

Press Release

Kallam Brothers Cottons Private Limited

February 15, 2021



Rating Upgraded, Reaffirmed and Assigned

Total Bank Facilities Rated*	Rs.97.15 Cr. (Enhanced from Rs.91.15 Cr)
Long Term Rating	ACUITE BB+/Stable (Upgraded)
Short Term Rating	ACUITE A4+ (Reaffirmed)

* Refer Annexure for details

Rating Rationale

Acuité has upgraded and assigned the long-term rating to '**ACUITE BB+** (read as ACUITE double B plus) from '**ACUITE BB** (read as ACUITE double B) and reaffirmed the short term rating of '**ACUITE A4+** (read as ACUITE A four plus) on the Rs.97.15 crore bank facilities of Kallam Brothers Cottons Private Limited (KBCPL). The outlook is '**Stable**'.

The rating was earlier downgraded as per the press release dated January 20, 2021 on account of information risk. However, the company has now cooperated with Acuité for the review.

About the company

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. The company is promoted by Mr. Nagi Reddy and his family. 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 1 mega-watt (MW), and the same is supplied to the Telangana electricity board.

The rating upgradation on the bank facilities of KBCPL is driven by expected improvement in business risk profile and financial risk profile post FY2021 backed by sustained improvement in cotton yarn demand leading to higher yarn realisations. Additionally, closure of its existing long term debt obligations in near term and repayment of its Covid-19 related loans is expected to improve financial metrics over the medium term.

Analytical Approach

Acuité has considered the standalone business and financial risk profile of KBCPL to arrive at the rating.

Key Rating Drivers

Strengths

- Experienced management and established 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 2 decades of experience in the textile industry. The extensive industry experience of the promoters has enabled them to establish a healthy relationship with its various customers and suppliers. The company has total of 24 gins and 33840 spindle capacity and 1MW wind mill. Despite the unfavorable industry dynamics in FY2020, the company has managed to achieve the revenue of Rs.182.49 Cr. KBCPL generated revenue of Rs.113.68 Cr for 9M of FY2021. Acuité believes that the promoter's extensive industry experience and established relation with its customers and suppliers will aid KBCPL's business risk profile over the medium term.

- **Moderate working capital management**

The working capital management of KBCPL remained moderate, evident from its GCA days of 135 days as on March 31, 2020 as against 154 days as on March 31, 2019. The inventory days stood at 104 days and 122 days as on March 31, 2020 and 2019, respectively. KBCPL reported Gross Current Assets (GCA) of about 135 days as on March 31, 2020 as against 154 days March 31, 2019. 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 110-125 days over the last three years ending March 31, 2020. The company procures material from farmers and agents in Andhra Pradesh, Maharashtra, Karnataka and Gujarat. Now, the company started procuring the material from Cotton Corporation of India (CCI) and credit period of 90 days is offered and upon submission of LC later on, the credit period is extended to 90 days more. Altogether the company is receiving the credit period of 180 days on procurement of raw material at comparatively lower prices when compared to ginners. It usually gets 10-15 days credit period from other 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 too. The company gives a credit of around 30-45 days to its customers. The creditor days stood at 35 days and 47 days as on March 31, 2020 and 2019, respectively. The bank lines remained utilized around 90 percent for the last six months ended January 2021. Acuité believes that KBCPL's working capital cycle will remain moderate over the medium term.

- **Continuous support from promoters' in the form of unsecured loans**

The promoters' have been continuously supporting the business by infusing unsecured loans into the business to meet its working capital requirements or in case of any other exigencies. The unsecured loans of Rs.20.86 Cr have been maintained by the company as on March 31, 2019; the same is treated as Quasi Equity. In FY2020, in order to meet its liquidity shortfall, the promoters' have infused further Rs.2.79 Cr in to the business (treated as debt). Over the medium term, the management is planning to infuse further Rs.2.50-5.00 Cr in the business. Acuité believes that promoters' support to the company in order to meet its liquidity shortfall would be a key rating sensitivity.

- **Improvement expected from H2FY2021**

Due to impact of COVID-19, the company has witnessed lower revenue in H1FY21 as reflected in its revenue of Rs.58.02 Cr until September, 2020. From H2FY21, the revenue is expected to pick as witnessed in revenue for the Q3FY21 at Rs.55.66 Cr; leading to 9MFY21 revenue of Rs.113.68 Cr. Higher exports along with improving cotton yarn realizations is expected to aid revenue growth and profitability in H2FY21 and thereon. Yarn prices, mainly those of cotton yarn, have increased sharply in Q2 & Q3 of FY2021 as inventories dried up and supplies have failed to match demand and spinning mills delayed resumption of their operations across the country. There was a sudden rise in demand for yarn from the garment and cloth sectors resulting in the non-availability of stocks. The other reason for increase in yarn prices is due to increase in raw material price, i.e. cotton has also increased.

