Vadilal Enterprises Limited

September 26, 2019

Ratings

Facilities	Amount (Rs. Crore)	Ratings[1]	Rating Action ^
Long-term Bank Facilities	25.34	**CARE BBB (Triple B); Under credit watch with negative implications**	**Revised from CARE BBB (CE) [Triple B (Credit Enhancement)]; Under credit watch with negative implications**
Long/Short-term Bank Facilities	0.50	**CARE BBB / CARE A3+ (Triple B / A Three Plus); Under credit watch with negative implications**	**Revised from CARE BBB (CE) / CARE A3+ (CE)[Triple B (Credit Enhancement) / A Three Plus (Credit Enhancement)];Under credit watch with negative implications**
Total Facilities	**25.84 (Rupees Twenty Five Crore and Eighty Four Lakh Only)**		

Details of facilities in Anneuxre-1

^ The ratings assigned to the above-said bank facilities of Vadilal Enterprises Ltd. (VEL) were previously based on credit enhancement in the form of an unconditional and irrevocable corporate guarantee of Vadilal Industries Limited (VIL; rated: CARE BBB / CARE A3+; Under credit watch with negative implications). However, CARE has now assessed the ratings of VEL based on 'combined' analytical approach of VIL and VEL and has removed the 'CE' suffix as the guarantee does not provide any credit enhancement.

Detailed Rationale & Key Rating Drivers

The ratings of Vadilal Enterprises Limited (VEL) continue to remain 'under credit watch with negative implications' owing to lack of clarity about future leadership of the company on the back of heightened differences among the promoters of the Vadilal group [comprising of VIL and its group company Vadilal Enterprises Ltd. (VEL)] which led to significant delays in publication of its quarterly results on the stock exchange for the last two quarters and which could impact the performance of the group going forward. CARE will take a view on the ratings of VEL once there is timely publication of its financial results for the forthcoming quarter, resolution of differences among the promoters and clarity on future leadership of the group.

The ratings of the bank facilities of VEL continue to derive strength from the vast experience of the promoters of Vadilal group, the group's long-standing track record with established operations in ice-cream business, more than a century old presence of the 'Vadilal' brand in the domestic ice-cream market supported by its strong marketing and distribution network, growing scale of operations backed by expansion in geographical reach both in domestic and export markets along with regular introduction of new flavours/variants in its product basket. The ratings also take cognizance of the management's articulation about deferment of large size debt funded capital expenditure plan which is expected to improve the leverage of the group in coming years. Further, ratings derive strength from improvement in the financial performance of Vadilal group during FY19 (refers to the period from April 1 to March 31) & Q1FY20 based on its delayed published financial results.

The above strengths are, however, tempered on account of capital intensive nature of business resulting in relatively high leverage, susceptibility of profitability to volatile raw material prices, seasonality associated with the business and high competition in the ice-cream segment from the organized as well as unorganized segments. The ratings are also constrained due to heightened differences among the promoters of Vadilal group leading to recurring instances of delay in publication of its financial results on the stock exchange in recent past, resignation of two independent directors raising concerns over the corporate governance in the group and disclaimer of opinion given by its statutory auditor in the audit report for FY19.

The ability of the Vadilal group to significantly increase its scale of operations through greater geographical diversification amidst high competition, improve its capital structure and efficiently manage its working capital requirements would be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Experienced promoters

The company is promoted by the promoters of VIL and operate under common management platform. Currently, the operations of VEL are managed by the third and fourth-generations of the family i.e. Mr. Rajesh Gandhi, Director, Mr.

[1] *Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

Devanshu Gandhi, Director and Mr. Kalpit Gandhi, Director and CFO (Son of Mr. Rajesh Gandhi). While Mr. Rajesh Gandhi looks after the overall operations of the company, Mr. Devanshu Gandhi looks after the sales, marketing and distribution functions. Apart from the finance function, Mr. Kalpit Gandhi looks after the plant operations on day to day basis.

Long standing track record having established 112- year old brand 'Vadilal'

The brand 'Vadilal' has been enjoying a well-known legacy for more than a century in the domestic ice-cream and frozen dessert business. The brand has healthy market share in the states like Gujarat, Rajasthan, UP and Haryana. The product portfolio of VIL's ice-cream and frozen dessert includes more than 150 flavors and varieties in different forms like cups, candies, cones, kulfis, tubs, large packs, etc. Apart from ice-cream and frozen dessert, VIL also ventured into processed food business under the brand 'Quick Treat'. Further, the revenue stream is also well diversified geographically as Vadilal group earns nearly 70%-75% of its ice-cream revenue from the states of Gujarat, Rajasthan, Uttar Pradesh and Haryana; whereas balance comes from other states.

