Prabhat Dairy Limited

December 21, 2017

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term - Fund Based – Term Loan	45.50	45.50	[ICRA]A+ (Stable); Reaffirmed
Long Term - Fund Based- Cash Credit / WCDL	125.00	175.00	[ICRA]A+ (Stable); Reaffirmed
Long Term / Short Term – Unallocated	2.00	22.00	[ICRA]A+ (Stable) / A1; Reaffirmed
Short Term - Non Fund Based – LC/BG	15.00	45.00	[ICRA]A1 ; Reaffirmed
Total	**187.50**	**287.50**	

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]A+ (pronounced as ICRA A plus) to the Rs. 170.50 crore long-term fund based facilities, short term rating of [ICRA]A1 (pronounced as ICRA A one) to the Rs. 15.00 crore short term non fund based facilities and long term / short term rating of [ICRA]A+/A1 (pronounced as ICRA A plus / A one) to the Rs. 2.0 crore unallocated facilities of Prabhat Dairy Limited (‘PDL’ or the company). ICRA has also assigned a long-term rating of [ICRA]A+ (pronounced as ICRA A plus) to the additional Rs. 50.00 crore long-term fund based facilities, short term rating of [ICRA]A1 (pronounced as ICRA A one) to the Rs. 30.00 crore short term non-fund based facilities and long term / short term rating of [ICRA]A+/ A1 (pronounced as ICRA A plus / A one) to the Rs. 20.00 crore unallocated limits of the company. The outlook on the long term is Stable.

Rationale

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

The reaffirmation continues to take comfort from the healthy revenue growth of ~21% in FY2017 and H1FY2018 supported by increased realisations as well as new product additions. The company has reported revenue of ~25% CAGR over the past four years. Over the years, the group was able to maintain healthy profitability as compared to peers by strategically shifting its product mix towards high margin bearing value added dairy products (VADPs) like ghee, WMP, cheese, UHT milk etc as against traditional milk sales. ICRA also derives comfort from the comfortable capital structure of the group as reflected in healthy debt protection and coverage indicators owing to adequate accruals; further supported by revenue proceeds from mega project benefit in FY2017. The ratings also continue to favourably factor in established procurement base of Prabhat group among dairy farmers supplemented by wide network of bulk coolers and chilling centres.

The ratings however remain constrained by relatively higher working capital intensity as compared to its peers owing to higher debtor period upto 70 days since past five fiscals. High working capital intensity coupled with decline in profitability due to substantial increase in raw milk procurement cost by over 30% owing to inadequate milk availability in FY2017 has impacted the fund flows from operations. Additionally, given the expansion mode of the group in terms of setting up wide procurement base, continued sizeable capex over the years coupled with improving yet underutilised capacity has led to consistent negative free cash flows and suppressed ROCE for Prabhat. Under 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 provides comfort. At 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 organized co-operatives, private players and unorganized players and vulnerability to external factors like weather, disease outbreak etc and its exposure to government regulations, global demand supply scenario or milk products especially milk powder also constrains the rating. Nevertheless, increasing consumption of branded processed milk products and value added dairy products in domestic market on back of higher purchasing power, changing food habits and increasing health awareness will supplement the growth in long term.

Going forward, Prabhat is eyeing to more than double its Business to Consumer (B2C) sales from Rs. 400 crore to Rs.1000 crore, propelling its revenue share to 50% from 30%, implying strong 37% CAGR over FY2017-2020 in B2C segment. Moreover it has a medium term plan to reduce its dependence on open market sales and improve institutional sales revenue. As per Industry dynamics, as companies shift to higher VADP in B2C channel, though the profitability is expected to improve, the working capital needs may rise due to higher inventory stocking for longer shelf life products, higher processing time as well as higher credit periods.

Thus the ability of the group to improve profitability along with adequate working capital management will remain the key monitorable. Further ensuring adequate capacity utilisation for expanded capacities through sustained improvement in procurement base of milk while managing price volatility for milk products will also remain key sensitivity factors.

Outlook: Stable

ICRA believes Prabhat group is well placed to benefit from the huge business opportunity for the organized sector in the dairy industry. The growth is set to accelerate by penetration into a huge unorganized market (~78% of the Rs. 5.5 trillion dairy industry) led by fresh dairy products, a consumption and market shift to high margin VADPs and a large vegetarian population. The outlook may be revised to 'Positive' if Prabhat is able to realise this potential leading to substantial growth in revenue and profitability along with better working capital management; thus strengthening its financial risk profile. The outlook may be revised to 'Negative' if the profitability declines further from the current levels or if the liquidity position deteriorates due to stretch on the working capital cycle or any sizeable unanticipated, debt funded capex.

Key rating drivers

Credit strengths

Healthy revenue growth potential over the near to medium term – The operating income of the group has grown at a healthy CAGR of 24.8% over the past 4 years owing to new product addition and growth in conventional business lines catering to B2B segment. Going forward, as the market remain conducive, increasing capacity utilization for the new products and increase in volume for value added products like WMP, Ghee and Butter are expected to be the major driving factors for the revenue growth.

Above average 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 the logistics costs. Further, strategic product mix with shift towards high margin value added dairy products (VADPs) like ghee, WMP, cheese, UHT milk etc as against traditional milk sales augur well for the profitability.

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 is into procurement, processing and marketing of liquid milk and other value added milk products which include butter, ghee, cheese etc. At present, the group's 70% revenue comes from B2B institutional clients while the remaining 30% share being derived from the B2C segment. The group is now focussing to improve its B2C share by selling retail value added dairy products under its own brand name 'Prabhat'. As on March 2017, group is having presence in 26 states with 250 sales professionals, 650 distributors with over 1 Lac general trade outlets and 300 modern trade outlets. By FY2020, the group intends to have presence in over 2 Lacs general trade points and over 3000 modern trade outlets.

