MUDMAN PLC

No. 56/2020
21 April 2020

CORPORATES

Company Rating: BBB-
Outlook: Negative

Last Review Date: 14/06/19

Company Rating History:

Date	Rating	Outlook/Alert
11/05/17	BBB-	Stable

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RATIONALE

TRIS Rating affirms the company rating on Mudman PLC (MM) at "BBB-" and revises the rating outlook to "negative" from "stable". The "negative" outlook reflects the anticipated weakening operating performance, and the risk that the depth of the negative effect from the coronavirus (COVID-19) pandemic would be more severe than our projection. The "negative" outlook also reflects an expected rise in financial leverage driven by the company's overseas expansion plan and its weaker-than-expected operating performance resulting from the intense competition in the restaurant business. The rating continues to reflect the company's market position in the chain restaurant and quick service restaurant (QSR) market segments.

KEY RATING CONSIDERATIONS

COVID-19 to sharply affect MM's performance in 2020

The COVID-19 pandemic is severely disrupting the business environment of the country, particularly the restaurant industry, following the imposition of various measures to minimize the spread of the virus by the government with focus on social distancing encouragement. The measures include the country lockdown which has led to travel restrictions, as well as work-from-home and stay-at-home initiatives, and mandatory mall and shop closures, particularly dine-in restaurants. MM has temporarily closed some of its QSRs and all of its dine-in restaurants for as long as the government requires. The company shifts to focus more on take-out and delivery capability to capture heightened eat-in demand during the stay-at-home period.

TRIS Rating expects MM's sales to decline substantially by around 30% to Bt2.2 billion in 2020. We expect sales to drop by 50%-70% during the mandatory closure period and by 10%-30% during post lockdown, assuming that the outbreak can be largely contained by mid-2020. We expect sales to gradually recover to Bt3.3-Bt3.5 billion per annum over 2021-2022. We expect the company to be able to reduce its fixed costs by around 30% during the lockdown period as the company has taken steps to reduce costs, including cutting payroll and negotiating with landlords for rent waiver or reduction. We project the company's earnings before interest, tax, depreciation and amortization (EBITDA) to fall to Bt180 million in 2020, from Bt550 million in 2019, and recover to Bt530-Bt560 million per annum in 2021-2022.

Well-known QSR and restaurant brands

MM's market position is underpinned by its well-known restaurant brands and moderate level of market coverage. The company's restaurant portfolio features three franchised brands ("Dunkin' Donuts", "Au Bon Pain", and "Baskin Robbins") and an owned brand "Greyhound Café" (GHC). The company also operates a Greyhound Café restaurant in London and "Le Grand Vefour", a two Michelin-star French fine-dining restaurant in Paris. GHC contributed around 40% of the company's EBITDA in 2019 while the three franchised brands accounted for around 60%. MM's restaurant network includes 281 Dunkin' Donuts outlets, 78 Au Bon Pain outlets, 29 Baskin Robbins outlets, and 25 Greyhound Café locations as of December 2019.

Seeking opportunities abroad

As part of an effort to diversify internationally, the company in late 2017 acquired a well-known two Michelin-star French restaurant, Le Grand Vefour, in Paris. Besides, the company opened its first owned GHC restaurant outside Thailand in London in the same period. Le Grand Vefour's performance has improved slightly since the acquisition as its EBITDA turned slightly positive in 2019. However, GHC London's performance fell short of expectation as its sales declined in 2019 from a year earlier.

The company aims to continue expanding in the overseas market where it sees greater growth potential. Despite the ongoing pandemic situation, the company, together with business partner Mr. Guy Martin, the head chef of Le Grand Vefour, plans to open several more restaurants in 2020-2021. Around five restaurants in France will be added to its portfolio each year. TRIS Rating holds the view that the overseas expansion adds uncertainty to the company's business profile as the operating environments of the restaurant industry vary widely from country to country, while the headwinds caused by the pandemic are also intensifying the challenges. However, if the overseas expansion is successful, it will provide the company with more diversified sources of revenue and better growth prospects.