Strong marketing and distribution network

Vadilal group has marketing presence in 23 states of India with the support of 63 C&F agents, over 1,200 distributors, more than 55,000 retailers and 290 distribution vehicles. The group also offers a wide range of ice-cream and frozen desserts through nearly 300 SKUs (Stock Keeping Units) in leading modern trade outlets like Reliance Fresh, More, Hyper City, D-Mart, Food Bazaar and Star Bazaar, etc. Furthermore, the group mainly exports its processed food product, frozen desserts along with ice-creams to 45 countries across four continents, the key markets include USA, South-East Asian and European countries.

Volume backed consistent growth in scale of operations and improvement in profitability during FY19 and Q1FY20 along with steady demand outlook for ice-cream industry

The total operating income (TOI) of Vadilal group which registered a compounded annual growth rate (CAGR) of nearly 11% on combined basis during last three years ended FY19, grew by ~10% during FY19 on y-o-y basis alongwith improvement in PBILDT margin by 386 bps on y-o-y basis to 13.58% on the back of increase in the sales volume in domestic market as well as export market of its overall range of products coupled with largely stable sales realization and procurement of majority of its raw material requirement [especially skimmed milk powder (SMP)] during winter period at a relatively low cost during the said period. Further, as per provisional results for Q1FY20, TOI of the group increased by 21% on y-o-y basis to Rs.354.08 crore along-with improvement in PBILDT margin by 146 bps on y-o-y basis on the back of volume growth and procurement of SMP at relatively low price. The growth in the sales volume was supported by geographical expansion coupled with continuous introduction of new products/flavors. Moreover, the ice-cream consumption is likely to exhibit steady growth due to changing lifestyle, growing urbanization and rise in disposable income.

Improvement in debt-coverage indicators during FY19 & Q1FY20

Vadilal group's debt coverage indicators i.e. total debt/ GCA and interest coverage improved to 3.04 times & 5.46 times respectively during FY19 compared with 4.16 times & 3.62 times during FY18. Its interest coverage improved further to 17.50 times during Q1FY20 mainly due to seasonality effect & improved profitability.

Liquidity Analysis

Liquidity position of the group continued to remain moderate as indicated from the modest average working capital utilisation of around 44% and 27% for VIL and VEL respectively during the past twelve months ended June 2019. However, the utilisation levels remain high during peak season i.e. from October to March largely due to higher inventory requirement on the back of relatively cheaper procurement of raw materials to ensure smooth functioning of operations during the upcoming summer season. Furthermore, operating cycle on a combined basis largely remained stable at 58 days for FY19. Current ratio continued to remain below unity at 0.94 times as on March 31, 2019 mainly due to high amount of current portion of long term debt. As articulated by the company's management, on combined basis, the group has made prepayment of debt pertaining to FY20 to the extent of Rs.12.44 crore during April 2019 to July 2019 out of its operating cash accruals during this period.

Key Rating Weaknesses

Heightened differences among the promoter group leading to instances of delay in publication of financial results on the stock exchange & lack of clarity about future leadership of the company

Both VIL & VEL published their financial results on the stock exchange for the year and quarter ended March 31, 2019 & quarter ended June 30, 2019 on August 24, 2019 post multiple instances of postponement of meetings of its Board of Directors. As communicated by the company management, the reason for delay in publication of its results was because of some ongoing dispute amongst the brothers in the promoter group. Because of the same, publication of results of VIL & VEL for Q2FY19 was also delayed earlier. Amidst this dispute among the promoters, in July 2019, two independent directors of VIL & VEL resigned from the Board citing hostile atmosphere in the board meetings making it impossible for them to add any value in the interest of the company. Accordingly, upon reduction of strength of independent directors, Mr. Rajesh Gandhi also had to step down from the post of Chairman and Mr. Vijay Shah, an independent director of the company was appointed as Chairman with immediate effect to comply with the SEBI regulation of Section 17(1) of Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015. However, Mr. Rajesh Gandhi continues to be a director of the company and a part of the Board. Further, in March 2019, the board could not re-appoint Mr. Rajesh Gandhi and Mr. Devanshu Gandhi as Managing Directors of the company and resolved to look for professional management. In view of the on-going heightened differences between the promoters leading to lack of clarity on future leadership, the operational performance of the company, its essential capex plans and its market image are likely to have negative impact in short to medium term.

Disclaimer of opinion by statutory auditor in the audit report of FY19

The statutory auditor of the VIL and VEL has issued disclaimer of opinion in their audit report to the financial statements for the year ended March 31, 2019. As per the audit report of VEL, the promoter directors of the company have made various allegations and counter allegations on each other primarily relating to the operations and management of the company on a wide range of matters including potential personal expenses claimed as official expenses, funds management, dissemination of price sensitive information, demand for re-examination of books of account of past periods, legitimacy of salaries paid to relatives of the promoter directors, payments made to a vendor without services being received and independence of Independent Directors, amongst others. However, on July 23, 2019, the promoter directors have jointly communicated to the board of VEL about withdrawal of all the allegations made on each other except for the allegation with respect to claiming of personal expenses as business expenses of Rs.45.90 lakh by Rajesh Gandhi during FY14-FY18 and Rs.53.39 lakh by Devanshu Gandhi during FY14-FY19. The Board has appointed independent law firm to conduct an enquiry into matters stated in the audit report and report of enquiry is currently awaited.

