

May 10, 2022

Khemani Distilleries Private Limited: [ICRA]BBB(Stable) assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Term Loan	25.00	[ICRA]BBB(Stable); assigned
Total	25.00	

*Instrument details are provided in Annexure-1

Rationale

To arrive at the rating of Khemani Distilleries Private Limited (KDPL), ICRA has consolidated the financials of KDPL, Royal Distilleries Private Limited (RDPL), which got merged with KDPL effective from October 2021, and Cosmic Traders given the operational, managerial and financial linkages within these entities. The consolidated financials are to be referred as the KDPL Group.

The assigned rating factors in KDPL's proven operational track record of around three decades in the alcohol industry backed by experienced promoters and a strong management team, its diversified product portfolio along with long-standing relationship to manufacture and sell various brands of United Spirits Limited (USL - rated [ICRA]AA+; Positive/ [ICRA]A1+) under contract manufacturing and franchisee agreement, which caters to the Diu, Daman and Silvassa market. ICRA also considers its healthy operating margins over the period under study, given the company's focus on premium products sale for USL which has contributed to around 45% of total sales for the last three fiscals. ICRA also notes the family settlement agreement between the initial promoters (brothers) in October 2021 leading to transfer of own brand export business to the other brother (Mr. Suresh Khemani), along with an acquisition of RDPL's operating business by KDPL for a consideration of Rs.90 crore.

The rating, however, remains constrained by KDPL's moderate scale of operations, vulnerability of the margins to the volatility in raw material prices, and moderate debt coverage indicators. ICRA also notes that the company has a history of extending loans and advances to related and unrelated parties, where a significant portion of the same was written-off in FY2021 leading to losses at the net level. The rating also factors in the high dependence on USL for its majority of sale, and its presence in the highly regulated industry limiting its pricing power and susceptibility to adverse regulatory changes.

The Stable outlook on the [ICRA]BBB rating reflects ICRA's opinion that the KDPL Group will maintain its credit profile in the near to medium term driven by the proven experience of its promoters, established relationship with USL and growing focus on premium products, which entail higher margins.

Key rating drivers and their description

Credit strengths

Promoters proven track record of around four decades in alcohol industry – KDPL belongs to the Khemani Group which was promoted by two brothers viz. Mr. Ashok Khemani and Mr. Suresh Khemani, and the Group operates various entities in the distillery and brewery industry in Diu, Daman and Silvassa. The Group set-up RDPL in 1983 and KDPL in 1993 and both the entities are primarily involved in the manufacture of Indian-Made Foreign Liquor (IMFL) and Country Liquor (CL). Also, the Group is present in the perfumes industry via Perfunova International Limited and beer manufacturing through Blossom Industries Limited. Given the wide variety of products the Group deals in the alcoholic beverage industry for around four decades, reflects its strength and it is assisted by the second generation, along with an experienced management team. However, the brothers, through a mutually agreed family settlement, divided the Group business in October 2021, where the

own export brands were transferred from RDPL and KDPL to the other brother (Mr. Suresh Khemani), including an acquisition of RDPL's operating business by KDPL for a consideration of Rs.90 crore.

Diversified product portfolio along with longstanding relationship with USL as a contract manufacturer and franchisee – The product portfolio of KDPL comprises Extra Neutral Alcohol (ENA) and IMFL where KDPL utilises ENA for its captive consumption apart from external sale to perfumes & sanitizer players and industrial uses. KDPL manufactures IMFL of its in-house brands and of USL under contract manufacturing agreement for its premium brands and franchisee agreement for its popular brands for long. As per the agreement, for premium brands, KDPL manufactures products and sells through Cosmic Traders in the Diu, Daman and Silvassa region against agreed conversion and distribution charges whereas for the export of these products, KDPL directly sells from its manufacturing location to the port. For popular brands, KDPL has a franchisee agreement with USL to manufacture and sell these products by paying fixed royalty to USL. Given USL's leading position in the Indian market, KDPL leverages on this factor over the years.

