March 18, 2020

Kanco Tea & Industries Limited: Ratings downgraded

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits – Term Loan	20.10	16.00	[ICRA]BB (Negative); Downgraded from [ICRA]BB+ (Negative)
Fund-based Limits – Cash Credit	15.40	20.00	[ICRA]BB (Negative); Downgraded from [ICRA]BB+ (Negative)
Non-Fund based Limits – LC/ LG	0.60	0.60	[ICRA]A4; Downgraded from [ICRA]A4+
Unallocated Limits	1.75	1.25	[ICRA]BB (Negative)/ [ICRA]A4; Downgraded from [ICRA]BB+ (Negative)/ [ICRA]A4+
Total	**37.85**	**37.85**	

** Instrument details are provided in Annexure-1*

Rationale

The downward revision in the ratings takes into consideration the drop in realisation in the current fiscal along with an increased labour cost, which would impact Kanco Tea & Industries Limited's (KTIL) profitability and cash accruals. While assigning the ratings, ICRA has also factored in that the entity's cash accruals from core operation are not sufficient to meet its debt service obligations.

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 FY2020 and the likely recovery of loans/advances, extended earlier to one of its Group companies in FY2021.

The ratings, however, continue to be impacted by the weak financial risk profile of the company, characterised by a leveraged capital structure and low level of coverage indicators. The ROCE of the company continues to remain depressed and is likely to deteriorate further in FY2020. 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.

The Negative outlook on the [ICRA]BB rating reflects ICRA's opinion that the cash accruals from the company's core operations will continue to remain inadequate to service its debt obligations. Accordingly, the liquidity position of KTIL would continue to remain stretched in the near term, at least.

Key rating drivers and their description

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 2,499 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. 187/kg compared to the North Indian auction average of around Rs. 158/kg during the first nine months of FY2020.

Credit challenges

Drop in realisation and high labour cost continue to exert pressure on operating margin – The operating margin (OPM) of the company witnessed a steady decline to 5.89% in FY2018 from 14.76% in FY2016, primarily on the back of increasing labour costs. With an improvement in realisation, the OPM marginally improved to 6.62% in FY2019. The net margin was supported by high non-operating income (profit on sale of plot of land of tea estate) and stood at 4.97% in FY2019. During the current financial year, a drop in realisation and high labour cost are likely to adversely impact the operating profitability and cash accruals of the company. The ROCE of the company continues to remain depressed and is likely to decline further in FY2020.

Leveraged capital structure and low level of coverage indicators – 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. The capital structure of the company continued to remain leveraged with a gearing of 1.49 times (1.51 times as on March 31, 2018) as on March 31, 2019. The coverage indicators continue to remain at a low level on account of low profits as well cash accruals and a high debt level. ICRA does not foresee any major improvement in the coverage indicators of the company during the current fiscal.

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 the business, which would continue 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: Stretched

The company generated negative fund flow from operations (FFO) over the past two years, which is likely to continue in FY2020 as well. The average utilisation of fund-based working capital limits has remained at around 80% during the last one year. ICRA notes that the proceeds from the sale of a plot of land in one of its gardens supported its cash flows in FY2020. The liquidity position of the company is likely to remain stretched in view of the sizeable debt servicing obligations compared to its estimated cash accruals from the core operation, and would continue to remain dependent on non-operating income to meet its debt servicing, at least in the near term. Nevertheless, ICRA considers the cash inflows expected in FY2021 from the likely recovery of loans/advances extended earlier to one of its Group companies, which would support its liquidity position to some extent.

Rating sensitivities

Positive triggers – ICRA may revise KTIL's long-term rating outlook if the entity demonstrates a significant growth in production and realisation, thereby improving operating profits as well as liquidity profile on a sustained basis.

Negative triggers – Pressure on KTIL's ratings may arise in case of weakening of the financial risk profile owing to a drop in production and if the realisation does not improve enough to recover increasing labour costs, and /or if the company is unable to recover loans/advances, extended earlier to one of its Group companies in a timely manner, adversely impacting its liquidity position.

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 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 2,499 hectares, of which around 64% is under tea cultivation.

Key financial indicators

	FY2018 (Audited)	FY2019 (Audited)	9M FY2019 (Unaudited)	9M FY2020 (Unaudited)
Operating Income (Rs. crore)	53.08	55.07	51.57	56.28
PAT (Rs. crore)	0.03	2.74	4.38	9.05
OPBDIT/ OI (%)	5.89%	6.62%	17.34%	16.65%
RoCE (%)	6.53%	9.57%	-	-
Total Outside Liabilities/Tangible Net Worth (times)	1.93	1.84	-	-
Total Debt/ OPBDIT (times)	13.57	12.60	-	-
Interest Coverage (times)	0.74	0.76	2.50	2.73
DSCR	1.11	1.22	-	-

Source: Kanco Tea & Industries Limited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Rating (FY2020)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated	Amount Outstanding Mar 31, 2019	Current Rating	Earlier Rating	FY2019	FY2018		FY2017
					18-Mar-2020	5-Apr-2019	18-Jul-2018	12-Mar-2018	27-Sep-2017	7-Oct-2016
1	**Term Loan**	Long Term	16.00	19.17	**[ICRA]BB (Negative)**	[ICRA]BB+ (Negative)	[ICRA]BB+ (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
2	**Cash Credit**	Long Term	20.00	15.04	**[ICRA]BB (Negative)**	[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]A4+	[ICRA]A3	[ICRA]A3	[ICRA]A3+
4	**Unallocated Limits**	Long Term/ Short Term	1.25	NA	**[ICRA]BB (Negative)/ [ICRA]A4**	[ICRA]BB+ (Negative)/ [ICRA]A4+	-	-	[ICRA]BBB- (Stable)/ [ICRA]A3	[ICRA]BBB (Stable)/ [ICRA]A3+

Amount in Rs. crore
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 click here

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	Term Loan	March 2017	-	March 2026	16.00	[ICRA]BB (Negative)
NA	Cash Credit	-	-	-	20.00	[ICRA]BB (Negative)
NA	Letter of Credit	-	-	-	0.30	[ICRA]A4
NA	Letter of Guarantee	-	-	-	0.30	[ICRA]A4
NA	Unallocated Limits	-	-	-	1.25	[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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