

July 30, 2020

Sapphire Foods India Private Limited: Long-term rating reaffirmed and outlook revised to Negative for Issuer Rating; Long-term and Short-term ratings assigned to the bank limits

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 (Negative); Reaffirmed, Outlook revised from Stable
Long-term - Term Loan	0.00	71.25	[ICRA]BBB (Negative); assigned
Long-term/Short-term - Unallocated amount	0.00	128.75	[ICRA]BBB (Negative)/[ICRA]A3+; assigned
Total	0.00	200.00	

*Instrument details are provided in Annexure-1

Rationale

The revision in the outlook to Negative follows the impact of the pandemic induced lockdown on Sapphire Foods India Private Limited's (SFIPL) operations, leading to adverse impact on sales and subsequent profitability for the year FY2021. The Indian quick service restaurant (QSR) segment saw a decline in its footfalls towards the end of February 2020, since India reported its first coronavirus patient. Temporary shutdown of malls was initiated by various state governments in March 2020, thereby affecting the company's revenues for the month. The pan-India lockdown announced by the Government of India (GoI) on March 24, 2020 and its further extension adversely impacted the company's topline in Q1 FY2021. While the restaurants report the lack of any revenues from dine-in operations, delivery sales have supported the top line to an extent.

The restaurants have high operating as well as financial leverage, and are highly susceptible to any reduction in revenues. While the delivery business commenced from some outlets since April 2020 and the company is attempting to optimise its expenses, a slump in sales have led to a sharp reduction in cash accruals and losses in Q1FY2021. SFIPL (standalone) reported an operating loss on an operating income of Rs.72.28 crore in Q1FY2021, on account of under absorption of costs due to lower sales. However, the trajectory of sales has been on an uptrend and ICRA expects the losses to be recouped to a large extent in H2 FY2021. The company has term loan repayment obligations of Rs. 9.80 crore (including the new term loan availed in July 2020) in FY2021. The repayment for the year reduced during the year owing to moratorium on payments permitted by the Reserve Bank of India (RBI) from March 2020 to August 2020. At a consolidated level, operations in the Gamma Group (subsidiary of SFIPL) were not impacted considerably. Sales for Q1 FY2021 were in line with the corresponding quarter of the previous year. The Gamma Group reported sales of ~Rs. 40.00 crore in Q1 FY2021.

The management does not plan to undertake any incremental capex in SFIPL (standalone), other than those in progress, unless the operating environment improves, and they foresee the demand for new outlets. The debt in SFIPL's (standalone) balance sheet as on March 31, 2021 is likely to be higher by ~Rs.10.00 crore than the previous year, following an incremental term loan of Rs. 20.00 crore availed by the company in July 2020 as a reimbursement of capex completed in the second half of FY2020.

With debt repayment of ~Rs.9.80 crore due in FY2021 at a standalone level, adequate liquidity as reflected by free cash balance of ~Rs. 10.00 crore as on June 30, 2020, and recent planned capital infusion to the extent of Rs. 41.00 crore, by the current investors, ICRA does not foresee any stress on repayments in the near term. Furthermore, the company has received loan disbursement of Rs. 20.00 crore in July 2020, which can be utilised to complete the capex of ongoing outlet launches. The internal accruals of the subsidiary in Sri Lanka is expected to remain adequate to meet the term loan repayment of Rs. 3.81 crore in FY2021 and to partially meet the capex requirement. Nevertheless, prolonged decline in sales or slower-than-expected ramp-up in revenues from its Indian operations can result in a moderation in the company's credit profile. ICRA will continue to monitor the situation as it evolves during the current fiscal and will take appropriate rating action wherever required.

The ratings 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 ratings, however, takes 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. In addition, the ratings consider SFIPL's healthy financial profile characterised by a robust revenue growth, its comfortable capitalisation and coverage indicators and low working capital requirements in the past.

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 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 190 KFC stores in West, North, South and Central India and 168 Pizza Hut outlets in western, southern and central India as on March 31, 2020. 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 are in the process of infusing Rs. 41.00 crore through rights issue to support the liquidity, against which the company has started receiving the subscription amount.

Financial profile characterised by robust revenue growth, comfortable capitalisation and coverage indicators and low working capital requirements in the past; liquidity profile in FY2021 supported by planned infusion by investors – At a consolidated level, SFIPL commenced its operations with the acquisition of outlets in 2015 and clocked sales of Rs. 328.73 crore in FY2016. With the acquisition of additional outlets and their rising average daily sales, the consolidated revenues grew by 139% and 22% in FY2017 and FY2018, respectively. The company continued its growth spree in FY2019 and FY2020 when the consolidated operating income stood at Rs. 1193.82 crore and 1,349.19 crore, respectively. Its capitalisation and coverage indicators have remained comfortable owing to its strong tangible net worth base and limited reliance on external borrowings. The consolidated debt of Rs. 69.00 crore as on March 31, 2020 comprises term loans of Rs. 65.74 crore and working capital borrowings of Rs. 3.26 crore. The interest coverage ratio stood at 5.60 times and net cash accruals/total debt at 85% in FY2020. SFIPL's inventory and debtor days have historically remained low due to the nature of its business. In addition, the company receives an extended credit period from its suppliers due to its high bargaining power, which has always kept its working capital requirement low. While, the credit profile is expected to be impacted by the pandemic in FY2021, the liquidity is supported by planned equity infusion through rights issue by the existing shareholders up to the extent of Rs. 41.00 crore, against which the company has started receiving the subscription amount.

