

June 28, 2024

Desai Brothers Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fixed Deposit	240.00	240.00	[ICRA]A+ (Stable); reaffirmed
Total	240.00	240.00	

*Instrument details are provided in Annexure-I

Rationale

The rating reaffirmation for Desai Brothers Limited (DBL) factors in its comfortable financial risk profile, as evident from its steady revenue growth, healthy internal accrual generation and strong liquidity position in FY2024. ICRA expects that the same would sustain over the near term, supported by DBL's established position in its key business segment. DBL's revenue rose to Rs. 1,667.3 crore in FY2024 (from Rs. 1,563.8 crore in FY2023), driven by a 23% growth in its snacks division, even as the beedi division continued to witness a modest growth of 6%. Despite continued volatility in raw material prices, DBL was able to sustain its operating margins by increasing the operating leverage and because of its established position in the beedi division. The company's capital structure also continues to remain comfortable with sustained net debt negative position. Its liquidity position remains strong, aided by healthy accrual generation. The rating continues to factor in DBL's position as one of the leading players in the fragmented beedi industry in India, supported by its established operational track record and extensive experience of its promoters in the business, the company's established brand presence with strong loyalty, and its wide distribution network. The company has maintained its market position despite competition from the unorganised beedi segment, other tobacco products, along with restrictions on sales promotions for tobacco products.

However, the rating is constrained by DBL's revenue concentration in a highly regulated beedi manufacturing industry on the back of health-related concerns. While revenue contribution from the snacks division has grown at a healthy pace to 11% in FY2024 from 3% in FY2019 and is expected to continue to grow further (resulting in increased business diversification), the beedi business is expected to remain the mainstay, accounting for the lion's share of the company's revenues. DBL also remains exposed to regulatory framework with regards to procurement of tendu leaves, sales, and distribution of beedi, along with requisite packaging norms. It also faces intense competition from the unorganised sector. Owing to persistent adverse weather conditions during this fiscal, ICRA expects a further rise in the cost of the key raw material (tendu leaves), which may last till FY2025, moderating the company's overall profitability. The impact will be partially offset by softening of tobacco prices and annual price hikes undertaken by the company in the beedi division.

The Stable outlook on the rating reflects ICRA's opinion that the company will continue to benefit from its established track record and strong brand presence with a wide distribution network, enabling it to generate healthy cash accruals and sustain its strong liquidity profile.

Key rating drivers and their description

Credit strengths

Established presence and strong distribution network in the beedi manufacturing industry – DBL is one of the major players in the beedi manufacturing industry with a production capacity of about six crore beedi sticks per day. Its products are sold under the trademark, Desai Beedi. The company has a strong brand presence, along with the larger established brands, in a fragmented beedi industry in Rajasthan, Haryana and Madhya Pradesh. These states contribute over 85% to the revenues of the beedi division. Despite competition from the unorganised beedi segment and other tobacco products, along with

restrictions on sales promotions for tobacco products, it has successfully maintained its market share owing to an established distribution network and strong brand loyalty.

Comfortable financial profile with strong liquidity position – The company witnessed a moderate revenue growth of 6.6% in FY2024, supported by a modest rise in beedi sales and a healthy growth in the snacks division on the back of increased focus of the management and a lower revenue base. DBL's RoCE (21-22% in FY2024) remains strong, given the low capital intensity of the beedi business. The beedi business is labour-intensive with no major capex requirements, whereas incremental capex by DBL is primarily undertaken in the snacks division. However, the company continues to grow its snacks division through an asset-light model. The company's financial profile remains robust with an estimated gearing of 0.2 times and TD/OPBITDA of 0.7 times in FY2024, supported by healthy internal cash accruals. The debt consists of only fixed deposits from shareholders and directors (one to three years).

Credit challenges

Competition from unorganised sector in beedi segment – The volume sale of beedi has been impacted in the last few years owing to competition from cheap beedis from the unorganised sector. The small producers in the unorganised sector do not register themselves with the tax authorities and use brand names of reputed companies in an unauthorised way to sell their products. This helps such producers to sell their products at a much cheaper rate than the rate offered by the organised sector. The company has appointed vigilance officers and is also using complex colours on its packaging to stop unauthorised usage of its brand name.

