June 12, 2023

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-1*

Rationale

The rating reaffirmation for Desai Brothers Limited (DBL) factors in its steady revenue growth in FY2023, healthy internal accrual generation and a comfortable capital structure, with minimal reliance on external bank debt. These factors have continued to result in a strong liquidity profile, with sizeable investments in quoted equity shares, mutual funds, bonds, and debentures, totalling to ~Rs. 982 crore as on March 31, 2023[1]. Additionally, the ratings continue 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 well-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.

The rating is, however, constrained by DBL's revenue concentration in a highly regulated *beedi* manufacturing industry on the back of health-related concerns. The diversification is expected to increase with growth in its snacks business, though the share of the snacks business is expected to remain below 15% of total revenue in the medium term. The company remains exposed to the regulatory risks from procurement of tendu leaves, sale, and distribution of *beedi*, along with the requisite packaging norms. It also faces intense competition from the unorganised sector. ICRA also notes the rising input cost with significant increase in raw material costs and the impact of adverse weather conditions on the quality of tendu leaves in the last two fiscals. Moreover, rise in raw material costs along with moderate increase in labour costs are expected to marginally impact the company's profitability, as it is unable to fully pass on the same, given the highly competitive intensity of the industry.

The Stable outlook on the rating reflects ICRA's opinion that the company will continue to benefit from its long operational track record and its established brands, 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 with a leading position in Rajasthan – DBL is one of the major players in the *beedi* manufacturing industry with a production capacity of about seven 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 to over 85% of its revenues of the *beedi* division. Despite competition from the unorganised *beedi* segment and other tobacco products, plus an operating environment characterised by restrictions on sales promotions for tobacco products, it has successfully maintained its market share owing to an established distribution network and strong brand loyalty.

Favourable financial profile – The company witnessed steady revenue growth of 15.8% in FY2023, supported by steady growth in *beedi* sales and healthy growth in the snacks division, on the back of increased management focus and a lower revenue

[1] Measured at cost and not at fair value.

base. DBL's RoCE (21-22% in FY2023) remains very strong, given the low capital intensity of the *beedi* business, though deployment of accruals in other ventures drags down the return indicators to an extent. The *beedi* business is labour-intensive with no major capex requirements, whereas incremental capex by DBL is primarily in the snacks division. The company's financial profile remains robust with estimated gearing of 0.2 times and a TD/OPBITDA at 1.0 times in FY2023, supported by healthy internal cash accruals. The debt mainly includes fixed deposits from shareholders and directors (one to three years) and the cumulative participating redeemable preference shares.

Strong liquidity profile – DBL has a strong liquidity profile, supported by healthy net cash accruals post any buyback/dividends and no debt repayments. It had substantial investments of mutual funds, equity shares, bonds of Rs. 982 crore as on March 31, 2023.

Credit challenges

Competition from unorganised sector in *beedi* segment – The volume sale of *beedi* has been impacted in the last few years owing to the competition from low-cost *beedis* in the unorganised sector. The unregistered and counterfeit producers sell the product 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 prevent counterfeiting and maintain its market share.

High revenue concentration of *beedi* business; vulnerability to Government policies, regulations and growing health awareness – DBL generates ~89% of total revenue from the *beedi* division and ~10% of revenue 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 grow at a faster pace, supported by increased capacity and the management 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 total revenue in the medium term. With the consumption of *beedis* being 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 i.e., tendu leaves, is also regulated by the Government.

High input costs likely to impact profitability – The considerable firming up of key raw materials (tendu leaves & tobacco) and labour costs have exerted pressure on the company's profitability, given its inability to fully pass on the same to its customers. Moreover, erratic spells of rain during the procurement season in the current fiscal is also expected to impact the quality of leaves, resulting in relatively lower production yield and increased costs.

Liquidity position: Strong

DBL's liquidity is **strong**, supported by healthy cash/bank including FD balance of Rs 66.5 crore and investments in mutual funds, bonds and equity share amounting to Rs. 982 crore as on March 31, 2023 (values at cost). Moreover, fund flow from operations is expected to remain healthy at Rs. 130-150 crore and minimal capex of ~Rs. 8-10 crore planned in FY2024 will 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 led by diversification in its business profile.

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

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	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, Desai Beedi. The company is one of the largest *beedi* manufacturers in India with a production capacity of around seven 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. Most of its surplus funds have been invested in mutual funds and listed equity shares by the treasury department.

Key financial indicators (audited)

DBL – Standalone	FY2021	FY2022	FY2023*
Operating income	1200.8	1349.9	1562.7
PAT	208.6	173.2	255.5
OPBDIT/OI	22.9%	17.9%	19.0%
PAT/OI	17.4%	12.8%	16.4%
Total outside liabilities/Tangible net worth (times)	0.5	0.4	-
Total debt/OPBDIT (times)	1.0	1.2	-
Interest coverage (times)	9.0	7.4	-

*PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; Source: Company, ICRA Research, All ratios as per ICRA calculations. * Provisional and abridged financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years				
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Mar 31, 2023 (Rs. crore)	Date & Rating in	Date & Rating in FY2023			Date & Rating in FY2022	Date & Rating in FY2021
					Jun 12, 2023	Jul 20, 2022	Jun 8, 2022	Apr 27, 2022	Apr 29, 2021	-
1	**Fixed Deposits**	Long-term	240.00	203.8	**[ICRA]A+ (Stable)**	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	MAA- (Stable)	MAA- (Stable)	-
2	**Letter of Credit and Bank Guarantee**	Short-term	-	-	-	[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 No.	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 22 6114 3442
kinjal.shah@icraindia.com

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

Pawan Mundhra
+91 20 6606 9918
pawan.mundhra@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

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.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches