January 14, 2020

Srinivasa Farms Private Limited: Ratings downgraded to [ICRA]BBB(Negative)/[ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long Term: Cash credit facilities	65.00	70.60	Downgraded to [ICRA]BBB from [ICRA]BBB+; Outlook revised to Negative from positive
Long Term: Term Loan facilities	7.32	17.97	Downgraded to [ICRA]BBB from [ICRA]BBB+; Outlook revised to Negative from positive
Long/ Short Term: Unallocated	0.68	31.50	Downgraded to [ICRA]BBB/[ICRA]A3+ from [ICRA]BBB+/A2; Outlook revised to Negative from positive
Total	**73.00**	**120.07**	

** -Instrument details are provided in Annexure 1*

Rationale

The revision in ratings and outlook reflects the deterioration in the company's operational and financial performance during the past 18 months, owing to a sharp increase in maize prices, which is the key ingredient for manufacturing poultry feed, high mortality and low body weight gain in broiler operations, and higher fixed overheads in layer breeding and in its chicken processing plant's (CPP) operations. Further, FY2019 and H1FY2020 was the transition phase for Layer and broiler breeds which also impacted the operational performance. Srinivasa Farms Private Limited (SFPL) reported operating losses of 13.5% in H1 FY2020 and 5.9% in FY2019, down from operating profits of 4.2% in FY2018. The operational performance in layer and broiler divisions is expected to improve in H2 FY2020 on the back of softening of maize prices from November 2019, reduction of mortality levels in broiler operations from December 2019, and expected improvement in profitability at layer and CPP operations. Despite this, the company is likely to report operating losses in FY2020. Weak earnings, coupled with an increase in working capital debt as compared to FY2018 to support the cash losses and increased working capital requirements resulted in an adverse impact on the coverage indicators. Further, the incremental funding requirements are met by infusion of fresh equity of Rs. 120.54 crore in the past 18 months including Rs. 65 crore from the International Finance Corporation (IFC) in May 2019, Rs. 3.50 crore unsecured loans from promoters and realisation of Rs. 22.58 crore from divestment of non-core investments. IFC agreed to invest a total of Rs. 130 crore in SFPL to support its poultry operations and the remaining Rs. 65 crore is expected to be infused by IFC in the near term post the completion of the labour audit and implementation of Environmental and Social Management System.

The ratings, however, factor in the exclusive pan-India franchise agreement with Hyline International for distribution of its layer breed (W80), increased acceptability of W80 among poultry farmers with significant repeat purchases from layer farmers and start of Environmentally Controlled farms for raising Commercial Broilers by Integration farmers from Q1 FY2021, would improve the performance of birds and control mortality. The ratings draw support from the vertically-integrated nature of SFPL's operations with presence in production of poultry feed, soya de-oiled cake, soya oil, layer and broiler breeding, integration farming, chicken processing and chicken retail outlets under the Freshen brand. The ratings continue to draw comfort from the SFPL's established presence spanning more than four decades in the poultry business and its favourable long-term demand prospects for the domestic poultry industry, backed by favourable socio-economic factors.

Key rating drivers and their description

Credit strengths

Vertically-integrated poultry business – SFPL has presence across the value chain of the poultry industry including production of poultry feed, soya processing, breeding of layer and broiler chicks, contract farming, CPP and chicken retail sales under the Freshen brand. Further, the Srinivasa Hatcheries Group has more than four decades of presence in poultry operations.

Exclusive franchise agreement with Hyline International – SFPL has entered into a pan-India exclusive franchise agreement with Hyline International, a leading genetic layer breeder, for distribution of layer chicks in August 2017. The increased acceptance of W80 layer breed is likely to support its revenue growth over the medium term.

Equity infusion from IFC and promoters to support SFPL's poultry operations – SFPL received a total equity infusion of Rs. 120.54 crore over the past 18 months comprising Rs. 55.54 crore from promoters and Rs. 65 crore from IFC, an investment arm of the World Bank. IFC agreed to invest Rs. 130 crore in May 2019 to support SFPL's expansion of poultry operations and the remaining Rs. 65 crore is likely to be infused post completion of the labour audit in the near term. The company received Rs. 22.15 crore in FY2019 by divesting its non-core investments and refund of advances extended earlier.

Credit challenges

Modest operating performance – The operating margins declined to -5.9% in FY2019 and -13.5% in H1 FY2020, as against 4.2% in FY2018 on account of losses in broiler integration operations, layer breeding and CPP segments. The broiler division operations were impacted due to high mortality levels and low body weight gain, while high fixed overheads affected the layer and CPP operations. Further, the demand for layer and broiler DOCs impacted in the overall market as poultry farmers realisation was lower than the cost of production which dis-incentivised farmers to place new batch of chicks. With reduction in mortality levels in December 2019 in broiler division on the back of corrective steps undertaken in farm management and feed, coupled with softening of maize prices from November 2019, the operating performance is expected to improve in the near term and would be a key rating monitorable.

