

June 07, 2019

## Kanan Devan Hills Plantations Company Private Limited: Ratings re-affirmed; outlook revised to Negative

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based- Working Capital Facilities	93.00	93.00	[ICRA]A-/re-affirmed; outlook revised to Negative from Stable
Fund based – Term loans	15.00	15.00	[ICRA]A-/re-affirmed; outlook revised to Negative from Stable
Fund based – Unallocated limits	22.00	22.00	[ICRA]A-/re-affirmed; outlook revised to Negative from Stable
Fund based – Interchangeable sub-limits	(90.00)	(90.00)	[ICRA]A2+; re-affirmed
<b>Total</b>	<b>130.00</b>	<b>130.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The revision in outlook reflects the expected moderation in KDHP's performance in the coming quarters because of the impending wage increase, which is likely to adversely impact earnings and consequently result in tight cash flows and modest credit metrics in FY2020. The overall wage costs for the current fiscal is likely to increase by more than 10% and thus KDHP's operating margins are expected to reduce to around 2-3%. ICRA notes that the wage increase in KDHP's gardens have been due since July 2018 and is likely to be implemented in the coming months. With volumes likely to remain largely in line with the FY2019 levels, the actual extent of the impact of wage increase on earnings would be largely dependent on the tea price trends and would remain a key rating sensitivity. The ratings remain supported by the strong operational and financial linkages of Kanan Devan Hills Plantations Company Private Limited (KDHP) with Tata Global Beverages Limited (TGBL, rated [ICRA]AA+/Stable/[ICRA]A1+) and its established presence in the domestic bulk tea industry. KDHP is also the largest tea plantation company in South India. ICRA expects TGBL to continue to support KDHP in the form of deferment of repayment of loans and advances for supplies taken given the linkages and track record of support seen over the years. A consistent increase in wage costs in the recent fiscals resulted in low operating profitability and earnings of KDHP in FY2018 and FY2019. Its overall performance has been supported by the steady revenues on the back of firm tea prices and strong volumes, aided by favourable yields and productivity of KDHP's estates. Further, with KDHP's earnings likely to remain low in the near term against firm debt levels, key credit metrics are expected to be at the modest levels for the current fiscal. The company is increasing its focus on the premium orthodox variety of tea and the bought leaf operations to support better realisations and reduce wage costs. The ratings also consider the adverse age profile of tea bushes, necessitating continuous investments towards re-plantation. Besides, there are risks associated with tea for being an agricultural commodity with production levels and consequently earnings dependent on agro-climatic conditions.

## Outlook: Negative

ICRA believes that KDHP's operating profitability and cash flows are likely to be under pressure in the coming quarters, with the proposed increase in wage rates unlikely to be adequately compensated by an improvement in tea realisations. The overall performance is likely to be supported to some extent by its established presence with increasing revenue contribution from orthodox tea and bought leaf operations. The outlook may be revised to Stable if KDHP records better-than-expected revenues and earnings, driven by healthy production and favourable trend in tea realisations, which would support its liquidity profile and debt coverage metrics.

## Key rating drivers

### Credit strengths

**Credit strength derived from its linkages with TGBL** - KDHP enjoys considerable financial flexibility, derived from its importance to TGBL, given the strong operational and financial linkages. The tea plantation gardens managed by KDHP have been given on a long-term lease by TGBL, which holds a 28.5% stake in KDHP. Further, about 25% of KDHP's overall sales is made to TGBL, to which KDHP has been supplying since its inception. TGBL sources a major portion of its south Indian tea requirements from KDHP, which also remains the sole supplier of green leaf to TGBL's instant tea division in Munnar. ICRA notes that in addition to the long-term loan extended by TGBL to KDHP, it has allowed deferment of repayments due to it, to help KDHP tide over its temporary liquidity constraint.

**High productivity of tea estates and increasing focus on production from bought-leaf and orthodox tea to support volumes and contribution levels** – KDHP is an established player in the domestic bulk tea industry and the largest plantation company in South India. Productivity and outturn ratio over the years have been better than the regional averages, supporting its overall volume of made tea. The company produces about 9-10% of the overall south Indian tea and its average realisations attract a premium to the regional auction averages, illustrating the quality of tea produced. While KDHP is primarily a CTC producer, which accounts for around 70% of the total tea produced, production of orthodox tea has grown steadily over the years with the management looking to increase it to 40% levels in the coming fiscals. The shift towards orthodox tea bodes well for the overall blended realisations of KDHP, which is important given the expected increase in employee costs, going forward. Further, the company is looking at increasing its bought leaf operations, which apart from increasing volumes would also reduce the fixed cost intensity in the business.

