May 28, 2024 (Revised)

M. K. Shah Exports Limited: Long-term rating reaffirmed and short-term rating downgraded; outlook revised to Negative from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term – Fund-based -Term loans	104.00	104.00	[ICRA]A(Negative); reaffirmed, outlook revised to Negative from Stable
Long term/Short term – Fund-based - Working capital facilities^	80.50	80.50	[ICRA]A(Negative)/[ICRA]A2+; short-term rating downgraded from [ICRA]A1 and long-term rating reaffirmed; outlook revised to Negative from Stable
Long term/Short term – Unallocated Limit	5.50	5.50	[ICRA]A(Negative)/[ICRA]A2+; short-term rating downgraded from [ICRA]A1 and long-term rating reaffirmed; outlook revised to Negative from Stable
Total	**190.00**	**190.00**	

**Instrument details are provided in Annexure-I; ^includes cash credit, WCDL, export packing credit*

Rationale

ICRA has taken a consolidated view of M. K. Shah Exports Limited (MKSEL), M. K. Shah Teas LLP (LLP) and M. K. Shah Realty (MKSR) to arrive at the ratings, together referred to as the Group, given the common management, significant operational and financial linkages and cash flow fungibility among the entities.

The rating action and change in outlook primarily factors in the weaker-than-anticipated performance of the Group in FY2024, owing to a significant drop in orthodox (ODX) realisation as well as increase in wage rates, which adversely impacted its consolidated profits and cash flow. While the profitability and debt protection metrics were also affected, the lower cash flow from operations impacted the liquidity position to an extent. In the current fiscal, as per initial trends, orthodox tea prices have remained firm during April and May 2024. However, the sustenance of firm tea prices during the peak tea producing months from June to October 2024 would be critical for an overall improvement in the financial risk profile of the entity and will remain a key monitorable.

The ratings continue to factor in MKSEL's established presence as one of the largest producers of ODX tea in India. MKSEL had acquired eight gardens in FY2019 from Mcleod Russel India Limited (MRIL), which significantly increased its scale of operations. Going forward, the favourable age profile of the tea bushes and MKSEL's focus on improving productivity are likely to support its cost structure. The consolidated leverage ratio (total debt/OPBDITA) moderated in FY2024 but is likely to improve in the current fiscal owing to an expected improvement in profitability and prepayment led by better cash flows. At present, MKSEL is entitled to receive a subsidy of Rs. 10/kg on the production of ODX tea from the Assam Government as well as income tax exemption on agricultural income. Besides MKSEL, both MKSR and LLP receive interest subsidy on working capital, supporting the profitability.

The ratings, however, factor in the risks associated with tea being an agricultural commodity as well as the cyclicality inherent in the fixed-cost intensive nature of the industry that leads to volatility in profits and cash flows for bulk tea producers such as MKSEL. The basic daily wages of tea estate workers in Assam have increased by Rs. 18 per manday from October 2023 and have significantly increased the production cost. The ratings are also constrained by the company's sizeable financial exposure to Group entities, which did not yield commensurate returns, negatively impacting its ROCE. Nevertheless, a steady level of non-operating income (rent from real estate properties, interest on capital invested in Group entities etc) supports MKSEL's cash accruals to some extent.

Key rating drivers and their description

Credit strengths

Experienced promoters and established presence as one of the largest producers of ODX tea in India – MKSEL, incorporated in 1992, is one of the largest ODX tea producers in India. After the acquisition of eight tea estates from Mcleod Russel India Limited (MRIL) in FY2019, MKSEL's scale of operations increased substantially. At present, it manufactures only ODX tea with an area under cultivation of 8,460 hectares (as of FY2024) spread across 13 gardens in Assam compared with 2,513 hectares and five tea estates in FY2018 (prior to the acquisition). In FY2024, MKSEL's tea production stood at 18.6 million kg (mkg), accounting for around 18% of the overall ODX tea produced in India. The promoters have a vast experience in the tea plantation sector and the export markets. MKSEL's superior quality of ODX tea commands a significant premium over the North Indian auction averages. In addition to sales through auction houses and private parties, MKSEL exports a portion of its produce. This year, the entity has also started selling through private auctions, resulting in some cost savings. A major portion of the Group's exports is routed through LLP, which procures tea from MKSEL. Additionally, exports through the realty entity- MKSR - supported the overall export volumes in the last fiscal.

