McLeod Russel India Limited

June 08, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount(Rs. crore)	Rating Action
Term Loan	360.00	360.00	[ICRA]AA-; Downgraded from [ICRA]AA(Negative) and placed Under rating watch with developing implications
Fund-based Bank Facilities	600.00	600.00	[ICRA]AA-; Downgraded from [ICRA]AA(Negative) and placed Under rating watch with developing implications
Fund-based Bank Facilities**	200.00	200.00	[ICRA]AA-; Downgraded from [ICRA]AA(Negative)/[ICRA]A1+ reaffirmed and Placed Under rating watch with developing implications
Non-fund-based Bank Facilities	18.80	18.80	[ICRA]A1+; Reaffirmed and Placed Under rating watch with developing implications
Commercial Paper Programme	300.00	300.00	[ICRA]A1+; Reaffirmed and Placed Under rating watch with developing implications
Total	**1478.80**	**1478.80**	

*Instrument details are provided in Annexure-1
**Fungible with LT facilities

Rating action

ICRA has downgraded the long-term rating assigned to the Rs. 360-crore[1] term loans, Rs. 600-crore long-term fund-based bank facilities and Rs. 200-crore fund-based working capital limits of McLeod Russel India Limited (MRIL) to [ICRA]AA- (pronounced ICRA double A minus) from [ICRA]AA (pronounced as ICRA double A). The Rs. 200.00-crore fund-based working capital limits have also been rated on the short-term scale, for which ICRA has reaffirmed the rating at [ICRA]A1+ (pronounced ICRA A one plus). The rating for the Rs. 18.80 crore non-fund-based bank facilities and the Rs. 300-crore commercial-paper programme has also been reaffirmed at [ICRA]A1+ [2]. The ratings have also been placed under rating watch with developing implications.

Rationale

The revision in the long-term rating factors in MRIL's weaker than expected operational performance in FY2018. While an increase in tea realisations, together with a rise in tea production from own estates and overall sales volumes, supported the core operating profit margin of the company to some degree, the extent of the improvement remained below ICRA's expectations. Additionally, continued high level of exposure to group companies in FY2018, with the quantum of the exposure exceeding ICRA's expectations, also had an adverse impact on the ratings. With the loans advanced to the group companies being largely funded by external debt, MRIL's debt-coverage indicators remained weak on an absolute basis, notwithstanding some improvement during the year.

The ratings have also been placed under rating watch with developing implications given the proposed sale of certain tea estates, which is expected to generate a considerable cash inflow. Part of the sale proceeds are to be used for paring debt, and are thus likely to result in some improvement in the overall financial profile of the company. However, the extent of

[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

the improvement will be determined by the final sale value of the tea estates and the timeliness of receipt of the corresponding cash flows. Moreover, the company has also initiated the process for carrying out a share buyback from the open market, to the extent of Rs. 100 crore. The net reduction in debt levels, post conclusion of the above, will remain a key rating sensitivity. ICRA will continue to monitor the developments in this regard and will review the performance once more clarity emerges.

The ratings continue to favourably take into account the company's leading position among tea plantation companies in India, and the premium quality of the company's teas, which fetch realizations that are higher than industry averages. Considerable non-operating income, which provided substantial support to cash flows in FY2018, and a conservative capital structure, notwithstanding the increase in debt levels in recent years, also positively impacted the ratings. The ratings, however, also factor in the risks associated with tea being an agricultural commodity, which is dependent on agro-climatic conditions, as well as the inherent cyclicality of the fixed cost intensive tea industry that leads to variability in profitability and cash flows of bulk tea producers such as MRIL. Production costs are expected to be adversely impacted by further increases in the wage rates of tea estate workers going forward as well. ICRA, nonetheless, notes that MRIL's considerable bought leaf operations, along with the favourable age profile of its tea bushes, mitigates the risks associated with the fixed cost intensive nature of the bulk tea industry to an extent. Moreover, profits from overseas operations have also supported operating profits on a consolidated basis.

