April 20, 2020

Barbeque Nation Hospitality Limited: Ratings downgraded to [ICRA]A-(Negative)/[ICRA]A2+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loans	101.50	101.50	[ICRA]A-(Negative); Downgraded from [ICRA]A+(Negative)
Short-term fund-based limits	30.00	30.00	[ICRA]A2+; Downgraded from [ICRA]A1
Total	**131.50**	**131.50**	

**Instrument details are provided in Annexure-1*

Rationale

The rating action follows the impact of the novel coronavirus (Covid-19) outbreak on Barbeque Nation Hospitality Limited's (BNHL) restaurant operations. Since India reported its first coronavirus patient towards the end of January 2020, the impact on the restaurant segment has been severe, more so in March 2020. Footfalls across most restaurants have crashed across the country, following the pan-India 21-day lockdown announced by the Government of India (GoI) on March 24, 2020. Given the discretionary nature of spend, ICRA expects the revival in the industry to be prolonged, contributed by widespread economic slowdown and mandatory/voluntary social distancing practised by people over the next couple of quarters. Similar to other discretionary spends like travel and tourism, amusement parks and theatres, the food service industry is highly susceptible to exogenous shocks like wars, terror attacks, diseases and meltdowns. ICRA expects significant pressure on footfalls over the next two quarters.

BNHL is seeking a moratorium on payments from its lenders as a part of the Covid-19 Regulatory Package announced by the Reserve Bank of India (RBI) on March 27, 2020. Accordingly, some of the scheduled payment obligations that were due in March 2020, pertaining to the Rs. 101.50-crore term loan facilities rated, were deferred by the company. However, despite the missed payment and the absence of a formal approval from the lenders allowing a payment relief, ICRA has not recognised this instance as a Default as of now. This is based on ICRA's expectation that a formal approval for rescheduling the loan would be received soon, as permitted by the RBI, as a part of the relief measures announced recently. The non-recognition of default in this case is as per the guidance provided by the SEBI circular (SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53) dated March 30, 2020. It may, however, be noted that if the lenders do not approve of the moratorium in due course, ICRA would review the above stance on default recognition.

BNHL has significant operating and financial leverage, making it highly susceptible to a reduction in revenues. With the expected moratorium in place, the company would not have any debt repayment obligations till the end of May 2020. However, fixed expenses like employee costs, rentals and other fixed overheads would still need to be serviced. These fixed obligations are expected to stretch the company's liquidity, given that there are no cash inflows during the period of closure. ICRA understands that BNHL is in talks with its landlords to defer the rent obligation for the period of closure, which is expected to reduce its immediate cash outflow. BNHL would have to rely on its limited cash and undrawn overdraft facility to service the same. The management is exploring fresh fund-raising options and expects tax refund of ~Rs. 9 crore in near term. With sizeable leverage and debt-servicing requirements post moratorium, the sharp contraction in revenues will have a detrimental impact on the company's ability to service its debt. The duration and extent of the lockdown, which is still uncertain, followed by its impact on the economy and discretionary spends in the coming months will have a significant impact on the performance of restaurants. ICRA will continue to monitor the situation as it evolves.

The ratings also take into account the contraction in the operating margins and the inorganic investment write-offs in FY2019 coupled with the debt-funded buyout of Red Apple Kitchen Consultancy Private Limited (Toscano Restaurant) in FY2020. BNHL'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. The standalone margins were further impacted by lower pricing in H1 FY2020.

On a consolidated basis, the operating margins fell to 10.0% in FY2019 from 13.4% in FY2018 due to lower operating margins 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 in FY2019, significantly impacting the company's consolidated 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, on the back of which it posted an operating margin of 12.3% (adjusted for AS116 rentals) in 9M FY2020, up from 10.0% in FY2019 on a consolidated basis. Going forward, BNHL is likely to put a hold on expansion and focus on profitability in the international market.
The ratings continue to factor in BNHL's strong brand image in the restaurant segment along with its healthy YoY revenue growth of 26% in FY2019. While the company witnessed healthy same store sales growth (Indian operations) in FY2019, the increase in the number of outlets to 126 in FY2019 from 102 in FY2018 also supported the higher footfall. The growth continued in 9M FY2020 with BNHL witnessing 18.6% revenue growth on a consolidated basis though the same is likely to be impacted by the ongoing Covid-19 outbreak in India. The company's strong brand image facilitates its entry in new markets at competitive rentals, supporting its revenues and operating margins. BNHL has also filed documents for its initial public offering (IPO) in February 2020.

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 faces intense competition from regional players.

To diversify into newer categories and counter competition, in December 2019, BNHL acquired a 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 a 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.

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 in FY2019; likely to be impacted in Q4 FY2020 and FY2021 by ongoing Covid-19 outbreak – The company posted a healthy revenue growth of 23.2% in FY2019 under its standalone (Indian) 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 on the back of which the company witnessed revenue growth of 13.4% on a standalone basis. However, owing to the ongoing Covid-19 outbreak, the growth is likely to be impacted to a certain extent in Q4 FY2020 and FY2021.

Credit challenges

Exposure to exogenous shocks – As a result of the Covid-19 pandemic, BNHL's outlets across the country have been closed since March 24, 2020, following the nationwide lockdown announced till May 3, 2020. The footfalls across the outlets started witnessing a downward trend from the beginning of March 2020 owing to the outbreak. With the possibility of further restrictions on restaurants going forward, coupled with the discretionary nature of spend, the impact on footfalls is expected to be severe in the coming months. The revival of the growth in footfalls will be a key monitorable.

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. BNHL 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 BNHL'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 due to the acquisition of Toscano Restaurant in December 2019.

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

BNHL's liquidity position is **adequate**. While the cash and undrawn overdraft facility buffer is limited, the management is exploring fund-raising options and expects tax refund of ~Rs. 9 crore in near term. The company is also seeking a moratorium on payments from its lenders. However, the fixed expenses in the form of employee costs, rentals and other fixed overheads are expected to adversely impact the liquidity in the near term. 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. Nevertheless, ICRA could upgrade BNHL's ratings if it demonstrates a 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.

Negative triggers – A prolonged lockdown and continued pressure on the earnings, leading to further deterioration in the company's liquidity and credit metrics, may lead to a rating downgrade.

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 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 has 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, BNHL 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 (Consolidated, 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 (FY2021)				Chronology of Rating History for the Past 3 Years						
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018			
					20-Apr-2020	19-Feb-2020	21-Jan-2019	14-Jan-2019	19-Jan-2018	28-Dec-2017	02-Nov-2017	07-Jul-2017
1	Fund Based – Term Loans	Long Term	101.50	NA	[ICRA]A- (Negative)	[ICRA]A+ (Negative)	[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]A2+	[ICRA]A1	[ICRA]A1+	-	-	-	-	-
3	Unallocated Limits	Long Term	-	-	-	-	-	-	-	[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]A2+

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

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About ICRA Limited:

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