Thin profitability and intense competition

MM's revenue base is small and profitability is lower than peers. MM's revenue was Bt3 billion and adjusted EBITDA was Bt550 million in 2019, with an EBITDA margin of 18%. The company's pretax return on permanent capital was low at around 1.5% in the same year. Same-store sales for each brand fell 6%-10% in 2019 as a result of intense competition and the sluggish economy in Thailand.

Going forward, TRIS Rating expects intense competition in the restaurant industry to continue, and the weakening performance to be exacerbated by the pandemic in 2020. We expect same-store sales for each brand to fall by 25%-35% in 2020 and gradually recover to the pre-COVID-19 levels in 2022. We expect the intense competition to continue exerting pressure on the company's profitability in 2021-2022 as restaurant operators may need to spend more on marketing activities and offer sales promotions to stay competitive.

Leverage to rise from COVID-19 impacts and overseas expansion

MM's financial leverage is expected to rise as a result of deteriorating operating performance in 2020 and capital spending for its expansion in France. The company plans to continue its investment in France but scale back capital expenditure in all other areas. TRIS Rating expects its capital expenditure to be around Bt300 million per annum in 2020-2021 and drop to Bt160 million in 2022. We project the company's debt to EBITDA ratio to rise briefly to around 10 times in 2020, from 2.7 times in 2019, based on the assumption that the pandemic can be largely contained by around mid-2020. We project the debt to EBITDA ratio to revert back to 4.2 times in the following years, reflecting a gradual recovery in performance to the pre-pandemic levels. The debt to capitalization ratio is expected to range upward to 47%-54% in 2020-2022, from 35% in 2019.

MM's debentures have a key financial covenant that requires the company to maintain its interest-bearing debt to equity ratio below 3 times. As of December 2019, the ratio was 0.3 times. Also, the company's long-term bank loan has key financial covenants that require the company to maintain the total liabilities to equity ratio below 2 times, the debt service coverage ratio above 1.2 times, and the net debt to EBITDA ratio below 3 times. As of December 2019, the ratios were 0.56 times, 1.93 times, and 2.97 times, respectively. Going forward, we view that the company has considerable headroom to comply with the debentures' financial covenant. However, for the long-term bank loan financial covenants, the company may need to seek a waiver on the debt service ratio and debt to EBITDA ratio thresholds due to the impact of the pandemic on its cash flow in 2020.

Weaker cash flow generation to pressure liquidity in the next several months

TRIS Rating expects the company to experience stretched liquidity in the near term from the pandemic impact. The company has long-term bank debts of Bt66 million and short-term bank debts of around Bt200 million coming due in 2020. The company's sources of liquidity include cash on hand of around Bt140 million and available revolving credit lines of around Bt100 million. If the short-term bank debt can be rolled over, we estimate the company's liquidity sources could weather around five months of operating loss during the lockdown period as the company has taken steps to reduce selling and administration costs during the dine-in restaurant closure period.

BASE-CASE ASSUMPTIONS

- MM's revenue to drop by around 30% in 2020 and gradually recover to pre COVID-19 trading level in 2021-2022.
- Gross profit margin to stay in the 59%-60% range.
- EBITDA margin to drop to 8% in 2020 and recover to 15%-16% in 2021-2022.
- Total capital spending to be around Bt300 million per annum in 2020-2021 and Bt160 million in 2022.

RATING OUTLOOK

The "negative" outlook reflects anticipated weakening operating performance and higher leverage resulting from the impact of the COVID-19 pandemic, and the risk that the depth of the impact turns out to be more severe than our projection or the company's recovery from the economic fallout takes longer than expected.

