

Press Release

Kallam Brothers Cottons Private Limited

October 30, 2019

Rating Downgraded and Assigned



| | |
|-------------------------------------|---|
| Total Bank Facilities Rated* | Rs. 91.15 Cr |
| Long Term Rating | ACUITE BB+ / Stable (Downgraded from ACUITE BBB-/Stable) |
| Short Term Rating | ACUITE A4+ (Downgraded from ACUITE A3) |

* Refer Annexure for details

Rating Rationale

Acuite has downgraded long term rating to '**ACUITE BB+**' (read as **ACUITE double B plus**) from **ACUITE BBB-** (read as **ACUITE triple B Minus**) and the short term rating to '**ACUITE A4+**' (read as **ACUITE A four plus**) from **ACUITE A3** (read as **ACUITE A three**) to the above mentioned bank facilities of KALLAM BROTHERS COTTONS PRIVATE LIMITED. The outlook is '**Stable**'.

The rating downgrade on account of significant decline in operating margins leading to deterioration in debt protection metrics of the company. The debt service coverage ratio stood at 1.09 times for FY2019 (Prov.) as against 1.35 times in the previous year. Further, Debt/EBITDA stood at 5.17 times for FY2019 (Prov.) as against 4.20 times in FY2018. This has resulted in tightly matched liquidity of the company marked by NCA/CPLTD cushion of 1.19 times in FY2019. Further, Acuite expects decline in operational performance due to tepid market conditions which likely to affect the financial risk profile and liquidity of the company. However, the rating also factors experienced management, long track record of operations and moderate financial risk profile.

Kallam Brothers Cottons Private Limited (KBCPL) is a Guntur based company started as partnership firm in the year 2001 and converted to 'Private Limited in the year 2003. It is engaged in cotton ginning and manufacturing of yarn. The company's ginning and spinning division is located at Dhulipalla Village, Guntur. It has 24 gins and 33,840 spindles to produce yarn, count ranging from 16s to 40s. They have an operating wind mill with an installed power generation capacity of one mega-watt (MW), and the same is supplied to the electricity board. . Of the total revenues in FY2019, ginning division contributed around 38 percent, spinning division contributed 62 per cent and remaining is from power division.

Analytical Approach

Acuite has taken standalone view of business and financial risk profile of KBCPL to arrive at the rating.

Key Rating Drivers

Strengths

Experienced management, long track record of operations

KBCPL is engaged in the cotton ginning and spinning for more than a decade. The company is promoted by Mr. Nagi Reddy and his family who possess more than two decades of experience in the textile industry. The extensive industry experience of the promoters has enabled them to establish a healthy relationship with various customers and suppliers. The company sells yarn to more than 30 customers in both domestic and export markets. In FY2019, around 36 percent of the revenues came through exports and remaining through sale in domestic market. Acuite believes that the company will benefit from the experience of the management and long track record of operations over the medium term.

Weaknesses

Deterioration in financial risk profile

The financial risk profile of the company has deteriorated marked by moderate gearing (Debt-Equity), total outside liabilities to total net worth (TOL/TNW) and debt protection metrics. Total net worth stood modest at Rs.60.02 crore (Includes quasi equity of 20.86 crore) as on 31 March, 2019. The gearing and TOL/TNW are moderate at 1.45x and 1.95x in FY19 as against 1.36x and 1.73x in FY18 respectively. The same is due to increased utilization of working capital limits.. Debt protection metrics of interest coverage ratio and net cash accruals to total debt is moderate at 2.04 times and 0.09 times respectively in FY2019. Debt service coverage ratio has significantly deteriorated to 1.09 times as against 1.35 times in FY2018. Further, the company is planning a debt funded capital expenditure for installation of one megawatt solar power plant for Rs.7.00 crore, which will be funded through equity and debt in the ratio of 33:67. Cash accruals are expected to be in the range of Rs.7-8 crore against the high repayment obligations of around Rs 8.00 crore during FY2020-FY2021. Acuite believes that the financial risk profile of the company is expected to be continues to remain moderate on account of modest accretion to reserves.

