Venkateshwara Hatcheries Private Limited

November 05, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount	Current Rated Amount	Rating Action
Term Loan	Rs.311.87 crore	Rs.309.38 crore	[ICRA]BBB+(Stable); Upgraded from [ICRA]BBB(Stable)
Cash credit	Rs.239.50 crore	Rs.233.50 crore	[ICRA]BBB+(Stable); Upgraded from [ICRA]BBB(Stable)
Long term -unallocated	Rs. 6.13 crore	-	-
Short-term Loans	Rs. 350.00 crore	Rs. 364.62 crore	[ICRA]A2; Upgraded from [ICRA]A3+
Non-fund Based	Rs. 13.75 crore	Rs. 13.75 crore	[ICRA]A2; Upgraded from [ICRA]A3+
Total	**Rs. 921.25 crore**	**Rs. 921.25 crore**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating outstanding on the Rs. 309.38 crore (revised from Rs 311.87 crore) term loan facilities and Rs.233.50 crore (revised from Rs 239.50 crore) cash credit facilities of Venkateshwara Hatcheries Private Limited (VHPL / the company) from [ICRA]BBB (pronounced ICRA triple B) to [ICRA]BBB+ (pronounced ICRA triple B plus). The outlook on the long-term rating has remained 'stable'. ICRA has also upgraded the short-term rating outstanding on the Rs.364.62 crore (revised from Rs 350.00 crore) short-term loans and 13.75 crore short-term non-fund based facilities of VHPL from [ICRA]A3+ (pronounced ICRA A three plus) to [ICRA]A2 (pronounced ICRA A two).

Rationale

The ratings upgrade takes note of the strong improvement in profitability in FY2018 and H1FY2019 on the back of improved broiler realisations and muted feed costs; and the consequent improvement in liquidity profile, capitalisation and coverage indicators of the company. Supported by strong cash accruals in FY2018, VHPL's coverage indicators like total debt/OPBIDTA and interest-coverage improved to 1.7x (2.8x - FY2017) and 5.6x (3.1x – FY2017), respectively. ICRA believes VHPL's profitability indicators will sustain in current fiscal as well, which along with repayment of existing debt will further improve coverage indicators over the medium term.

The ratings continue to derive comfort from strong position enjoyed by the Venkateshwara Hatcheries (VH) group in the domestic poultry business on the back of fully integrated operations starting from 'Pureline breeding' to contract broiler farming and from animal healthcare products to captive feed mills. VH group has widest geographic presence in the domestic poultry industry and established relations with poultry farmers. The group has strong R&D capabilities and its broiler & layer breed command dominant market share in commercial poultry farming in the country on the back of proven operating parameters of the breed. VH group has presence in value added segments like animal healthcare products, poultry vaccines, SPF eggs and processed chicken providing stable revenue stream and better margins. ICRA also takes note of healthy long-term demand prospects for the domestic poultry industry because of favorable socio-economic factors.

The poultry industry has benefited from the favorable supply-demand scenario and muted feed prices resulting in lower production costs over last two years and consequent improvement in margins. Profitability for poultry business remains susceptible to volatile broiler realisations combined with seasonal nature of demand for the poultry products in India though industry is expected to sustain healthy performance in current fiscal as well. Given favorable monsoon, feed prices are expected to remain modest in the near term supporting margins for the industry though ensuring remunerative broiler realisations remain a sensitivity indicator for the industry.

The ratings, however, remain constrained by sizeable direct & indirect financial support provided to overseas subsidiaries and group companies in the form of equity investments, unsecured loans and corporate guarantees, (majorly to Blackburn Rovers football club and sister concern Uttara Foods and Feeds private Limited [UFFPL]), which constrains financial flexibility and drag overall return indicators. Incremental financial support to subsidiaries has increased in FY2018, which has partially offset benefits of improved profitability in the core Indian poultry business. ICRA believes that potential write-offs in these investments will significantly erode net-worth of VHPL. Overseas subsidiaries will continue to require support going forward which management intends to fund through group liquidity and sale of non-core assets without stressing operational cash flows of VHPL. Part of the financial support to these subsidiaries and sister concern was met through interest bearing unsecured loans from cash rich group company Venco Research and Breeding Farms Private Limited (VRBF) and other related parties along with preference shares infused by the promoters. UFFPL's operations have turned around in FY2018 and its entire long-term debt is refinanced with longer tenure loan, thereby allaying liquidity pressure at that entity. Going forward, extent and funding of such future financial support and impact of any write offs remain key concerns given size of investment vis-a-vis overall net-worth of the group.

VHPL's profitability remain susceptible to the volatility in feed prices, especially maize and soymeal. Moreover, perishable nature of product and seasonal demand pattern restricts pricing flexibility for industry participants. Driven by modest feed prices, the performance of various players in poultry sector has witnessed substantial turnaround over last two years after 3-4 years of weak performance. However, VHPL's ability materially reduce its debt level and contingent liabilities from current levels, remain crucial to sustain its credit profile during cyclical downturn.

