Kanco Tea & Industries Limited

April 05, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits – Term Loan	21.85	20.10	[ICRA]BB+ (Negative); Reaffirmed and outlook revised from Stable
Fund-based Limits – Cash Credit	15.40	15.40	[ICRA]BB+ (Negative); Reaffirmed and outlook revised from Stable
Non-Fund based Limits – ILC/ ILG/ FLG	0.60	0.60	[ICRA]A4+; Reaffirmed
Unallocated Limits	0.00	1.75	[ICRA]BB+ (Negative)/ [ICRA]A4+; Reaffirmed and outlook revised from Stable
Total	**37.85**	**37.85**	

**Instrument details are provided in Annexure-1*

Rationale

The revision in the outlook on the long-term rating from Stable to Negative considers the steady decline in the operating margin of Kanco Tea & Industries Limited (KTIL) over the last two years, primarily on the back of increasing labour costs. Despite an improvement in realisation, the operating margin of the company is estimated to be adversely impacted in FY2019 as well due to a steep rise in costs on account of the proposed hike in wage rates of tea workers in Assam with effect from March 2018.

Meanwhile, the ratings derive 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. While arriving at the ratings, ICRA considers the cash inflows from sale of a plot of land in one of its gardens in FY2019 and the likely recovery of loans/advances, extended earlier to one of its Group companies, in FY2020.

The ratings, however, continue to be impacted by the deterioration in the financial risk profile of the company over the last two years due to a fall in cash accruals from business, a steady increase in debt level and weakening of debt coverage indicators. The ROCE of the company also continued to remain depressed. The ratings are further constrained by the risks associated with tea for being an agricultural commodity, which depends on agro-climatic conditions as well as the inherent cyclicality of the fixed-cost intensive tea industry that lead 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. 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. Moreover, the company has significant debt-service obligations, which are likely to keep its cash flows under pressure in the near to medium term.

Outlook: Negative

ICRA believes that KTIL will continue to benefit from the extensive experience of its management. Nevertheless, an adverse cost structure due to increasing labour cost is likely to keep the company's margins under pressure, as reflected by the Negative outlook. The outlook may be revised to Stable if a substantial growth in production and realisation strengthens the company's profitability indicators. The ratings may be downgraded if there is a decline in the overall cash accruals from business and/or if the company is unable to recover loans/advances, extended earlier to one of its Group companies in a timely manner, which could adversely impact the liquidity position of the company.

Key rating drivers

Credit strengths

Experience of the management in the tea industry – The promoters of the company have more than three decades of experience in the tea industry. The company owns three tea gardens spread over a cultivable area of around 2,503 hectare (HA) and operates under the leadership of Mr. Umang Kanoria.

Superior quality of tea as evident from the premium commanded by the company's produce 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. 189/kg compared to the North Indian auction average of around Rs. 157/kg during the first nine months of FY2019. The quality of tea from the newly acquired garden (Bamonpookrie Tea Estate) improved following maintenance/ upgradation activities undertaken by the current management, as depicted by improved realisation of tea in 9M FY2019 vis-a-vis 9M FY2018. ICRA expects that the same would lead to an improvement in the overall weighted average realisation of tea produced by KTIL in the medium term.

Credit challenges

Declining operating margin because of increasing labour costs, which is likely to continue in FY2019 – The operating margin of the company witnessed a steady decline from 14.76% in FY2016 to 5.89% in FY2018 primarily on the back of increasing labour costs. Despite an improvement in realisation, the profitability of the company is estimated to be adversely impacted in FY2019 as well due to a steep rise in labour expenses on account of the proposed wage hike effective from March 2018. The ROCE of the company also continued to remain depressed. ICRA expects that overall profits and cash accruals from the business are likely to be adversely impacted in FY2019 compared to FY2018.

Deterioration in the financial risk profile over the last two years – The debt level of the company has increased over the last two years due to predominantly debt-funded capital expenditure incurred to acquire the Bamonpookrie Tea Estate and increased working capital borrowings. ICRA notes the deterioration in the financial risk profile over the last two years, led by a fall in cash accruals from business, a steep increase in debt level and weakening of coverage indicators.

Significant debt service obligations likely to keep cash flows under pressure – ICRA notes that the company has significant debt service obligations compared to its current cash accruals from business, which are likely to exert pressure on its cash flows in the near to medium term.

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.

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 also 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

The company generated negative fund flow from operations (FFO) in FY2018, which is likely to continue in FY2019 as well. The average utilisation of fund-based working capital limits has remained at a high level during the last one year. ICRA notes that the proceeds from the sale of a plot of land in one of its gardens has supported its cash flows in FY2019. The liquidity position of the company is likely to remain tight in view of the sizeable debt servicing obligations compared to its estimated cash accruals from business. Nevertheless, ICRA considers the cash inflows expected in FY2020 from the likely recovery of loans/advances, extended earlier to one of its Group companies, which would support its liquidity position to some extent.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Indian Bulk Tea Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone financial statement

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 CTC (crush, tear, curl) variety, which it sells in the domestic market through a mix of auction and private sales. The company's three gardens in upper Assam are spread over 2,503 hectares, of which around 64% is under tea cultivation.

Key financial indicators

	FY2017 (Audited)	FY2018 (Audited)	9M FY2018 (Unaudited)	9M FY2019 (Unaudited)
Operating Income (Rs. crore)	41.08	53.08	51.33	51.57
PAT (Rs. crore)	0.93	0.03	9.20	4.38
OPBDIT/ OI (%)	7.55%	5.89%	24.86%	17.34%
RoCE (%)	6.04%	6.53%	-	-
Total Debt/ TNW (times)	1.33	1.51	-	-
Total Debt/ OPBDIT (times)	12.13	13.57	-	-
Interest Coverage (times)	2.97	0.74	3.87	2.50

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	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018		Date & Rating in FY2017
			(Rs. crore)	Mar 31, 2018	April 2019	July 2018	March 2018	September 2017	October 2016
1	**Term Loan**	Long Term	20.10	20.80	**[ICRA]BB+ (Negative)**	[ICRA]BB+ (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
2	**Cash Credit**	Long Term	15.40	12.78	**[ICRA]BB+ (Negative)**	[ICRA]BB+ (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
3	**Letter of Credit/ Guarantee**	Short Term	0.60	-	**[ICRA]A4+**	[ICRA]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3+
4	**Unallocated Limits**	Long Term/ Short Term	1.75	NA	**[ICRA]BB+ (Negative)/ [ICRA]A4+**	-	-	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB (Stable)/ [ICRA]A3+

Source: Kanco Tea & Industries Limited

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

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	New Term Loan	March 2017	-	March 2026	20.10	[ICRA]BB+ (Negative)
NA	Cash Credit	-	-	-	15.40	[ICRA]BB+ (Negative)
NA	Letter of Credit	-	-	-	0.30	[ICRA]A4+
NA	Letter of Guarantee	-	-	-	0.30	[ICRA]A4+
NA	Unallocated Limits	-	-	-	1.75	[ICRA]BB+ (Negative)/ [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:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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