Favourable age profile of tea bushes and operational efficiency positively impact cost structure – MKSEL's garden costs are largely fixed, in line with that of the industry, with labour costs accounting for a major part of the production cost. Hence, the profitability of the bulk tea producers is highly correlated with productivity. MKSEL follows sound garden practices and continuous uprooting and fresh plantation, which resulted in a favourable age profile of its bushes, with nearly 70% of the bushes being less than 50 years old, supporting the productivity.
In FY2021, MKSEL's yield was affected by the pandemic and the yield of the acquired gardens was more severely impacted by the flood in Upper Assam, resulting in a drop in the overall yield to 1,566 kg/hectare in FY2021 from 2,011 kg/hectare in FY2020. Nevertheless, MKSEL's focus on improving the yield, particularly that of the acquired gardens, led to a significant rise in the overall yield to 1,939 kg/hectare in FY2022 and 2,064 kg/hectare in FY2023. The average yield of the acquired gardens (~2,100 kg/hectare in FY2024) is still significantly lower than that of the original gardens (~2,300 kg/hectare in FY2024). Hence, there is a scope for further improvement in the overall productivity, going forward. This is likely to mitigate the risks associated with the fixed-cost nature of the industry, favourably impacting the company's cost structure and hence profitability.

Conservative capital structure – MKSEL incurred a sizeable amount of long-term debt (Rs. 115 crore) to acquire the gardens from MRIL in FY2019, and its working capital borrowing also increased with the scaling up of operations. However, the company's consolidated capital structure remained conservative, reflected in a gearing of 0.4 times as on March 31, 2024. The consolidated debt level is likely to decline with the prepayment of term loan in the current fiscal (around Rs. 20 crore prepaid in FY2024), supported by healthy accruals. A reduction in debt and improved profits are likely to strengthen the consolidated debt coverage metrics, going forward.

Credit challenges

Weak earnings in FY2024, adversely impacting leverage and coverage indicators - MKSEL's financial performance remained weaker-than-expected in FY2024 owing to a significant drop in orthodox (ODX) realisation as well as increase in wage rates, which adversely impacted the Group's consolidated profits and cash flows. The Group's profitability and debt protection metrics were also affected, reflected in TD/OPBDITA of 5.0 times and interest coverage of 2.7 times in FY2024 compared with TD/OPBDITA and interest coverage of 2.9 times and 6.2 times, respectively, in FY2023. The lower cash flow from operations also impacted the liquidity position to an extent.
In the current fiscal, as per initial trends, orthodox tea prices have remained firm during April and May 2024. Improved demand from Iran is likely to support ODX prices in the current fiscal. However, the sustenance of firm tea prices during the peak tea

producing months from June to October 2024 would be critical for an overall improvement in the financial risk profile of the entity.

Increase in cost of production due to wage rate hike for tea estate workers – The basic daily wages for tea estate workers in Assam have increased by Rs. 18 per manday from October 2023. This increased the made-tea production cost by ~Rs. 9-10/kg in FY2024. However, a sharp rise in MKSEL's realisations would offset the impact of the cost inflation to an extent. A gradual improvement in MKSEL's yield due to incremental plantations and addition of area under cultivation is also likely to mitigate the cost pressure. Besides, Government incentives such as the income tax exemption on agricultural income, interest subsidy on working capital and subsidy on ODX tea production in Assam would support the profitability, to some extent.

Risks associated with tea being an agricultural commodity and inherent cyclicality of the fixed-cost intensive tea industry – Tea production depends on weather conditions, making the crop vulnerable to agro-climatic risks. Moreover, most of the tea estate costs are fixed, with manpower expenses accounting for a major portion of the production cost. Given the fixed-cost intensive nature of the tea business, the yield of the gardens and the out-turn ratio (defined as black tea produced to green leaf consumed) directly impact the cost structure and hence the profitability of bulk tea players, including MKSEL.

Sizeable investment in Group entities – MKSEL's investment in its Mauritius-based wholly-owned subsidiary, Vaksana Holdings (which acquired a 70% stake in a tea estate in Congo in FY2014 through step-down subsidiaries), stood at Rs. 24.6 crore (Rs. 6.0-crore equity and the balance redeemable preference shares) as on March 31, 2024. The return from the investment in Vaksana Holdings has remained nil so far. Lack of commensurate returns from investments in Group entities, the sizeable capital invested to acquire the tea estates from MRIL in FY2019 and muted market conditions have adversely impacted MKSEL's consolidated ROCE, which stood at 3.9% in FY2024. Nevertheless, the ROCE is likely to improve in the current fiscal, aided by a healthy operating profit and firm realisations.