Relatively high leverage due to high capital intensity of the business; albeit expected improvement in leverage on account of deferment of its previously planned large-sized debt funded capital expenditure plans

Ice-cream manufacturing and distribution industry is capital intensive in nature requiring investment in production facilities, innovative products in terms of flavours and packaging, as well as marketing assets like cold storage chain, deep freezers, refrigeration equipped delivery vehicles, push card, etc. During last four years ended FY19, Vadilal group on a combined basis had incurred capital expenditure of around Rs.176 crore which was funded through term debt of Rs.109 crore and balance through internal accruals. Also, the seasonality associated with the business leads to high working capital utilization as on balance sheet dates. Consequently, despite improvement, the leverage of the group has continued to remain relatively high marked by an overall gearing of 1.36 times as on March 31, 2019 (1.68 times as on March 31, 2018).

In order to expand its footprints in Northern and Eastern regions of India, the group had plans to establish new production facility in East India. Along with that the group also had plans to establish cold storage facilities near its Bareilly plant in Uttar Pradesh. The envisaged cost for these two projects was around Rs.70 crore which the company was planning to fund through term loan of Rs.49 crore and remaining through internal accruals. The execution of these two projects was expected to be spread over FY19 and FY20. However, as articulated by the company management, the said capex plans have been deferred by the company. Hence, the leverage of the group is expected to gradually improve going forward.

Susceptibility of Vadilal group's profitability to volatile raw material prices such as Skimmed Milk Powder (SMP) due to its linkages with international markets

The major raw materials for manufacturing of ice-cream are SMP, milk, butter and cream, which Vadilal group procures from local dairies near its manufacturing units. The prices of key raw materials have increased gradually over the years given the rising demand and constrained supply scenario. Also, each financial year during the period from November to January, the raw material prices are at their lowest due to dynamics of dairy industry. The group focuses on procuring their entire requirement for the upcoming summer season during this period to avail the benefit of better quality raw material at lower prices. Globally, SMP prices had declined substantially from April 2014 mainly due to weak demand from one of the largest importer i.e. China along with abolition of three decade old milk production quota system within European Union (EU) countries resulting in enhanced supply. Thus, as an effect of quota abolition, the global prices of SMP remained weak on the back of oversupply. However, during FY19, post announcement of various subsidies by Government of Gujarat, Government of Maharashtra and Central Government on export of SMP, its prices have shown an increasing trend. However, in domestic market the production of milk and milk products are increasing leading to sufficient supply which is expected to keep the prices under check. Further, during FY19, the group also earned nearly 17% of net sales from export whereas the company has no imports on the other side. Hence, the group is exposed to adverse fluctuation in foreign currency exchange rates. However, the group generally enters into forward covers which mitigate the forex risk to some extent.

Seasonality of demand as well as challenges arising from changing consumer tastes and preferences
The sales of Vadilal group are normally concentrated over the summer months, reflecting the seasonality of the business. Hence, the group's working capital intensity is at its peak level in the last quarter of the financial year as it has to accumulate raw material inventory for meeting the demand in the upcoming summer season. The business is also susceptible to changing tastes of consumers requiring investments in fixed assets leading to highly capital intensive operations.

High competition in the ice-cream segment from the organized as well as un-organized markets
Indian ice-cream market is largely dominated by un-organised players with innumerable small and seasonal companies doing the business. Further, there are large number of big and medium-sized ice-cream companies in India which leads to a highly competitive environment. Although, there is a huge opportunity for industry players since India is one of the fastest growing countries in ice-cream production and consumption due to its large population and growing per capita income; however, Vadilal faces high competition from various other established brands like Amul, Havmor, Kwality Walls, Cream Bell, Mother Dairy, Top 'N' Town, Dinshaw's, etc in its various key markets. In addition, Vadilal faces competition from unorganized ice-cream manufactures at local level.

Analytical Approach: Combined. CARE has taken a combined view of the consolidated financials of Vadilal Industries Limited (VIL) and VEL due to their strong managerial and operational linkages whereby VEL acts as the marketing arm for selling and distribution of Vadilal brand Ice-cream, frozen desserts and processed food products manufactured by VIL in India. List of entities getting consolidated in VIL is placed at **Annexure-3**.

