Dodla Dairy Limited

March 25, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based -Term Loan	45.00	70.00	[ICRA]A+(Positive); Reaffirmed
Fund-based – Cash Credit*	72.50	72.50	[ICRA]A+(Positive)/A1+; Reaffirmed
Short-term fund based limits	30.00	30.00	[ICRA]A1+; Reaffirmed
Unallocated Limits	62.00	37.00	[ICRA]A+(Positive); Reaffirmed
Total	**209.50**	**209.50**	

*Cash credit interchangeable with short-term loans

Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings takes into account Dodla dairy Limited's (DDL) the recent debt funded acquisition of processing plant of KC Diary Products Pvt. Ltd for a total consideration of Rs. 103 crore which provides an entry into central Tamil Nadu. The company availed US $ 15 million (equivalent to Rs. 110 crore) of INR denominated NCD from International Finance Corporation (IFC) out of which first tranche of ~Rs. 55 crore was disbursed in February 2019. The remaining Rs 55 crore will be disbursed in November 2019. Meanwhile, DDL has liquidated its mutual fund investments to the tune of Rs. 41 crore to fund the acquisition. Further, the new milk processing unit at Rajahmundry commenced operations in March 2019; with this, the overall, installed milk processing capacity of DDL increased to 17.05 lakh liters per day (LLPD) from 12.55 LLPD. The rating also favorably takes into account the moderation in raw milk prices during current flush season which resulted in improved profitability to 7.90% in 9MFY2019 from 7.0% in FY2018. The positive outlook reflects ICRA's expectation of sustained improvement in DDL's liquid milk business over the medium term supported by increased milk procurement by entering into new geographies and considerable improvement in the capital structure post IPO (expected by Q2FY2020) on account of networth augmentation and prepayment of debt.. The ratings continue to factor in the well-established position of the Dodla brand and its diversified presence across the districts of Andhra Pradesh (AP), Karnataka and parts of Tamil Nadu (TN) and Telangana. DDL's established procurement base supported by a wide network of bulk coolers and chilling centres helps it maintain a steady source of liquid milk from dairy farmers. The ratings also draw comfort from the favourable growth prospects given the low penetration of the organized sector in the dairy industry. DDL's entry into newer geographies and its ability to develop value-added products are crucial for sustaining the current growth momentum. The ratings favorably take into account the growth in liquid milk volumes to 22.14 LLPD in 9MFY2019 owing to its entry into newer geographies, expanding customer and milk procurement base. This coupled with significant growth in curd sales, enabled DDL to report Operating Income (OI) in 9MFY2019 to Rs. 1,187.2 crore. The ratings also draw comfort from the healthy financial profile of the company characterized by robust capital structure with low gearing of 0.2 times, strong debt coverage indicators with interest coverage of 13.1 times, TOL/TNW of 0.7 times and comfortable liquidity position with unencumbered liquid surplus of ~Rs. 83 crore as on December 31, 2018.

The ratings, however, are constrained by the commoditised nature of operations, intense competition from organised co-operatives, private sector and unorganised players may negatively impacts the ratings. Also, the company's vulnerability to external factors such as weather and disease outbreaks affects the ratings. Given the stiff competition from milk cooperatives – especially in Karnataka and TN (which account for around half of its turnover) – DDL's pricing flexibility in these markets is constrained by its existing high price differential with milk co-operatives in these states. Nonetheless, the company has been largely able to pass on the hike in input costs in the past. Further, the proportion of value added products decreased in overall revenue mix to 29% in FY2018 from 33% in FY2017 due to decrease in sales of butter and ghee as the prices for the same has increased after the implementation of GST. The sustainability of revenues from value-added products remains to be seen. While the current acquisition had led to increase in debt levels and depletion of liquid reserves, the operational nature of the acquired plant with readily available market along with healthy cash generation from existing operations provides comfort. That said, going forward, any sizeable debt funded capex would remain a key rating sensitivity. ICRA notes that DDL's international operations (Lakeside Dairy Limited) are self-sufficient and no funding support from DDL is envisaged going forward.

Outlook: Positive

The positive outlook factors in the ICRA's expectation of sustained improvement in DDL's liquid milk business over the medium term supported by increased milk procurement by entering into new geographies. Further, the moderation in raw milk prices during current flush season is expected to result in improved profitability. The outlook may be revised to Stable in case of deterioration of debt coverage indicators on account of debt funded capex/ acquisition or if the operational performance is worse than expected and/or significant funding support to foreign subsidiaries. Its capex plans, IPO timelines and the impact of the same on the capital structure will be closely monitored.

Key rating drivers

Credit strengths

Healthy growth in OI: DDL's liquid milk volumes witnessed a growth to 22.14 LLPD in 9MFY2019 owing to its entry into newer geographies, expanding customer and milk procurement base. This coupled with significant growth in curd sales, enabled DDL to report Operating Income (OI) in 9MFY2019 to Rs. 1,187.2 crore.

Established brand in southern India and favourable growth prospects: The Dodla brand is well established in the liquid milk segment of southern India and has diversified presence across the districts of AP, Karnataka and parts of Tamil Nadu and Telangana combined with favourable growth prospects given the low penetration of the organised sector in the dairy industry.

