July 20, 2020

Dodla Dairy Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-convertible Debenture Programme	110.00	110.00	[ICRA]A+(Positive); Reaffirmed
Fund-based Term Loan	70.00	30.10	[ICRA]A+(Positive); Reaffirmed
Fund-based Cash Credit#	72.50	135.00	[ICRA]A+(Positive)/[ICRA]A1+; Reaffirmed
Short-term Fund-based Limits	30.00	40.00	[ICRA]A1+; Reaffirmed
Unallocated Limits	37.00	4.4	[ICRA]A+(Positive); Reaffirmed
Total	**319.50**	**319.50**	

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

Rationale

The reaffirmation of positive outlook for company's long-term rating reflects ICRA's expectation of improvement in profitability in FY2021, driven by the reduction in procurement price of raw milk as the Covid-19 pandemic lowered the demand from hotels and confectioneries for milk and milk products. With the decrease in the procurement price, and no consequent change in the selling price, the company registered an EBIDTA of Rs. 50.2 crore (Q1FY2020: Rs. 31.9 crore) on an operating income (OI) of Rs. 425.54 crore (Rs. 527.42 crore), resulting in an operating margin of ~12% in Q1FY2021 (as per provisional numbers). While the sales volume is likely to decline, the absolute profits for FY2021 are expected to improve.

The reaffirmation of ratings takes into account the 14% growth in the liquid milk sales volume (33.8 crore litre (CL) in FY2020 from 29.74 CL in FY2019), owing to its entry into newer geographies, and expansion in customer and milk procurement base. This coupled with a significant increase (24%) in milk products sales, enabled DDL to report 25% growth in the operating income (OI) in FY2020 (on a standalone basis) to Rs. 1987.6 crore from Rs. 1595.3 crore in FY2019. 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 wide procurement base, supported by a network of bulk coolers and chilling centres, helps it maintain a steady source of liquid milk from dairy farmers. The raw milk procurement volume increased by 13% to 41.3 crore litre (CL) in FY2020 from 36.6 CL in FY2019. The ratings further draw comfort from the healthy financial profile of the company, characterised by robust capital structure with low gearing of 0.3 times, strong debt coverage indicators with interest coverage of 9.2 times, TD/OPBDITA of 1.0 times as on March 31, 2020 on a consolidated basis. The liquidity position is comfortable, with unencumbered liquid surplus of ~Rs. 53.9 crore as on June 30, 2020 and average utilisation of 20% of fund-based limits for the fifteen-month period from January 2019 till March 2020. The ratings also draw comfort from the favourable long-term growth prospects, given the low penetration of the organised sector in the dairy industry. DDL's entry into newer geographies and its ability to improve sale of value-added products are crucial for sustaining the current growth momentum.

The ratings are, however, constrained by the inherent volatility in the liquid milk business, as reflected in the drop in the operating margin to 4.9% in FY2020 from 7.2% in FY2019 for standalone entity; on a consolidated basis the operating margin reduced to 6.9% in FY2020 from 7.8% for FY2019. The drop in margin was due to floods in major procurement regions of Dodla, which lowered animal fodder availability and consequently decreased raw milk produce. Low produce increased raw milk prices by 9.62% in Q4FY2020; the company was able to pass on the increase in raw milk prices to its customers partially (realisation increased by 3.93% in this period) with a lag. The ratings are also constrained by the commoditised operations and the intense competition from organised co-operatives, private-sector and unorganised players. Also, the company remains vulnerable to external factors, such as weather and disease outbreaks. Given the intense competition from milk co-operatives, especially in Karnataka and TN (which account for more than half of DDL's turnover), DDL's pricing flexibility could remain constrained by its existing high price differential with the milk co-operatives. In the past, the company was able to partially pass on the increase in input costs with a lag. The ratings further take into account the Rs. 21.7 crore invested by DDL in its wholly owned subsidiary, Orgafeed Pvt Ltd. DDL's international operations (Uganda and Kenya operations) are self-sufficient and no funding support from DDL is envisaged, going forward. ICRA notes that DDL incurred Rs. 76.9 crore capex in FY2020 on a standalone basis for regular maintenance and for setting up new chilling centres and bulk coolers. The capex was funded from the company's internal accruals. Further for FY2021, in addition to regular maintenance, the company plans to acquire a new processing plant for Indian operations at an estimated capex of Rs. 50 crore, to be funded from internal accruals. Additionally, it also plans to set up a new processing plant in Kenya at an estimated capex of Rs. 50 crore, to be funded partly through Rs. 10 crore debt raised at Lakeside Dairy Limited and the rest from existing funds from Dodla Holding Pte Ltd; no incremental fund outflow is envisaged from the Indian entity towards its African operations.