Established procurement base ensuring regular supply of liquid milk at competitive prices from farmers, supplemented by network of bulk coolers and chilling centres - At present, group sources 70% of the total milk requirement through direct sourcing from 1,200 villages twice a day. It has a milk processing capacity of 15 lacs litres per day (LPD) with 480 milk collection centres, 150 bulk milk coolers and 20 milk chilling plants in an around its procurement area. Prabhat aims to take milk procurement from less than 9 lacs litres per day (LPD) at present to 14 Lacs LPD by FY2020 for which it intends to double its dairy farmer base in 2 years, while also widening milk collection and chilling centre network by 80% in three years.

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 three different categories viz premium ingredients, speciality ingredients and co-manufacturing. The group leverages on its institutional relationships and quality certifications obtained from such institutional customers to further increase its product offerings and product sale volumes to these institutional customers and their affiliates in India and globally. 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.

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. The group has a comfortable gearing of 0.3 times and TD/ OPBDITA of 1.7 times as on September 30, 2017. Though there has been a marginal increase in net gearing owing to increase in working capital debt on account of increase in business operations; further impacted by reduced profitability due to elevated raw milk procurement prices. Yet the overall capital structure remains comfortable in the near term.

Credit weaknesses

Financial profile characterized by relatively higher working capital intensity
The working capital intensity of the group remains higher than all its industry peers owing to its B2B nature of business resulting in higher debtor days going upto 70 days. Moreover as the group transits towards a VADP player in B2C channel its working capital intensity may moderate in the medium term. However group's intention to reduce focus on open market sales in B2B segment and resultant rationalisation of inventory will absorb the impact to an extent.

Consistent negative free cash flows and suppressed RoCE - Prabhat has consistent negative cash flows and lower Return on Capital Employed (ROCE) due to significant capital expenditure undertaken by the group over the years coupled with improving yet underutilized installed capacity. As the group transits from a specialty ingredients B2B provider to a value-added retailer, ICRA expects the ROCE to improve in the medium term. However due to present reliance on B2B segment, the ROCE is likely to remain suppressed in the near term.

Limited brand presence and high geographical concentration–At retail level, the group has limited brand presence and high geographical concentration since ~80% of the retail sales come from specific regions of Maharashtra. Thus it limits the group's scale of operation. However 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 Prabhat brand in the long term.

Ability to sustain the profitability remains critical, given the government regulated industry, dynamic raw milk price movements and supply demand scenario
The profitability of Prabhat is largely affected by the raw material price fluctuation which in turn affects the sales realisations. Any adverse movement in the price of raw materials could have an adverse impact on its margins as witnessed during FY2017 and H1FY2018, considering the limited ability to pass on the price hike owing to high competitive intensity and high government regulations.

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

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

Links to applicable criteria:

Corporate Credit Rating Methodology

About the Prabhat group:

Prabhat Dairy Limited (PDL) is part of Srirampur (Maharashtra) based Prabhat group with key other company in the group being Sunfresh Agro Industries Private Limited. Incorporated in 1998, Prabhat group is promoted by Nirmal family with integrated milk and dairy products manufacturing being the key business area. The group has 15 lac litres per day of milk processing capacity with multi product capabilities. Prabhat offers wide range of products like pasteurized milk, flavoured milk, sweetened condensed milk, UHT milk, yoghurt, dairy whitener, clarified butter (ghee), cheese, paneer, skimmed & whole milk powder, ingredients for baby foods, lassi , chaas and gulab jamun mix. Group's major client includes leading global & domestic FMCG companies like Mondelez, Abbott, Nestle, ITC, 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 100% step down subsidiary of PDL.

In FY2017, the group reported a consolidated net profit of Rs. 100.5 crore on an operating income of Rs. 1410 crore, as compared to a net profit of Rs. 64.1 crore on an operating income of Rs. 1168.0 crore in the previous year.

Key Financial Indicators (Audited)

	FY 2016	FY 2017	H1FY2018
Operating Income (Rs. crore)	1167.7	1409.9	745.2
PAT (Rs. crore)	23.2	47.3	14.9
OPBDIT/ OI (%)	9.9%	8.6%	8.0%
RoCE (%)	11.0%	10.9%	8.1%
Total Debt/ TNW (times)	0.2	0.3	0.3
Total Debt/ OPBDIT (times)	1.3	1.6	1.7
Interest coverage (times)	2.8	4.1	3.4
NWC/ OI (%)	30%	32%	30%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

Instrument		Current Rating (FY2018)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	December 2017	January 2017	FY2016	FY2015
1	Term Loan	Long Term	45.50	45.50	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	-	-
2	Cash credit / Working Capital Demand Loan	Long Term	175.00	-	**[ICRA]A+ (Stable)**	**[ICRA]A+ (Stable)**	-	-
3	Unallocated	Long term/ Short Term	22.00	-	**[ICRA]A+ (Stable) / A1**	**[ICRA]A+ (Stable) / A1**	-	-
4	Letter of Credit & Bank Guarantee	Short Term	45.00	-	**[ICRA]A1**	**[ICRA]A1**	-	-

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	Dec 2017	NA	June 2020	45.50	[ICRA]A+ (Stable)
NA	Cash Credit / WCDL	NA	NA	NA	175.00	[ICRA]A+ (Stable)
NA	Unallocated	NA	NA	-	22.00	[ICRA]A+ (Stable) / A1
NA	Letter of Credit & Bank Guarantee	NA	NA	-	45.00	[ICRA]A1

Source: Prabhat Dairy Limited.

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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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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