June 26, 2020

# Tata Coffee Limited: Ratings reaffirmed; rated amount enhanced

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Fund-based Bank Facilities | 65.00 | 150.00 | [ICRA]AA(Stable)/ [ICRA]A1+ Reaffirmed/ Assigned |
| Commercial Paper | 30.00 | 30.00 | [ICRA]A1+ Reaffirmed |
| **Total** | **95.00** | **180.00** | |

*Instrument details are provided in Annexure-1

## Rationale

The reaffirmation of ratings factors in the improvement in the consolidated performance of Tata Coffee Limited (TCL), driven by strong performance of Eight O' Clock Coffee (EOC) and healthy profits from Vietnam operations, which recently commenced operations. TCL's consolidated revenues grew by ~9% in FY2020 due to steady volume growth in EOC and incremental revenue from the freeze-dried instant coffee operations at Vietnam, while standalone revenues remained largely stable. Consolidated operating margins increased by ~200 bps to 16.2% in FY2020 owing to an increase in profits from EOC (because of lower advertising expenses) and healthy contribution levels from Vietnam operations. The increase was notwithstanding a decline in standalone operating margin, which was adversely impacted by moderation in plantation profitability, as decline in production led to under-absorption of costs. Improvement in consolidated operating profits in FY2020 resulted in stable debt coverage indicators, in spite of the increase in debt contracted to fund the capex towards the Vietnam facility, with interest cover and net debt/OPBITDA at 5.0 times and 3.2 times respectively in FY2020. With the outbreak of Covid-19, increase in 'at-home' consumption of coffee is likely to cushion the impact of a decline in 'out-of-home' consumption. The production of the domestic plantation division of TCL is likely to see an improvement with better distribution of rainfall in the current year. Consolidated performance is likely to be supported by the ramp-up in production at the Vietnam facility as well.

The ratings factor in TCL's diversified nature of operations, with presence in roast and ground coffee, instant coffee and plantation coffee along with a geographically diversified revenue base. The ratings also favourably factor in the conservative capital structure (both at standalone and consolidated levels) which along with the status of being a Tata Group company and a subsidiary of Tata Consumer Products Limited (TCPL, rated at [ICRA]AA+(Stable)/ [ICRA]A1+) provides significant financial flexibility to the company. However, the company's coffee and tea businesses are exposed to risks of adverse agro-climatic conditions, notwithstanding the steps taken to reduce such risks. In addition, the commoditised nature of the instant-coffee business, which faces intense competition, and the sensitivity of operating margins to adverse movements in coffee prices, impact the business risk profile of the company, notwithstanding the integrated nature of operations of the standalone entity. Nonetheless, the stable outlook reflects ICRA's expectations that TCL's operating performance would be supported by its established presence and diversified product offerings across geographies. Credit metrics are expected to remain stable in the near term, both at the standalone and the consolidated levels.

## Key rating drivers

## Credit strengths

**Diversified nature of operations, geographically diversified revenue base -** TCL has a diversified revenue base with presence in roasted and ground (R&G) coffee, plantation coffee, instant coffee, tea and pepper. In FY2020, income from the US-based Eight O'clock Coffee (EOC) accounted for ~60% of the consolidated turnover of the company, followed by instant coffee division at ~20% and plantation coffee at ~6%. The balance is contributed by tea, pepper and allied products. EOC is an established player in the US R&G coffee market. Exports account for the major portion of the standalone income. While green coffee is exported primarily to the premium markets of Europe, instant coffee is exported to number of countries / geographies including Russia / CIS, the African continent, Europe, Middle East and South East Asia. With the expected ramp up of Vietnam operations, the overall operating profile of the company is expected to strengthen further.