The premium and popular brands of USL contributed 46% and 6% to total sales in FY2021 (38% and 4% in 9M FY2022, respectively), respectively, which indicates the customer concentration risk and the risk of renewal at favourable terms with USL. However, KDPL has a long-standing relationship with USL which reflects its consistency in product offering and compliance to the standards set by USL.

Healthy margin levels over the years driven by higher sales of premium brand products – The KDPL Group reported healthy margins over the years marked by an operating margin in the range of 15-18 % in the last three fiscals and 18.32% in FY2022 as per standalone (provisional) financials. The same has been largely driven by focus on sale of premium products, which contributed to around 45% to total sales at a standalone level for the last three fiscals ending FY2021.

The capital structure of the KDPL Group remained comfortable marked by a gearing ratio which remained around 0.33-0.35 times in the last two years ended FY2020 in the absence of any external debt. However, KDPL availed a term loan of Rs.150 crore in FY2021 for the acquisition of RDPL, leading to moderation in FY2021. However, given KDPL has prepaid Rs.16.25 crore towards the term loan and it has repaid majority of its unsecured loans with interest (for loans taken from the Suresh Khemani Group as a part of the settlement) in FY2022, coverage numbers are expected to improve from FY2022 onwards.

Credit challenges

Moderate scale of operations – The scale of operations remained moderate at a consolidated level marked by an operating income of around Rs.367 crore and Rs.352 crore in FY2019 and FY2020, respectively, and it declined to around Rs.313 crore in FY2021 owing to the adverse impact on demand due to the Covid-19 pandemic. Further, due to transfer of own export brands to the Suresh Khemani Group, sale from FY2023 is expected to be impacted to the extent of around Rs.55.0 crore. Hence, ICRA expects the scale of operations of the KDPL Group will continue to remain moderate in the near to medium term.

Susceptibility of profitability to volatile raw material prices – The rise in the prices of key raw materials (rice), packing materials and freight costs put pressure on the profit margins of the KDPL Group. KDPL generates around 45 % of total revenue from the sale of premium brands of USL where it can fully pass on the price hikes to USL as per the arrangement of contract manufacturing entered with USL. However, for popular brands, the price volatility risk is borne by KDPL albeit it can adjust the sale prices periodically whereby it can mitigate this risk to some extent. Also, for its own brands, the volatility in raw material prices impacts the margins.

History of extension of loans and advances to associate and unrelated parties; significant write-off witnessed in FY2021, leading to losses at net level – The company has a history of extending loans and advances in the past and its total exposure of advances was Rs. 62.87 crore as on March 31, 2019, including Rs.51.50 crore to some external unrelated entities (Rs.30.0 crore to Shree Naman Developers Pvt. Ltd. (SNDPL) and Rs.20.0 crore to United Breweries (Holding) Ltd. (UBHL)) and balance

to associate concerns. The company charges interest of 12% on these loans, however, the same has not been received in actual and has been accrued over the years. The total interest accrued on such loans was Rs. 31.3 crore, Rs. 18.9 crore and Rs.1.73 crore as of FY2019, FY2020 and FY2021, respectively. KDPL has received all the dues from SNDPL in FY2020 whereas it has written-off all the dues from UBHL (Rs.38.53 crore) in FY2021, given its weak financial position. In FY2022, the company has outstanding advances of Rs. 24.8 crore, which is mainly to its associate concerns. Given the history of extension of such advances, and write-offs thereon impacting the net worth, going forward, movement of such advances will be a key rating monitorable. Any further advances, which impacts the liquidity profile, or delay in receipt of the present ones, or large write-offs impacting the net worth, will remain critical from a credit perspective.

Highly regulated industry restricts pricing flexibility – The liquor industry is highly regulated by state governments, who control the sales and distribution, making the operations of the KDPL Group susceptible to the changes in Government policies. The prices of end products are also finalised in accordance with the Government-fixed norms for a year and any change is generally discouraged. Hence, given the stiff regulation of increase of final product along with taxes and duties, the pricing flexibility remains limited for the operating players. Any change in the Government policies with respect to production, distribution of liquor, taxation, and state excise duty, or any material changes in the duty structure, may impact the liquor industry and in turn the company.

