May 24, 2019 Revised

Dodla Dairy Limited: Ratings assigned for Non-convertible Debenture Programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	0.00	110.0	[ICRA]A+(Positive); Assigned
Fund-based - Term Loan	70.00	70.00	[ICRA]A+(Positive); Outstanding
Fund-based - Cash Credit#	72.50	72.50	[ICRA]A+(Positive)/[ICRA]A1+; Outstanding
Short-term Fund-based Limits	30.00	30.00	[ICRA]A1+; Outstanding
Unallocated Limits	37.00	37.00	[ICRA]A+(Positive); Outstanding
Total	**209.50**	**319.50**	

#Cash credit interchangeable with short-term loans
**Instrument details are provided in Annexure-1*

Rationale

The ratings take into account Dodla Dairy Limited's (DDL's) recent debt-funded acquisition of business and brands of KC Dairy Products Private Limited for a total consideration of Rs. 108 crore, providing it an entry into central Tamil Nadu (TN). The company availed US$ 15 million (equivalent to Rs. 110 crore) of INR-denominated NCD from International Finance Corporation (IFC), out of which the first tranche of ~Rs. 55 crore was disbursed in February 2019. The remaining Rs. 55 crore may be disbursed in or before 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, DDL's overall installed milk processing capacity increased to 17.38 lakh litre per day (LLPD) from 12.75 LLPD. The ratings also favourably take into account the moderation in raw milk prices during the current flush season, which resulted in an improved profitability to 7.20% in FY2019 from 7.0% in FY2018.

The Positive outlook reflects ICRA's expectation of a sustained improvement in DDL's liquid milk business over the medium term. This would be supported by increased milk procurement by entering into new geographies and considerable improvement in the capital structure post IPO (expected by Q2 FY2020), on account of net worth 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 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 organised 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 favourably take into account the growth in liquid milk volumes to 21.93 CL(crore litre) in 9M FY2019 owing to its entry into newer geographies, and expanding customer and milk procurement base. This, coupled with a significant growth in curd sales, enabled DDL to report an operating income (OI) of Rs. 1,597 crore in FY2019 (provisional). The ratings also draw comfort from the company's healthy financial profile, characterised by robust capital structure with low gearing of 0.4 time, strong debt coverage indicators with interest coverage of 10.7 times and TOL/TNW of 0.9 time, and comfortable liquidity position with an unencumbered liquid surplus of ~Rs. 39.8 crore as on March 31, 2019.

The ratings, however, are constrained by the commoditised nature of operations and the intense competition from organised co-operatives, and private-sector and unorganised players. Also, the company's vulnerability to external factors, such as weather and disease outbreaks, affects the ratings. Given the intense competition from milk co-operatives, especially in Karnataka and TN (which account for around half of its turnover), DDL's pricing flexibility is constrained by its existing high price differential with the milk co-operatives. Nonetheless, the company has primarily passed on hikes in input costs in the past. Further, the proportion of value-added products decreased in the overall revenue mix to 29% in FY2018 from 33% in FY2017 due to decrease in sales of butter and ghee, the prices for which have increased after the implementation of Goods and Services Tax (GST). The sustainability of revenues from value-added products remains to be seen. While the current acquisition 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. 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 ICRA's expectation of a 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 the 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 in case of significant funding support to foreign subsidiaries. Its capex plans, IPO timelines and their impact 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 21.93 CL in 9M FY2019 owing to its entry into newer geographies, and expanding customer and milk procurement base. This, coupled with significant growth in curd sales, enabled DDL to report an OI of Rs. 1,597 crore in FY2019(provisional).

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 TN and Telangana. It has 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 company's healthy financial profile, characterised by robust capital structure with low gearing of 0.4 time, strong debt coverage indicators with interest coverage of 10.7 times and TOL/TNW of 0.9 time, and comfortable liquidity position with an unencumbered liquid surplus of ~Rs. 39.8 crore as on March 31, 2019.

Acquisition of KC Dairy Products Private Limited brand and business - DDL has acquired the brand and business of KC Dairy Products Private Limited, increasing its production capacity by 12.75 LLPD to 17.38 LLPD. The acquisition gave it an access to the strong operating network of KC Dairy Products Private Limited in Madurai and other nearby places, hence establishing a stronger network in the central TN region.

Established procurement network - DDL has a 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 the Rajahmundry plant and the acquisition of KC Dairy Products Private Limited, the company has 13 plants with a milk processing capacity of 17.38 LLPD, 55 milk chilling centres and 18 bulk milk coolers in an around its procurement area.