Key rating drivers and their description

Credit strengths

Improvement in profitability in Q1FY2021 – The profitability in Q1FY2021 improved, driven by the reduction in procurement price of raw milk as the Covid-19 pandemic lowered the demand from hotels and confectioneries for milk and milk products. With the decrease in the procurement price, and no consequent change in the selling price, the company registered an EBIDTA of Rs. 50.2 crore (Q1FY2020: Rs. 31.9 crore) on an OI of Rs. 425.54 crore (Rs. 527.42 crore) resulting in an operating margin of ~12% for Q1FY2021. While the sales volume is likely to decline, the absolute profits for FY2021 are expected to improve.

Healthy growth in OI driven by growth in milk volume sold – DDL's liquid milk volumes witnessed a growth of 14% to 33.8 CL in FY2020 from 29.74 CL in FY2019, owing to its entry into newer geographies and expansion in customer and milk procurement base. This coupled with a significant increase (24%) in milk products sales, enabled DDL to report 25% growth in the operating income (OI) in FY2020 (on a standalone basis) to Rs. 1987.6 crore from Rs. 1595.3 crore in FY2019. Further, DDL has registered impressive growth in turnover at a CAGR of 14.3% to Rs. 1987.6 crore in FY2020 from Rs. 1018.5 crore in FY2015.

Established brand in southern India with wide procurement base – The Dodla brand is a well-established name in the liquid milk segment of southern India and has diversified presence across districts of AP, Karnataka, and parts of TN and Telangana. It has favourable long-term growth prospects, given the low penetration of the organised sector in the dairy industry. Further, DDL's wide procurement base ensures regular milk supply at competitive prices from farmers and is supplemented by a wide network of 57 milk chilling centres and 16 bulk milk coolers. DDL procures milk from AP, Tamil Nadu, Karnataka and Telangana, which are closer to Hyderabad, Chennai and Bangalore markets. The raw milk procurement volume increased by 13% to 41.3 crore litre (CL) in FY2020 from 36.6 CL in FY2019.

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 0.3 times, strong debt coverage indicators with interest coverage of 9.2 times, TD/OPBDITA of 1.0 times as on March 31, 2020 on a consolidated basis. The liquidity position is comfortable, with unencumbered liquid surplus of ~Rs. 53.9 crore as on June 30, 2020 and average utilisation (20%) of fund-based limits for the fifteen-month period from January 2019 till March 2020.

Credit challenges

Inherent volatility in liquid milk business: The operating margin reported by the company is lower at 4.9% in FY2020 compared to 7.2% in FY2019 on a standalone basis owing to inherent volatility in the liquid milk business. On a consolidated basis the operating margin reduced to 6.9% in FY2020 from 7.8% for FY2019. The drop in margin was due to floods in major procurement regions of Dodla, which lowered animal fodder availability and consequently decreased raw milk produce. Low produce increased raw milk prices by 9.62% in Q4FY2020; the company was able to pass on the increase in raw milk prices to its customers partially (realisation increased by 3.93% in this period) with a lag.