Liquidity position: Adequate

The company’s liquidity has remained adequate, supported by the unutilised sanctioned working capital limits of Rs.25 crore and healthy cash accruals. Further, the company had free cash and balance of Rs.29.40 crore as on March 31, 2021. The company has largely prepaid its repayments for FY2023 and the repayment obligations for FY2024-FY2025 will be in the range of Rs.22-25 crore, which is expected to be adequately funded through cash accruals.

Rating sensitivities

Positive factors - ICRA could upgrade KDPL’s rating if there is a consistent rise in top line with growth in the margins, which leads to an overall improvement in the coverage metrics on a sustained basis. Specific credit metric of DSCR above 1.6 times on a sustained basis can be a positive trigger.

Negative factors - Pressure on KDPL’s rating could arise in case of decline in top line or erosion of the margins, which weakens the coverage metrics on a sustained basis. Any increase in advances or delay in recoverability or any write-off of such advances which materially impact the credit metrics will also be a trigger for a downgrade. Specific credit metric of interest coverage below 3 times on sustained basis can be a negative trigger.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	The rating is based on the consolidated financials of Khemani Distilleries Private Limited, Royal Distilleries Private Limited (merged in KDPL from October 2021) and their distribution arm, Cosmic traders.

About the company

KDPL belongs to the Khemani Group, which was formed in 1983 by two brothers, Mr. Ashok Khemani and Mr. Suresh Khemani. KDPL, incorporated in 1993, manufactures and sells ENA and IMFL of its in-house brands and USL brands, catering to the Indian (primarily Diu, Daman, Silvassa and Gujarat) and overseas markets. The company has rice/grain-based ENA plant with a capacity of 21.54 million litres per annum and a bottling capacity of 66 lakh cases per annum at the U.T. of Daman. Also, the

company has an in-house steam based captive power plant (CPP) with a capacity of 3.75 Mega Watt which helps in saving power costs and an Effluent Treatment Plant (ETP) with a capacity of 600 kilo litre per day that ensures environment compliances are met.

Key financial indicators (Consolidated)

	FY2020	FY2021
Operating Income (Rs. crore)	352.89	313.27
PAT (Rs. crore)	29.68	-0.39
OPBDIT/OI (%)	17.16%	17.86%
PAT/OI (%)	8.41%	-0.12%
Total Outside Liabilities/Tangible Net Worth (times)	0.54	0.83
Total Debt/OPBDIT (times)	1.92	4.36
Interest Coverage (times)	2.80	2.45

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, All ratios as per ICRA calculations,

Key financial indicators (Standalone)

	FY2020	FY2021
Operating Income (Rs. crore)	312.83	291.82
PAT (Rs. crore)	11.58	-7.86
OPBDIT/OI (%)	14.61%	16.04%
PAT/OI (%)	3.70%	-2.69%
Total Outside Liabilities/Tangible Net Worth (times)	0.79	1.29
Total Debt/OPBDIT (times)	2.50	5.17
Interest Coverage (times)	2.13	2.07

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation, All ratios as per ICRA calculations,

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Current Rating (FY2023)				Chronology of Rating History for The past 3 Years			
	Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2022 (Rs. crore)	Date & Rating in	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	
				May 10, 2022				
1 Fund based-Term Loan	Long-Term	25.00	115.00*	[ICRA]BBB (Stable)	-	-	-	

*Outstanding against the total sanctioned term loan of Rs.150 crore

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-Term Fund Based- Term Loan	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: www.icra.in

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	Term Loan	2021	NA	2027	25.00	[ICRA]BBB (Stable)

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

Annexure-2: List of entities considered for consolidated analysis –

Company Name	Ownership	Consolidation approach
Khemani Distilleries Private Limited*	100%	Full consolidation
Cosmic traders	Promoter Owned	Full consolidation

*RDPL was merged in KDPL from October 2021 onwards

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545300
shamsherd@icraindia.com

Srikumar Krishnamurthy
+91 44 45964318
ksrikumar@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Ruchi Shah
91 79 4027 1500
ruchi.shah@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@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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ICRA Limited



Registered Office

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

Tel: +91 11 23357940-45



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