January 14, 2021

Kanco Tea & Industries Limited: Ratings reaffirmed, outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits – Term Loan/ GECL	16.00	17.25	[ICRA]BB (Stable); Reaffirmed and outlook revised from Negative
Fund-based Limits – Cash Credit	20.00	20.00	[ICRA]BB (Stable); Reaffirmed and outlook revised from Negative
Non-Fundbased Limits – LC/ LG	0.60	0.60	[ICRA]A4; Reaffirmed
Unallocated Limits	1.25	-	-
Total	**37.85**	**37.85**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook of the long-term rating to Stable from Negative takes into consideration the steep rise in the realisation of tea, which is likely to result in an improvement in Kanco Tea & Industries Limited's (KTIL) profitability and cash accruals in the current fiscal compared to the previous fiscal.

The ratings continue to draw comfort from the management's extensive experience in the tea industry and the company's focus on production of premium quality tea that commands a higher price over the average market realisation. ICRA notes that with increased profits and cash accruals from business, driven by significant rise in the realisation, the debt protection metrics are likely to witness an improvement in FY2021.

The ratings are, however, impacted by the leveraged capital structure and moderate level of coverage indicators coupled with net losses that the company incurred in FY2020. ICRA notes KTIL's significant debt servicing obligation in the near to medium term, which would keep the cash flows under pressure. The ratings are further constrained by the risks associated with tea, being an agricultural commodity, which depends on agro-climatic conditions as well as the inherent cyclicality of the fixed-cost intensive tea industry leading to variability in profitability and cash flows of bulk tea producers such as KTIL. The concentration of all three gardens of the company in Assam further accentuates the agro-climatic risks. In addition, domestic tea prices are influenced by international prices and hence the demand-supply situation in the global tea market, in ICRA's opinion, would continue to have a bearing on the profitability of Indian players, including KTIL.

The Stable outlook on the [ICRA]BB rating reflects ICRA's opinion that the cash accruals from the company's core operations will be adequate to service its debt obligations.

Key rating drivers and their description

Credit strengths

Experience of management in tea industry – The company's management have more than three decades of experience in the tea industry. It owns three tea gardens, spread over a cultivable area of around 2,499 hectare (HA) and operates under the leadership of Mr. Umang Kanoria.

Superior quality of tea reflected by premium commanded by KTIL compared to average market prices – KTIL's superior quality of tea in the domestic market results in a premium for its produce compared to the industry average. The weighted average realisation of tea produced by the company was around Rs. 332/kg compared to the North Indian auction average of around Rs. 261/kg during the first half of FY2021.

Improvement in realisation likely to favourably impact profitability in FY2021 – The realisation for the company's tea has increased significantly in H1 FY2021 to Rs. 332/kg compared to Rs. 198/kg in H1 FY2020. ICRA notes that the lockdown announced by Government of India (GoI) following the Covid-19 pandemic has resulted in production loss by KTIL, like all other players in the industry. Thus, the overall shortage of tea availability in the market led to the sharp increase in tea realisations. This is likely to provide some respite to the tea players and support its profitability in the current fiscal. However, the extent of sustainability of such an improvement in the price, going forward, remains to be seen considering the moderation in realisation already witnessed in the third quarter of the current fiscal.

Credit challenges

Net losses incurred in previous fiscal – KTIL's operating income (OI) stood at Rs. 59.86 crore in FY2020, up by 9% over FY2019, due to an increase in tea production. However, the absence of commensurate uptick in realisation to absorb the increased labour cost and an exceptional loss of Rs. 2.98 crore towards arrear wages and bonus for the prior period adversely impacted its profitability, resulting in net loss of Rs. 2.59 crore in FY2020 compared to a net profit of Rs. 2.74 crore in FY2019. This, along with a fair value loss on investment of Rs. 5.40 crore through other comprehensive income led to an erosion in its net worth in FY2020.

Leveraged capital structure and moderate level of coverage indicators – The company's debt level has remained at an elevated level since FY2017 due to predominantly debt-funded capital expenditure incurred to acquire the Bamonpookrie Tea Estate and increased working capital borrowings. Its capital structure continued to remain leveraged with a gearing of 1.94 times (1.49 times as on March 31, 2019) as on March 31, 2020. The coverage indicators remained at a low level on account of low profits as well cash accruals and a high debt level in FY2020. With profits and cash accruals, the coverage indicators are likely to witness an improvement in FY2021.

Significant debt service obligations likely to keep cash flows under pressure – ICRA notes that the company has significant debt service obligations in the near to medium term compared to its expected cash accruals, which is likely to keep its cash flows under pressure.

Risks associated with tea for being an agricultural commodity – Tea production depends on agro-climatic conditions, which subject it to agro-climatic risks. Moreover, tea estate costs are primarily fixed, mainly related to labour, which are independent of the volume of production and accounts for around 50% of the production cost. This leads to variability in profitability and cash flows of bulk tea producers such as KTIL. The concentration of all three gardens of the company in Assam further accentuates agro-climatic risks. Further, intervention of the Government in fixation of the wage rate could adversely impact its profitability.