Outlook: Stable

ICRA expects VHPL's credit profile to remain stable with satisfactory debt coverage indicators and healthy cash accruals. The outlook may be revised to Positive if there is sustainable reduction of investments in loss making subsidiaries and recovery of past investments done in these entities. The outlook may be revised to negative in case of a significant downturn in the Indian broiler industry due to global factors, substantial increase in raw material prices or weakening in market position, thereby materially impacting profitability and return indicators, which may have a bearing on the company's leverage indicators. Management has guided to support incremental funding in group companies by tapping liquidity from other cash rich group companies. Consequently, any incremental bank borrowing plans to support stressed group entities could result in downward rating pressure.

Key rating drivers

Credit strengths

Long standing experience of the group in poultry and poultry related business; Fully integrated poultry business with the group being the largest integrated poultry group in the country - The founder of VH group Mr.BV Rao is a pioneer in the Indian Broiler industry. With presence in the industry for over four decades, the group has developed its own variety of domestically adapted Cobb series – Vencobb 300, 400 and 400s, making it the dominant breed in the poultry market. Currently, Cobb commands two third market share as per the management. Further the group is vertically integrated with poultry feeds to processed chicken and animal health products.

Presence in higher value-added segments like vaccines yields higher margins - VHPL is a leading player in the domestic poultry vaccines market. It supplies to all its contract farms and other players who source cobb chicken. The PBIT margins in the vaccines segment was around 38% in FY2018 and this segment contributed to 7% of VHPL's revenues and 12% of VHPL's PBIT profits in FY2018. Presence in this segment support VHPL's overall contribution margins resulting in superior profits when compared to peers.

Strong R&D capabilities resulting in higher operating efficiencies, resulting in lower production costs- With well-developed research units (Venco Research and Venkateshwara Research), VH group's overall operating efficiencies have improved with lower feed requirement by way of better feed conversion ratio of 1.6-1.7 (Industry peers: 1.8-2) and lower mortality rates of chicks at 7% (industry peers: 6-8%)

Diversified geographic presence of broiler operations in the country along with strong share in layer market provides some cushion against volatility associated with the poultry business- VHPL has poultry farms in the southern, central and western regions of India. It has presence in over 15 Indian states directly. Apart from broilers, it has a strong presence in the layer industry also, resulting in favourable diversification

Strong improvement in profitability on back of lower feed costs and favourable realisations for broiler as well as related products like day old chick (DOC) and hatching egg (HE)- Domestic feed prices have remained stable over the last two years. Further, broiler realisations have improved following higher demand driven by rising disposable incomes and ban on illegal beef slaughtering. Poultry consumption is expected to grow by 7-8% in the near term driven by increase in fast food chains and other socio-economic factors.

Healthy long-term demand prospects for the poultry industry given favourable socio-economic factors- With rising income levels, higher disposable incomes and growing number of fast food outlets, demand for poultry meat is increasing.

Credit challenges

Sizeable unyielding investments amounting to ~Rs. 1500 crore and contingent liabilities including corporate guarantees of more than ~Rs. 500 crore given to loss making subsidiaries and sister concern – Majority of investments are yielding minimal or no returns, thereby dragging overall indicators. Moreover, given continuing losses in few of these subsidiaries, there could be possibility of write-offs in these investments which will materially impact net-worth of the company. The management has committed that any incremental group support will only be through unsecured loans from cash rich companies (e.g. Venco Research) or sale of non-operational assets and not through any incremental borrowings. Major support has been extended to Uttara Foods and Feeds (UFFPL) and Blackburn Rovers football club. Promoters along with VHPL infused funds to the tune of Rs.400 crore in UFFPL which resulted in turnaround of the company. UFFPL reported profits in FY2018 and management do not anticipate major incremental support from the group for the firm; however, the football club will continue to require funding support of Rs 140-150 crore, annually.

Exposed to high volatility in realisations on back of seasonal nature of demand; margins remain exposed to vagaries of demand supply scenario and product pricing in open market- Industry wide efforts to maintain broiler supply in market have resulted in improved operating environment which gets reflected in improved performance across all poultry players. Nevertheless, regulatory uncertainty like dumping from USA remains a challenge for industry's profitability. Management expects weak cold storage infrastructure as well as preference for live bird will continue to support performance of Indian players.

High susceptibility to raw material price fluctuations which largely consists of Maize and Soymeal; remain exposed to vagaries of agro climatic conditions and international demand supply scenario for same – Around 70% of total cost for the company is feed cost, which largely comprises of Soymeal and Maize. Prices of these commodities are driven by agro-climatic conditions and international prices.