RATING SENSITIVITIES

We could downgrade the rating if the company's operating performance is weaker than our expectation due to a prolonged impact of the COVID-19 pandemic or the recovery from the pandemic situation takes longer than we expect. We would also consider lowering the rating if the company makes overly aggressive debt-funded investments or the performance of new investments overseas significantly fall short of our expectations. We could revise the outlook to "stable" if the company's operating performance demonstrates signs of sustainable recovery such that the credit metric outperforms or tracks our base-case projection.

COMPANY OVERVIEW

MM was established in 2006 and listed on the Market for Alternative Investment (MAI) on 11 April 2017. As of December 2018, Sub Sri Thai PLC (SST), a warehouse and document storage service provider, was the major shareholder, owning 64% of the paid-up shares. The company has two lines of business: food and beverages and fashion apparel. The company is the master franchisee of the Dunkin' Donuts, Au Bon Pain, and Baskin Robbins brands in Thailand. In 2014, the company expanded to the full-service restaurant segment by acquiring the Greyhound Group, which owns and operates the GHC chain and also produces and distributes fashion and lifestyle products under the Greyhound brand. MM also operates a hospital food court under the "M-Kitchen" brand and provides in-patient food services in a private hospital.

KEY OPERATING PERFORMANCE

Chart 1: Sales Contribution

Business	2016		2017		2018		2019	
Line	Bt Million	%	Bt Million	%	Bt Million	%	Bt Million	%
Dunkin' Donuts	1,152	40	1,020	36	1,048	34	957	33
Au Bon Pain	724	25	698	25	683	22	621	21
Baskin Robbins	105	4	108	4	108	3	101	3
Greyhound Cafe	704	24	844	30	947*	31	944*	32
Greyhound Fashion and Lifestyle	181	6	139	5	150	5	147	5
Le Grand Vefour					137	4	131	5
Others	25	1	23	1	22	1	20	1
Eliminations	-2	0	-1	0	-13	0	-8	0
Total sales	2,889	100	2,832	100	3,082	100	2,913	100

* *Including GHC London*
Source: MM

Chart 2: Number of Outlets

Food Outlets	Outlet Number	Type of Restaurant
Dunkin' Donuts	281	QSR
Au Bon Pain	78	QSR
Baskin Robbins	29	QSR
Greyhound Café	25*	Full service restaurant
Greyhound Café (franchised)	16	Full service restaurant
Le Grand Vefour	1	Fine dining French restaurant
Total outlets	**431**	

* *Including GHC London*
Source: MM

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

Unit: Bt million

	---------------------Year Ended 31 December --------------------				
	2019	2018	2017	2016	2015
Total operating revenues	3,060	3,233	2,962	2,992	2,889
Earnings before interest and taxes (EBIT)	64	75	36	66	66
Earnings before interest, taxes, depreciation, and amortization (EBITDA)	552	523	510	502	447
Funds from operations (FFO)	462	436	424	422	338
Adjusted interest expense	89	81	80	100	97
Capital expenditures	154	174	266	154	181
Total assets	4,210	4,301	4,338	3,815	4,057
Adjusted debt	1,470	1,355	1,152	1,715	1,645
Adjusted equity	2,696	2,788	2,845	1,815	2,144
Adjusted Ratios					
EBITDA margin (%)	18.03	16.18	17.23	16.79	15.47
Pretax return on permanent capital (%)	1.48	1.75	0.91	1.76	1.69
EBITDA interest coverage (times)	6.22	6.49	6.37	5.04	4.61
Debt to EBITDA (times)	2.67	2.59	2.26	3.42	3.68
FFO to debt (%)	31.43	32.20	36.84	24.63	20.53
Debt to capitalization (%)	35.29	32.70	28.82	48.59	43.42

RELATED CRITERIA

- Rating Methodology – Corporate, 26 July 2019
- Key Financial Ratios and Adjustments, 5 September 2018
- Group Rating Methodology, 10 July 2015

Mudman PLC (MM)

Company Rating:	BBB-
Rating Outlook:	Negative

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