.5
Interest coverage (times)	4.9	4.6

*Source: Company, ICRA Research; Amount in Rs. crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; All the figures mentioned in the above table and in the rationale are as per ICRA's calculations; *as per INDAS; ^includes Lease Liabilities*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current (FY2025)			Chronology of rating history for the past 3 years					
				FY2024		FY2023		FY2022	
	Type	Amount Rated (Rs. crore) as on Aug 31, 2024	Oct 7, 2024	Date	Rating	Date	Rating	Date	Rating
Term Loan	Long Term	15.82	[ICRA]A (Stable)	11-Aug-23	[ICRA]A (Stable)	05-Aug-22	[ICRA]A (Stable)	01-Nov-21	[ICRA]BBB+ (Positive)
			-	-	-	-		16-Apr-21	[ICRA]BBB (Stable)
Bank Guarantee	Long Term	60.00	[ICRA]A (Stable)	11-Aug-23	[ICRA]A (Stable)	05-Aug-22	[ICRA]A (Stable)	01-Nov-21	-
			-	-	-	-		16-Apr-21	-
Unallocated Limits	Long-term and Short-term	124.18	[ICRA]A (Stable)/ [ICRA]A2+	11-Aug-23	[ICRA]A (Stable)/ [ICRA]A2+	05-Aug-22	[ICRA]A (Stable)/ [ICRA]A2+	01-Nov-21	[ICRA]BBB+ (Positive)/ [ICRA]A2
			-	-	-	-		16-Apr-21	[ICRA]BBB (Stable)/[ICRA]A3+
Issuer Rating	-	-	-	-	-	-		01-Nov-21	-
			-	-	-	-		16-Apr-21	[ICRA]BBB (Stable); Withdrawn

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term Fund based facilities – Term Loan	Simple
Long Term Non-Fund based facilities – Bank Guarantee	Simple
Unallocated limits	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 analysing 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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan II	February 24, 2021	8.34%	October 2026	9.09	[ICRA]A(Stable)
NA	Term Loan IV	June 11, 2021	9.00%	June 2027	6.73	[ICRA]A(Stable)
NA	Bank Guarantee	-	-	-	60.00	[ICRA]A(Stable)
NA	Unallocated	-	-	-	124.18	[ICRA]A(Stable)/[ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Gamma Pizzakraft Lanka Private Limited	100%	Full Consolidation
French Restaurants Private Limited	100%	Full Consolidation
Gamma Island Food Private Limited	74.74%	Full Consolidation

Source: Company

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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