Liquidity position: Adequate

The company's liquidity position is likely to remain adequate. The consolidated cash flow from operations fell to Rs. 4.65 crore in FY2024 owing to a decline in realisation and increase in wage rates. However, the cash flow from operations is expected to improve in FY2025, supported by buoyant ODX prices. Its debt repayment obligation will be Rs. 9.6 crore for FY2025 but would increase to Rs. 12.5 crore in FY2026 and FY2027 due to a ballooning repayment structure. However, a sizeable term loan pre-payment (around Rs. 30 crore) in the current fiscal would reduce the overall debt service obligation in the near to medium term. Further the entity has no major capex plans, going ahead, supporting the liquidity.

Rating sensitivities

Positive factors – Healthy profitability and cash accruals, along with the reduction of debt on a sustained basis, will be the key factors for an upgrade. A decline in the consolidated total debt/OPBDITA of less than 1.5 times on a sustained basis may also trigger an upgrade.

Negative factors – ICRA may downgrade the ratings if the consolidated profitability and cash accruals deteriorate significantly, or if any sizeable debt-funded capex/acquisition adversely impacts the consolidated leverage and liquidity. Specific triggers for downgrade will be consolidated interest coverage of less than 4.5 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[Corporate Credit Rating Methodology](#) [Tea](#)
Parent/Group support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the financials of MKSEL with its Group entities, M. K. Shah Teas LLP and M. K. Shah Realty (as mentioned in Annexure-II), given the close business, financial and managerial linkages among them

About the company

M. K. Shah Exports Limited (MKSEL), incorporated in 1992, was promoted by Late Mukundray Shah. The company is an orthodox tea producer and has 13 tea estates in Assam with 8,388 hectares of land under cultivation (as of FY2022), including eight estates acquired from McLeod Russel India Limited in July 2018. In FY2024, MKSEL manufactured 18.6 mkg tea vis-à-vis 18.62 mkg in FY2023; however, the sales volumes increased to Rs. 18.9 crore in FY2024 from Rs. 17 crore in FY2023.

In July 2019, the promoters had set up M. K. Shah Teas LLP, in which MKSEL is a partner. Since then, most of the tea exports of the Group have been routed through this LLP. However, MKSEL directly exports to a few countries like Iran, Germany, Japan etc, as per the client requirement. MKSEL sells tea to the LLP, which is finally exported, and the LLP provides advances for the exports to MKSEL, thus having strong operational and financial linkages between them.

In FY2024, the company started a tea business in partnership entity M. K. Shah Realty. Earlier, this entity was into real estate leasing and had LRD loans which were paid off in FY2024 with support from MKSEL. The operations here are similar to the LLP entity, involving buying tea from MKSEL and then exporting it.

Key financial indicators

MKSEL	Standalone		Consolidated^	
	FY2023	FY2024*	FY2023	FY2024*
Operating income	463.8	440.4	478.2	452.3
PAT	39.1	7.2	43.4	9.1
OPBDIT/OI	14.8%	7.7%	15.6%	9.09%
PAT/OI	8.4%	1.6%	9.1%	2.01%
Total outside liabilities/Tangible net worth (times)	0.8	0.7	0.8	0.7
Total debt/OPBDIT (times)	2.7	5.0	2.9	5.1
Interest coverage (times)	5.3	2.5	6.2	2.7

*PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; ^ICRA estimates; Amount in Rs. crore; *Provisional results*
Source: Company, ICRA Research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years			
	Type	Amount rated (Rs. crore)	Amount outstanding as of March 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022
				May 28, 2024	-	Mar 20, 2023	Apr 18, 2022	Apr 07, 2021
1 Fund-based - Term loans	Long term	104.00	65.27	[ICRA]A (Negative)	-	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Positive)
2 Fund-based - Working capital facilities*	Long term/ Short term	80.50	-	[ICRA]A (Negative) /[ICRA]A2+	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A2+	-
3 Unallocated limit	Long term/ Short term	5.50	-	[ICRA]A (Negative) /[ICRA]A2+	-	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A2+	-
4 Fund-based - Working capital facilities	Long term	-	-		-	-	-	[ICRA]A- (Positive)
5 Fund-based - Working capital facilities	Short term	-	-	-	-	-	-	[ICRA]A2+

