

March 31, 2024

Hardcastle Restaurants Private Limited: Rating of [ICRA]AA- (Stable) reaffirmed for Issuer rating and [ICRA]AA-(Stable)/[ICRA]A1+ assigned for bank facilities

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Issuer Ratings	-	-	[ICRA]AA- (Stable); reaffirmed
Short-term – fund-based – working capital facilities	0.0	275.0	[ICRA]A1+; assigned
Long-term – Interchangeable	0.0	(70.0)	[ICRA]AA- (Stable); assigned
Short-term – Interchangeable	0.0	(25.0)	[ICRA]A1+; assigned
Unallocated limits	0.0	25.0	[ICRA]AA- (Stable)/[ICRA]A1+; assigned
Total	0.0	300.0	

*Instrument details are provided in Annexure-I

Rationale

The reaffirmation of rating for Hardcastle Restaurants Private Limited (HRPL) factors in the strength derived from HRPL's position as the licensee operator of McDonalds in the southern and western markets in India, its strong brand recognition in the domestic and international markets, reputation as one of the largest quick service restaurant (QSR) chains globally and its professional management. The rating also reflects HRPL's operational presence of more than 25 years in India, along with a growing store count, which stood at 380 as of December 2023. ICRA also notes its better operational metrics reflected by the steady rise in its average daily sales post-Covid, driven by growing delivery sales that also resulted in a sharp rise in sales in FY2023.

The profit margins also expanded in FY2023 on considering the operating leverage benefits, which in turn strengthened the debt protection metrics. Over the medium term, the company is expected to accelerate store expansions efforts with around 200-250 additional stores to be opened by December 2027. ICRA understands that the company will largely fund this capex spends through internal accruals and has the flexibility to reconsider its store expansion programme based on future demand, so as to maintain the debt protection metrics. ICRA notes that HRPL generally enters long-term real estate deals for its stores (typically for over 20-25 years), which initially result in higher lease debt, but benefits in terms of any sharp buoyancy in future rent increase, given the long-contracted period.

The rating, however, is constrained by the company's vulnerability of earnings to raw material price variation in an inflationary regime, exposure to changing consumer preferences, execution risk from aggressive expansion plans, and their corresponding impact on return on capital employed (RoCE) due to under absorption of fixed costs as stabilisation of the new stores entails a gestation period. The rating also considers the fact that HRPL's business strength is completely reliant on the McDonalds brand strength, and adherence to compliance norms laid out in the master franchise development agreement (MFDA) remains critical from a credit perspective. HRPL's profitability is also exposed to royalty payments to its principal, with any unanticipated rise in the same remaining a key rating monitorable. The ratings also consider the increasing competition from players in the organised and unorganised markets.

ICRA notes that the company recently faced allegations related to the quality of cheese used in the McDonald's products at an outlet in Maharashtra and media news of Maharashtra Food and Drugs Administration (FDA) suspending operations in one of the outlets. ICRA highlighted these issues in its release dated March 5, 2024. Further to this, the holding company of HRPL, M/s Westlife Foodworld Limited (WFL), issued a statement on the exchange, informing that it had received a clean sheet from

the Food Safety and Standards Authority of India (FSSAI) under the administration of the Ministry of Health and Family Welfare, Government of India, and the National Accreditation Board for Testing and Calibration Laboratories (NABL), within days. They confirmed that the quality of cheese being used is according to the standards and that no substitute is being used for the cheese in its product offerings.

The Stable outlook on the [ICRA]AA- rating reflects ICRA's opinion that HRPL's credit profile will remain supported by the strong McDonalds brand and diverse menu offerings, supported by robust supply chain back-up, growing acceptability, favourable long-term demand outlook and increasing penetration of QSR brands in India.