**Integrated nature of operations; focus on quality -** At the standalone level, TCL is a fully-integrated coffee company with its own coffee plantations, curing unit, R&G coffee facility and instant coffee production plants. The integrated nature of its operations mitigates the adverse effects of the volatility in coffee prices. The company's focus on selling high quality value added and differentiated coffee results in higher realisations compared to market/terminal prices. More than 90% of the company's plantation coffee is exported, with a major portion to the premium markets of Europe. The company is also the exclusive supplier of superior quality Arabica beans to Tata Starbucks stores in India. The instant coffee division (ICD) remains the major revenue contributor with a share of more than 50% of the standalone revenues. The capacity utilisation level of the ICD has been healthy at more than 95% for the last few years. In the tea segment, the company has increased its focus on producing better quality orthodox teas, the share of which has shown an increasing trend in the overall tea volumes.

**Status as a Tata Group company lends considerable financial flexibility –** TCL's status as a Tata Group company and a 57.48% subsidiary of TCPL lends considerable financial flexibility. TCL also enjoys significant operational and managerial linkages with its parent. TCL supplies R&G coffee to Tata Starbucks Private Limited and manufactures coffee under the brand Tata Coffee Grand, which is marketed and distributed by TCPL.

**Favourable financial risk profile -** The capital structure of the company, both at the standalone as well as the consolidated levels, remained healthy with gearing of 0.07 times and 0.73 times as of end-FY2020, respectively. While debt for the standalone entity only comprises working capital loans, the consolidated debt includes term loans towards EOC business as well as the instant coffee plant in Vietnam. Debt coverage indicators remained stable with the interest cover and net debt/OPBITDA at 5.0 times and 3.2 times respectively in FY2020 times. While a significant portion of the long-term debt of the consolidated entity is due for repayment in the medium term, proven ability of the company to refinance debt at favourable terms in the past provides comfort. The term loans on the books of Tata Coffee Vietnam have an extended repayment schedule, supporting coverage indicators going forward. While the operating profile of the consolidated entity would strengthen with the expected scaling up of the Vietnam business, debt coverage indicators of the consolidated entity, in ICRA's opinion, are likely to remain largely stable in the near term.

## Credit challenges

**Susceptibility of plantation business to adverse agro-climatic conditions -** The performance of the plantation businesses of coffee, tea and pepper remains exposed to agro-climatic risks, including incidents of pest attacks. While TCL has worked extensively to mitigate such risks, including adequate irrigation facilities, adverse weather conditions impacted coffee production in FY2020, which in turn affected the standalone profitability and business returns of the company.

**Exposure to volatile coffee prices; commoditised nature of the instant coffee business -** While the integrated nature of operations mitigates the adverse effects of volatile coffee prices, the overseas operations of TCL, namely EOC is exposed to fluctuation in Arabica coffee prices, which is the primary raw material. At the standalone level too, TCL remains partially exposed to volatility in coffee prices. However, a healthy product portfolio, with focus on speciality and premium differentiated coffees, established relationships with customers and consistent and superior quality of the offerings are expected to support the business profile, going forward.

## Liquidity position: Strong

TCL's consolidated liquidity position is expected to remain comfortable given the healthy cash flow generation, sizeable cash and liquid investments of around Rs. 220 crore as on March 31, 2020 and sufficient undrawn lines of credit. The company also enjoys considerable financial flexibility given its status as a TCPL subsidiary.

## Rating sensitivities

**Positive triggers** – The long-term rating may be upgraded if a firm trend in coffee prices, along with an improved performance of the instant coffee division and higher production of green coffee, leads to an improvement in the consolidated operating profitability and debt coverage indicators, on a sustained basis.

**Negative triggers** – The ratings may be downgraded if there is an unfavourable movement in coffee prices and/or deterioration in performance of the EOC business, leading to subdued performance of the consolidated entity.

| **Analytical Approach** | **Comments** |
|---|---|
| Applicable Rating Methodologies | [Corporate Credit Rating Methodology] |
| Parent/Group Support | Parent/Group Company: Tata Consumer Products Limited<br>TCL is a 57.48% subsidiary of TCPL, which is rated [ICRA]AA+(Stable) / [ICRA]A1+. TCL's strong parentage provides significant financial flexibility to the company. It also enjoys operational linkages with TCPL as it processes coffee for the joint venture, Tata Starbucks and also manufactures coffee under Tata Coffee Grand, which is marketed and distributed by TCPL. |
| Consolidation / Standalone | For arriving at the ratings, ICRA has considered the consolidated financials of Tata Coffee Limited. As on March 31, 2020, the company had four subsidiaries, enlisted in Annexure-2 |