Intense competition with limited pricing flexibility – The business has a commoditised nature of operations with intense competition from organised co-operatives, private dairies and unorganised players. This could also affect the procurement given the low switching costs for farmers. Further, the company remains vulnerable to external factors, such as weather and disease outbreaks. In Karnataka and TN, which account for more than half of DDL's turnover, DDL's pricing flexibility could remain constrained given the existing high price differential between the price set by milk co-operatives and DDL's consumer pack price. In the past, the company was able to partially pass on increase in input costs with a lag.

Liquidity position: Strong

DDL's liquidity is strong—it had unencumbered cash balance of Rs. 53.94 crore as on June 30, 2020 and 20% average utilisation (average cushion of Rs. 98 crore) against sanctioned fund-based limits for the fifteen-month period from January 2019 to March 2020. The debt repayment falling due for FY2021 is Rs. 23.3 crore, which can be comfortably met through cash flow from operations.

Rating sensitivities

Positive triggers – ICRA may upgrade DDL's rating if the company demonstrates a significant improvement in profitability while maintaining its scale.

Negative triggers – Negative pressure on the ratings may arise if any significant decline in revenue and profitability weakens debt protection metrics or significantly depletes liquid reserves. Specific credit metrics that could lead to a downgrade of ratings include TD/OPBDITA being above 1.75 time on a sustained basis.

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 14 LLPD. DDL also entered into the markets of Uganda in FY2015 through its subsidiary, Lakeside Dairy Limited with the acquisition of operations of Hillside Dairy and Agriculture Limited. The unit runs a milk processing unit with 1 LLPD capacity. The revenue in FY2020 from this subsidiary was ~Rs. 140.5 crore with an EBITDA of ~Rs. 42 crore on a provisional basis.

As per the unaudited financials, the company reported an operating income of Rs. 1987.6 crore with a net profit of Rs. 35.5 crore on a standalone basis. The consolidated OI and EBITDA are estimated at Rs. 2137.0 crore and Rs 148.2 crore respectively.

Key financial indicators (consolidated)

	FY2019	FY2020*
Operating Income (Rs. crore)	1688.8	2137.0
PAT (Rs. crore)	63.0	59.1
OPBDIT/OI (%)	7.8%	6.9%
PAT/OI (%)	3.7%	2.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	0.7
Total Debt/OPBDIT (times)	1.2	1.0
Interest Coverage (times)	12.3	9.2

*Source: DDL; * ICRA estimates based on unaudited standalone FY2020 financials*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020	FY2019		FY2018
					20-Jul-2020	24-May-2019	25-Mar-2019	20-Sep-2018	30-Oct-2017
1	NCD	Long Term	110.0	55.0	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)			
2	Term Loan	Long Term	30.10	30.10	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)
3	Cash Credit	Long Term/ Short Term	135.0	-	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Positive)/ [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+
4	Short-term Fund-based	Short Term	40.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
5	Unallocated Limits	Long Term	4.4	-	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)

Amount in Rs. crore

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
INE021O07016	NCD	Jan-2019	9.00%	Mar-2027	110.00	[ICRA]A+(Positive)
NA	Term Loan	Feb-2015	9.45%	Oct-2021	10.69	[ICRA]A+(Positive)
NA	Term Loan	Feb-2019	8.80%	Dec-2021	19.41	[ICRA]A+(Positive)
NA	Cash Credit	-	-	-	135.00	[ICRA]A+(Positive)/[ICRA]A1+
NA	Short-term Fund-based	-	-	-	40.00	[ICRA]A1+
NA	Unallocated Limits	-	-	-	4.40	[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
Dodla Holding Pte Ltd	100%	Full Consolidation
Dodla Dairy kenya Limited	99.9%	Full Consolidation
OrgaFeed Private Limited	100%	Full Consolidation
Global VetMed Concepts Pvt Ltd	47.94%	Equity Method

Source: DDL

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About ICRA Limited:

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