Key rating drivers and their description

Credit strengths

Strong brand presence globally with master franchise agreement with one of the world's largest QSR brand – HRPL holds the master franchise agreement with McDonald's Corporation, a leading global food service brand with more than 41,000 restaurants in 115 countries (as of September 2023). Leveraging the strength of the McDonalds brand, HRPL benefits from global best practices, robust supply chain management ensuring consistent taste and quality across outlets, and the ability to attract customers through diverse product offerings, including brand extensions like McCafé, McBreakfast and McDelivery, etc, with an established network of stores and delivery partners.

Exclusive franchise to operate in West and South India – HRPL has the exclusive franchisee to operate the McDonalds chain of restaurants in western and southern India, establishing a dedicated geographical presence limiting competition from other franchises of the same brand. As of December 2023, HRPL had a store count of 380 in the West and South India. HRPL follows a stringent model of store opening selection, driven by global directives, which includes long leases of over 20-25 years, which ensure uninterrupted operations, coupled with favourable leasing conditions, given the long contractual period.

Comfortable financial profile – HRPL has witnessed healthy growth after the pandemic, with robust rise in average daily sales (ADS) and same store sales growth (SSSG). The ADS grew from ~Rs. 1,44,000 in FY2020 to Rs. 1,87,000 in FY2023, while the SSSG stood at 57% and 36.1% in FY2022 and FY2023, respectively. The growth in ADS and SSSG can be attributed to boost in its delivery business, innovation in menu/product offerings and uptick in the dine-in business after the pandemic. Driven by these stimuluses, the top line posted a growth of 60% in FY2022 and 45% in FY2023, along with better profitability levels due to operating leverage benefits, leading to improvement in debt metrics. Though growth is expected to taper in the current fiscal, given the softer demand conditions as well as high base effect, it is expected to be backed by notable store launches and constant menu innovations. The financial profile also remains comfortable supported by healthy profitability levels and adequate debt protection metrics, which posted a sharp improvement in FY2023 with Interest cover of 4.2 times as of March 2023.

Credit challenges

Considerable planned capex over medium term to pressurise RoCE; soft demand conditions and inflationary environment remain near-term challenges – After the healthy improvement in operating margins to ~17.1% in FY2023, the same witnessed moderation to around 16.1% for 9M FY2024. The drop in margins is attributable to inflationary pressures, which have impacted consumer sentiments resulting in lower discretionary spends. Further, the company has notable capex plans to add about 200-250 stores by December 2027, which is likely to put pressure on the return indicator, since new stores need a gestation period before generating optimum returns. However, comfort is drawn from the company's flexibility to reconsider its store expansion programme based on future demand and evolving market dynamics.

Compliance with terms and conditions as per MFDA remains critical – Given that HRPL's business strength is completely reliant on the strong McDonalds brand, adherence to the terms and condition of the MFDA remains utmost critical for the continuity of this brand strength. Under the MFDA with McDonald's Corporation, the company is also required to pay royalty

as a percentage of its revenues, which stood at 4.5% in FY2024 and is slated to rise to 5.0% for the period FY2025-FY2026. Any sharp rise in royalty payments that materially impact its margins and overall credit profile, will remain a key monitorable.

Intense competition from organised and unorganised players; operations exposed to inherent supply chain risks— HRPL faces intense competition from unorganised as well as organised QSR players like Dominos, KFC and Burger King. The company's ability to sustain its growth and improve its profit margin amid intense competition will remain critical. Also, its sales are exposed to uncontrollable factors like disease outbreaks (Avian Influenza/ bird flu), disruption in supply chain due to lower produce quality and changing consumer preferences.

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. HRPL has taken initiatives to reduce waste, including packaging optimisation, safe disposal information, food recovery, operations training and packaging reclamation programmes. Periodic food safety and quality assessments at restaurants and vendor sites help ensure operational consistency. The company has also taken many initiatives and has a continuous monitoring and review process for foods safety, energy conservation, waste management, and other safety procedures.

Social considerations: The QSR industry faces challenges from the healthy food alternatives in the market today. Further, being a labour-intensive segment, shortage of skilled staff and high attrition can impact operations, food and services of the company, which can damage its reputation and customer base. HRPL conducts in-house learning and development programmes that are linked to career growth. In addition, the company prefers internal talent for new leadership positions, which incentivises the planning of longer-term careers in the company.