Outlook: Ratings placed under watch with developing implications

The ratings have been placed under watch with developing implications, given the proposed sale of certain tea estates, the proceeds from which are expected to be used for reduction of debt. MRIL has entered into memorandums of understanding (MoUs) with M. K. Shah Exports Limited (M.K. Shah), an orthodox tea manufacturer, and Luxmi Tea Company Private Limited (Luxmi Tea), a manufacturer of CTC, orthodox and green tea, for the above-mentioned sale. As per the MoU, M.K. Shah is to purchase eight tea estates in MRIL's Doom Dooma Circle, which manufacture around 10.5 mkgs of tea annually, and contributed to around 12% of MRIL's turn-over in FY2017. Sales proceeds are estimated at Rs. 331 crore. Luxmi Tea is to purchase 4 tea estates in the Moran area, manufacturing around 4 mkg of tea annually. The estates contributed to around 6% of MRIL's turn-over in FY2017, and are slated to be sold for around Rs. 141 crore. Conclusion of the deals is expected post completion of due-diligence and other sale formalities. Part of the inflow is expected to be utilized for paring debt. ICRA also notes that the company has planned a buyback of shares to the extent of Rs. 100 crore. The net reduction in debt levels, post conclusion of the above, will remain a key rating sensitivity. ICRA will continue to monitor the developments in this regard and will review the situation once more clarity emerges.

Key rating drivers

Credit strengths

Status of being one of the largest bulk tea producers globally, with a geographically diversified production base – MRIL produced around 89 mkg of tea in FY2018, accounting for almost 7% of the total domestic tea production. The consolidated production of around 118 mkg accounted for around 5% of the global production of black tea. Stand-alone production increased by around 5% during the year, and consolidated production, by around 3%. The globally diversified production base of the consolidated entity, with gardens in India, Uganda, Rwanda and Vietnam mitigates the risks arising from adverse agro-climatic conditions to some extent, although exposure to geo-political risks remains.

Superior quality of tea produced by MRIL; high productivity and bought-leaf operations reduce the risks associated with the fixed-cost intensive nature of operations to some extent - The teas produced by MRIL are known for their quality, both in the domestic as well as in the export markets, fetching a premium over industry averages. The favourable age profile of MRIL's tea bushes, with around 93% of the Indian bushes being below 50 years of age, results in MRIL recording a high tea estate yield. This directly impacts the cost structure due to the fixed-cost-intensive nature of the industry. Moreover, the inclusion of bought-leaf operations, which aids in better absorption of fixed overheads, in the company's sales mix also reduces the overall fixed cost intensity of the bulk tea business.

Considerable non-operating income and high profits from overseas operations, which provided substantial support to cash flows in FY2018, and a conservative capital structure; notwithstanding the increase in debt levels in recent years – While the operational performance of MRIL's plantation business has weakened in recent years, with the muted increase in realisations remaining unable to compensate for the substantial increase in costs – particularly wages, cash flows have been supported by considerable non-operating income. In FY2018, the company received Rs. 154 crore of special dividend from its wholly owned subsidiary, Boreilli Tea Holdings Plc (UK) (BTHL), as repatriation of partial proceeds from the sale of treasury stock held by BTHL. This, together with interest and other non-core income led to a net cash accrual of around Rs. 150 crore during the year on a standalone basis. NABARD deposits built up over the past years led to a healthy bank balance as well, which supports the overall liquidity position of the company, notwithstanding some decline in the quantum of the balances in the past few years. Cash flows were even stronger on a consolidated basis, with overseas operations generating an incremental operating profit of around Rs. 128 crore, over and above the Rs. 13.99 crore generated by domestic operations, leading to consolidated net cash accruals of Rs. 321 crore. The capital structure also remained conservative on both a standalone and a consolidated basis, notwithstanding the increase in standalone debt levels in recent years. Consolidated debt levels were lower than in previous years, with operating profits and partial proceeds from the sale of treasury stock being used to pare debt. Going forward, ICRA notes that cash flows in FY2019 are also expected to be supported by non-operating income in the form of proceeds from the sale of tea estates.

Credit challenges

Continued pressures on core operating profitability during FY2018, notwithstanding some improvement over the previous year – While an increase in tea realisations, together with a rise in tea production from own estates and overall sales volumes, supported the core operating profit margin of the company to some degree, the operating profitability of the company remained muted at 1% on a standalone basis during FY2018. Production costs were adversely impacted by higher wages and power and fuel costs, and the increase in tea realizations remained inadequate to compensate for the rise in costs. This, together with increased debt levels, resulted in continued pressures on debt coverage indicators as well, nowithstanding some improvement over FY2017 levels. However, ICRA notes that on a consolidated basis, the company reported an operating profit of Rs. 142 crore in FY2018, supported by healthy profitability from overseas operations.

Largely debt-funded exposure to group companies leads to increase in overall debt levels and results in pressure on debt coverage – The total debt in FY2018 increased considerably, primarily due to additional bank borrowing being raised to fund loans and advances to group companies. Enhanced debt levels, together with the consequent rise in interest costs, exerted pressure on debt-protection metrics. Going forward, ICRA notes that the receipt of proceeds from the proposed of certain tea estates would be likely to result in a reduction in debt levels and consequently an improvement in debt coverage indicators.

