February 19, 2020

Barbeque Nation Hospitality Limited: Long-term rating reaffirmed; short-term rating downgraded to [ICRA]A1; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term Loans	105.88	101.50	[ICRA]A+(Negative); Reaffirmed, Outlook revised to Negative from Stable
Short-term Fund-based Limits	30.00	30.00	[ICRA]A1; Downgraded from [ICRA]A1+
Total	**135.88**	**131.50**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the rating reflects the deterioration in Barbeque Nation Hospitality Limited's (BNHL) financial profile with a contraction in the operating margins, write off of inorganic investments, and the debt-funded buyout of Red Apple Kitchen Consultancy Private Limited (Toscano Restaurant). The company's standalone operating margins contracted to 13.9% in FY2019 from 15.0% in FY2018 owing to the loss of the GST input tax credit (ITC) availed by the company earlier as well as its inability to raise the prices of its offerings adequately due to intense competition and the general slowdown in the economy. BNHL's profitability in FY2019 was impacted on account of GST payments made by the company on its consumables and services availed whereas it was unable to claim the ITC on the same following the change in the GST regime for restaurants. The company is taking certain steps to counter the impact like renegotiating with landowners to reduce the rentals and by conducting some of the activities in-house.

On a consolidated basis, the operating margins fell to 10.0% in FY2019 from 13.4% in FY2018 due to weaker operations in India and losses from the international operations. The disposal of BNHL's investment in Prime Gourmet Private Limited (PGPL), which owned and operated the fast food franchisees of Johnny Rockets, resulted in a net loss of Rs.18.9 crore for the company in FY2019, significantly impacting the company's net margins.

BNHL expanded its store count to seven in the international market (one in Malaysia and six in the UAE) as of December 2019 from five as of March 2019. While the international operations incurred an EBITDA loss of ~Rs. 23.3 crore in FY2019, ICRA understands that the company has been able to turn around the operations in H1 FY2020 and expects the same to post an EBITDA profit in FY2020. Going forward, BNHL is likely to go slow on expansion and focus on profitability in the international market.

The ratings continue to favourably factor in BNHL's strong brand image in the restaurant segment along with its healthy revenue growth of 26% in FY2019. While the company witnessed healthy same store sales growth (India operations) in FY2019, the increase in the number of outlets to 126 in FY2019 from 102 in FY2018 also supported the higher footfall. The company's strong brand image facilitates its entry in new markets at competitive rentals, supporting its revenues and operating margins. BNHL is in the process of filing documents for its initial public offering (IPO) and is expected to go public in H1 FY2021. The company is planning to repay its entire debt with the funds raised from the IPO and use the remaining amount as growth capital.

In India, BNHL opened 23 new stores in FY2018, 24 new stores in FY2019 and 12 new stores in 8M FY2020, leading to significant capital expenditure on its books. Over the last two years, it has funded its capex through internal accruals and external debt, which, in turn, impacted the coverage and capitalisation metrics. Although BNHL continues to be the largest barbeque restaurant brand with a presence across the country, it continues to face intense competition from regional players.

To diversify into newer categories and counter competition, the company recently acquired 61.35% stake for Rs. 67.5 crore in Red Apple Kitchen Consultancy Private Limited, which owns Toscano Restaurant & Wine Bar, from Samar Retail Private Limited, which belongs to the same promoter group. Toscano is a fine dining Italian restaurant, which has 11 outlets across India with a major presence in Bangalore. Toscano recorded a top line of Rs. 37 crore with healthy operating profit margin in FY2019. The acquisition was funded by a Rs. 50-crore high-cost external debt, leading to a deterioration in BNHL's debt indicators. The company expects to repay the same from the IPO proceeds.

Key rating drivers and their description

Credit strengths

Strong brand image – The company has a strong brand image in the restaurant segment, which facilitates its entry in new markets at competitive rentals, supporting its revenues and operating margins. BNHL has witnessed healthy revenue growth over the last three fiscals aided by the addition of new stores and the consequent increase in the number of covers sold. BNHL has a pan-India presence through 138 restaurants as on November 30, 2019.

Healthy revenue growth under Indian operations – The company posted a healthy revenue growth of 23.2% in FY2019 under its standalone (India) operations, supported by healthy same store sales growth and continuous expansion in the number of outlets. ICRA understands that same store sales growth continued to be moderately healthy in H1 FY2020. For FY2019, the standalone operations accounted for ~95% of the overall revenue and ~62.8% of the consolidated debt.

Credit challenges

Debt-funded capex/investment impacting net margins – BNHL's debt levels were impacted over the last 2-3 years by the continuous addition of new stores funded partially through debt and the recent debt-funded acquisition of Red Apple Kitchen Consultancy Private Limited (Toscano Restaurant). This led to higher interest costs, resulting in relatively lower net margins compared to the rating category benchmarks.

Reduction in margins owing to regulatory changes and write offs – In November 2017, the GST rate levied on restaurants was slashed to 5% from 18%. However, the restaurants could no longer claim the ITC against the taxes paid for raw material and other operating expenses. BNHL's profitability in FY2019 was impacted on account of GST payments made by the company on its consumables and services availed whereas it was unable to claim the ITC on the same. Further, the impact could not be passed on to the customers due to pricing pressure resulting from competition and the general slowdown in the economy. The company is taking certain steps to counter the impact like renegotiating with landowners to reduce the rentals and by conducting some of the activities in-house.