High revenue concentration of beedi business; vulnerability to Government policies, regulations and growing health awareness – DBL generates ~89% of its total revenue from the beedi division and ~10% from the snacks division. This exposes the company to the regulatory risks associated with the beedi industry due to health-related concerns. The revenue from the snacks division has grown at a strong pace in last two fiscals and is expected to continue to rise at a faster pace, supported by increased capacity and the management's plans to enter new markets. This will help the company reduce its dependence on the beedi segment. However, the share of the snacks division is expected to remain below 15% of the total revenue in the medium term. As the consumption of beedi is a health hazard, like other tobacco products, the industry remains tightly regulated in advertising and tax structure. India's tobacco product manufacturers need to comply with pictorial warnings on their packages, which affect volume growth for the industry. Further, the procurement of the major raw material, tendu leaves, is also regulated by the Government.

Profitability remains vulnerable to raw material price volatility – Considerable firming up of key raw materials (tendu leaves) and labour costs exerted pressure on the company's profitability in FY2024, given its inability to fully pass on the same to its customers. However, increased operating leverage and healthy growth in the snacks division revenues have enabled the company to largely sustain its operating margins in FY2024. Moreover, erratic spells of rain during the procurement season in the current fiscal is also likely to impact the quality of leaves, resulting in relatively lower production yield and increased costs. While the same is likely to be partially offset by annual price hikes undertaken by the company and some softening in tobacco prices, the company's overall operating margins are likely to moderate slightly in the current fiscal.

Liquidity position: Strong

DBL's liquidity remains **strong**, supported by steady internal accrual generation and healthy cash/fixed deposit balance of Rs. 76.3 crore and investments in mutual funds, bonds and equity shares amounting to Rs. 1,145 crore as on March 31, 2024 (valued at cost). In FY2024, DBL redeemed cumulative participating redeemable preference shares of Rs. 113.69 crore and bought back equity shares worth Rs. 150 crore, funded through accrual generation in the fiscal and surplus liquidity available. Going forward, fund flow from operations is expected to remain healthy at Rs. 200-210 crore and the minimal capex of Rs. 8-10 crore planned in FY2025 is likely to be funded by internal accruals. Overall, ICRA expects DBL to be able to meet its near-term commitments comfortably through its internal accruals and available cash surplus.

Rating sensitivities

Positive factors – ICRA could upgrade DBL’s rating if there is any sustained improvement in its revenue and accrual generation, led by diversification in its business profile, while maintaining strong liquidity position on a sustained basis.

Negative factors – Pressure on DBL’s rating could arise if the company’s revenue and profitability decline owing to regulatory changes, weakening its business risk profile, or if there is any large unplanned debt-funded capital expenditure, leading to a deterioration in the liquidity position, on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Fast Moving Consumer Goods
Parent/Group support	Not applicable
Consolidation/Standalone	The rating is based on the standalone financial statement of the rated entity.

About the company

DBL, owned and managed by the Pune-based Desai family, manufactures and sells beedis under its trademark brand, Desai Beedi. The company is one of the largest beedi manufacturers in India with a production capacity of around six crore sticks per day. In May 2013, DBL started the snack business by leveraging its strength in the sale and distribution of beedis. It markets its snack products under the Pitaara brand and chips under the brand, Chipseez. It has also invested in the renewable energy (windmills) and hospitality sectors.

