July 30, 2021

Kandala Distributors: Rating reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based/ CC	6.00	10.00	[ICRA]BB+(Stable) reaffirmed
Total	**6.00**	**10.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation takes into consideration the track record of Kandala Distributors (Kandala) and experience of its promoters in the pharmaceutical industry. ICRA notes the established relationships with the principals and the sole super-stockist/clearing and forwarding agent (CFA) status enjoyed by the firm in the region allocated to it by the principals in the Karnataka market. The principals include reputed pharmaceutical companies such as British Biologicals, Hegde & Hegde LLP, MSD Pharmaceuticals Ltd., Albert David Ltd., among others. The rating draws comfort from its established relationship with a large client base and a wide product portfolio.

However, the rating is constrained by its moderate scale of operations, thin margins owing to the trading nature of operations and high geographical concentration risk. Further, the rating continues to be constrained by the firm's average financial risk profile, characterised by stretched coverage indicators and a low net worth base. The rating also considers the competition in the pharmaceutical distribution space. Besides, the rating notes that Kandala is a partnership firm, which increases the capital withdrawal risk, as witnessed in the past years.

The Stable outlook on the [ICRA]BB+ rating reflects ICRA's opinion that Kandala will continue to benefit from its extensive track record of operations and established relationships with reputed pharmaceutical companies.

Key rating drivers and their description

Credit strengths

Long experience of the promoters and established track record of the firm in pharmaceutical distribution business – Kandala was set up in 1992. The firm has more than three decades of track record in the pharmaceutical distribution business as a CFA/ super stockist for various pharmaceutical companies in Karnataka. Kandala caters to a large number of customers in the Karnataka (especially in Bengaluru) market, which are a mix of wholesalers/ sub-stockists, medical retail chains etc.

Established relationships with pharmaceutical companies – The firm has been able to establish strong relationships with its suppliers. It is the sole super stockist/ C&F agent for the regions allocated to it in Karnataka for many of its supplier brands. Associations with reputed pharmaceutical companies such as Albert David Ltd., British Biologicals Pvt Ltd, Hegde & Hegde provide stability to revenues.

Wide product portfolio – Kandala is responsible for maintaining stock of various pharma companies and forwarding required stock keeping units (SKUs) to the stockists on request. It has a wide product portfolio of about 1,500 SKUs of different pharmaceutical companies and caters to more than 500 stockists and retailers in the Karnataka region.

Credit challenges

Trading nature of business leads to low operating margin – The drug distribution system in India is highly tiered with multiple levels between the manufacturer and the end-consumer. Owing to the regulated nature of drug prices in India, the margins at each level in the distribution chain are primarily fixed by the principal. Further, considering the limited value addition by distributors, low bargaining power against larger suppliers and a large number of players in the segment, the margins are relatively thin, as indicated by an operating margin of 1.5% in FY2021 (provisional). The scale of operations continues to be moderate with the firm reporting an OI of Rs. 174.6 crore in FY2021, which declined from Rs. 192.9 crore in FY2020, mainly due to various pandemic related challenges in Q1 FY2021 wherein the sales volume declined with lower sales of lifestyle and cosmetology range of products. Further, deferment of elective surgeries also affected the sales volume.

Stretched coverage indicators – The financial risk profile is marked by stretched coverage indicator, with Total Debt/OPBITDA of 4.1 times and interest coverage of 2.2 times in FY2021 (provisional) and low net worth base (Rs. 6.7 crore as on March 31, 2021). The gearing of the firm stood moderate at 1.6 times as on March 31, 2021, which improved from 2.6 times as on March 31, 2020 due to lower working capital borrowing. A significant portion of the debt as on March 31, 2021 is in the form of interest-bearing unsecured loans from promoters and relatives.

Intense competition in pharmaceutical distribution space owing to low entry barriers – The presence of a large number of players due to low entry barriers in the pharma distribution business intensifies competition in the segment, thereby putting pressure on the margins. Nevertheless, the company's established presence in Bengaluru provides competitive advantage to some extent.

Inherent risk associated with partnership firms – Kandala is exposed to the risks associated with a partnership firm, including the capital withdrawal risk, which can adversely impact its capital structure.

Liquidity position: Adequate

Kandala's liquidity profile is adequate with moderate average utilisation of working capital limits (53% between July 2020 and June 2021), providing adequate buffer. Further, with a modest repayment obligation of Rs. 0.3 crore in FY2022 and Rs. 0.4 crore in FY2023, the projected cash accruals would be sufficient to meet the repayment requirements. Also, the firm's promoters and related parties have consistently infused funds in the form of unsecured loans to support liquidity requirements.

Rating sensitivities

Positive factors – ICRA could upgrade the rating if Kandala's scale of operations and operating margin improve further on a sustained basis. An improvement in coverage indicators on a sustained basis would also lead to an upgrade. Specific credit metrics that could lead to a rating upgrade include TOL/TNW of less than 2.0 times on a sustained basis.

