

Press Release

Kanchana Udyog

October 03, 2018

Rating Assigned



Total Bank Facilities Rated*	Rs. 10.00 Cr.
Long Term Rating	ACUITE BB- / Outlook: Stable

* Refer Annexure for details

Rating Rationale

Acuité has assigned long-term rating of '**ACUITE BB-**' (read as **ACUITE BB minus**) on the Rs. 10.00 crore bank facilities of Kanchana Udyog. The outlook is '**Stable**'.

Kanchana Udyog (KU) is a proprietary concern established in December 2013 by Mr. Prasadraj Kanchan. The entity is engaged in the business of two-wheeler dealership for Honda Motorcycle and Scooter India Private Ltd (HMSL). The entity has 5 showrooms and service centers located at Kankanady, BC Road, Vittal, Thokkottu and Kuloor. The showrooms are located in and around Mangalore (Karnataka).

Key Rating Drivers

Strengths

- **Experienced management and established track record of operations**

Mr. Prasadraj Kanchan, Promoter, has more than 10 years of experience in the current line of operations. He is well supported by his wife Mrs. Sukanya Kanchan with a decade of experience in the current business. The promoters also have dealerships for TVS Motors Company Limited, Ashok Leyland Limited and Hyundai Motor India Limited under various private limited/partnership concerns. Acuité believes that the entity will continue to benefit from its experienced management and established relations with its principal.

- **Efficient working capital operations**

Kanchana has efficient working capital operations as evident from Gross Current Asset (GCA) days of 56 as on March 31, 2018 (Provisional) as against 87 days as on March 31, 2017. The low GCA days were mainly due to moderate inventory and low debtor levels. The inventory days are moderate at 33 in FY2018, since the entity maintains inventory levels of 30-45 days in line with HMSL norms and to maintain sufficient number of vehicles model-wise. The debtor days stood at 17 days as on March 31, 2018 (Provisional), majorly receivables from vehicle financiers. Efficient working capital management has led to moderate utilisation of working capital limits over the past six months ended July 2018 to the extent of 85 percent. Acuité believes that the working capital operations of the firm will remain efficient as evident from efficient collection mechanism and moderate inventory levels in the business.

- **Improving scale of operations and healthy operating margins**

KU's operating income is at modest level though improved from Rs.41.29 crore in FY2016 to Rs.53.19 crore, witnessed compound annual growth rate (CAGR) of 13 percent. The growth is augmented by addition of two new showrooms in FY2017. The operating margin over the years under review stood at ~6.00 percent in line with the industry trend; moderate margins are supported by around ~25.00 percent of the revenues from sale of spare and services. Acuité believes that improving revenue profile while maintaining its profitability at about 6 percent is key rating sensitivity factors over the medium term.

Weaknesses

• Below average financial risk profile

The financial risk profile is marked by high gearing (debt-to-equity), modest net worth, and moderate debt protection metrics. The net worth stood at Rs.2.55 crore as on 31 March, 2018 (Provisional) increased by Rs.0.71 crore as compared to FY2017. Gearing is high at 3.27 times (Provisional) as on March 31, 2018 though improved from 6.97 times as on March 31, 2017. Gearing levels improved due to moderation in the holding levels. Total outside liabilities to tangible net worth (TOL/TNW) is high at 4.43 times as on March 31, 2018 (Provisional) as compared to 8.74 times as on March 31, 2017. The management in July 2018 has infused capital of Rs.2.40 crore, which would improve the capital structure over the medium term. Debt protection metrics of interest coverage ratio (ICR) and net cash accruals to total debt (NCA/TD) are moderate at 2.10 times and 0.20 times respectively for FY2018 (Provisional). Acuite believes that the financial risk profile is expected to improve over the medium term supported by expected increase in scale of operations, cash accruals and promoter's equity infusion.

• Cyclical associated with Auto Industry

The auto industry is inherently vulnerable to the economic cycles and is sensitive to the interest rate environment and the level of fuel prices. Further, there is a volatile trend linked to the festive seasons. Any hike in interest rates, increasing cost of purchase coupled with high fuel prices is likely to dampen the demand for vehicles or delay the purchase. KU has witnessed sharp increase in monthly volumes to about 1089 and lowest volumes of about 600 during FY2018. Improvement of macroeconomic factors like revival of industrial production, lowering of interest rates, rise in disposable income will help in improving the credit profile of automobile dealers. Dealerships deriving higher proportions of their incomes from services, spares and accessories will benefit more compared to those with major source of revenue deriving from sale of vehicles.

• Intense competition from other automobile players

Automobile business is a highly fragmented in nature with large number of players in the market. The market faces aggressive competition on account of established presence of authorised dealers of other automobile manufacturers. The nature of business being trading of automobiles is characterised by high competition, low profitability margins, high amount of working capital requirements. KU has limited negotiating power as the margins on products are set by HMSL thereby restricting the company to earn incremental income. Furthermore, the margin is constrained by intense competition in the dealership space. Automobile dealers would also be required to offer better terms like providing discounts on purchases, additional accessories to attract new customers. Such initiatives would create margin pressure and negatively impact the revenue earning capacity of the firm besides modest scale of operations.

Analytical Approach

Acuite has considered the standalone business and financial risk profiles of the Kanchana Udyog to arrive at this rating.

Outlook: Stable

Acuite believes that the outlook on KU will remain 'Stable' over the medium term on account of the experience of the promoters in the dealership business. The outlook may be revised to 'Positive' in case the firm registers significant growth in its revenues while maintaining its profitability. Conversely, the outlook may be revised to 'Negative' in case of any significant stretch in its working capital management leading to deterioration of its financial risk profile and liquidity.

About the Rated Entity - Key Financials

	Unit	FY18 (Provisional)	FY17 (Actual)	FY16 (Actual)
Operating Income	Rs. Cr.	53.19	49.43	41.29
EBITDA	Rs. Cr.	3.28	3.40	2.54
PAT	Rs. Cr.	1.21	1.42	1.17
EBITDA Margin	(%)	6.17	6.88	6.16
PAT Margin	(%)	2.28	2.87	2.83

ROCE	(%)	21.62	22.14	39.42
Total Debt/Tangible Net Worth	Times	3.27	6.97	6.91
PBDIT/Interest	Times	2.10	2.29	2.33
Total Debt/PBDIT	Times	2.56	3.78	3.92
Gross Current Assets (Days)	Days	56	87	80

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

None

Any other information

None

Applicable Criteria

- Default Recognition - <https://www.acuite.in/criteria-default.htm>
- Trading Entities - <https://www.acuite.in/view-rating-criteria-6.htm>
- Financial Ratios And Adjustments - <https://www.acuite.in/view-rating-criteria-20.htm>

Note on complexity levels of the rated instrument

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

Rating History (Upto last three years)

Not Applicable

*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	4.50	ACUITE BB- / Stable
Working Capital Term Loan	Not Applicable	Not Applicable	Not Applicable	3.00	ACUITE BB- / Stable
Term loans	Not Applicable	Not Applicable	Not Applicable	1.20	ACUITE BB- / Stable
Inventory Funding	Not Applicable	Not Applicable	Not Applicable	1.30	ACUITE BB- / Stable

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About Acuite Ratings & Research:

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