# Prabhat Dairy Limited

February 13, 2019

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| Long Term – Fund Based TL | 45.5 | 45.5 | [ICRA]A+&; reaffirmed and Continues to remain under watch with developing implications |
| Long Term – Fund Based / CC | 175.0 | 370.0 | [ICRA]A+&; reaffirmed and Continues to remain under watch with developing implications |
| Long Term / Short Term – Unallocated | 22.0 | - | - |
| Short Term – Non Fund Based | 45.0 | 30.0 | [ICRA]A1&; reaffirmed and Continues to remain under watch with developing implications |
| **Total** | **287.5** | **445.5** | |

*Instrument details are provided in Annexure-1

## Rationale

ICRA has taken a consolidated view of Prabhat Dairy Limited (PDL) and its 100% step-down subsidiary, Sunfresh Agro Industries Private Limited (SAIPL) (together referred as Prabhat Group), while arriving at the ratings because of the strong management, business and financial linkages between the two.

The rating continues to remain under watch with developing implication on account of PDL's announcement of entering into definitive agreements with Tirumala Milk Products Private Limited (TMPPL), a wholly owned subsidiary of the French dairy multinational, Groupe Lactalis, for the sale of its dairy business for a consideration of Rs. 1,700.0 crore, as on January 21, 2019. The transaction is subject to customary closing adjustments and regulatory conditions, including shareholder's approval, Competition Commission of India (CCI) approval and receipt of No Objection Certificates (NOCs) from all the existing bankers of PDL.

The transaction has two parts, wherein SAIPL would be sold to TMPPL for Rs. 1,227.18 crore. The additional Rs. 472.82 crore agreed in the transaction would come from the slump sale of PDL's dairy business on a going concern to SAIPL. The same includes specified tangible and intangible assets, contracts, rights, personnel and employees, data and records, inventory, and other assets and liabilities as agreed by the parties in the deal. The management expects the transaction to be completed by Q1 FY2020.

The rating reaffirmation continues to derive comfort from the healthy revenue growth of the Group, which has grown at a CAGR of ~20% in the past four fiscals. Over the years, the Group was able to maintain healthy profitability as compared to its peers by strategically shifting its product mix towards high margin bearing value-added dairy products (VADPs) like ghee, whole milk powder (WMP), cheese, ultra high temperature (UHT) processing milk, etc, as against traditional milk sales. ICRA expects the average realisations of key dairy products to remain lower in FY2019 as compared to the previous fiscal, which will moderate the revenue growth of the Group to an extent. However, Government subsidies coupled with low procurement cost may support the operating profitability during the fiscal as witnessed in H1 FY2019. ICRA also derives comfort from the comfortable capital structure, healthy debt protection and coverage indicators owing to adequate accruals, further supported by improvement in debtor recovery cycle in FY2018, which led to low working capital borrowings. The ratings also continue to favourably factor in the established procurement base of the Group among dairy farmers supplemented by a wide network of bulk coolers and chilling centres. These ensure a regular supply of raw milk, a recognised regional brand, 'Prabhat' for pouched milk and clarified butter (*ghee*), as well as a diversified product portfolio. The extensive track record of promoters in the dairy industry and established relationship of the company with key institutional clients leading to assured revenues from supply contracts also provide comfort to the ratings.

The ratings, however, remain constrained by low return on capital employed (ROCE) of the Group, given its expansion mode in terms of setting up a wide procurement base and sizeable capex incurred in the past coupled with improving yet underutilised capacity of key product categories. Under the Business-to-Business (B2B) segment, the Group has moderate customer concentration on institutional business, though healthy share of business with its major clients, addition of new institutional clients and renewal of supply contracts over the years provide comfort. At the retail level, the Group's limited brand presence and high geographical concentration also constrains the rating, given ~80% of the retail sales coming from specific regions of Maharashtra. High competitive intensity from organised co-operatives, private players and unorganised players and vulnerability to external factors like weather and disease outbreak, as well as its exposure to Government regulations, the global demand–supply scenario or milk products, especially milk powder, also constrain the rating.

