CREDIT RATING REPORT

April 2022

Lotus Chocolate Company Limited

Rating Action

Total Bank Loan Facilities Rated	**Rs.80 million**
Long Term Rating	**CRISIL BB+/Stable (upgraded from CRISIL BB/Stable)**

1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Rating History

Date	Long Term Rating	Short Term Rating	Rating Watch/Outlook
Mar 15, 2022	CRISIL BB+	-	Stable
Dec 30, 2020	CRISIL BB	-	Stable
Sep 25, 2019	CRISIL BB	-	Stable
Mar 20, 2019	CRISIL B+	-	Stable

Detailed rationale

CRISIL Ratings has upgraded its rating on the long-term bank facility of Lotus Chocolate Company Ltd (LCCL) to 'CRISIL BB+/Stable' from 'CRISIL BB/Stable'.

The upgrade reflects LCCL's improved business and financial risk profile marked by nil term debt, minimal reliance on external borrowing for working capital requirement and support from the promoters in the form of non-interest bearing unsecured loans. Furthermore, the rollover of Rs 74 million - 10% redeemable cumulative preference shares (RCPS) with the redemption period of 10 years had received NCLT approval in July 2019.

Revenue moderated to Rs 479 million in fiscal 2021 (Fiscal 2020: Rs 699 million) due to the pandemic induced disruption in manufacturing and supply chain. However, operating margin improved to 5% in fiscal 2021 from 2.24% in fiscal 2020 driven by gross margin (which improved by 375 bps) with the company sourcing raw material from Kerala and Andhra Pradesh through long term contracts compared to sourcing from spot markets earlier. Also realizations for the products were higher in fiscal 2021.

Post normalization of business environment, company's performance has improved substantially with Rs. 608.1 million of revenue being recorded during the first nine months of fiscal 2022. Gross margins during the period has further improved by 281 bps owing to better realizations leading to operating margin of over 7% for the period.

LCCL is expected to exceed Rs 800 million in revenue for fiscal 2022 driven by steady demand while operating margin would be maintained around 7%.

The rating continues to reflect LCCL's long track record in the cocoa industry and the promoters' ongoing financial support. These strengths are partially offset by modest scale of operations, low networth and susceptibility to volatility in cocoa bean prices.

Key rating drivers

Strengths

- Longstanding presence in the cocoa and chocolate products industry.
- Access to need-based financial support from promoters.

Weaknesses

- Modest scale of operations.
- Limited pricing power and susceptibility to volatility in cocoa bean price.
- Modest financial risk profile.

Outlook: Stable

CRISIL believes LCCL will continue to benefit from its long track record in the industry, established relationship with key customers, forthcoming promoter support and low reliance on external debt.

Rating sensitivity factors

Upward factors

- Sustained revenue growth of over 10% at margins of over 7% resulting in improved cash generation.
- Improvement in networth and sustenance of adequate debt protection metrics.

Downward

- Steep increase in debt due to large capex or working capital resulting in interest cover of less than 1.5 times and stretch in liquidity.
- Steep decline in revenues and margins impacting cash generation.
- Change in stance of promoter support.

Liquidity: Adequate

Liquidity is adequate, driven by promoter support which has enabled the company to manage operations and fund losses, nil long term debt obligations and low external debt. Going forward, cash accrual is expected at around Rs 30-40 million per annum over the medium term against which the company has no term debt obligation. Bank limit utilisation was low at less than 30% for the 12 months through February 2022. Liquidity is likely to remain adequate supported by largely unutilised bank lines and continued promoter support.

About the company

Incorporated in 1988 and promoted Mr Prakash Pai (managing partner of Puzzolana Machinery Fabricators) and his brother, Mr Ananth Pai, LCCL processes cocoa beans into cocoa powder and cocoa butter, and also sells chocolates under the Lotus brand. Head office is in Hyderabad and manufacturing unit in Medak, Andhra Pradesh.