## About the company

TCL, a 57.48% subsidiary of Tata Consumer Products Ltd., is a fully integrated coffee company with its own coffee plantations, coffee-curing factories, R&G coffee facility and instant coffee production plants. With a total area of around 7,400 Hectares under coffee cultivation, spread over two districts in Karnataka and one estate at Valparai in Tamil Nadu, TCL accounts for around 3% of the total coffee produced in India. TCL also has six tea plantations located in South India, with a total area of around 2,400 Hectares, producing around 5.6 million kg (MKg) of black tea. The instant coffee business of TCL is supported by its manufacturing plants, with an installed capacity of ~ 8,400 TPA, located at Toopran (in Telangana) and Theni (in Tamil Nadu). TCL acquired the US-based Eight O'Clock Coffee Company (EOC) in June 2006. The acquisition was structured as a leveraged buyout with the entire equity of EOC being held by Consolidated Coffee Inc (CCI). TCL holds a 50.08% stake in CCI while the rest is held, directly and indirectly, by TCPL. In May 2019 TCL commissioned a 5,000 MT freeze-dried instant coffee plant in Vietnam.

In FY2020, TCL (standalone) reported a net profit after tax (PAT) of Rs. 73.21 crore on an operating income (OI) of Rs. 716.84 crore compared to a PAT of Rs. 71.58 crore on an OI of Rs. 710.76 crore in FY2019. On a consolidated basis, TCL reported a PAT of Rs. 141.01 crore on an OI of Rs. 1,963.46 crore in FY2020 compared to a PAT of Rs. 106.89 crore on an OI of Rs. 1,811.83 crore in FY2019.

## Key financial indicators – Consolidated (Audited)

| | FY2019 | FY2020 |
|---|---|---|
| Operating Income (Rs. crore) | 1,811.83 | 1,963.46 |
| PAT (Rs. crore) | 106.89 | 141.01 |
| OPBDIT/OI (%) | 14.19% | 16.21% |
| RoCE (%) | 9.10% | 9.78% |
| | | |
| Total Outside Liabilities/Tangible Net Worth (times) | 1.07 | 1.12 |
| Total Debt/OPBDIT (times) | 4.49 | 3.85 |
| Interest Coverage (times) | 5.61 | 4.91 |
| DSCR | 3.76 | 3.16 |

*Source: Company*

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

## Any other information: None

## Rating history for last three years:

| | Instrument | Current Rating (FY2021) | | | | Chronology of Rating History for the past 3 years | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs Crore) | Date & Rating 26-Jun-2020 | Date & Rating In FY2020 19-Jul-2019 | In FY2019 31-May-2018 | In FY2017 28-Feb-2017 | 30-Dec-2016 |
| 1 | Fund Based Bank Facilities | Long Term/ Short Term | 150 | NA | [ICRA]AA (Stable) / [ICRA]A1+ | [ICRA]AA (Stable)/ [ICRA]A1+ | [ICRA]AA (Positive)/ [ICRA]A1+ | [ICRA]AA (Positive)/ [ICRA]A1+ | [ICRA]AA (Positive)/ [ICRA]A1+ |
| 2 | Commercial Paper | Short Term | 30 | Nil | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ | [ICRA]A1+ |

## 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 | Long-Term/ Short-Term Fund-based Limits | - | - | - | 150.00 | [ICRA]AA (Stable)/ [ICRA]A1+ |
| NA | Commercial Paper | - | - | - | 30.00 | [ICRA]A1+ |

*Source: Tata Coffee Limited*

## Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| Consolidated Coffee Inc. | 50.08% | Full Consolidation |
| Eight O'Clock Holdings Inc. | 50.08% | Full Consolidation |
| Eight O'Clock Coffee Company | 50.08% | Full Consolidation |
| Tata Coffee Vietnam Company Limited | 100.00% | Full Consolidation |

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## About ICRA Limited:

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