BNHL acquired PGPL in FY2017 to expand its presence in the quick service restaurant (QSR) segment through the international Johnny Rockets brand in India. Despite efforts from the company's end, the limited flexibility of the brand owners led to continued losses. BNHL decided to write off its investment in PGPL and close down the Johnny

Rockets stores in FY2019. This led to a net loss of Rs. 18.9 crore from the disposal of investments in FY2019, impacting the company's net margins.

Stretched free cash flow position – The company's free cash flow position remains negative on account of the continuous capital expenditure to set up new stores. It was further stretched owing to the recent acquisition of Toscano Restaurant.

Intense competition – BNHL's presence in a highly competitive market restricts its pricing flexibility to a certain extent. The company's average price per customer (APC) growth across regions remained subdued in FY2019 and H1 FY2020 due to limited pricing power. This, in turn, impacted its credit profile.

Liquidity position: Adequate

The company's liquidity position is **adequate** with cash and liquid investments of Rs. 6.6 crore, undrawn term loans of Rs. 17.8 crore and an undrawn overdraft facility of Rs. 17.4 crore as on September 30, 2019. In relation to these sources of cash, BNHL has a capex commitment of ~Rs. 85 crore for FY2020 for which a term loan of Rs. 25 crore has already been tied up. The company is planning to go public in H1 FY2021 and repay its entire debt with the IPO proceeds, which will support its liquidity position. Based on the current debt profile, repayments are expected to be Rs. 35.4 crore in FY2020, Rs. 56.7 crore in FY2021 and Rs. 51.3 crore in FY2022. These can be funded through internal accruals in the absence of primary fund raising. The company has strong financial flexibility with a record of raising equity in the past from reputed firms such as CX Partners and Alchemy Capital.

Rating sensitivities

Positive triggers – Given the current Negative outlook, a rating upgrade is less likely in the near term. ICRA could upgrade BNHL's rating if it demonstrates significant growth in its operating and net margins along with a reduction in its debt levels and an improvement in its liquidity and capital structure. Specific credit metrics that could lead to an upgrade include adjusted RoCE (excluding Ind-AS 116 rentals) of more than 20.0% and adjusted TD/OPBDITA (excluding Ind-AS 116 rentals) of less than 1.5x on a sustained basis.

Negative triggers – Pressure on the ratings could arise if the company is unable to raise the expected quantum of money from the IPO for prepaying its debt. Further, any significant debt-funded capex or investment, without the desired level of accruals, leading to further deterioration of the capital structure and liquidity, could impact the ratings. Specific credit metrics that could lead to a downgrade include adjusted TD/OPBITDA (excluding Ind-AS 116 rentals) of more than 2.0x on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial statements of the company

About the company

As of November 2019, BNHL had operations in about 138 restaurants across India and seven restaurants in the international market. The company was incorporated in October 2006 as a wholly-owned subsidiary of Sayaji Hotels Limited (SHL). SHL currently owns a 45.1% share in BNHL through its wholly-owned subsidiary – Sayaji Housekeeping Services Limited. The balance is held by CX Partners, Alchemy Capital and other individual promoters. In FY2017, the company acquired PGPL, which owns and operates the fast food franchisees of Johnny Rockets, an international QSR chain offering burgers, shakes and rolls at its outlets. However, the same was wound up in H1 FY2019 and the company wrote off its investment in the same. Recently, BNHL purchased a 61.35% stake in Red Apple Kitchen Consultancy Private Limited from Samar Retail Private Limited (same promoter group), which manages Toscano Restaurant & Wine Bar, a fine dining Italian restaurant which has 11 outlets across India.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	586.3	739.0
PAT (Rs. crore)	3.5	-29.9
OPBDIT/OI (%)	13.4%	10.0%
RoCE (%)	14.6%	1.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.1	1.4
Total Debt/OPBDIT (times)	1.6	2.1
Interest Coverage (times)	4.2	4.4
DSCR	1.3	1.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years						
		Type	Amount Rated	Amount Outstanding	Rating	FY2019		FY2018				FY2017
					19-Feb-2020	21-Jan-2019	14-Jan-2019	19-Jan-2018	28-Dec-2017	02-Nov-2017	07-Jul-2017	18-Nov-2016
1	Fund Based – Term Loans	Long Term	101.50	NA	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
2	Fund- based Limits	Short Term	30.00	NA	[ICRA]A1	[ICRA]A1+	-	-	-	-	-	-
3	Unallocated Limits	Long Term	-	-	-	-	-	-	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	Commercial Paper Programme	Short Term	-	-	-	-	[ICRA]A1+ withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	-

Amount in Rs. crore

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	Term Loan	NA	4.92-9.70%	NA	101.50	[ICRA]A+(Negative)
NA	Fund Based Limits	NA	9.05-9.50%	NA	30.00	[ICRA]A1

Source: Barbeque Nation Hospitality Limited

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Prime Gourmet Private Limited	100%	Full consolidation
Barbeque Nation Mena Holding Limited	100%	Full consolidation
Barbeque-Nation Restaurant LLC	49%	Full consolidation
Barbeque Nation (Malaysia) Sdn Bhd	100%	Full consolidation
Barbeque Nation Holdings Pvt Ltd	100%	Full consolidation
Barbeque Holdings Pvt Ltd	100%	Full consolidation
Barbeque Nation International LLC	49%	Full consolidation

Analyst Contacts

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra Ponniah
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 80 4332 6407
mythri.macherla@icraindia.com

Shivam Nagpal
+91 80 4332 6418
shivam.nagpal@icraindia.com

Relationship Contact

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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

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For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata	+ (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore	+ (91 80) 2559 7401/4049
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Hyderabad	+ (91 40) 2373 5061/7251
Pune	+ (91 20) 2556 0194/ 6606 9999

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