

Lakshmi Tobaccos

April 13, 2018

Rating

Facilities	Amount (Rs. crore)	Rating ¹	Rating Action
Long-term Bank Facilities	9.90	CARE B+; Stable (Single B Plus; Outlook: Stable)	Assigned
Total	9.90 (Rupees Nine crore and Ninety lakh only)		

Details of facilities in Annexure-1

Detailed Rationale & Key Rating Drivers

The rating assigned to the bank facilities of Lakshmi Tobaccos (LT) are tempered by small scale of operations, leveraged capital structure and weak debt coverage indicators, declining profitability margins, working capital intensive nature of operations due to high inventory holding period, vulnerability to government regulations, climatic risks and proprietorship nature of constitution with inherent risk of withdrawal of capital. The rating, however, derives strength by long track record and experience of the proprietor for more than three decades in tobacco business, growth in total operating income during the review period, favorable location for operating tobacco business and stable outlook of tobacco industry.

Going forward, ability of the firm to increase its scale of operations and improve profitability margins and to manage working capital requirements efficiently would be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Weaknesses

Small scale of operations with low net worth base

The firm has a track record of around eighteen years, however, the total operating income (TOI) of the firm remained low at Rs.40.36 crore in FY17 with a low net worth base of Rs.3.76 crore as on March 31, 2017 as compared to other peers in the industry.

Leveraged capital structure and weak debt coverage indicators

The capital structure of the firm marked by debt equity and overall gearing stood leveraged during the review period. However, the debt equity and the overall gearing of the firm improved from 1.04x and 3.15x respectively as on March 31, 2015 to 0.38x and 2.82x as on March 31, 2017 due to increasing net worth at the back of accretion of profits to reserves. The PBILDT interest coverage ratio has deteriorated from 1.43x in FY 15 to 1.23x in FY17 due to increase in interest cost at back of high utilization of working capital limits. The total debt to GCA (TD/GCA) has deteriorated from 45.63x in FY15 to 51.40x in FY17 due to decrease in gross cash accruals (GCA) levels.

Declining profitability margins

Profitability margins of the firm are seen declining during the review period. The PBILDT margin of the firm has decreased from 4.39% in FY15 to 3.74% in FY17 due to increase in raw material cost. The PAT margin has been declining year-on-year from 0.92% in FY15 to 0.48% in FY17 due to increase in interest cost at back of availing term loans and increase in

¹Complete definition of the ratings assigned are available at www.careratings.com and other CARE publications

utilization of working capital bank facilities as the operations of the firm are working capital intensive owing to trading nature of business.

Vulnerability of the tobacco business to government regulations and to climatic risks affecting tobacco availability

Tobacco products form a major source of revenue in the form of taxes to both central as well as state government and hence there are regular modifications in taxation laws/tax rates with respect to the same. Due to the harmful nature of the product, the various state governments have banned

Manufacture and sale of various tobacco products under the Food Safety and Standards (Prohibition and Restrictions on Sales) Regulations, 2011 and availability of tobacco is highly susceptible to the factors like area under cultivation, Climatic risk, crop yield. Hence, the profitability margins of the firm are vulnerable to government regulations on tobacco products and availability of tobacco.

Working capital intensive nature of operations due to high inventory holding period

The firm has working capital intensive nature of operations due to high inventory holding period. Owing to trading nature of business and availability of tobacco is seasonal in nature (susceptible to climatic risks), the firm has to buy the tobacco depending on availability. Due to market demand fluctuations, the firm holds the inventory till it gets better pricing. Hence the firm has elongated inventory holding period of 106 days in FY17.

As the firm is purchasing Virginia tobacco (VFC) on auction platforms, the average creditor's payment period is 7-10 days. The firm also purchases Virginia tobacco (VFC) from small dealers and pays within 1 month from the date of invoice. However for purchase of Non-VFC from farmers the firm pays within 1-7 days from the date of invoice. The firm receives the payment from its customers within 1-15 days from the date of invoice. The operating cycle of the firm is stood at 81 days in FY17. Average working capital utilization of the firm during the last 12 months period ended 28st February 2018 is 85%.

Proprietorship nature of constitution with inherent risk of withdrawal of capital

Constitution as a proprietorship has the inherent risk and possibility of withdrawal of capital at a time of personal contingency which can adversely affect the capital structure of the firm. Furthermore, proprietorships have restricted access to external borrowings as credit worthiness of the proprietor would be a key factor affecting the credit decision of lenders.