Risks associated with tea for being an agricultural commodity, as well as the inherent cyclicality of the fixed-cost intensive tea industry - Tea production depends on agro-climatic conditions, which subjects it to agro-climatic risks. Moreover, tea estate costs are primarily fixed, with labour-related costs, which are independent of the volume produced, accounting for around 50% of the production cost. This leads to variability in profitability and cash flows of bulk tea producers such as MRIL.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Rating Methodology for Entities in the Indian Bulk Tea Industry

About the company:

McLeod Russel India Limited (MRIL), the tea plantation company of the Kolkata-based B.M. Khaitan Group, was originally incorporated as Eveready Company India Private Ltd. on May 5, 1998. MRIL was formed after the demerger of the bulk-tea business from Eveready Industries India Ltd. (EIIL) with effect from April 1, 2004. MRIL has acquired several other companies like Williamson Tea Assam in FY2006, Doom Dooma Tea Company in FY2007 and Moran Tea in FY2008. These acquisitions helped MRIL increase the number of tea estates to 53 in India, with the total land under tea cultivation being 33,723 hectares (Ha). MRIL also acquired tea estates through its subsidiaries in Vietnam (three tea estates and seven factories), Uganda (six tea estates and five factories) and Rwanda (two tea estates and two factories) between CY2009 and CY2014, which took the total production to around 118 Mkg on a consolidated basis during FY2018. In the recent past, MRIL has sold one tea estate in the Dooars, and is proposing to sell twelve more in Assam. Post conclusion of the sale, the company would have 40 tea estates with the capacity to manufacture around 52 mkg of tea from own leaves. MRIL is primarily a producer of CTC tea, which accounts for around 96% of the total tea production.

In FY2018, on a standalone basis, the company reported a net profit of Rs. 67.26 crore on an operating income of Rs. 1596.34 crore, compared to a net profit of Rs. 30.53 crore on net sales of Rs. 1,388.65 crore in the previous year. On a consolidated basis, the entity reported a net profit of Rs. 219.16 crore in FY2018 on the back of an operating income of Rs. 2055.29 crore, as against a net profit of Rs. 64.45 crore on net sales of Rs. 1772.11 crore in the previous year.

Key financial indicators (audited)

Standalone

	FY2017	FY2018
Operating Income (Rs. crore)	1485.40	1596.34
PAT (Rs. crore)	30.53	67.26
OPBDIT/OI (%)	2.1%	0.9%
RoCE (%)	6.0%	NA
Total Debt/TNW (times)	0.58	NA
Total Debt/OPBDIT (times)	26.32	NA
Interest coverage (times)	0.24	0.08

Source: Annual Reports of Company

Note:

1.The above table includes profit on compulsory acquisition of land by Government received in FY2017 as part of operating revenue; however, while assigning the rating, ICRA has considered the same as non-operating income

2. Annual report for FY2018, containing detailed financial schedules, is yet to be published

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating June 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 August 2017	Date & Rating in FY2017 August 2016	Date & Rating in FY2016 August 2015
1	Term Loan	Long Term	360.00	290.00*	[ICRA]AA- &	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA+ (Stable)
2	Fund-based Bank Facilities	Long Term	600.00	NA	[ICRA]AA- &	[ICRA]AA (Negative)	[ICRA]AA (Stable)	[ICRA]AA+ (Stable)
3	Fund-based Bank Facilities**	Long Term/ Short Term	200.00	NA	[ICRA]AA- &/ [ICRA]A1+ &	[ICRA]AA (Negative)/ [ICRA]A1+	[ICRA]AA (Stable)/ [ICRA]A1+	[ICRA]AA+ (Stable)/ [ICRA]A1+
4	Non-fund-based Bank Facilities	Short Term	18.80	NA	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Commercial Paper Programme	Short Term	300.00	Nil	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+

**As on March 31, 2018*

& Under rating watch with developing implications

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	Mar, 2015 – Sep, 2017	NA	FY2020-FY2024	360.00	[ICRA]AA- &
NA	Fund-based Bank Facilities	NA	NA	NA	600.00	[ICRA]AA- &
NA	Fund-based Bank Facilities**	NA	NA	NA	200.00	[ICRA]AA- &/ [ICRA]A1+ &
NA	Non-fund-based Bank Facilities	NA	NA	NA	18.80	[ICRA]A1+ &
NA	Commercial Paper Programme	NA	NA	NA**	300.00	[ICRA]A1+ &

& Under rating watch with developing implications

***Not placed at present*

Source: MRIL

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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