Export market performance of Indian tea critical to sustain buoyancy in domestic tea prices – Notwithstanding the large domestic consumption base that India has, exports play a vital role in maintaining the overall demand-supply balance in the domestic market. Healthy export realisation is crucial for maintaining domestic realisations as un-remunerative prices in the export market may lead to exporters dumping the produce in the domestic market, which in turn would exert a downward pressure on domestic prices.

Liquidity position: Stretched

The company generated negative cash flow from operations over the past three years. With improvement in the profitability, ICRA expects that the cash flow from operations would be sufficient to service its debt obligations and planned capital expenditure in the current fiscal. Further, it availed a guaranteed emergency credit line (GECL) of Rs. 6.00 crore in September 2020, which would provide an additional comfort to its liquidity position in the near term. However, ICRA notes that KTIL has significant debt service obligations in the near to medium term, which would exert pressure on its cash flows. Further, it has a planned capex of around Rs. 1.75 crore in FY2021 for increasing its production capacity by 10 lakh kg for production of orthodox/CTC tea, along with regular capex of Rs. 2-3 crore per annum, which would keep its liquidity position **stretched** in the near to medium term.

Rating sensitivities

Positive triggers – ICRA may upgrade KTIL's ratings if the entity demonstrates significant growth in production, profitability and cash accruals from business, strengthening its financial risk profile. Further, improvement in the liquidity position of the company may also positively impact the ratings. Specific credit metric that may lead to an upgrade of the entity's ratings include interest coverage of more than 2.50 times on a sustained basis.

Negative triggers – ICRA may downgrade KTIL's ratings if there is higher-than-anticipated fall in realisation and/or production of the tea, adversely impacting its financial risk profile. Further, any negative regulatory development in the tea industry could also impact the ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Indian Bulk Tea Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the company

About the company

Incorporated in 1983, Dhanvaridhi Concerns Limited (DCL) started as an investment company. The tea division of Kanco Enterprises Limited (KEL), a Group company of Kanco Tea & Industries Limited (KTIL), was transferred to DCL on April 1, 2009 and the name of the company was changed to Kanco Tea & Industries Limited in April 2010. The company primarily produces black tea of crush, tear, curl (CTC) variety for selling in the domestic market through a mix of auction and private sales. KTIL's three gardens in upper Assam are spread over 2,499 hectares, of which around 64% is under tea cultivation.

Key financial indicators

	FY2019 Audited	FY2020 Audited	H1 FY2020 Unaudited	H1 FY2021 Unaudited
Operating Income (Rs. crore)	55.07	59.86	35.89	49.99
PAT (Rs. crore)	2.74	-2.59	12.86	21.53
OPBDIT/OI (%)	6.62%	3.28%	31.10%	50.35%
PAT/OI (%)	4.97%	-4.33%	35.83%	43.07%
Total Outside Liabilities/Tangible Net Worth (times)	1.84	2.00	1.39	1.41
Total Debt/OPBDIT (times)	12.60	22.63	1.84	0.83
Interest Coverage (times)	0.76	0.44	4.89	12.78

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding (31-12-2020)	Rating	FY2020		FY2019	FY2018
					14-Jan-2021	18-Mar-2020	05-Apr-2019	18-July-2018	12-Mar-2018
1	Term Loan/ GECL	Long Term	17.25	17.25	[ICRA]BB (Stable)	[ICRA]BB (Negative)	[ICRA]BB+ (Negative)	[ICRA]BB+ (Stable)	[ICRA]BBB- (Stable)
2	Cash Credit	Long Term	20.00	-	[ICRA]BB (Stable)	[ICRA]BB (Negative)	[ICRA]BB+ (Negative)	[ICRA]BB+ (Stable)	[ICRA]BBB- (Stable)
3	Letter of Credit/Bank Guarantee	Short Term	0.60	-	[ICRA]A4	[ICRA]A4	[ICRA]A4+	[ICRA]A4+	[ICRA]A3
4	Untied Limits	Long term/ Short Term	-	-	-	[ICRA]BB (Negative)/ [ICRA]A4	[ICRA]BB+ (Negative)/ [ICRA]A4+	-	-

Amount in Rs. crore

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 click here

Annexure-1: Instrument details

ISI	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	20.00	[ICRA]BB (Stable)
NA	Term Loan	March 2017	NA	March 2026	12.33	[ICRA]BB (Stable)
NA	Guaranteed Emergency Credit Line (GECL)	September 2020	NA	September 2025	4.92	[ICRA]BB (Stable)
NA	Bank Guarantee/Letter of Credit	NA	NA	NA	0.60	[ICRA]A4

Source: Kanco Tea & Industries Limited.

Annexure-2: List of entities considered for consolidated analysis: Not Applicable

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About ICRA Limited:

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