November 09, 2017

Desai Brothers Limited

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Short term – Non fund based – Bank Guarantee	25.00	[ICRA]A1+ reaffirmed
Mediun term - Fixed Deposit	100.00	MAA-/Stable reaffirmed
Medium term - Fixed Deposit	50.00	MAA-/Stable Assigned
Total	**175.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the rating of [ICRA] A1+ (pronounced ICRA A One plus) assigned to the Rs. 25.00[1] crore short term non-fund based facilities and the rating of MAA- (pronounced as M double A minus) assigned to the Rs. 100.00 crore fixed deposit programme of Desai Brothers Limited ('DBL'/'the company')[2]. ICRA has also assigned a fresh medium term rating of MAA- (pronounced as M double A minus) to the Rs. 50.0 crore fixed deposit programme with a stable outlook. This is the high-credit-quality rating assigned by ICRA. The rated instrument carries low credit risk.

Rationale

The ratings reaffirmation continue to derive comfort from the strong capital structure and robust liquidity profile of the company characterized by consistent healthy cash accruals, minimal dependence on external funding and sizeable liquid investments as well as cash balance to the tune of Rs. ~475 crore as on March 31, 2017 providing additional financial flexibility. The ratings also factors in long track record of promoters, established branded presence with strong brand loyalty and wide distribution network with DBL being one of the leading players in the fragmented beedi industry in India. The company has been able to maintain its market position despite competition from un-organized beedi segment, other tobacco products and restrictions on sales promotions for tobacco products. ICRA takes note of moderate decline in margins in FY2017; given the sharp increase in raw material i.e. tendu leaves cost witnessed during the year. However expected gain in current fiscal arising out of favourable changes in tax structure post GST implementation in the beedi segment will support margin expansion, which contributed over 80% of the company's revenues and 78% of profit before interest and tax (PBIT) during FY2017.

The company also has a strong presence in the food processing industry, through the Mother's Recipe brand with healthy market share in categories like pickle and pastes in domestic market as well as sale of gherkins in exports market. Going forwards, DBL's expected launch of new products under namkeen division in the northern eastern states by leveraging its existing distribution network will support the revenue growth over the medium term.

The ratings however remains constrained by DBL's presence in highly regulated beedi manufacturing industry on back of health related concerns and company remain exposed to overall regulatory framework with regards to procurement of tendu leaves, sales & distribution of beedi along with requisite packaging norms. The volumes for beedi sales has been declining over the years given restrictions on sales promotions, competition from other tobacco products and change in consumer smoking habits; though

[1] *100 lakh=1 Crore= 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications.*

company has been able to register value growth and maintain margins by improving realization, thereby offsetting impact of declining volume and increased tax obligations. The food processing business also remains exposed to agro climatic conditions prevailing in the country. ICRA also takes note of the recent investment in namkeen division will require further funding support over the medium term, though in the wake of the healthy accruals generated by the established business divisions of the company, the liquidity condition is expected to remain comfortable. ICRA also takes note of lower than expected business offtake in the hospitality division though its impact on overall profitability remains marginal. ICRA expects company will continue to strengthen its presence in food processing industry via organic and inorganic expansion over medium term, which will be primarily funded by internal accruals. Consequently, DBL is expected to remain net debt free company over the medium term.

Key rating drivers

Credit strengths

- **Long standing presence and strong distribution network across major states, among the larger established brands in the fragmented beedi industry with a leading position in Rajasthan**
  DBL is one of the major players in beedi manufacturing industry with a production capacity of about 7 crore beedi sticks per day. The beedis are sold under the trademark 'Desai beedi'. DBL enjoys a strong brand presence in Rajasthan, Haryana and Madhya Pradesh; the company generated over 80% of total sales from these three states during FY2017. The company has been able to maintain its market share despite competition from un-organized beedi segment, other tobacco products and restrictions on sales promotions for tobacco products owing to established distribution network and strong brand loyalty.

- **Established market position of 'Mother's Recipe' brand in the domestic processed food industry; healthy export revenue share**
  The company diversified its operations in the ethnic foods business in 2002, and has been witnessing steady growth in its revenue contribution from this division. The company offers wide variety of pickles and pastes catering to different taste preferences and same has been the major revenue driver for 'Mother Recipe' brand in the domestic market over the years. The company also has healthy presence in exports market with over 40% of sales coming from exports to countries like Russia, Netherland, Australia, Middle East, USA, etc.

- **Healthy profitability over the years; recent changes in tax structure post GST implementation will further drive margin expansion**
  DBL's operating margins remained healthy over the years majorly driven by Beedi division as 80% of the company's revenues and ~78% of the company' s profits come from Beedi division itself which has 15%-17% operating margins. Going forward, ICRA expects a further increase in profitability owing to favourable changes in tax structure post GST implementation in the states where the company has significant market presence.

- **Favourable financial profile characterized by healthy return on capital employed and minimal debt;** DBL's RoCE remains very strong given low capital intensity of beedi business. Beedi business is a labor intensive business with no major capex requirements and incremental capex by DBL is primarily in food division only. This resulted in strong capital structure over the years. The long term debt majorly includes FDs from relatives of shareholders (1-3 year) and deposits from thekeddars for beedi making and agents for distribution of beedi. The company has minimal dependence on outside funding and even after considering investments in hospitality venture, liquidity profile remains strong.