Key financial indicators (audited)

DBL – Standalone	FY2023	FY2024*
Operating income	1563.8	1667.3
PAT	231.5	244.5
OPBDIT/OI	19.0%	19.1%
PAT/OI	14.8%	14.7%
Total outside liabilities/Tangible net worth (times)	0.4	0.3
Total debt/OPBDIT (times)	1.1	0.7
Interest coverage (times)	10.9	11.7

Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA’s calculations; Amount in Rs. crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2025)		Chronology of rating history for the past 3 years							
		Amount rated (Rs. crore)	Amount outstanding as of March 31, 2024 (Rs. crore)	Date & rating in FY2025		Date & rating in FY2024			Date & rating in FY2023		Date & rating in FY2022
				Jun 28, 2024	Jun 12, 2023	Jul 20, 2022	Jun 8, 2022	Apr 27, 2022	Apr 29, 2021		
1	Fixed Deposits	240.00	207.7	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	MAA- (Stable)	MAA- (Stable)		
2	Letter of Credit and Bank Guarantee	-	-	-	-	[ICRA]A1+ Reaffirmed and withdrawn	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+		

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term - Fixed Deposits	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long Term - Fixed Deposits	NA	11%	NA	240.00	[ICRA]A+ (Stable)

Source: Company

Annexure II: List of entities considered for consolidated analysis - Not Applicable

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545328
shamsherd@icraindia.com

Kinjal Shah
+91 6114 3442
kinjal.shah@icraindia.com

Deepak Jotwani
+91 124 4545 870
deepak.jotwani@icraindia.com

Aruna Ganesh
+91 22 6169 3368
aruna.ganesh@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

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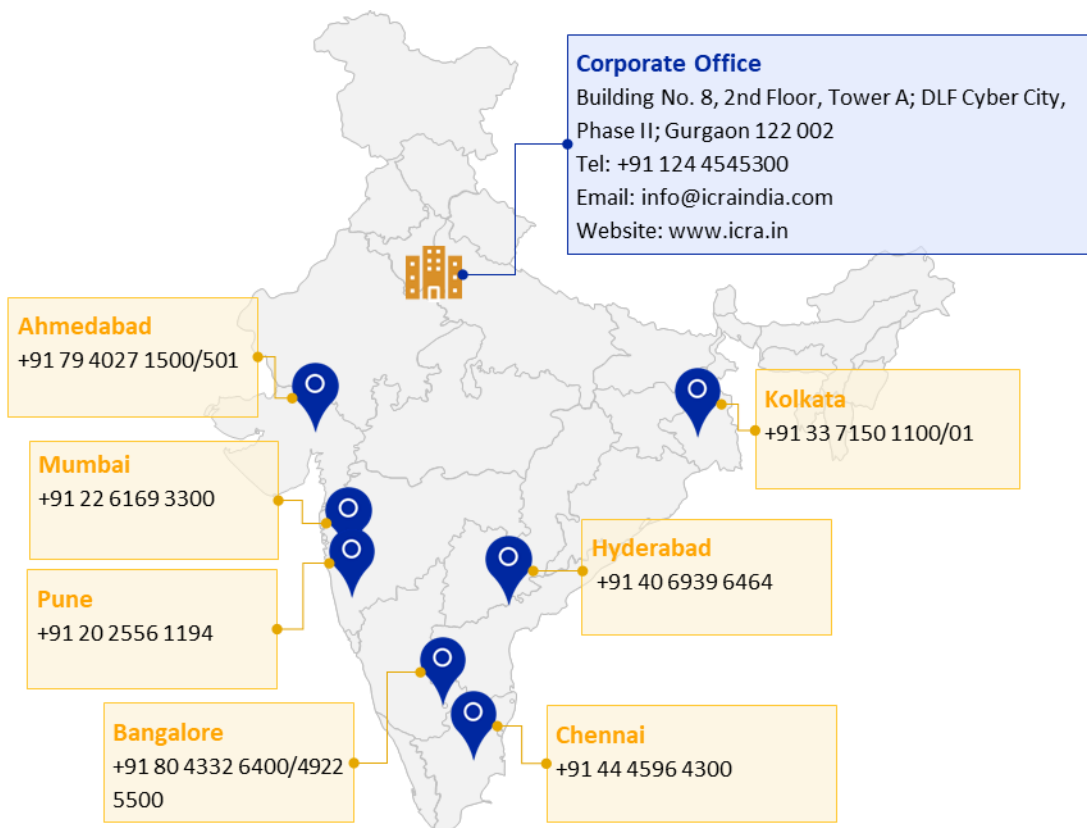
Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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