Working capital intensive operations

KBCPL's operations are working capital intensive with Gross Current Assets (GCA) of about 156 days in FY2019 as against 150 days in FY2018. The cotton industry is marked by high inventory holding levels. Cotton is generally procured during the season beginning from October to March to sustain the raw material requirement for upcoming 5-6 months until the start of the next season; it is reflective in terms of its inventory days of 110-130 days over the last three years ending March, 2019. The company procures material from farmers and agents in Andhra Pradesh, Maharashtra, Karnataka and Gujarat. It gets usually 10-15 days credit period from suppliers. The company sells yarn in both domestic and export market. It exports to Japan, Korea, Middle East and China. Export sales were backed by LC. The company gives a credit of around 30-45 days to its customers. KBCPL's working capital limits over the last twelve months period was utilized at an average of 88 per cent as on September 2019. Acuite expects the operations of the company to remain working capital intensive on account of the high inventory levels maintained by the company due to seasonal nature.

Susceptibility of profitability to volatility in raw material prices

Operating margins of the company decreased to 7.98 percent in FY2019 when compared to 11.04 percent in FY2018 due to increase in price of raw material and decline in yarn realizations. The prices of cotton are highly dependent on agro-climatic conditions and the purchase price of cotton depends on the prevailing demand-supply situation which limits bargaining power with suppliers as well.

Acuite believes that the operating margins of the company are likely to remain susceptible to volatility in raw material prices over the medium term.

Intense competition in the textile industry

The company is exposed to intense competition in the highly fragmented textile industry. The company also faces stiff competition from organized and unorganized players in the industry.

Rating Sensitivity Factor

- Net cash accruals of the company are expected to tightly match with the repayment obligations.
- Sequential deterioration in profitability. These factors are likely to affect the financial performance of the company.

Material Covenants

- As mentioned in sanction letter the company cannot withdraw of unsecured loans but the company has withdrawn unsecured loan of Rs.2.00 crore in FY19.

Liquidity Position: Stretched

KBCPL has stretched liquidity marked by tightly matching net cash accruals to its maturing debt obligations, slow realisation of subsidy from government and withdrawal of unsecured loans from the company. The company reported cash accruals of Rs.8.05 crore in FY19, while its maturing debt obligations were Rs. 6.74 crore over the same period. The cash accruals of the company is estimated to remain around Rs.7.00 – 8.00 crore during FY2020-FY2021 while its repayment obligation is estimated to be around Rs. 8.00 Crore. The company is yet to receive export and interest subsidy of Rs.13.55 crore from government of Andhra Pradesh which is pending from the last four years. Further, the company has withdrawn unsecured loans of Rs.2 crore from the entity which has also led to stretch in liquidity. Operations are working capital intensive with gross current asset (GCA) days of 156 in FY 2019. This has led to high reliance on working capital borrowings; the cash credit limit in the company remains utilized at 88 percent during the last 12 months period ended September 2019. The company's maintains unencumbered cash and bank balances of Rs.0.29 crore as on March 31, 2019. The current ratio of the company stood weak at 0.89 times as on March 31, 2019. The company is likely to incur debt funded capex of Rs.7.00 crore over the medium which is likely to be funded by equity and external borrowing in the ratio of 33:67. Acuite believes that the liquidity of the company is likely to remain stretched over the medium term on account of low cash accrual and repayments, lower than expected operating performance over the medium term.

Outlook: Stable

Acuite believes that the outlook on KBCPL will remain 'Stable' over the medium term on the back of experience of management and long track record of operations. The outlook maybe revised to 'Positive' in case of sustained increase in operating income and profitability. Conversely, the outlook maybe revised to 'Negative' in case of any further stretch in its working capital cycle or higher than expected deterioration in financial risk profile and liquidity.

About the Rated Entity - Key financials

| | Unit | FY19 (Provisional) | FY18 (Actual) | FY17 (Actual) |
|-------------------------------|---------|--------------------|---------------|---------------|
| Operating Income | Rs. Cr. | 200.70 | 162.39 | 180.00 |
| EBITDA | Rs. Cr. | 16.01 | 17.92 | 16.72 |
| PAT | Rs. Cr. | 4.40 | 6.18 | 3.88 |
| EBITDA Margin | (%) | 7.98 | 11.04 | 9.29 |
| PAT Margin | (%) | 2.19 | 3.81 | 2.15 |
| ROCE | (%) | 9.00 | 10.76 | 11.31 |
| Total Debt/Tangible Net Worth | Times | 1.95 | 1.73 | 1.88 |
| PBDIT/Interest | Times | 2.04 | 2.29 | 1.88 |
| Total Debt/PBDIT | Times | 5.17 | 4.20 | 4.35 |
| Gross Current Assets (Days) | Days | 156 | 150 | 128 |

Status of non-cooperation with previous CRA (if applicable)

None

Any other information

Not Applicable

Applicable Criteria

- Default Recognition - <https://www.acuite.in/criteria-default.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.htm>
- Manufacturing Entities - <https://www.acuite.in/view-rating-criteria-4.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/criteria-complexity-levels.htm>

Rating History (Up to last three years)

| Date | Name of Instrument / Facilities | Term | Amount (Rs. Cr.) | Ratings/Outlook |
|----------------|---------------------------------|------------|------------------|-----------------------------------|
| 07 August 2018 | Cash Credit | Long term | 30.00 | ACUITE BBB- / Stable (Reaffirmed) |
| | Term Loan | Long term | 28.15 | ACUITE BBB- / Stable (Reaffirmed) |
| | SLC | Long term | 6.00 | ACUITE BBB- / Stable (Reaffirmed) |
| | Cash Credit | Long term | 18.00 | ACUITE BBB- / Stable (Reaffirmed) |
| | Letter of Credit | Short term | 8.00 | ACUITE A3 (Reaffirmed) |
| | Proposed Bank Facility | Long term | 1.00 | ACUITE BBB- / Stable (Reaffirmed) |
| 18 April 2018 | Cash Credit | Long term | 30.00 | ACUITE BBB- / Stable (Assigned) |
| | Term Loan | Long term | 28.15 | ACUITE BBB- / Stable (Assigned) |
| | SLC | Long term | 4.50 | ACUITE BBB- / Stable (Assigned) |
| | Cash Credit | Long term | 18.00 | ACUITE BBB- / Stable (Assigned) |
| | Letter of Credit | Short term | 2.00 | ACUITE A3 (Assigned) |

*Annexure – Details of instruments rated

| Name of the Facilities | Date of Issuance | Coupon Rate | Maturity Date | Size of the Issue (Rs. Cr.) | Ratings/Outlook |
|------------------------|------------------|----------------|----------------|--|----------------------------------|
| Cash Credit | Not Applicable | Not Applicable | Not Applicable | 30.00 | ACUITE BB+ / Stable (Downgraded) |
| Term Loan | Not Applicable | Not Applicable | Not Applicable | 17.36 | ACUITE BB+ / Stable (Downgraded) |
| SLC | Not Applicable | Not Applicable | Not Applicable | 6.00 | ACUITE BB+ / Stable (Downgraded) |
| Cash Credit | Not Applicable | Not Applicable | Not Applicable | 18.00 | ACUITE BB+ / Stable (Downgraded) |
| Letter of Credit | Not Applicable | Not Applicable | Not Applicable | 8.00 | ACUITE A4+ (Downgraded) |
| Letter of Credit | Not Applicable | Not Applicable | Not Applicable | 4.00 | ACUITE A4+ (Assigned) |
| Proposed Bank Facility | Not Applicable | Not Applicable | Not Applicable | 7.79 [Enhanced from Rs. 1.00 crore] | ACUITE BB+ / Stable (Downgraded) |

Contacts

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About Acuité Ratings & Research:

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