## Outlook: Ratings on watch

ICRA notes that post transaction implementation, when the Prabhat Group will exit its core dairy business (98.24% of the Group's consolidated revenues in FY2018), there is likely to be a material impact on its operational and financial profile, going forward. PDL intends to foray into the animal nutrition business, which includes cattle feed, nutrition supplements and animal genetics, as a part of backward integration. To that effect, it has entered into strategic alliance with the Danish firm, Dansk Landbrugs Grovvareselskab (DLG group), which produces high-quality, vitamin-mineral feeds and farm supplies. The extent of utilisation of the transaction of net proceeds in the animal nutrition business by the entity and its resultant impact on the financial risk profile in terms of capital structure, coverage indicators and liquidity position remain to be seen and will be a key monitorable from a rating perspective.

## Key rating drivers

## Credit strengths

**Above average operating profitability owing to increasing share of value-added products -** The operating profitability of the Group is better than peers due to its strong procurement network concentrated in certain geographies, reducing logistics costs. Further, strategic product mix with shift towards high margin VADPs like ghee, WMP, cheese, UHT milk, etc, as against traditional milk sales augured well for the profitability.

**Robust capital structure and return indicators -** The capital structure of the Group improved significantly in FY2016 owing to pre-payment of debt of Rs. 185.00 crore through the IPO proceeds in the fiscal. The Group has a comfortable gearing of 0.1 time and TD/ OPBDITA of 1.3 times as on September 30, 2018, supplemented by strengthened net worth due to improved profitability. ICRA expects the company to reduce its inventory holdings to take advantage of ongoing positive price movement in H2 FY2019, coupled with timely receipt of subsidies, which should improve the working capital intensity and reduce the fiscal end debt levels. The gearing is expected to remain at 0.1 time, TD/OPBDITA at 0.7 time and interest coverage at 6.7 times in FY2019.

**Diversified product basket with majority of sales in B2B segment; expanding presence in B2C segment through its brand name, 'Prabhat', in Western Maharashtra –** The Group procures, processes and markets liquid milk and other value-added milk products, which include butter, ghee, cheese, etc. At present, the Group's 65% revenue comes from B2B institutional clients, while the remaining 35% share is driven by the B2C segment. As on March 2018, the brand was present in 26 states with 250 sales professionals, 650 distributors with over 1 lakh general trade outlets and 300 modern trade outlets.

**Established relationship with key institutional clients leading to assured revenue from supply contracts –** The Group has a wide portfolio of institutional clients for its value-added products such as ghee, WMP and sweetened condensed milk across different categories, viz., premium ingredients, speciality ingredients and co-manufacturing. The Group leverages its institutional relationships and quality certifications obtained from such institutional customers to further increase its product offerings and product sale volumes to such customers and their affiliates in India and around the globe. However, it also faces the risk of concentration and overdependence on a few institutional customers. Any change in positioning with these customers could impact revenues.

## Credit weaknesses

**Weak ROCE owing to capital intensive nature of business -** Over the years, the group's ROCE had remained low due to significant capital expenditure undertaken in the past coupled with improving yet underutilised installed capacity. As on March 31, 2018, the ROCE remained at 8.8% as against 17.5% in FY2015. Due to present reliance on B2B segment, the ROCE is likely to remain suppressed in the near term as well. However, ICRA also notes that as the Group transits from a speciality ingredients B2B provider to a value-added retailer, and as the capex investment undertaken earlier start fetching revenues, the ROCE is expected to improve in the medium term.

**Limited brand presence and high geographical concentration risk -** At retail level, the Group faces limited brand presence and high geographical concentration risk since ~80% of its retail sales are driven by specific regions of Maharashtra. This limits the Group's scale of operations. However, the Group's intention to increase the brand presence by increasing the brand promotion expense will likely reduce the geographical concentration and provide nationwide presence for the Prabhat brand in the long-term.