Robust capital structure and coverage indicators: The ratings draw comfort from the healthy financial profile of the company characterized by robust capital structure with low gearing of 0.2 times, strong debt coverage indicators with interest coverage of 13.1 times, TOL/TNW of 0.7 times and comfortable liquidity position with unencumbered liquid surplus of ~Rs. 83 crore as on December 31, 2018.

Acquisition of KC Diary: DDL has acquired the business of KC Diary Products Pvt. Ltd, hence increasing its production capacity by 12.5 LLPD to 17.05 LLPD. The acquisition gave Dodla access to strong operating network of KC Diary in Madurai and other nearby places, hence establishing stronger network in central Tamil Nadu region.

Established procurement network: DDL's wide procurement base ensuring regular supply of milk at competitive prices from farmers, supplemented by a wide network of bulk coolers and chilling centres. After the commencement of operations of Rajahmundry plant and acquisition of KC diary, the company has 14 plants with a milk processing capacity of 17.05 LLPD, 51 milk chilling centres and 15 bulk milk coolers in an around its procurement area.

Credit challenges

Stiff competition from other players: This business has commoditised nature of operations with strong competition from organised co-operatives, private diaries and unorganised players and its vulnerability to external factors such as weather and disease outbreaks.

Decrease in revenues from value-added products: The proportion of value added products decreased in overall revenue mix to 29% in FY2018 from 33% in FY2017 due to decrease in sales of butter and ghee as the prices for the same has increased after the implementation of GST. The sustainability of revenues from value-added products remains to be seen.

Little control over procurements costs: The company has little control over the procurement costs of liquid milk as these are impacted by intense competition from state-owned milk co-operatives and other private dairies and low switching costs for farmers. In Karnataka and TN, which account for around half of DDL's turnover, the pricing flexibility for the company is constrained given the existing high price differential between the milk co-operatives and DDL's consumer pack price.
Depletion of liquid reserves: DDL has liquidated its mutual fund investments to the tune of Rs. 41 crore to fund the acquisition of KC Diary. However, the operational nature of the acquired plant with readily available market along with healthy cash generation from existing operations provides comfort.

Liquidity Position:

The liquidity position of the company remains comfortable with liquid surplus of Rs. 83 crore as on December 31, 2019 Further, the average utilisation of working capital limits stood at 38% from July 2017 to December 2018, strengthening liquidity position of the company. DDL has principal repayment obligation of Rs. 8.3 crore for FY2020.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation / Standalone	Consolidated

About the company:

Incorporated in 1995, Dodla Dairy Limited (DDL) is promoted by Mr. D. Sesha Reddy and Mr. D. Sunil Reddy. The company is involved in processing and sale of milk and milk products under the Dodla brand with a market presence predominantly in four southern states viz. Andhra Pradesh, Karnataka, Tamil Nadu and Telangana. In July 2017, TPG Dodla Dairy Holdings Pvt. Ltd. acquired 27% stake in Dodla. At present, the promoters hold 73% stake and the remaining 27% stake is held by TPG Dodla Dairy Holdings Pvt. Ltd. DDL has 14 processing and packaging units with a processing capacity of 17.05 lakh litres per day, including processing capacity of recently acquired KC Diary. DDL also entered into the markets of Uganda in Fiscal 2015 with the acquisition of operations of Hillside Dairy and Agriculture Ltd. by their subsidiary Lakeside Dairy Ltd. The unit runs at a milk processing unit with 1 LLPD capacity and currently it is producing around 45000 LPD. The revenues in FY2018 from this subsidiary was around Rs 53 crore with an EBITDA of around Rs. 5 crore.

Key financial indicators – DDL (Consolidated)

	FY2017 Audited	FY2018 Audited
Operating Income (Rs. crore)	1,410.00	1,590.50
PAT (Rs. crore)	45.9	57.1
OPBDIT/OI (%)	6.2%	7.0%
RoCE (%)	21.70%	21.00%
Total Debt/TNW (times)	0.5	0.4
Total Debt/OPBDIT (times)	1.6	1.2
Interest coverage (times)	10.8	10.8

Source: DDL

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the past 3 years					
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating March 2019	Date & Rating September 2018	Date & Rating in FY2018 October 2017	Date & Rating in FY2017 December 2016	Date & Rating in FY2017 May 2016	Date & Rating in FY2016 April 2015
1	Term Loan	Long Term	70.00	70.00	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)
2	Cash Credit	Long Term/ Short Term	72.50	72.50	[ICRA]A+ (Positive)/ A1+	[ICRA]A+ (Positive)/ A1+	[ICRA]A+ (Stable)/A1 +	[ICRA]A+ (Stable)/ A1	[ICRA]A- (Positive)/ A2+	[ICRA]A- (Stable)/ A2+
3	Short-term fund-based	Short Term	30.00	30.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A2+	[ICRA]A2+
4	Unallocated limits	Long Term	37.00	37.00	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A- (Positive)	[ICRA]A- (Stable)

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

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan	Feb-2015	9.75%	Oct-2021	45.00	[ICRA]A+(Positive)
NA	Term Loan	Feb-2019	9.40%	Nov-2022	25.00	[ICRA]A+(Positive)
NA	Cash Credit	-	-	-	72.50	[ICRA]A+(Positive)/A1+
NA	Short-term Fund-based	-	-	-	30.00	[ICRA]A1+
NA	Unallocated limits	-	-	-	37.00	[ICRA]A+(Positive)

Source: DDL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Lakeside Dairy Limited	100%	Full Consolidation

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