- **Strong liquidity profile supported by consistent accruals, healthy cash balances and liquid investments to the tune of Rs. 425 crore as on March 2017**
  Apart from the consistent cash accruals, DBL's liquidity profile is further significantly supported by substantial liquid investments in the form of mutual funds and cash balances to the tune of Rs. 475 crore as on March 2017 which itself contributes ~50% of the company's total assets.

Credit weaknesses

- **Beedi business, the main contributor to profits, remains vulnerable to Government policies, regulations and growing health awareness; however, company has been able to maintain margins over the years despite decline in volumes**
  Being a health hazard, like other tobacco products, beedi industry too remains tightly regulated in terms of duty structure and advertising. India's tobacco product manufacturers need to comply with pictorial warnings on packages which is potentially affecting volume growth for the industry in addition to increasing packaging costs**.** Further the ceiling on the procurement of major raw material i.e. tendu leaves by the government has resulted in the capping of the corresponding production and sales volumes. However despite declining volumes, DBL has been able to maintain its margins through its ability to achieve healthy price realisations owing to strong brand loyalty amount the key consumer segments.

- **Raw material prices in the foods business are vulnerable to climatic conditions and agriculture output; limited pricing power may have negative impact on profitability in case of adverse movement in raw material cost**
  The food processing business also remains exposed to agro climatic conditions prevailing in the country. Prices of most of the DBL's raw materials are volatile and are dependent on crop produce and market demand-supply parameters. Adverse movements in raw material costs can result in downward pressure on profitability as increasing prices may not be feasible in wake of competition in domestic and export market.

- **Continuous deployment of cash accruals in diverse ventures which drag overall return indicators; however diversification benefit may provide benefits in the long term**
  In order to diversify and scale up its business, DBL has adopted the acquisition policy under which it is steadily acquiring companies manufacturing specific food products and having specific geographic presence. Though these investments are likely to benefit the company in the long term, the current deployment of cash accruals in these ventures is likely to drag the overall return indicators of the company in near term. Going forward, DBL's strategic initiates to ramp up the business from these businesses remains to be seen and will be a key monitorable.

Sensitivity

- Company's ability to sustain its revenue growth and profitability indicators, by diversifying its revenue mix and reducing its dependency on beedi segment
- Large investments in non-core businesses or any debt funded expansion plans, which could materially impact company's capital structure
- Adverse regulatory measure in beedi business

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:
Corporate Credit Rating Methodology
Fast Moving Consumer Goods Industry

About the Company:
Desai Brothers Limited, owned and managed by Pune based Desai family, is engaged in the manufacturing and selling of beedis under its trademark – 'Haribhai Desai. The company is one of the largest beedi manufacturers in India with a production capacity of around 7.0 crore sticks per day. Beedis account for about ~80% of total revenues. The Company diversified into ethnic food business in 2001 and acquired the 'Mother's Recipe' brand from American Dry Fruits Limited in 2002. The food division manufactures and distributes ethnic Indian processed foods like pickles, pastes, ready to cook, papads, curry power, chutney, ready to eat and spices in the domestic and exports markets. The company also has investment in Wind Mills. Majority of surplus funds of the company have been invested in liquid securities by their Treasury Department.

In July, 2013 the group ventured into hospitality through a wholly owned subsidiary (Savannah Hotels Private Limited) which is now merged in DBL with effect from 1st April 2015. The company owns a property in Whitefield, Bengaluru and operates a 102 room 4 Star Hotel on a management contract basis with Four Points by Sheraton. The company also acquired Gujarat based food company Brink Foods Private Limited in FY2017 which is majorly into wafers manufacturing business.

Key Financial Indicators:

	FY2016 (Audited)	FY2017 (Audited)
Operating Income (Rs. crore)	1144.5	1166.7
PAT (Rs. crore)	121.1	91.8
OPBDIT/ OI (%)	15.0%	13.4%
RoCE (%)	30.0%	22.0%
Total Debt/ TNW (times)	0.2	0.2
Total Debt/ OPBDIT (times)	0.7	1.0
Interest coverage (times)	8.7	9.0
NWC/ OI (%)	16%	19%

OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress);
NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	November 2017	FY2017	FY2016	FY2015
1	Fixed deposits	Medium term	100.00	-	[ICRA]MAA-/ Stable	[ICRA]MAA-/ Stable	[ICRA]MAA-/ Stable	MAA-
2	Fixed deposits	Medium term	50.00	-	[ICRA]MAA-/ Stable	-	-	-
3	Non fund based	Short term	25.00	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
	Total		**175.00**					

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 www.icra.in

Annexure-1

Instrument Details

Name of Instrument	Date of Issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Crore)	Current Rating and Outlook
Fixed deposits	-	-	-	150.00	[ICRA]MAA- (Stable)
Short Term non fund based – Bank Guarantee	-	-	-	25.00	[ICRA]A1+
Total				**175.00**	

Source: Company Information

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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