**Includes cash credit, WCDL, export packing credit*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term – Fund-based -Term loans	Simple
Long term/Short term – Fund-based - Working capital facilities*	Simple
Long term/Short term – Unallocated limit	Not applicable

**Includes cash credit, WCDL, export packing credit*

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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term – Fund-based -Term loan	Sep-2018	-	Dec-2028	74.00	[ICRA]A (Negative)
NA	Long term – Fund-based -Term loan	Jun-2021	-	Dec-2028	30.00	[ICRA]A (Negative)
NA	Long term/Short term – Fund-based - Working capital facilities*	-	-	-	80.50	[ICRA]A (Negative) /[ICRA]A2+
NA	Long term/Short term – Unallocated limit	-	-	-	5.50	[ICRA]A (Negative) /[ICRA]A2+

*Source: Company; *includes cash credit, WCDL, export packing credit*

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	MKSEL Ownership	Consolidation Approach
M. K. Shah Teas LLP	15% (as on March 31, 2024)	Full Consolidation
M. K. Shah Realty	15% (as on March 31, 2024)	Full Consolidation

CORRIGENDUM

Document dated May 28, 2024 has been corrected with revisions as detailed below:

• In Pg 4, in the rating history table short term rating for Fund-based - Working capital facilities for PR dated April 18, 2022 has been removed as the same would not be applicable.

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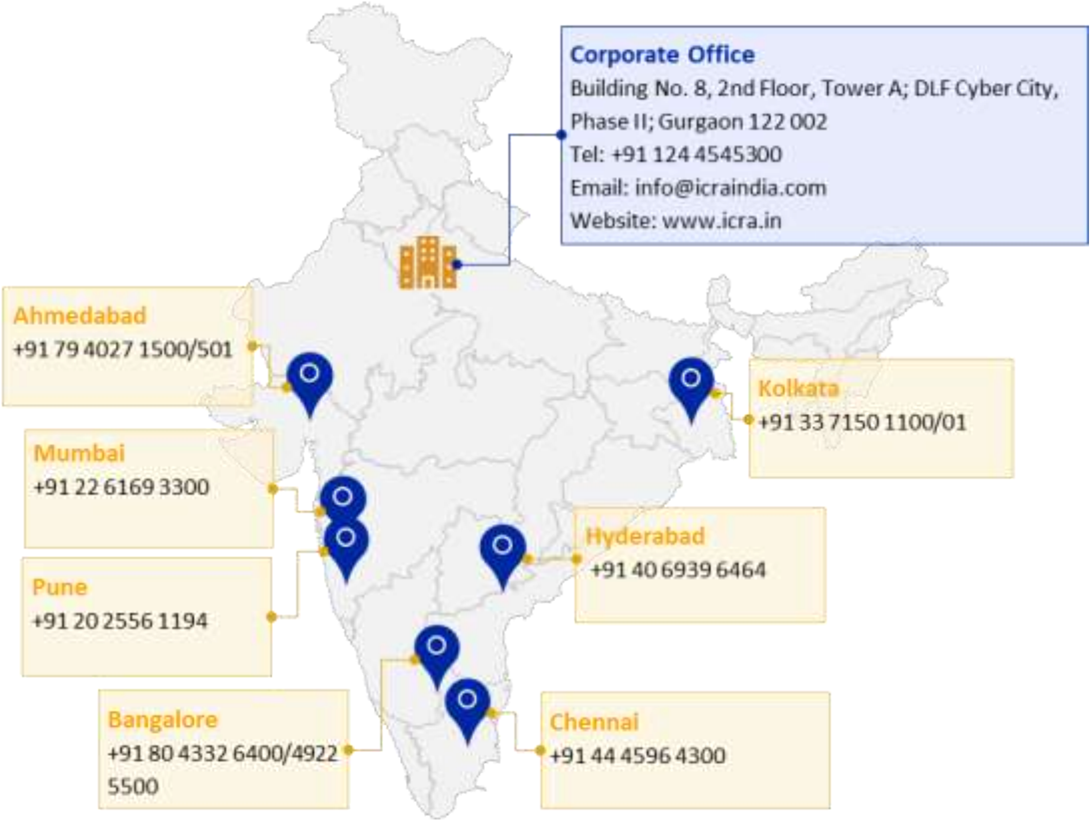

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