Credit challenges

Government's measures towards containment of Covid-19 pandemic to impact the financial profile adversely in FY2021 due to high overheads in form of rentals and employee cost – Most of SFIPL's outlets across the country have been closed since March 24, 2020, following the nationwide lockdown announced by the GoI. The company commenced delivery operations from April 2020 and is currently operating 247 stores for delivery. The company reported an operating loss of Rs.29.54 crore on an operating income of Rs. 72.28 crore following high fixed overheads in form of rentals and employee costs. The revival of the growth in footfalls and the management's ability to manage its overheads during the year will be crucial.

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. However, ICRA notes that the cash accruals have been improving since FY2018. 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 over 280 KFC and Pizza Hut outlets during FY2021 to FY2023 period as per the development agreement with Yum! Brands. While the company has deferred its capex plans for FY2021 due to the pandemic, the company would require an investment of Rs. 150-170 crore per annum for opening of these outlets, going forward. Thus, a prudent funding pattern, with limited reliance on debt for aggressive 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 is **adequate**. The company had a free cash balance of ~Rs. 47.00 crore as on March 31, 2020. The fund flow from operations has remained positive during the past three fiscals owing to its positive operating profitability. However, it is expected to turn negative in FY2021 following loss at the operating level in its Indian operations. The management has deferred its capex plans in India until the market stabilises and intends only to complete the work for five ongoing outlets in FY2021. The company has availed the moratorium from March 2020 to August 2020, extended by the RBI and its consolidated repayment obligation for FY2021 stands at Rs. 13.56 crore. ICRA notes that the current investors are in the process of infusing additional funds of Rs. 41.00 crore in FY2021 and the company has also availed a term loan of Rs. 20.00 crore as a reimbursement of capex incurred in H2 FY2020. The Group's ability to generate healthy accruals will remain critical for building up liquidity.

Rating sensitivities

Positive triggers – The outlook might be revised to Stable in case of an earlier than anticipated recovery in operations leading to improvement in debt protection metrics. Turnaround of operations with positive EBDITA will also be a positive rating trigger.

Negative triggers – The rating might be downgraded in case of prolonged decline in sales or slower than expected ramp-up in revenues resulting in moderation in the company's financial profile. A delay in raising capital in a timely manner impacting the company's liquidity and growth plans could also be a credit negative. In addition, non-adherence to the clauses of development agreements with Yum! Brands will put pressure on SFIPL's rating.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	No
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 190 KFC stores and 168 Pizza Hut stores in India as on March 30, 2020. In addition, it operates 64 stores in Sri Lanka, two in Maldives and seven in Gurugram (India) through its subsidiaries. As on March 30, 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, on a provisional basis, SFIPL (consolidated) reported a net loss of Rs. 48.52 crore on an OI of Rs. 1,349.19 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	1349.19
PAT (Rs. crore)	-44.66	-48.52
OPBDIT/OI (%)	3.44%	4.87%
PAT/OI (%)	-3.74%	-3.60%
Total Outside Liabilities/Tangible Net Worth (times)	0.53	0.37
Total Debt/OPBDIT (times)	2.34	1.05
Interest Coverage (times)	4.31	5.60

Provisional

Source: SFIPL

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2021) Type	Current Rating (FY2021)		Rating 30-July-2020	Rating History for the Past 3 Years		
		Amount Rated	Amount Outstanding*		FY2020 13-Feb-2020	FY2019	FY2018
1 Issuer Rating	-	-	-	[ICRA]BBB (Negative)	[ICRA]BBB (Stable)	-	-
2 Term Loan I	Long-term	51.25	51.25	[ICRA]BBB (Negative)	-	-	-
3 Term Loan II	Long-term	20.00**	-	[ICRA]BBB (Negative)	-	-	-
4 Unallocated Limits	Long-term and Short-term	128.75	-	[ICRA]BBB (Negative)/[ICRA]A3+	-	-	-

*As on March 31, 2020; **Sanctioned in July 2020

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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Issuer Rating	-	-	-	-	[ICRA]BBB(Negative)
NA	Term Loan I	June 2018	9.80%-10.70%	August 2023	51.25	[ICRA]BBB(Negative)
NA	Term Loan II	July 1, 2020	14%	September 2023	20.00	[ICRA]BBB(Negative)
NA	Unallocated amount	-	-	-	128.75	[ICRA]BBB(Negative)/[ICRA]A3+

Source: SFIPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Subsidiary Companies		
Gamma Pizzakraft Overseas Private Limited	99%	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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