### Credit weaknesses

**Earnings and coverage metrics likely to deteriorate in the near term** – Despite the relatively stable volumes witnessed in the recent fiscals (FY2018 and FY2019), a steady increase in operating costs has limited the improvement in earnings and consequently debt coverage metrics of KDHP. With the expected increase in wage costs in FY2020, the company is likely to incur net losses and low cash profits depending on the extent of the hike and improvement in tea prices. Weak earnings and firm debt levels are likely to result in deterioration in credit metrics in FY2020 and improve over the medium term with growth in revenues and earnings.

**Adverse age profile of the bushes; however, favourable yields and defined re-plantation policy mitigate risk to an extent** - The age profile of the tea bushes remains adverse, with more than 75% of the bushes being more than 80 years old, necessitating continuous investment towards re-plantation. ICRA notes that the company has been taking specific steps to address the same by following a definite annual re-plantation policy, undertaking re-plantation of ~1-1.5% of the total area per annum. Further, the yields have been supported till date through increasing acreage under high-yielding clones, healthy levels of infilling in the past and other focused efforts taken towards sustaining productivity. Further, production levels are exposed to agro-climatic conditions, as witnessed in FY2017 and Q2 FY2019 when volumes were limited by drought conditions and excess rainfall, respectively.

## Liquidity position

KDHP's cash flows have been constrained in the recent past owing to modest accruals, limited by high operating costs and an increase in working capital requirements. The capital expenditure incurred during the recent quarters towards upgradation of its facilities have also impacted the free cash flows of the company. The overall liquidity position remains supported to an extent by the free cash reserves held (which stood at around Rs. 10 crore as on March 31, 2019) and some buffer in utilisation of the working capital facilities. While the cash profits in the near term is likely to be low given the expected increase in wage rates, KDHP's liquidity position is expected to be supported by its linkages with TGBL and no proposed capital expenditure over the medium term.

## Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Indian Bulk Tea Industry</a>
Group Support	The ratings factor in the continued support from TGBL, given the strong linkages and importance of KDHP to it. There exists a track record of financial support, through deferment of repayments for the long-term loans extended by TGBL to KDHP.
Consolidation	Not applicable

## About the company:

KDHP was incorporated in 2005, when it took over the operations of South Indian tea plantations of the erstwhile Tata Tea Limited (now TGBL,) and became the largest tea plantation company in South India. The company has taken on lease the land holdings, including tea gardens from TGBL, for 30 years. KDHP produces about 25 million kg of tea per annum, including around 3-4 million kg from bought-leaf operations, and has a workforce of ~11,000. KDHP has seven tea estates (spread across ~9,000 hectares), all located within Munnar and has 16 factories, which produce varieties of tea. It mainly produces the CTC variety, but is increasing its focus on the orthodox variety during the recent fiscals. The company is one of the largest exporters of tea from South India and generates a portion of its income from marketing of its packet tea brand in Kerala.

## Key financial indicators (audited)

Particulars (in Rs. Crore)	FY2018	FY2019
Operating Income (Rs. crore)	342.1	352.3
PAT (Rs. crore)	0.5	3.8
OPBDIT/OI (%)	4.0%	5.3%
RoCE (%)	6.9%	10.0%
Total Debt/TNW (times)	1.0	1.1
Total Debt/OPBDITA (times)	6.4	5.0
Interest coverage (times)	1.9	2.2

Source: KDHP and ICRA research

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

**Any other information: None**

**Rating history for last three years:**

Instrument	Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating June 2019	Date & Rating in FY2019 Jan 2019	Date & Rating in FY2018 Jan 2018	Date & Rating in FY2017 -
1 Fund based- Cash Credit	Long Term	93.00	-	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-
2 Fund based – Term loans	Long Term	15.00	11.25	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-
3 Fund based – Unallocated limits	Long Term	22.00	-	[ICRA]A- (Negative)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	-
4 Fund based – Working Capital sub-limits	Short Term	(90.00)	-	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	-

*\*Outstanding as on March 31, 2019; Source: KDHP*

**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](http://www.icra.in)

### Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	93.00	[ICRA]A-(Negative)
NA	Term Loans	Q2 FY2018	-	Q2 FY2022	15.00	[ICRA]A-(Negative)
NA	Unallocated	-	-	-	22.00	[ICRA]A-(Negative)
NA	Fund based sub-limits	-	-	-	(90.00)	[ICRA]A2+

Source: KDHP

### Annexure-2: List of entities considered for consolidated analysis – Not applicable

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