Negative factors –Pressure on the rating could arise if there is a substantial reduction in revenue and margins on a sustained basis, an increase in working capital intensity or any sizeable capital withdrawal, leading to a tight liquidity position. Specific credit metrics that could lead to a rating downgrade include interest cover of less than 2.2 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	The rating is based on the firm's standalone financial profile

About the company

Kandala Distributors is a partnership firm formed in 1992 and is involved in the distribution of pharmaceutical products. The firm is a super stockist/clearing and forwarding agent of pharmaceutical companies and caters to stockists all over Karnataka. The firm trades in over 1,500 branded drugs with supplies from pharmaceutical companies like British Biologicals, Hegde & Hegde LLP, MSD Pharmaceuticals Ltd, Albert David Limited, among others. It operates from four warehouses in Bengaluru across a total area of 31,000 sq. ft. and is equipped with walk-in coolers and refrigerators for temperature-controlled stocking of medicines. The firm has one sister concern, Kandalaa, which is a jewellery retail outlet.

Key financial indicators

	FY2020	FY2021 (Prov.)
Operating Income (Rs. crore)	192.9	174.6
PAT (Rs. crore)	1.5	1.4
OPBDIT/OI (%)	1.5%	1.5%
PAT/OI (%)	0.8%	0.8%
Total Outside Liabilities/Tangible Net Worth (times)	4.3	2.3
Total Debt/OPBDIT (times)	5.7	4.1
Interest Coverage (times)	2.7	2.2

PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation;
Note: Amount in Rs. crore; All calculations are as per ICRA Research
Source: Company data, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					July 30, 2021	-	Jan 30, 2020	July 31, 2018
1	Cash Credit	Long-term	10.00	-	[ICRA]BB+(Stable)	-	[ICRA]BB+(Stable)	[ICRA]BB+(Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple

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, is available on ICRA's 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	Cash Credit	NA	NA	NA	10.0	[ICRA]BB+(Stable)

Source: *Firm;*

Annexure-2: List of entities considered for consolidated analysis

Not applicable

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About ICRA Limited:

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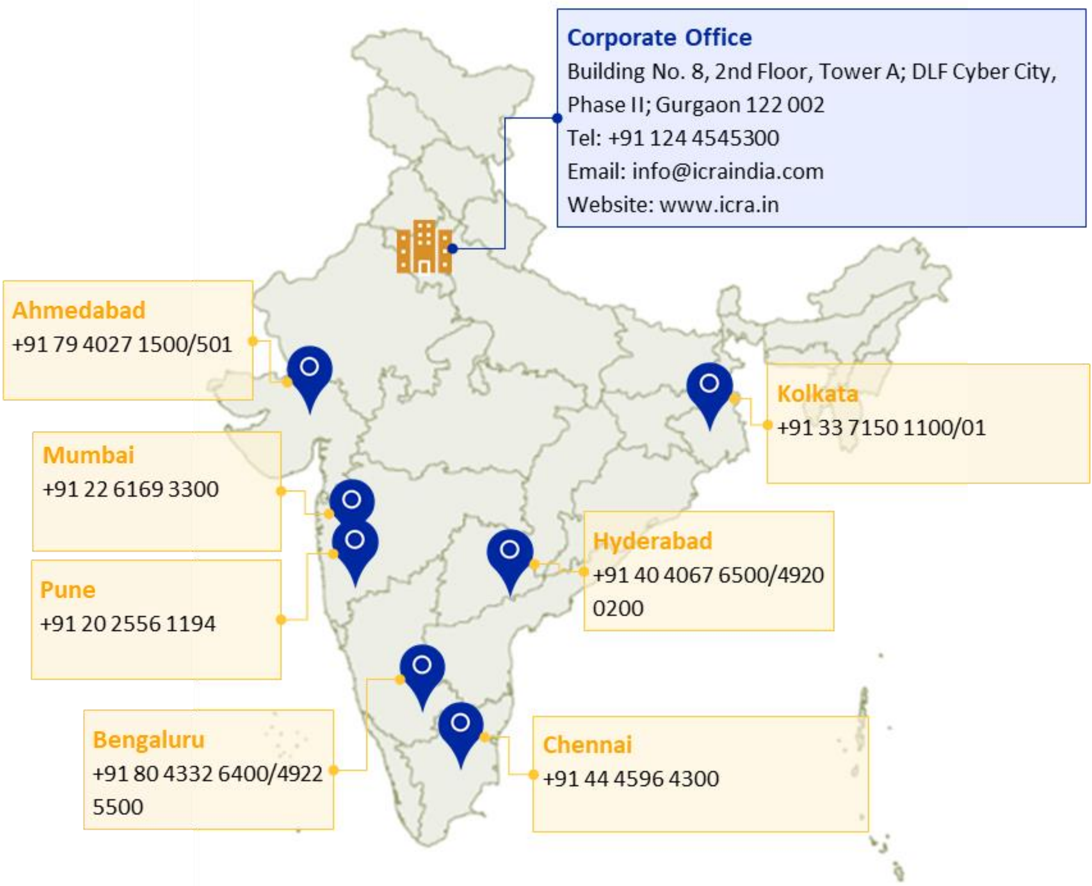

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