

IPO Grading rationale for Raj Oil Mills Limited (ROML)

The IPO grade assigned by ICRA reflects the long presence of ROML in the Indian edible oils market, popular brands in Western India, buoyant growth prospects for the Indian edible oils market and its currently high profitability. The grading is, however, constrained by the relatively small scale of operations that are concentrated in the Western region and challenges involved in scaling up operations, given the highly competitive nature of the edible oils industry and significant volume growth planned by the company. Also, the company's profitability and earnings prospects would remain susceptible to the movement in international edible oil prices and duty differential between crude and refined oil. ICRA has also taken note of the history of civil and criminal litigation against the company.

ROML is a regional market participant, with an established presence in Western India with popular brands like *Cocoraj* (coconut oil) and *Guinea* (groundnut oil and sunflower oil). The company has hitherto focussed mainly on retail sales. Currently, its operating margins at 13.9% are higher than the industry average.

ROML is setting up new projects at Manor, Maharashtra and Jaipur, Rajasthan in order to increase its crushing/filtering/refining combined capacity significantly from current 35000 tonnes per annum (tpa) to 226500 tpa. The investment for the same is estimated at Rs 750 million, and would be financed primarily from the IPO proceeds. The company is entering into crushing of groundnut, mustard and sesame seeds, as opposed to its current sourcing of crude/refined oil and filtration. ICRA expects this backward integration to enhance the cost-competitiveness of the company and reduce its dependence on external suppliers for crushing. The company also plans to enter into the bulk segment with the increase in capacity. ICRA expects the lower margins in the bulk segment to partially offset the improvement in profitability arising from backward integration.

ROML plans to enter into the Northern Indian market segment by setting up its mustard and til oil manufacturing plants at Jaipur, Rajasthan. In ICRA's view, the company's ability to establish itself in regions other than Western India would remain a challenge since it involves dedicated efforts towards brand promotion and expansion of marketing & distribution network. ROML plans to set up rented outlets at shopping malls and rented warehousing facilities at strategic locations to ensure timely supply.

The demand outlook for the Indian edible oils market is buoyant, with likely increase in per-capita edible oil consumption in the medium term. However, the share of imports is expected to increase further due to the relatively slower pace of growth in production. Currently, domestic edible oil manufacturers are protected by the duty differential between crude and refined oil. Their profitability would suffer an adverse impact with any decline in duty differential. The profitability of domestic edible oil manufacturers is also exposed to fluctuations in international edible oil prices and agroclimatic conditions that affect domestic oilseed prices.

ROML revenues have grown at a compounded annual growth rate (CAGR) of 15.6% over the period from 2003 to 2007. The company's operating margins witnessed consistent improvement to 13.9% in 2007 owing to an uptrend in global edible oil prices. The company posted high return on capital employed (RoCE) and return on networth (RoNW) of 68.9% and 59.2%, respectively, in 2007 because of the low capital intensity in its current operations. The company's ability to sustain its high operating margins and return indicators remains to be seen, with increase in working capital intensity following its plans to set up crushing plants. Commensurate with its expansion plans, the company may also need to further professionalize its set-up and increase its management bandwidth.

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