Weaknesses

- **Moderate financial risk profile**

The financial risk profile of the company remained moderate with moderate capital structure and debt protection metrics. The networth marginally improved to Rs.60.50 Cr as on March 31, 2020 as against Rs.60.02 Cr as on March 31, 2019 on account of modest profit generated in FY2020. The gearing stood at 1.17 times as on March 31, 2020 as against 1.45 times as on March 31, 2019 on account of improving debt levels. Debt protection metrics Interest Coverage Ratio (ICR) and Debt Service Coverage Ratio (DSCR) deteriorated owing to increase in interest expense and decline in EBITDA in absolute terms. ICR stood at 1.50 times in FY2020 as against 2.04 times in FY2019. DSCR fell to below unity and stood at 0.77 times as on March 31, 2020 as against 1.09 times as on March 31, 2019 due to declining EBIT and increasing interest expenses. Though, the company has managed to service its debt obligations through promoters' fund support. TOL/TNW stood at 1.57 times as on March 31, 2020 as against 1.95 times as on March 31, 2019. The financial risk profile is expected to be remained moderate and marginally improve in near term as the proposed capex plan was withdrawn. Acuité believes that the financial profile of the KBCPL is expected to be at similar levels over the medium term owing to moderate accretion to reserves and absence of any significant debt-funded capex plans.

- **Revenue and operating margins impacted on account of Covid-19 & unfavorable industry dynamics in**

FY2020 and H1FY2021

Revenues of the company declined marginally to Rs.181.38 crore in FY2020 from Rs.198.43 crore in FY2019 on account of falling cotton yarn realisations. Yarn realization declined to Rs.181/kg in FY2020 from Rs.185/kg in FY2019. Also, the decline in exports to 10 percent in FY2020 from 36 percent in FY2019 has led to decline in revenues. The EBITDA margins of the company has marginally declined to 7.03 percent in FY2020 when compared to 7.98 percent in FY2019 owing to higher raw material cost and lower revenue.. This decline in EBITDA in absolute terms to Rs.12.82 Cr in FY2020 from Rs.16.01 Cr in FY2019 has led to decline in PAT levels as well. In addition, increase in interest expense has also led to decline in PAT margins to 0.26 percent in FY2020 from 2.19 percent in FY2019. The exports for FY2020 have come down to 10 percent owing to impact of trade war between China and USA, as China is one of the largest importers of cotton from India. In H1FY21, the company reported revenue of Rs.58.02 Cr, which relatively lower due to lean season as well outbreak of Covid-19. Subsequently, with improvement in demand, the 9MFY21 revenue were at Rs. 113.68 Cr. Howbeit, despite better demand in H2FY21, the overall revenue for FY21 is expected to be lower by 3-5 percent due to lower output in H1FY21. Acuité believes that KBCPL's operating performance remained impacted due to outbreak of Covid-19 and unfavorable industry dynamics in FY2020 and H1Y2021.

- **Susceptibility to fluctuation in raw material prices**

The main raw material purchased by the company is cotton. Hence, the margins are susceptible to changes in cotton prices. Cotton being an agricultural commodity, the availability and price of the same, is highly dependent on agro-climatic conditions. Despite the prevalence of Minimum Support Price (MSP), the purchase price depends on the prevailing demand-supply situation, which limits bargaining power with the suppliers as well. KBCPL is engaged in manufacture of fine counts, which provides some cushion from raw material price fluctuations. Acuité believes that KBCPL should be able to maintain its operating profitability around existing levels notwithstanding the volatility in prices of its key inputs, on the back of its established position in the market.

Rating Sensitivities

- Lower-than-expected revenue and profitability
- Any further deterioration in working capital management leading to deterioration in financial risk profile and liquidity
- Timely infusion of promoters' funds into the business
- Any large debt-funded capital expenditure incurred leading to deterioration in its financial risk profile and liquidity
- Timely receipt of the subsidy from the AP government