Exposed to inherent industry risk of disease outbreak (bird flu) though regional outbreaks have marginal impact only – The industry is exposed to outbreak of diseases such as Avian Influenza (bird flu). However, any such occurrence is generally localised and shouldn't have any meaningful impact on overall domestic demand.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:

Corporate Credit Rating Methodology
Impact of Parent or Group Support on an Issuer's Credit Rating

About the company:

VHPL is a part of the VH group which is the largest and fully integrated poultry player in India with strong presence in poultry broiler as well as layer segment along with sizeable presence in value added segments like animal healthcare products and processed chicken. The VH group was promoted by late Dr. B.V. Rao and started its operations in 1971 as a sole franchisee in India of Babcock Farm Inc., USA. The group's operations span the entire spectrum of poultry activities from pure-line breeding, grandparent and parent breeding and sale of commercial day-old chicks (DOCs) to contract commercial farming.

The company derives 90% of its business from poultry and poultry products which majorly include commercial grown up birds (broilers), DOC, and processed chicken while rest comes from Vaccine and egg powder division.

In FY2018, at standalone level, VHPL recorded a PBT of Rs.690.9 crore on an operating income of Rs.4261.1 crore as against a PBT of Rs.404.6 crore on an operating income of Rs.3,855.2 crore in FY2017.

Key financial indicators (audited)

Standalone	FY2017	FY2018
Operating Income (Rs. crore)	3855.2	4261.1
PAT (Rs. crore)	227.6	427.0
OPBDIT/OI (%)	15.6%	19.7%
RoCE (%)	26.5%	35.9%
Total Debt/TNW (times)	2.2	1.3
Total Debt/OPBDIT (times)	2.4	1.7
Interest Coverage (times)	3.6	5.6

Source: Company Data, ICRA Research; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE:PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress)

Key financial indicators (VHPL+UIPL+UFFPL)

Combined	FY2017	FY2018
Operating Income (Rs. crore)	4,709.6	5,512.7
PAT (Rs. crore)	191.6	421.3
OPBDIT/OI (%)	12.8%	16.8%
RoCE (%)	23.4%	37.0%
Total Debt/TNW (times)	3.3	1.8
Total Debt/OPBDIT (times)	2.9	1.8
Interest Coverage (times)	3.1	5.1

Source: Company Data, ICRA Research; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE:PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress)

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Sr. No.	Instrument	Type	Current Rating (FY2019)			Chronology of Rating History for the past 3 years			
			Amount Rated (Rs. Cr)	Amount Outstanding (Rs. Cr) *	Date & Rating in FY2019 Nov 2018	Date & Rating in FY2018 Nov 2017	Date & Rating in FY2017 Mar 2017	Nov 2016	Date & Rating in FY2016 Sep 2015
1	Term Loan	Long-term	Rs.309.38 crore	Rs.283.15 crore	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
2	Cash credit	Long-term	Rs.233.50 crore	Rs.186.31 crore	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
3	Unallocated	Long-term	-	-	-	[ICRA]BBB (Stable)	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB (Stable)
4	Short-term loans	Short-term	Rs. 364.62 crore	Rs. 357.40 crore	[ICRA]A2	[ICRA]A3+	[ICRA]A3	[ICRA]A3	[ICRA] A3+
5	Non-fund based	Short-term	Rs. 13.75 crore	Rs. 13.75 crore	[ICRA]A2	[ICRA]A3+	[ICRA]A3	[ICRA]A3	[ICRA]

*-as on March 31, 2018

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	Long-term Loan 1	FY2018	NA	FY 2021	201.61	[ICRA]BBB+(Stable)
NA	Long-term Loan 2	FY2013-FY2014	NA	FY 2019	39.78	[ICRA]BBB+(Stable)
NA	Long-term Loan 3	FY2011-FY2012	NA	FY 2021	10.73	[ICRA]BBB+(Stable)
NA	Long-term Loan 4	FY2011	NA	FY 2024	3.39	[ICRA]BBB+(Stable)
NA	Long-term Loan 5	FY2014-FY2015	NA	FY 2022	1.54	[ICRA]BBB+(Stable)
NA	Long-term Loan 6	FY2017-FY2018	NA	FY 2023	6.00	[ICRA]BBB+(Stable)
NA	Long-term Loan 7	FY2015-FY2016	NA	FY 2023	17.10	[ICRA]BBB+(Stable)
NA	Long-term Loan 8	FY2014-FY2015	NA	FY 2024	3.00	[ICRA]BBB+(Stable)
NA	Long-term Loan 9 (Proposed)	NA	NA	NA	26.23	[ICRA]BBB+(Stable)
NA	Cash credit	NA	NA	NA	233.50	[ICRA]BBB+(Stable)
NA	Short-term loans	NA	NA	NA	364.62	[ICRA] A2
NA	Non-Fund Based	NA	NA	NA	13.75	[ICRA] A2

Source: VHPL

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

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