August 11, 2023

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	70.68	32.49	[ICRA]A (Stable); Reaffirmed
Long-term – Non-Fund Based	50.36	77.73	[ICRA]A (Stable); Reaffirmed
Unallocated amount- Short-term and Long-term	78.96	89.78	[ICRA]A (Stable)/[ICRA]A2+; Reaffirmed
Total	**200.00**	**200.00**	

**Instrument details are provided in Annexure-1;*

Rationale

The reaffirmation of the ratings outstanding on the bank lines of Sapphire Foods India Limited (SFIL/the company) considers ICRA's expectation that the credit profile will remain comfortable supported by its strong business profile, as it is one of the national franchise for Kentucky Fried Chicken (KFC) and Pizza Hut (PH) in India, Sri Lanka and Maldives. The company reported a healthy revenue growth in FY2023 and in Q1 FY2024 supported by healthy Average Daily Sales (ADS) and sustained store additions. SFIL has a 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 provided impetus towards growth capital for the aggressive expansion plans. The rating continues to consider the diversified global presence of the group in India, Sri Lanka and Maldives. The Group operates PH, KFC brands in India & Maldives and it operates PH and Taco Bell brands in Sri Lanka. The ratings also derive comfort from the demonstrated support from the reputed promoter profile and an experienced management team.

The ratings, however, remains constrained by the company's subdued return on capital employed (RoCE) as SFIL is in its growth phase albeit the same turning positive since FY2022. Given the notable store additions planned in near to medium term, ICRA, expects recovery in return indictors to be gradual and will hinge on timely execution of capex related to store additions and successful ramp up over time. The ratings also factor in the pressure on margins for its Indian and Sri Lankan business due to softening consumer demand, high operating leverage, thereby necessitating adequate hike in prices for its portfolio so as to protect its overall margin portfolio, and will be a key rating monitorable in the near term. The ratings also consider the increasing competition from players in the organised and the unorganised markets.

ICRA also notes that the company has signed an amendment to the development agreement in FY2022 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 be a critical monitorable. KFC's sales are exposed to the inherent industry risk of a disease outbreak in the case of birds (poultry), which may impact both the supply as well as the consumption of chicken and 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 barring 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 about 55,000 restaurants in more than 155 countries and territories, with about 98% of outlets owned and operated by franchisees, licensees and affiliates. SFIL operated 358 KFC stores in West, North, South and Central India and 295 PH outlets in western, southern and central India as on June 30, 2023. The company also operates seven PH stores in Gurugram (Haryana, India), 105 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'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. Its investor profile includes Samara Capital, Creador and other high marquee foreign and domestic institutional investors. 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 – SFIL witnessed sharp uptick in sales in FY2023, with its operating income growing by 32% to Rs.2265.6 crore from Rs.1721.6 crore in FY2022 supported by healthy ADS and Same Store Sales Growth (SSSG). Being a high operating leveraged business, the margins for the period improved to 19.0% in FY2023 from 17.8% in FY2022 on the back of 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. Nevertheless, on-book liquidity levels is expected to moderate in the medium term on the back of significant expansion of stores.

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 Average Daily Sales across formats in both PH and KFC has improved on a year-on-year basis. The ADS for KFC stood at Rs. 135,000 in FY2023 as against Rs. 129,000 in FY2022. For PH the ADS stood at Rs. 57,000 in FY2022, improving marginally to Rs. 58,000 in FY2023. The SSSG stood at 15% for KFC in FY2023 and 12% for PH despite FY2022 being a high base year. The ADS and SSSG figures were subdued in Q1 FY2024 on the back of lower demand resulting in reduced ticket sizes, lower demand for Pizza products and impact of new stores which takes some time to stabilise its operations. Given the high operating leverage nature of business, the increase in scale of operations has translated into improvement in the OPBDITA margins to 19.0% in FY2023 from 17.8% in FY2022, while the PAT margins jumped to 10.3% in FY2023 from 2.7% in FY2022 albeit on the back of one-time deferred tax credit of Rs. 127.4 crore.