Credit challenges

Intense competition from other players - The business has a commoditised nature of operations with strong competition from organised co-operatives, private dairies and unorganised players. It is also vulnerable to external factors, such as weather and disease outbreaks.

Decrease in revenues from value-added products - The proportion of value-added products decreased in the overall revenue mix to 29% in FY2018 from 33% in FY2017 due to decrease in sales of butter and ghee, the prices of which have 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, its pricing flexibility is constrained given the existing high price differential between the price set by 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 Dairy Products Private Limited. 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 company's liquidity position remains comfortable, with liquid surplus of Rs. 39.8 crore as on March 31, 2019. Further, the average utilisation of working capital limits stood at 38% from July 2017 to December 2018, strengthening the liquidity position. DDL has a principal repayment obligation of Rs. 16.18 crore in FY2020.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	Consolidated; list of entities consolidated are provided in Annexure 2

About the company

Incorporated in 1995, Dodla Dairy Limited is promoted by Mr. D. Sesha Reddy and Mr. D. Sunil Reddy. The company processes and sells milk and milk products under the Dodla brand, with a market presence predominantly in four southern states viz. AP, Karnataka, TN and Telangana. In July 2017, TPG Dodla Dairy Holdings Private Limited acquired a 27% stake in DDL. At present, the promoters hold a 73% stake. DDL has 13 processing and packaging units with a processing capacity of 17.38 LLPD, including processing capacity of the recently acquired KC Dairy Products Private Limited. DDL also entered into the markets of Uganda in FY2015 with the acquisition of operations of Hillside Dairy and Agriculture Limited by its subsidiary, Lakeside Dairy Limited. The unit runs a milk processing unit with 1 LLPD capacity and currently produces ~52,000 LPD. The revenue in FY2018 from this subsidiary was ~Rs. 53 crore with an EBITDA of ~Rs. 7.2 crore.

Key financial indicators (Consolidated)

	FY2017 Audited	FY2018 Audited
Operating Income (Rs. crore)	1,440.00	1,590.50
PAT (Rs. crore)	45.3	57.1
OPBDIT/OI (%)	6.1%	7.0%
RoCE (%)	38.30%	21.00%
Total Debt/TNW (times)	0.5	0.4
Total Debt/OPBDIT (times)	1.6	1.2
Interest Coverage (times)	10.9	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 (FY2020)				Chronology of Rating History for the past 3 years				
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating May 2019	Date & Rating in FY2019 March 2019	September 2018	Date & Rating in FY2018 October 2017	Date & Rating in FY2017 December 2016	May 2016
1	NCD	Long Term	110	110	[ICRA]A+ (Positive)					
2	Term Loan	Long Term	70.00	70.00	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A- (Positive)
3	Cash Credit	Long Term/ Short Term	72.50	72.50	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A- (Positive)/ [ICRA]A2+
4	Short-term Fund-based	Short Term	30.00	30.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1	[ICRA]A2+
5	Unallocated Limits	Long Term	37.00	37.00	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)	[ICRA]A- (Positive)

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	NCD	Jan-2019	9.00%	Mar-2027	110.00	[ICRA]A+(Positive)
NA	Term Loan	Feb-2015	9.75%	Oct-2021	45.00	[ICRA]A+(Positive)
NA	Term Loan	Feb-2019	9.40%	Dec-2021	25.00	[ICRA]A+(Positive)
NA	Cash Credit	-	-	-	72.50	[ICRA]A+(Positive)/[ICRA]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

Corrigendum

Document dated May 24, 2019 has been corrected with revisions as detailed below:

- Acquisition cost of KC Dairy Products Private Limited changed to Rs. 108 crore from Rs. 103 crore earlier. Also acquisition of “processing plant” is replaced with “business and brands” in first line.
- Number of processing plants and installed capacity changed to 13 and 17.38 LLPD respectively from 14 and 17.05 LLPD earlier. Similarly, number of chilling centers was changed from 51 to 55 and bulk milk coolers from 15 to 18
- Liquid milk sales volume in 9MFY2019 revised to 21.93 CL from 22.14 LLPD
- Principal repayment obligation in FY2020 changed to Rs. 16.18 crore from Rs. 8.3 crore
- The milk production by Lakeside Dairy Limited updated to 52,000 LPD from 45,000 LPD and EBITDA for FY2018 changed to Rs.7.2 crore from Rs. 5 crore
- Key Financial Indicators: Consolidated numbers for FY2017 are given in place of standalone numbers
- In annexure 1, instrument maturity date is updated and NCD coupon rate changed from “9.2%” to “9.0%”

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