

December 11, 2020

DS Chewing Products LLP: [ICRA]A+(Stable) assigned for enhanced amount

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term fund-based bank facility (Cash Credit)	10.00	30.00	[ICRA]A+ (Stable); assigned/outstanding
Total	10.00	30.00	

*Instrument details are provided in Annexure-1

Rationale

The rating continues to draw strength from DS Chewing Products LLP's (DCPL's or the firm's) strong operational and financial risk profile. The firm's operational profile is supported by its established brand, Tulsi, in the chewing tobacco industry and its access to a strong distribution and sourcing network under a service agreement with the DS Group's flagship entity, Dharampal Satyapal Limited (DSL¹). DCPL also enjoys pricing power, given the strong brand loyalty its customers exhibit and its presence in a largely price-inelastic product segment (premium flavoured chewing tobacco), which is corroborated by the successful price hikes implemented by the firm in the past, without significant impact on sales volumes. These operational strengths and resulting efficiencies support large scale of operations and robust profitability metrics. Although the firm's revenues and profit margins are expected to moderate in the current fiscal owing to Covid-19 led lockdowns in the country as well as the temporary ban on manufacturing, sales and storage of chewing tobacco during Q1 FY2021 to contain the spread of the pandemic, these are expected to remain healthy. Moreover, low capital requirements of the business and healthy accruals have kept reliance on debt minimal in the past, translating into robust debt metrics, as indicated by Total Debt/ OPBDITA of 0.6 time and interest cover of 19.3 times in FY2020. In this context, ICRA has noted the infusion of significant interest-bearing unsecured loans in the firm in the past two years, taking the total debt to Rs. 114.6 crore as on March 31, 2020 from Rs. 0.7 crore as on March 31, 2018. The funds, together with internal accruals, which were bolstered by limited withdrawals in FY2020 vis-à-vis past trends, have been used to invest in Group companies and unrelated entities. While this has resulted in increased leverage (Total Debt/ Tangible Net Worth of 1.5 times as on March 31, 2020 vis-à-vis 0.03 time as on March 31, 2018), ICRA notes that reliance on external debt remains low and coverage metrics healthy. Further, these investments are discretionary in nature and subject to availability of adequate liquidity in the system. Having said that, prudent management of the level of withdrawals, and/or such investments will be critical for sustaining a strong liquidity profile and, hence, will be a rating sensitivity. Besides, the rating is also constrained by DCPL's reliance on a single brand and a single product segment, which is further accentuated by the vulnerability of the tobacco business to Government regulations. In this context, ICRA has taken a note of the firm's recent venture into manufacturing and export of *pan masala* under the Group's established brand 'Rajnigandha', which is expected to help it diversify its product portfolio, brand portfolio as well as geographical presence to some extent. The operations in this segment are, however, in a nascent stage at present and the extent of scaling up remains to be seen.

The Stable outlook on the [ICRA]A+ rating reflects ICRA's belief that DCPL will be able to maintain a strong financial profile, supported by its ability to command high profit margins, while keeping its reliance on debt low, despite a challenging H1 FY2021, which is expected to pull down revenues and profit margins for the full year FY2021.

¹ ICRA has [ICRA]AA-(Stable)/[ICRA]A1+ ratings outstanding for the bank facilities of DSL. Please refer to ICRA's website, www.icra.in, for further details.

Key rating drivers and their description

Credit strengths

Established brand in the chewing tobacco industry - Tulsi is among the leading brands in the domestic premium chewing tobacco industry. Thus, DCPL benefits from the strong brand recall, which augments its ability to charge a premium vis-à-vis other competing brands. This in turn translates into strong profitability and return metrics for the firm. Further, the ban on tobacco advertising, imposed more than a decade ago, benefits the firm as it acts as an entry barrier for new brands by preventing them from advertising and establishing their presence.

Strong pan India distribution and sourcing network - Due to the ban on tobacco advertising, tobacco manufacturers rely on point-of-sale advertisement, and hence having a dedicated distribution network is critical to maintain market share. DCPL benefits from its access to a pan India distribution network of depots, central stockists, distributors, wholesalers and retailers, which is also used for other products of the promoter Group for brands like Rajnigandha, Pass Pass, Pulse, Catch, etc.

Strong financial risk profile characterised by robust profitability and minimal dependence on external debt - DCPL's operational strengths and efficiencies support a large scale of operations with strong profitability metrics. Despite the anticipated decline in the firm's scale of operations and profitability in the current fiscal, owing to Covid-19 led disruptions in operations (including lockdowns and temporary ban on manufacturing, storage and sales of chewing tobacco in India during Q1 FY2021), the profitability and return indicators are expected to remain robust. Moreover, the low capital requirements of the business and adequate capitalisation by the partners result in minimal reliance on external debt, and hence support robust debt metrics Total Debt/ OPBDITA of 0.6 time and interest cover of 19.3 times in FY2020. ICRA notes that the capitalisation and coverage metrics remain strong despite substantial infusion of interest-bearing unsecured loans by the promoter Group during FY2019 and FY2020, to fund investments in Group companies and other unrelated entities, which increased the total debt levels and, consequently, the leverage for the firm. This has been partly supported by lower withdrawals by partners in FY2020, which bolstered the firm's retained cash flows. Total debt/ Tangible Net Worth stood at 1.5 times as on March 31, 2020 as against 0.03 time as on March 31, 2018. The firm, however, did not have any external debt on its books as on March 31, 2020.

Credit challenges

High concentration risk considering reliance on a single product segment and a single brand – Despite the business interests of partners across multiple product segments and a wide portfolio of brands, ICRA notes that DCPL is reliant on a single product segment, i.e., flavoured tobacco and a single brand, Tulsi. In this context, ICRA has taken a note of the firm's recent venture into manufacturing and export of *pan masala* under the Group's established brand 'Rajnigandha', which is expected to help it diversify its product portfolio, brand portfolio as well as geographical presence to some extent. The operations in this segment are, however, in a nascent stage at present and the extent of scaling up remains to be seen.