<u>The ratings reflect the following strengths:</u>

Longstanding presence in the cocoa and chocolate products industry

LCCL has been in the cocoa and chocolate products industry for 25 years. It has established strong relationship with reputed customers such as Amul (Kaira District Co-operative Milk Producers' Union Ltd), Mother Dairy Fruit & Vegetable Pvt Ltd and Parle Products Pvt Ltd.

Access to need-based financial support from promoters

The promoters have infused Rs 116.3 million into the business as of March 31, 2021. Hence, despite cash losses in the past, the company has been able to meet capital expenditure (capex) and incremental working capital requirement without resorting to bank borrowing. The promoters will, likely, continue to extend support whenever necessary as demonstrated in the past.

These strengths are partially offset by the following weaknesses:

Modest scale of operations

Despite having commenced operations in 1988, LCCL remains a modest player in the cocoa and chocolate industry, as reflected in revenue of Rs 550-650 million over the seven fiscals through 2020. The seasonal nature of key raw material, cocoa beans, and the management's conservative stance towards debt for building cocoa bean reserves during the off-season have resulted in low capacity utilisation. However, with expansion into new product segments and gradual ramp-up in capacity utilisation, revenue is expected to grow at a steady pace over the medium term. Revenues are expected to cross Rs. 800 million during fiscal 2022. Scale may, nevertheless, remain modest.

Limited pricing power and susceptibility to volatility in cocoa bean price

Operating margin is susceptible to volatility in cocoa bean price. This is compounded by the company's inability to fully pass on any increase in price to customers due to intense competition and modest scale. Hence, operating profitability was low at 2-4% over the past five fiscals. However, with improvement in realizations, change in method of product sourcing and better operating leverage owing to increasing scale, margins have improved to around 7% during the first nine months of fiscal 2022. However, margins will remain susceptible to input price volatility and limited pricing power.

Modest financial risk profile

Financial risk profile is modest marked by low net worth due to accumulated losses in the past. Networth is likely to remain low over the medium term because of modest scale and limited accretion to reserves. However, dependence on external debt is expected to be nominal owing to modest capex and continued funding support from promoters. Hence, interest coverage and net cash accrual to total debt ratios are expected to be healthy at over 10 times and 0.50 times, respectively over the medium term.

Key Financial Indicators (Standalone)

As on for the year ended March 31	Unit	2021	2020	2019
		Actuals	**Actuals**	**Actuals**
Net Sales	Rs Million	479	699	657
Operating Income	Rs Million	479	699	657
OPBDIT	Rs Million	24	16	20
PAT	Rs Million	17	9	13
Net Cash Accruals	Rs Million	24	15	20
Equity Share Capital	Rs Million	128	128	128
Adjusted Networth	Rs Million	(0.4)	(18)	(28)
Adjusted Debt	Rs Million	64	32	28

OPBDIT Margins	%	5.00	2.24	3.02
Net Profit Margins	%	3.60	1.26	2.03
ROCE	%	46.83	116.21	
PBDIT / Int. & Finance Charges	Times	12.45	8.23	13.47
Net Cash Accruals / Adjusted Debt	Times	0.37	0.48	0.71
Adjusted Debt / Adjusted Networth	Times	(143.57)	(1.73)	(1.01)
Adjusted Debt / PBDIT	Times	2.62	1.96	1.38
Current Ratio	Times	2.28	2.36	2.51
Cashflow from operations	Rs Million		22	5
TOL/ ANW	Times	(239.7)	(5.42)	(3.40)
Operating Income/Gross Block	Times	2.10	3.07	2.89
Gross Current Assets days	Days	146	94	98
Debtor Days	Days	72	35	38
Inventory Days	Days	74	48	58
Creditor Days	Days	32	35	35

In the first nine months of fiscal 2022, net profit after tax was Rs 40.2 million on net sales of Rs 608.1 million, against a net profit of Rs 10 million on net sales of Rs 300 million in the previous corresponding period.

Annexure 1: Bank-Details of Facility Classes

1.Cash Credit

Bank	**Amount (Rs.Mn.)**	**Rating**
Canara Bank	80.0	CRISIL BB+ / Stable
Total	80.0	-