

August 12, 2022

## Kandala Distributors: Rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	10.00	10.00	[ICRA]BB+(Stable); reaffirmed
<b>Total</b>	<b>10.00</b>	<b>10.00</b>	

\*Instrument details are provided in Annexure-I

### Rationale

The rating reaffirmation takes into consideration the established track record of Kandala Distributors (Kandala) and the experience of its promoters in the pharmaceutical industry. ICRA notes the firm's established relationship with the principals and its status as the sole superstockist/clearing and forwarding agent (CFA) in the regions allocated to it 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.

The rating is, however 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 its established relationship with reputed pharmaceutical companies.

### Key rating drivers and their description

#### Credit strengths

**Long experience of promoters and established track record of firm in pharmaceutical distribution business** – Kandala was set up in 1992. The firm has a track record of more than three decades 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 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. Its association with reputed pharmaceutical companies such as Albert David Ltd., British Biologicals Pvt Ltd, Hegde & Hegde provides stability to the revenues.

**Wide product portfolio** – Kandala is responsible for maintaining a stock of various pharma companies and forwarding the 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, the margins are relatively thin because of the limited value addition by distributors, the low bargaining power against the bigger suppliers and a large number of players in the segment; the operating margin was 1.5% in FY2021 and FY2022. The scale of operations continues to be moderate with the firm reporting an OI of Rs. 182.0 crore in FY2022, which improved from Rs. 174.6 crore in FY2021, on a low base, due to the easing of various pandemic-related challenges.

**Stretched coverage indicators** – The financial risk profile is marked by stretched coverage indicators, with a total debt/OPBITDA of 3.6 times and interest coverage of 2.4 times in FY2022 and a low net worth base of Rs. 6.9 crore as on March 31, 2022. The firm's gearing was moderate at 1.4 times as on March 31, 2022, which improved from 1.7 times as on March 31, 2021, due to lower working capital borrowing. A significant portion of the debt as on March 31, 2022, is in the form of interest-bearing unsecured loans from promoters and relatives.

**Intense competition in pharmaceutical distribution space** – The presence of a large number of players due to the low entry barriers in the pharma distribution business intensifies competition in the segment, thereby putting pressure on the margins. Nevertheless, the firm'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 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 (41% between June 2021 and May 2022), providing adequate buffer. Further, with a modest repayment obligation of Rs. 0.4 crore each in FY2023 and FY2024, the projected cash accruals would be sufficient to meet the repayment requirements. The firm has proposed capex plans of ~ Rs. 1.0 crore for FY2023 to set up various facilities at new warehouse and purchasing vehicles, which would be funded by internal accruals. Also, the firm's promoters and related parties have infused funds in the past in the form of unsecured loans to support the 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. A specific credit metric that could lead to a rating upgrade is TOL/TNW of less than 2.0 times on a sustained basis along with an increase in the net worth.

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

## Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	<a href="#">Corporate Credit Rating Methodology</a>
Parent/Group support	Not Applicable
Consolidation/Standalone	The rating is based on the standalone financials of the firm.

## 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, Kandala, which is a jewellery retail outlet.

## Key financial indicators

	FY2021	FY2022 (Provisional)
Operating income	174.6	182.0
PAT	1.4	1.7
OPBDIT/OI	1.5%	1.5%
PAT/OI	0.8%	0.9%
Total outside liabilities/Tangible net worth (times)	2.9	2.9
Total debt/OPBDIT (times)	4.1	3.6
Interest coverage (times)	2.2	2.4

Source: Firm, ICRA Research; \* Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. crore PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

Instrument	Type	Amount rated (Rs. crore)	Current rating (FY2023)		Chronology of rating history for the past 3 years		
			Amount outstanding (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
				August 12, 2022	July 30, 2021	-	Jan 30, 2020
1 Cash Credit	Long term	10.0	-	[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 are available on ICRA's website: [www.icra.in](http://www.icra.in)

## Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	10.0	[ICRA]BB+(Stable)

Source: Firm

## Annexure II: List of entities considered for consolidated analysis

Not applicable

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### Branches



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