Vulnerability of the tobacco business to Government regulations - Due to their adverse health effects, tobacco-based products remain susceptible to changes in Government policies related to sales, thus accentuating the product concentration risk. The Government disincentivises tobacco product consumption by levying high taxes and periodically increasing tax rates on their sale. Thus, the firm's ability to pass on these tax hikes remains critical for sales growth and profits. Apart from taxation, there have been instances of temporary ban on sales of these products in some states. This was recently witnessed during Q1 FY2021, when the Government imposed a temporary ban on manufacturing, sale and storage of tobacco across the country, to contain the spread of the novel coronavirus.

Funds withdrawal risk arising from partnership constitution of the entity and uncertainty on sizeable investments in non-return generating assets - Despite robust profitability, DCPL's retained cash flows have remained relatively modest in the past (except in FY2020), albeit sufficient, as withdrawals by partners have remained high amid minimal funding requirements, compared to the level of profits. In ICRA's view, prudent management of the level of withdrawals in the future will remain critical for sustaining a comfortable liquidity profile. In addition, the firm has made investments in related as well as unrelated entities in the past, investing ~Rs. 87.0 crore incrementally during FY2020. While on the one hand, a large chunk of these investments is expected to remain non-return generating in the near to medium term, on the other hand, there is uncertainty on the incremental equity commitments in such companies. Continued sizeable incremental investments and/or large funds withdrawals by the partners, which increases the firm's reliance on external debt and affects its liquidity profile, may affect its credit profile. The risk is, however, mitigated, considering the significant surplus cash generation capacity of the business as well as no external term borrowings on the firm's balance sheet, which provides it financial flexibility. Besides, the risk is mitigated, considering that these transactions are discretionary in nature and subject to the availability of adequate liquidity in the system.

Liquidity position: Strong

DCPL's liquidity profile remains **strong**, supported by healthy cash flow generation from operations, adequate cushion in working capital limits (undrawn fund-based bank facilities averaged at Rs. 15.8 crore in the six-month period ended October 2020, equivalent to ~76% of the drawing power available), and comfortable free cash and bank balance of Rs. 21.2 crore as on October 31, 2020. Given no fixed repayment obligations and no major capex outflows planned, the amount of cushion available in terms of unutilised limits and liquid cash and investments provides a healthy liquidity cushion. While there have been regular outflows in the form of incremental investments, loans and advances, they have been largely funded from surplus internal accruals (by reducing withdrawals) and/ or infusion of fresh funds by the partners, ensuring healthy liquidity cushion. ICRA, however, notes that, though discretionary in nature, any substantial cash outflows in the form of fund withdrawals by partners or other non-current investments may impact the firm's liquidity profile.

Rating sensitivities

Positive triggers – The long-term rating could be upgraded if the firm achieves a healthy diversification in its product portfolio, while achieving a healthy growth in its scale of operations and maintaining a robust financial risk profile.

Negative triggers –The ratings could be downgraded in case of any adverse regulatory developments for tobacco, which results in a sustained pressure on the firm's revenues and profitability as well as return indicators. Additionally, DCPL's rating would be prone to a downgrade if there is a sustained moderation in the firm's liquidity profile or if it undertakes aggressive debt-funded investments, which results in an increase in its leverage and a material moderation in its coverage metrics.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for entities in the Fast Moving Consumer Goods (FMCG) Industry
Parent/Group Support	Not applicable
Consolidation/Standalone	Standalone

About the company

Established in November 2014, DCPL is a Limited Liability Partnership (LLP) firm owned by Mr. Rajiv Kumar and Mr. Ravinder Kumar, who are promoters of the established Dharampal Satyapal (DS) Group. The firm processes and markets flavoured tobacco (*zarda*) under the Tulsi brand. The manufacturing facility of the firm is in Noida, Uttar Pradesh. As the brand is owned by its Group company, DS Sons Private Limited (DSSPL), DCPL pays royalty fee to DSSPL.

In FY2020, the firm reported a net profit of Rs. 124.8 crore on an operating income of Rs. 371.7 crore, compared to a net profit of Rs. 128.3 crore on an operating income of Rs. 389.8 crore in the previous year.

Key financial indicators

	FY2019	FY2020
	Audited	Audited
Operating Income (OI) (Rs. crore)	389.8	371.7
PAT (Rs. crore)	128.3	124.8
OPBDIT/OI (%)	54.1%	51.5%
PAT/OI (%)	32.9%	33.6%
Total Outside Liabilities/Tangible Net Worth (times)	6.9	3.2
Total Debt/OPBDIT (times)	0.4	0.6
Interest Coverage (times)	68.7	19.3

Source: Firm's financials, ICRA research; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest and tax

Status of non-cooperation with previous CRA: Not applicable

Any other information:

Considering the interest-bearing nature of the unsecured loans infused by the partners and uncertainty on their repayment, ICRA has not assigned any equity credit to such loans. Even though this moderates the firm's capitalisation and coverage metrics, they remain robust. Further, ICRA continues to derive comfort from sizeable cash accrual generation capacity of the business as well as minimal reliance on external debt.

Rating history for past three years

		Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating		Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018
				11-Dec-2020	19-Oct-2020	13-May-2019	19-Apr-2018	-
1	Cash Credit	30.00	NA	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	-

Amount in Rs. crore

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 [click here](#)

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	Cash Credit	NA	NA	NA	30.00	[ICRA]A+ (Stable)

Source: DS Chewing Products LLP

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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