Liquidity position: Adequate

The liquidity of the company is adequate with a healthy cash flow from operations. The liquidity is also supported by a healthy buffer of over Rs. 435 crore in its working capital facilities as of February 2024. The company has also cash and mutual funds of Rs. 80 crore as of March 2023. HRPL has plans to incur a sizable capex over the near to medium term, which is to be funded through internal accruals. There are no long-term debt obligations.

Rating sensitivities

Positive factors – ICRA could upgrade HRPL's rating if its revenues improve on the back of a continuous business expansion, along with profitability margins, leading to improvement in coverage indicators as well as return indicators.

Negative factors – Any material decline in revenue growth with a delay in ramp up of new stores leading to impact on profitability and return indicators can lead to a rating downgrade. Any unanticipated debt-funded capex, which impacts the credit metrics materially, or material weakening in the liquidity profile, will also be a negative rating trigger. Specific triggers that might result in a downgrade include DSCR less than 1.50 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	Standalone

About the company

Hardcastle Restaurants Private Limited was established by the BL Jatia family in 1995 as a joint venture (JV) between Hardcastle Restaurants Private Limited and the McDonald's Corporation. After HRPL reached a milestone of 100 stores in FY2010, McDonalds sold its shares and exited the JV in FY2011. The stake was acquired by Mr. Amit Jatia, who was the majority shareholder in HRPL. In FY2013, Westlife Development Limited (WDL), which is now Westlife Foodworld Limited (WFL), became the holding company for HRPL through a reverse merger (HRPL became the 100% subsidiary of WFL) and WFL was listed on the stock exchange. As of December 2023, the promoter's holding in WFL is 56.23%. On a standalone basis, WFL does not have any commercial operations. HRPL operates through 380 McDonalds restaurants across western and southern India (as on December 31, 2023) under a master franchisee arrangement with McDonald's Corporation.

Key financial indicators (audited)

HRPL	FY2022	FY2023
Operating income	1,575.6	2,277.0
PAT	-1.2	112.3
OPBDIT/OI	13.1%	17.1%
PAT/OI	-0.1%	4.9%
Total outside liabilities/Tangible net worth (times)	3.1	2.8
Total debt/OPBDIT (times)	5.1	3.1
Interest coverage (times)	2.5	4.2

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. Crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)			Chronology of rating history for the past 3 years				
		Amount rated (Rs. crore)	Amount outstanding as on December 31, 2023 (Rs. crore)	Date & rating in FY2024			Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
				March 31, 2024	Mar 05, 2024	Feb 20, 2024			
1 Issuer ratings	Long term	-	-	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	[ICRA]AA-(Stable)	-	-	-
2 Fund based – working capital facilities	Short term	275.0	-	[ICRA]A1+	-	-	-	-	-
3 Interchangeable	Long term	(70.0)	-	[ICRA]AA-(Stable)	-	-	-	-	-
4 Interchangeable	Short term	(25.0)	-	[ICRA]A1+	-	-	-	-	-
5 Unallocated limits	Long term/ Short term	25.0	-	[ICRA]AA-(Stable)/ [ICRA]A1+	-	-	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Issuer Ratings	Not Applicable
Short term – fund based – working capital facilities	Simple
Long term – Interchangeable	Simple
Short term – Interchangeable	Very 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	Issuer Ratings	NA	NA	NA	-	[ICRA]AA- (Stable)
NA	Short term – fund based – working capital facilities	NA	NA	NA	275.0	[ICRA]A1+
NA	Long term – Interchangeable-	NA	NA	NA	(70.0)	[ICRA]AA- (Stable)
NA	Short term – Interchangeable	NA	NA	NA	(25.0)	[ICRA]A1+
NA	Unallocated limits	NA	NA	NA	25.0	[ICRA]AA- (Stable)/ [ICRA]A1+

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure II: List of entities considered for consolidated analysis – Not applicable

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Branches



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