Applicable Criteria
Criteria on assigning Outlook and Credit Watch to Credit Ratings
Criteria for Short Term Instruments
CARE's Policy on Default Recognition
CARE's Methodology for Factoring Linkages in Ratings
CARE's methodology for manufacturing companies
Financial ratios – Non-Financial Sector

About the Company
Ahmedabad-based VEL, which was incorporated in 1985, primarily acts as the marketing arm for selling and distribution of Vadilal brand Ice-cream, frozen desserts and processed food products manufacture by VIL in India. The company is promoted by the promoters of VIL. Both these companies operate under the common management platform.

(Rs.Crore)

Brief Financials	VEL		Combined [VIL (Consolidated) +VEL] #	
	FY18 (A)	FY19 (A)	FY18 (UA)	FY19 (UA)
Total operating income	547.21	574.58	652.00	714.31
PBILDT	11.58	14.82	64.53	97.04
PAT	0.15	0.09	15.81	33.46
Overall gearing (times)	6.32	10.59	1.68	1.36
PBILDT Interest coverage (times)	4.63	4.02	3.62	5.46

A: Audited; UA: Unaudited
 # net of Inter-company transactions

Further, during Q1FY20 (Un-audited), VEL earned a total operating income of Rs.295.74 crore and PAT of Rs.11.18 crore as against total operating income of Rs.257.71 crore and PAT of Rs.5.06 crore during Q1FY19 (Un-audited).
On a combined basis, during Q1FY20 (Un-audited), Vadilal group earned a total operating income of Rs. 354.08 crore and PAT of Rs.48.85 crore as against total operating income of Rs.292.89 crore and PAT of Rs.37.41 crore during Q1FY19 (Un-audited).

Status of non-cooperation with previous CRA: Rating assigned by CRISIL to the fixed deposits instrument of the company continued to remain under 'Issuer not cooperating' category vide its press release dated December 31, 2018 in absence of requisite information.

Any other information: Not Applicable

Rating History (Last three years): Please refer Annexure-2

Annexure-1: Details of Facilities

Name of the Bank Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Fund-based - LT-Term Loan	-	-	April 2023	15.34	CARE BBB (Under Credit watch with Negative Implications)
Fund-based - LT-Cash Credit	-	-	-	10.00	CARE BBB (Under Credit watch with Negative Implications)
Non-fund-based - LT/ ST-Bank Guarantees	-	-	-	0.50	CARE BBB / CARE A3+ (Under Credit watch with Negative Implications)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
1.	Fund-based - LT-Term Loan	LT	15.34	CARE BBB (Under Credit watch with Negative Implications)	1)CARE BBB (CE) (Under Credit watch with Negative Implications) (22-Aug-19) 2)CARE BBB+ (SO) (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE BBB+ (SO); Stable (12-Sep-18)	1)CARE BBB+ (SO); Stable (28-Aug-17)	1)CARE BBB (SO) (21-Sep-16)
2.	Fund-based - LT-Cash Credit	LT	10.00	CARE BBB (Under Credit watch with Negative Implications)	1)CARE BBB (CE) (Under Credit watch with Negative Implications) (22-Aug-19) 2)CARE BBB+ (SO) (Under Credit watch with Developing Implications) (10-Jun-19)	1)CARE BBB+ (SO); Stable (12-Sep-18)	1)CARE BBB+ (SO); Stable (28-Aug-17)	1)CARE BBB (SO) (21-Sep-16)
3.	Non-fund-based - LT/ ST-Bank Guarantees	LT/ST	0.50	CARE BBB / CARE A3+ (Under Credit watch with Negative Implications)	1)CARE BBB (CE) (Under Credit watch with Negative Implications) / CARE A3+ (CE) (Under Credit watch with Negative Implications)	1)CARE BBB+ (SO); Stable / CARE A2 (SO) (12-Sep-18)	1)CARE BBB+ (SO); Stable / CARE A2 (SO) (28-Aug-17)	1)CARE BBB (SO) / CARE A3+ (SO) (21-Sep-16)

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2019-2020	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017
					(22-Aug-19) 2)CARE BBB+ (SO) / CARE A2 (SO) (Under Credit watch with Developing Implications) (10-Jun-19)			

Annexure-3: List of entities getting consolidated in VIL

Sr. No.	Name of the Entity	Subsidiary / Associate / Joint Venture	% Shareholding by VIL as on March 31, 2019
1.	Vadilal Industries (USA) Inc	Subsidiary	100.00
2.	Vadilal Industries Pty Ltd.	Subsidiary	100.00
3.	Vadilal Gulf (FZE)	Subsidiary	100.00
4.	Vadilal Cold Storage	Subsidiary	98.00

Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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About CARE Ratings:
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Our ratings do not factor in any rating related trigger clauses as per the terms of the facility/instrument, which may involve acceleration of payments in case of rating downgrades. However, if any such clauses are introduced and if triggered, the ratings may see volatility and sharp downgrades.

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