Key Rating Strengths

Long track record and experience of the Proprietor for more than three decades in tobacco business

Lakshmi Tobaccos (LT) was established in 2000 as a proprietorship firm, by Mr.S.Narayana Rao. Mr.Jayakumar is a graduate (B.Sc) and having around 35 years of experience in same line of business. The above factor helped the firm in approaching tobacco boards for purchasing tobacco in auction platforms and to establish relationship with customers.

Growth in total operating income during the review period

The total operating income of the firm increased steadily y-o-y at a CAGR of 32.18% i.e., from Rs.23.10 crore in FY15 to Rs.40.36 crore in FY17, at back of increase in sales volume supported by enhanced working capital limits as the operations of the firm are working capital intensive coupled with repetitive orders from existing customers. The firm is also deriving strength to increase sales value by further processing the Virginia tobacco, which involves conditioning of tobacco with heat and moisture, and finally re-drying the Virginia tobacco. Through this process, the firm can store the tobacco and sell the same when the market demand is high.

Favorable location for doing tobacco business

The firm has ease of approaching the suppliers of tobacco as the firm is having its administrative office cum godown at Tangutur (Andhra Pradesh) which is located in the major tobacco growing area in Andhra Pradesh.

Stable outlook of tobacco industry

Cigarettes currently represent one of the most popular forms of tobacco, accounting for nearly 90% of the global tobacco sales value. The global cigarette market today represents a multi-billion dollar market and according to IMARC group, its total revenues reached values worth US\$ 816 Billion in 2017, representing a CAGR of around 7% during 2009-2017. Despite falling volumes in developed markets as a result of an increasing awareness on the harmful effects of cigarette smoking, manufacturers have been able to increase value growth. Factors driving the cigarette market include a continuous increase in the prices of cigarettes and an increasing popularity of premium products. Another major factor driving the growth is the rising consumption of cigarettes in developing countries. Owing to the aforementioned reasons, the outlook for tobacco industry looks stable for the medium term.

Analytical Approach: Standalone

Applicable Criteria

[Criteria on assigning Outlook to Credit ratings](#)

[CARE's Policy on Default Recognition](#)

[Financial ratios – Non-Financial Sector](#)

[Rating Methodology - Wholesale Trading](#)

About the firm

Andhra Pradesh based, Lakshmi Tobaccos (LT) was established in the year 2000 as a proprietorship concern by Mr.S.Narayana Rao. Lakshmi Tobaccos (LT) is an authorized licensed dealer in tobacco registered with Tobacco Board for trading of Virginia tobacco (VFC). LT is mainly engaged in trading of Virginia tobacco. The firm also does trading of Non-VFC tobacco. The firm purchases the raw material i.e., Wet Virginia tobacco through the competitive bidding process conducted by Tobacco Board (TB) at Andhra Pradesh location. The TB collects the tobaccos from farmers, who are licensed holder to grow any particular tobacco. Further, these tobaccos are put in tender process. After successfully winning the tender, the firm processes the Virginia tobacco manually by separating the tobacco leaves, with the help of local contractual workers. After separation of tobacco leaves, the firm outsources the process like threshing. Threshing process involves conditioning of tobacco with heat and moisture, and finally re-drying the Virginia tobacco. The processing unit for separation of tobacco leaves is located at Tangutur which is 20 km away from Ongole, where tobacco is one of the major crops. The firm purchases Non-VFC tobacco from the local farmers. The firm sells the tobacco majorly to Maruthi Tobacco Suppliers.

Brief Financials (Rs. crore)	FY16 (A)	FY17 (A)
Total operating income	35.32	40.36
PBILDT	1.35	1.51
PAT	0.24	0.19
Overall gearing (times)	2.63	2.82
Interest coverage (times)	1.31	1.23

A-Audited

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not applicable

Rating History for last three years: Please refer Annexure-2

Note on complexity levels of the rated instrument: CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.

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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Cash Credit	-	-	-	9.90	CARE B+; Stable

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016	Date(s) & Rating(s) assigned in 2014-2015
1.	Fund-based - LT-Cash Credit	LT	9.90	CARE B+; Stable	-	-	-	-

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