Liquidity Position: Stretched

KBCPL has stretched liquidity marked by tightly matching net cash accruals to its maturing debt obligations, low unencumbered cash and bank balance, highly utilized bank lines and slow realisation of subsidy from the government. The company reported cash accruals of Rs.4.20 crore in FY2020, while it's maturing debt obligations were Rs.8.10 crore over the same period. The shortfall was met through Promoters contribution of Rs.2.79 Cr. Moreover, for March 2020 quarters' repayment obligation of Rs.1.60 Cr, the company availed Covid-19 moratorium. And further, Rs.2.00 Cr power bills settlement which was to be received from AP TRANSCO, out of that Rs.1.00 Cr has received by the company in FY2020; remaining is expected to be received in FY2021. The cash accruals of the company is estimated to remain around Rs.5.40 – 8.80 crore during FY2021-FY2023 while its repayment obligation is estimated to be around Rs.6.50-7.14 Crore. Any shortfall will be met through promoters' funds. The company is yet to receive export and interest subsidy of Rs.18.62 crore from government of Andhra Pradesh which is pending from the last four years. Out of this, the company is expecting 40-50 percent by March 2021 and remaining in FY2022. The current ratio stood at 0.88 times as on March 31, 2020; below 1 time as the subsidy receivable is considered under non-current assets. The current ration stands in the range of 1-1.5 times, the same is considered under current assets. The cash and bank balance stood low at Rs.0.26 Cr as on March 31, 2020. The working capital limits are almost 90 percent utilized for the last six months ended in October 2020. 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.

Outlook: Stable

Acuité believes that KBCPL will continue to benefit over the medium term due to its experienced management and established relationships with its suppliers and customers. The outlook may be revised to 'Positive', in case of higher-than-expected revenues and profitability with improvement in working capital management and liquidity. Conversely, the outlook may be revised to 'Negative' in case KBCPL registers lower-than-expected revenues and profitability or any significant stretch in its working capital management or any major debt-funded capex plan or delay in receipt of the subsidy leads to deterioration in its financial risk profile and liquidity.

About the Rated Entity - Key Financials

	Unit	FY20 (Actual)	FY19 (Actual)
Operating Income	Rs. Cr.	182.49	200.70
PAT	Rs. Cr.	0.48	4.40
PAT Margin	(%)	0.26	2.19
Total Debt/Tangible Net Worth	Times	1.17	1.45
PBDIT/Interest	Times	1.50	2.04

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

CRISIL, vide its press release dated July 20, 2018 had denoted the rating of Kallam Brothers Cottons Private Limited as 'CRISIL BB/A4+; ISSUER NOT COOPERATING' on account of lack of adequate information required for monitoring of ratings.

Any Material Covenants

None

Any other information

None

Applicable Criteria

- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Manufacturing Entities - <https://www.acuite.in/view-rating-criteria-59.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55>

Rating History (Upto last three years)

Date	Name of Instrument / Facilities	Term	Amount (Rs. Cr)	Ratings/Outlook
20-Jan-2021	Cash Credit	Long Term	30.00	ACUITE BB (Downgraded) Issuer not Cooperating
	Term Loan	Long Term	17.36	ACUITE BB (Downgraded) Issuer not Cooperating
	SLC	Long Term	6.00	ACUITE BB (Downgraded) Issuer not Cooperating
	Cash Credit	Long Term	18.00	ACUITE BB (Downgraded) Issuer not Cooperating
	Letter of Credit	Short Term	8.00	ACUITE A4+ Issuer not Cooperating
	Letter of Credit	Short Term	4.00	ACUITE A4+ Issuer not Cooperating
	Proposed Bank Facility	Long Term	7.79	ACUITE BB (Downgraded) Issuer not Cooperating
30-Oct-2019	Cash Credit	Long Term	30.00	ACUITE BB+/Stable (Downgraded)
	Term Loan	Long Term	17.36	ACUITE BB+/Stable (Downgraded)
	SLC	Long Term	6.00	ACUITE BB+/Stable (Downgraded)
	Cash Credit	Long Term	18.00	ACUITE BB+/Stable (Downgraded)
	Letter of Credit	Short Term	8.00	ACUITE A4+ (Downgraded)
	Letter of Credit	Short Term	4.00	ACUITE A4+ (Assigned)
	Proposed Bank Facility	Long Term	7.79	ACUITE BB+/Stable (Downgraded)
07-Aug-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 (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 (Upgraded)
Term loans	Jan 2012	14	June 2025	12.27	ACUITE BB+/ Stable (Upgraded)
SLC	Not Applicable	Not Applicable	Not Applicable	5.70	ACUITE BB+/ Stable (Upgraded)
Term Loan	Mar 2020	7.75	Mar 2022	2.49	ACUITE BB+/ Stable (Assigned)
Term Loan	Dec 2020	7.95	Dec 2025	10.25	ACUITE BB+/ Stable (Assigned)
Term Loan	Mar 2020	14	Mar 2021	2.44	ACUITE BB+/ Stable (Assigned)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	18.00	ACUITE BB+/ Stable (Upgraded)
Term Loan	Dec 2020	8.50	Dec 2025	2.68	ACUITE BB+/ Stable (Assigned)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	8.00	ACUITE A4+ (Reaffirmed)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	4.00	ACUITE A4+ (Reaffirmed)
Proposed	Not Applicable	Not Applicable	Not Applicable	1.32	ACUITE BB+/ Stable (Upgraded)

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About Acuité Ratings & Research:

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