## Liquidity position

The liquidity profile of the Group remains adequate considering the undrawn line of credit in cash credit facilities where it has average ~22% unutilised limits with respect to its drawing power.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology |
| Parent/Group Support | NA |
| Consolidation / Standalone | For arriving at the ratings, ICRA has considered the consolidated financials of Prabhat Dairy Limited. As on March 31, 2018, the company had a step-down subsidiary, which is listed in Annexure-2 |

## About the Group

Prabhat Dairy Limited is part of the Srirampur-based (Maharashtra) Prabhat Group, with the other key Group company being, Sunfresh Agro Industries Private Limited. Incorporated in 1998, the Group is promoted by the Nirmal family, whose key business area is integrated milk and dairy products manufacturing. The group enjoys a milk processing capacity of 15 lakh litres per day with multi-product capabilities. PDL offers a wide range of products like pasteurised milk, flavoured milk, sweetened condensed milk, UHT milk, yoghurt, dairy whitener, clarified butter (*ghee*), cheese, cottage cheese (*paneer*), skimmed and whole milk powder, baby food ingredients, etc. The Group's major client includes leading global and domestic FMCG companies like Mondelez, Abbott, Nestlé, ITC Ltd., Britannia, Future Group, Perfetti, Mother Dairy, Vadilal, Haldiram's, D Mart, Parle, Olam, Lotte, etc.

The Group has formed two separate entities for benefiting from Government policies (Industrial Promotion Scheme – 2007) with SAIPL being a 100% step-down subsidiary of PDL.

In FY2018, on a consolidated basis, the Group reported a net profit of Rs. 47.3 crore on an operating income of Rs. 1554.0 crore, as compared to a net profit of Rs. 46.9 crore on an operating income of Rs. 1410.0 crore in the previous year.

## Key financial indicators (audited)

| | FY2017 (Consolidated) | FY2018 (Consolidated) |
|---|---|---|
| Operating Income (Rs. crore) | 1410.0 | 1554.0 |
| PAT (Rs. crore) | 46.9 | 47.3 |
| OPBDIT/OI (%) | 9.0% | 8.6% |
| RoCE (%) | 11.4% | 8.8% |
| | | |
| Total Debt/TNW (times) | 0.3 | 0.1 |
| Total Debt/OPBDIT (times) | 1.5 | 0.6 |
| Interest coverage (times) | 4.3 | 4.0 |

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for last three years:

| | Instrument | Current Rating (FY2019) | | | | | Chronology of Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Date & Rating | | December 2017 | January 2017 | FY2016 |
| | | | | | February 2019 | January 2019 | | | |
| 1 | Term Loan facilities | Long Term | 45.5 | 39.6 | **[ICRA]A+&** | **[ICRA]A+&** | **[ICRA]A+ (Stable)** | **[ICRA]A+ (Stable)** | **-** |
| 2 | Cash Credit facilities | Long Term | 370.0 | - | **[ICRA]A+&** | **[ICRA]A+&** | **[ICRA]A+ (Stable)** | **[ICRA]A+ (Stable)** | **-** |
| 3 | Unallocated | Long Term/ Short Term | - | - | **-** | **[ICRA]A+& /A1&** | **[ICRA]A+ (Stable) / A1** | **[ICRA]A+ (Stable) / A1** | **-** |
| 5 | Non Fund based | Short Term | 30.0 | | **[ICRA]A1&** | **[ICRA]A1&** | **[ICRA]A1** | **[ICRA]A1** | **-** |
| | **Total** | | **445.5** | **39.6** | | | | | |

&: rating on watch with developing implications

## 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 | WCDL -I | - | - | - | 80.0 | **[ICRA]A+&** |
| | WCDL -II | - | - | - | 30.0 | |
| | WCDL -III | - | - | - | 60.0 | |
| | WCDL -IV | - | - | - | 35.0 | |
| | WCDL -V | - | - | - | 40.0 | |
| | WCDL -VI | - | - | - | 20.0 | |
| NA | Cash Credit - I | - | - | - | 15.0 | |
| | Cash Credit – II | - | - | - | 70.0 | |
| | Cash Credit - III | - | - | - | 20.0 | |
| NA | Term Loan – I | Dec-2017 | 8.35% | June-2020 | 37.5 | **[ICRA]A+&** |
| NA | Term Loan - II | Dec-2017 | 8.15% | March-2022 | 8.0 | |
| NA | Non-fund-based limits | - | - | - | 30.0 | **[ICRA]A1&** |

&: rating on watch with developing implications

*Source: The company information*

## Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| Sunfresh Agro Industries Private Limited (a step-down subsidiary of PDL) | 100.00% | Full Consolidation |

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## About ICRA Limited:

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