Moderate gearing levels and weak coverage indicators – Despite fresh equity infusion of Rs. 100.19 crore in H1 FY2020, the gearing remained moderate at 1.1 times as on September 30, 2019 owing to net losses of Rs. 31.54 crore in FY2019 and Rs. 35.92 crore in H1 FY2020. Further, the debt levels remained high at Rs. 125.77 crore as on September 30, 2019 on account of high working capital debt levels availed to support its increased working capital requirements. Weak earnings, coupled with increased debt levels resulted in an adverse impact on the coverage indicators.

Margins susceptible to raw material price fluctuations – SFPL uses maize and soya as its two main raw materials for production of feed. The poultry feed is the key cost component for broiler and layer breeding, and integration farming operations. The operating margins are susceptible to raw material price volatility and production levels, along with agro-climatic conditions as witnessed during the past two years.

Inherent risk of disease outbreak – The poultry industry is exposed to the inherent risk of disease outbreak (bird flu), which could potentially impact one cycle of flock, thereby impacting revenues and profitability.

Liquidity position: Adequate

The company's liquidity profile is adequate with average working capital limit utilisation at ~79% of the sanctioned limits in the past 12 months ending in September 2019. SFPL has repayment obligations of Rs. 3.54 crore in FY2020 and Rs. 2.67 crore in FY2021 and Rs. 35-crore capex plans in the near term. The funding requirement in FY2020 is met by the Rs. 120-crore equity infused already, while the future requirements would be met by pending equity infusion of Rs. 65 crore from IFC in the near term and improved profitability levels from FY2021.

Rating sensitivities

Positive triggers – The ratings are unlikely to be upgraded in the near term, given the expected operating losses for FY2020. However, turnaround of operations in broiler, layer and integration farming segments would be a key rating monitorable in the near term. The specific credit metrics that could result in an upgrade of SFPL's ratings include improvement in interest cover above 3.5 times and Debt/OPBDIT below 2.3 times on a sustained basis.

Negative triggers – Negative pressure on SFPL's ratings could arise in case of higher-than-estimated losses in FY2020 or delay in turnaround of operations in broiler, layer and integration farming segments. Any delay in expected equity infusion from IFC is likely to put negative pressure on its ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	None
Consolidation / Standalone	The ratings are based on standalone financial statements of the company.

About the company

Incorporated in 1983, SFPL is a part of the SH Group, which is an integrated poultry player in the domestic market with presence in poultry feed, soya processing, broiler and layer segments. SFPL entered into an exclusive pan-India franchise agreement with Hyline International (Hy-Line W-80) for distribution of layer chicks. The company has recently diversified into value-added segments such as processed chicken, liquid egg, etc. While the feed, broiler/layer DOC, integration and retail (Freshen brand) segments are undertaken by SFPL, it set up a chicken processing plant under its 100% subsidiary - SH Proteins Private Limited, which is amalgamated with SFPL with effective date of August 1, 2017. Moreover, SH Food Processing Private Limited, a 51% owned subsidiary of SFPL, is setting up a mega food park for poultry processing at a total cost of Rs. 115.0 crore (of which Rs. 50.0 crore is in the form of capital subsidy from the Government of Andhra Pradesh), which is expected to begin commercial operations in Q4 FY2020.

Key financial indicators (Standalone)

	FY2018	FY2019	6MFY2020*
Operating Income (Rs. crore)	616.6	625.5	289.9
PAT (Rs. crore)	12.3	-31.5	-35.9
OPBDIT/ OI (%)	4.2%	-5.9%	-13.5%
RoCE (%)	16.0%	-19.8%	-40.7%
Total Debt/ TNW (times)	1.3	3.6	1.1
Total Debt/ OPBDIT (times)	3.8	(4.4)	(3.2)
Interest Coverage (times)	4.2	(3.3)	(5.8)
DSCR	3.7	(1.7)	(4.4)

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 Jan 14, 2020	Date & Rating in FY2019 Oct 08, 2018	Date & Rating in FY2018 Aug 18, 2017	 Aug 3, 2017	Date & Rating in FY2017 Sept 2, 2016
1	Cash Credit	Long Term	70.60	-	[ICRA]BBB; (Negative)	[ICRA]BBB+; (Positive)	[ICRA]BBB+ (Stable)	[ICRA]BBB + (Stable);	[ICRA]BBB (Stable);
2	Term Loan	Long Term	17.97	17.97	[ICRA]BBB; (Negative)	[ICRA]BBB+; (Positive)	[ICRA]BBB+ (Stable)	[ICRA]BBB + (Stable);	[ICRA]BBB (Stable);
3	Unallocated	Long/ Short Term	31.50	-	[ICRA]BBB; (Negative)/ [ICRA]A3+	[ICRA]BBB+(Positive)/ [ICRA]A2;	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB + (Stable)/[ICRA]A2;	[ICRA]BBB (Stable)/[ICRA]A3+;

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: Fund Based Cash Credit	-	-	-	70.60	[ICRA]BBB (Negative)
NA	Long Term: Term Loan facilities	FY2019-FY2020	-	FY2023-FY2026	17.97	[ICRA]BBB (Negative)
NA	Long /Short Term: Unallocated	-	-	-	31.50	[ICRA]BBB (Negative) /[ICRA]A3+

Source: Company

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