Credit challenges

RoCE continues to be at subdued levels; operating margins under pressure amidst high inflation – The company's margins are expected to be under pressure in the near term owing to the softening consumer demand in India and the weak macro-economic situation in Sri Lanka. The margin for the India business is expected to be under pressure on account of inflationary input cost scenario and high overheads, necessitating adequate prices hikes to offset any such rise to protect the overall margins. The company has taken price hikes in the current fiscal both in the India and Sri Lanka market to counter rise in input costs. The consolidated RoCE which turned positive in FY2022, albeit continues to be at subdued level of 10.1% for FY2023[1], 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 is expected to only be gradual and will be contingent on ability to

[1] As per ICRA calculations

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.

Environment and Social Risks

Environmental considerations: The QSR industry is exposed to environment protection, food safety, human rights, working and safety conditions, etc., and 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 moving to products made from sustainable and biodegradable products by engaging with its vendors. The company also regularly monitors and provides training to employees in food handling and customer service 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, which ensures adherence to relevant laws and regulations and reduces environmental impact. The company has also taken many initiatives and has a continuous monitoring and review process towards foods safety, energy conservation, waste management, safety procedures.

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

Liquidity position: Adequate

SFIL's liquidity position is adequate. The company had a liquid balance of Rs. 290.2 crore (including fixed deposits and current investments) as on March, 2023, 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 and available cash balance. The cash accruals are expected to remain healthy in the medium term as against minimal debt obligations.

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 3.5 times 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, 2023, 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, 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 358 KFC stores in West, North, South and Central India and 295 PH outlets in western, southern and central India as on June 30, 2023. The company also operates seven PH stores in Gurugram (Haryana, India), 105 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)

Consolidated- SFIL	FY2022*	FY2023*
Operating Income (Rs. crore)	1,721.6	2,265.6
PAT (Rs. crore)	46.0	233.2
OPBDITA/OI (%)	17.8%	19.0%
PAT/OI (%)	2.7%	10.3%
Total Debt^/OPBDIT (times)	2.6	2.2
Interest Coverage (times)	3.9	4.9

*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 and in the rationale 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 (FY2024)				Chronology of Rating History for the past three years				
		Type	Amount Rated	Amount Outstanding as of Jul 31, 2023	Date & Rating in FY2024	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021	
			(Rs. crore)	(Rs. crore)	11-Aug-23	5-Aug-22	1-Nov-21	16-Apr-21	4-Mar-21	30-Jul-20
1	Issuer Rating	-	-	-	-	-	-	[ICRA]BBB (Stable); Withdrawn	[ICRA]BBB (Stable); Placed on notice of withdrawal	[ICRA]BBB (Negative)
2	Term Loan	Long term	32.49	32.49	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]BBB+ (Positive)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Negative)
3	Bank Guarantee	Long Term	77.73	77.73	[ICRA]A (Stable)	[ICRA]A (Stable)				
4	Unallocated Limits	Long-term and Short-term	89.78	-	[ICRA]A (Stable)/ [ICRA]A2+	[ICRA]A (Stable)/ [ICRA]A2+	[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: Click Here

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	8.4%	February 2024	10.06	[ICRA]A(Stable)
NA	Term Loan II	February 24, 2021	8.4%	October 2026	13.13	[ICRA]A(Stable)
NA	Term Loan IV	June 11, 2021	9%	June 2027	9.30	[ICRA]A(Stable)
NA	Bank Guarantee	-	-	-	77.73	[ICRA]A(Stable)
NA	Unallocated amount	-	-	-	89.78	[ICRA]A(Stable)/ [ICRA]A2+

Source: *Company*

Annexure-2: List of entities considered for consolidation

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*

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Srikumar K
+91 44 4596 4318
ksrikumar@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Sachidanand Thillai
+91 74015 51867
sachidanand.thillai@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 2433 1084
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches