

Food, Beverage & Tobacco/India IPO Grading report

Tara Health Foods Limited

Fitch IPO Grade 2(ind)

Fitch has assigned a grade of '2 (ind)' out of a maximum of '5 (ind)' to the proposed IPO of Tara Health Foods Limited. The grade indicates the below-average fundamentals of the issue relative to other listed equity securities in India

IPO Details

Tara Health Foods Limited proposes an IPO of 10,000,000 equity shares of INR10 each. The issue would constitute 33.28% of the post-issue paid-up capital of the company

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Related Research

Applicable Criteria

- Corporate Rating Methodology (November 2009)

Shareholding Pattern

	Pre-issue		Post-issue	
	No. of shares	(%)	No. of shares	(%)
Promoter Group A				
Balwant Singh	5,619,900	28.04	5,619,900	18.71
Jaswant Singh	5,424,100	27.06	5,424,100	18.05
Kulwant Singh	4,779,500	23.85	4,779,500	15.91
Promoter Group B				
Tejininder Singh	187,000	0.93	187,000	0.62
Rajvir Kaur	132,000	0.66	132,000	0.44
Parminder Kaur	132,000	0.66	132,000	0.44
Ranjit Kaur	132,000	0.66	132,000	0.44
Balwant Singh HUF	297,000	1.48	297,000	0.99
Jaswant Singh HUF	297,000	1.48	297,000	0.99
Kulwant Singh HUF	297,000	1.48	297,000	0.99
Gurmukh Singh	550,000	2.74	550,000	1.83
Gurwinder Kaur	165,000	0.82	165,000	0.55
Tara Health Care Products	2,031,5500	10.14	2,031,5500	6.76
Total Promoter Holding	20,044,000	100.00	20,044,000	66.72
Public Issue			10,000,000	33.28
Total			30,044,000	100.00

Source: Company, Fitch

Grading Rationale

- The grading assigned to Tara Health Foods Limited (Tara) factors in its aggressive business growth over the past three years, although working capital requirements have also increased significantly in line with revenue growth. The company has moved from being a small cattle-feed manufacturer in 2005 to an integrated cattle feed manufacturer and edible oil refiner, after setting up its own refinery and solvent extraction plant. In turn, a positive demand environment for both cattle feed and edible oil has helped the company reach optimum utilisation levels in the nine-month period ending December 2009, as reflected in a significant increase in turnover and improving margin profile. Tara's strong distribution network in the rural areas of northern India, and a strong brand image, has helped increase its market share in a highly "unorganised" cattle feed market, and to gain acceptability for its blended oils.
- Fitch Ratings expects future growth to be largely dependent on the company's policies regarding purchasing and working capital management. Tara has a limited track record of setting up and managing operations on a large scale, although management is confident of maintaining operational performance even with expanded capacity in both its business segments. To mitigate the risk of commodity price volatility — with the raw materials being seasonal in nature — the company endeavours to procure inventories for the whole year during peak supply periods, and stores it after initial processing for use during the year.
- Tara's established distribution channels, branding strategy and product differentiation have helped it face competition from unorganised players, and to generate margins higher than the industry average. However, the company faces challenges due to its concentration in northern India, the need to increase acceptability of its products outside its key markets, and liquidity constraints on account of high inventory and receivable requirements. The plan to raise equity to meet a portion of its working capital requirements could provide a cushion to its overall liquidity.

- The '2(ind)' grading factors in Tara's inherent cost advantage given its proximity to both raw material sources and end-markets — which results in significant savings in freight costs. The grading also takes into account the expansion in the company's EBITDAR margin to 24.2% in 9MFY10 (FY09: 15.6%), due to a combination of low-cost inventory and full utilisation of current capacities resulting in higher efficiencies. Revenue growth has been high over the past three years, with sales of INR2,311m in 9MFY09 versus INR314m in FY07. Tara has been able to improve its credit metrics, with net debt/EBITDA improving to 2.98x in FY09 from 5.6x in FY07, and interest cover also improving — to 3.98x in FY09 compared with 3.22x in FY07.
- Tara is among the few Punjab-based organised players in the rice bran oil and cattle/poultry feed industry. It sells its products in Punjab, Haryana, Delhi and Jammu & Kashmir.

Company Background

Present management took over a company called Ram Sahai Wool Combers in 2004, with a view to undertaking cattle-feed manufacturing activities in a corporate structure under "Tara Health Foods" — as against scaling-up the existing cattle-feed activity which had been carried out in their partnership firm Tara Feeds Factory since 2001.

Management

The company's founders are Chairman Mr Jaswant Singh and Managing Director Mr Balwant Singh. The six-member board includes three independent members.

Board of Directors

Name	Age Designation
Jaswant Singh	47 Chairman
Balwant Singh	44 Managing Director
Tejinder Singh	29 Whole Time Director
Jaspinder Singh Kolhar	65 Independent Director
Parshotam Bansal	55 Independent Director
Rajneesh Kumar	28 Independent Director

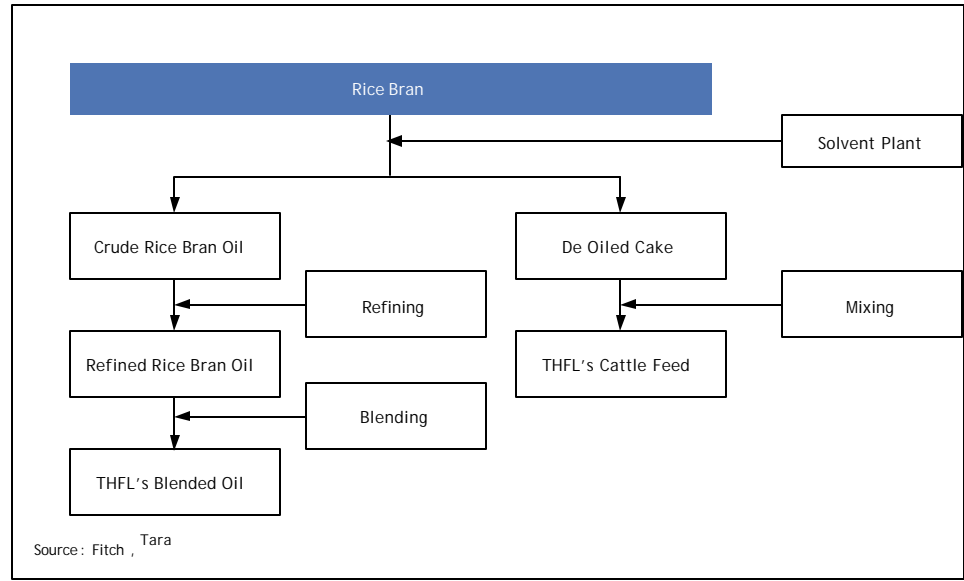
Source: Company Data

Business Overview

Catering to the needs of both human and animal nutrition, the company is focused on providing healthy and relatively cheaper products in both its business segments. It has tried integration of its operations by setting up a refinery and a solvent extraction plant in addition to its cattle-feed manufacturing plant. As of April 2010, the company has a 250 Tonnes Per Day (TPD) cattle feed plant, a 250TPD solvent extraction plant, and a 120 TPD edible oil refinery in Maler Kotla, Punjab, and another 250TPD cattle-feed plant in Uttaranchal. Cattle feed contributes about 60% of total revenue, and refined edible oils the rest 40%.

The company buys rice bran from the open market, and manufactures crude rice bran oil and rice bran de-oiled cakes in its solvent extraction plant. Rice bran gives out 85% of de-oiled cakes and 15% of rice bran oil (RBO) during the extraction process. This 85% of the output is used as the key ingredient for manufacturing cattle feed; and at current capacity, is enough to fulfil the entire requirements of the company in its Punjab plant, although the company has to purchase de-oiled cakes for its Uttaranchal cattle feed plant. The remaining 15% of crude rice bran oil is refined to make various types of refined edible oils, which include Rice Bran Oil, Olive Blended Oil and Cottonseed Oil. The oil from the solvent extraction plant is sufficient for about 33% of the company's RBO requirement. The 67% balance of crude rice bran oil is purchased locally from the open market.

Process Flow



Product Segments

The company's products can be divided into two major segments:

- **Oil**
 - Pure Refined Oil
 - ? Rice Bran Oil
 - ? Olive Oil
 - ? Cottonseed Oil
 - Blended **Refined Oil**
- **Animal Feed**
 - Cattle Feed
 - Poultry Feed

The animal feed segment contributes more to both total revenue and profit, as it is a higher-margin business — with the higher degree of value-addition being done in terms of product mixing, distribution and brand image. As far as rice bran and blended oils are concerned, prices are mostly market-dependent — which reduces the margins that Tara can generate from this segment.

Outlook for Demand and Pricing

The demand outlook for both segments in which the company operates is positive — given the increasing consumption of milk in the country, and the recent demonstration in consumer eating habits towards a shift from conventional edible oils to health-focussed edible oils. Cattle feed demand depends on the level of farmers' awareness and the increase in milk yield from using the cattle feed. The company is trying to increase awareness levels by organising regular seminars in villages. The R&D efforts are also going on simultaneously, to continuously improve the quality of the feed by obtaining regular feedback from farmers concerning the milk yield. The daily feed requirement also provides much downside support to demand, and makes demand inelastic to a certain extent.

In the edible oil segment, the major challenge is to shift consumers from traditional edible oils — like mustard, groundnut and sunflower — to rice bran and blended oils, which have been proved to be good for health. But as awareness increases, demand

is expected to pick up for this segment as well.

Pricing for edible oils is essentially market-driven, but the company can charge some premium for the value-addition and the patented refining process. But pricing for cattle feed is pretty flexible, and it is not very difficult to pass on any increases in raw material price to end-users — as has been demonstrated in the past.

Raw Material Sourcing Dynamics

The raw material for cattle feed entails various oil seeds cakes like rice bran, soybean, sunflower, mustard, maize, bajra, mineral mixtures and molasses. The company is located in the largest rice-producing district in Punjab, which is in turn the largest rice-producing state in India. Rice bran is purchased from rice millers based in Punjab, which ensures easy availability, competitive pricing and good quality. Other raw materials are available in Punjab or other neighbouring states like UP and Haryana.

In the case of edible oils, the company requires rice bran, crude olive oil and cotton seed oil. Rice bran oil and cotton seed oil is sourced from vendors within the country, whereas olive oil is imported from EU nations. As the availability of raw materials is seasonal in nature, the company has made warehousing arrangements to store sufficient raw materials.

The company has been quite successful in managing raw material price volatility in the last three years, by passing on any price increases to end-users. The company has revised its selling prices of cattle feed eight times in the last 12 months. There is no similar flexibility to change prices as far as edible oils are concerned, which explains the lower margins in that segment. According to the company, it can sustain around 25% margins in the cattle feed segment (which is about the industry average), and about 15% margins for edible oils — which is higher than the industry average due to the fact that the company gets a premium from the value-addition and blending with olive oil.

Distribution

Tara's major strength lies in its 2,500+ dealers spread over the northern Indian states of Punjab, Delhi, Himachal Pradesh and J&K, especially in rural areas. Distribution reach and brand image in rural areas is considered one of the biggest entry barriers in the cattle feed industry. The company has its own fleet of 35 trucks used for the delivery of end-products to the dealers/retailers at desired locations. Owning and operating its own fleet was considered necessary, with the extensive dealership network in remote villages and towns.

Sales and Marketing

Tara has been using a combination of various marketing techniques to establish its brand image and push through higher sales volumes. *Tara Gold*, a budget RBO brand, is sold through the retail format and has been able to gain market penetration due to its competitive price and quality. *Zaitoon Tara*, a premium blended oil brand, is marketed with selected organised and unorganised players, with the target audience being high-end localities in Metros and Tier 2 cities. The company has distributors in Delhi, Punjab and Himachal Pradesh, and is in the process of setting up distribution points in other areas as well.

Competition

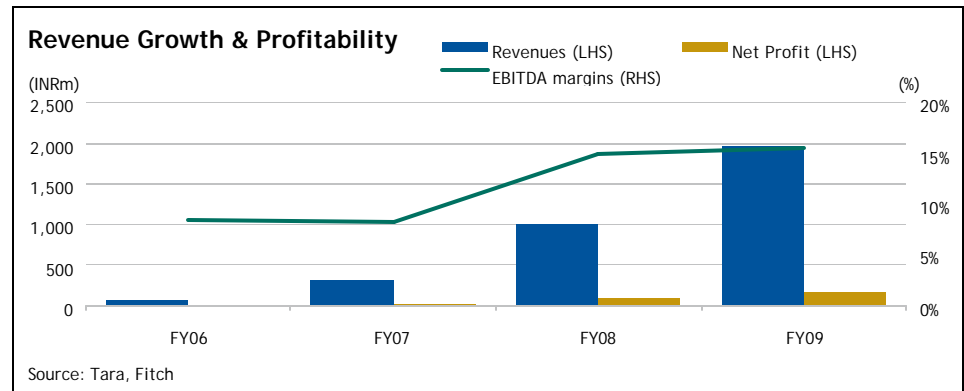
Competition depends on the product segments offered by other companies in the organised segment, besides other factors like quality, price, and capacity to deliver. The company has established its own brands to mitigate that risk. In the organised segment, major competitors could be Cargill India Pvt Ltd, Markfed, KS Oils Ltd and Sanwaria Agro Oils Ltd.

Financial Overview

Growth & Profitability

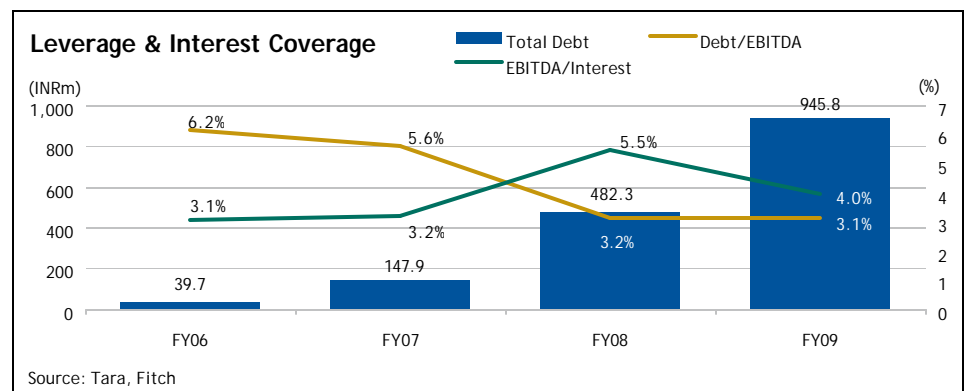
Revenue grew strongly over FY07-FY09, with sales of INR2,311m in 9MFY10 compared with INR314m in FY07. This has also been accompanied by an expansion in EBITDAR margin to 24.2% in 9MFY10, from 15.6% in FY09, due to a combination of low-cost inventory and full utilisation of current capacities resulting in higher efficiencies.

The company has a high dependence on the Punjab region, which contributed over 70% to revenue over FY09 and 9MFY10.

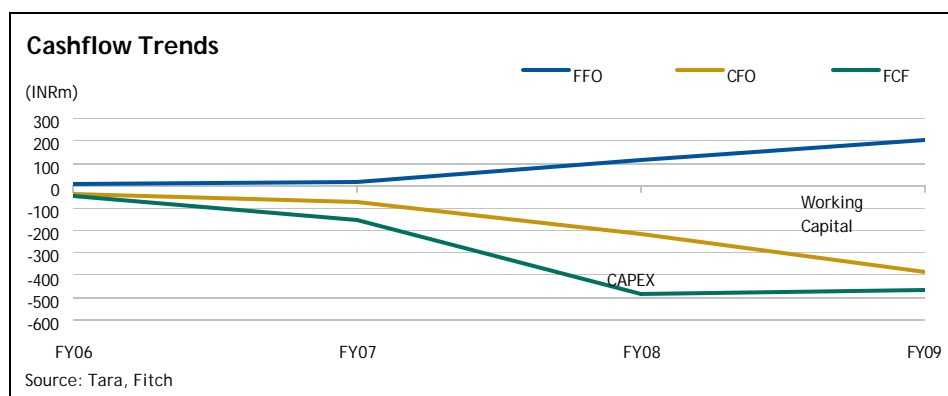


Leverage and interest cover

The company has had a trend of improving leverage levels and interest cover, as the expanded capacities have started generating revenue. Total debt in FY09 was INR 945.8m. Net debt/EBITDAR over the last two years has been slightly more than 3.0x (FY09: 3.1x and FY08: 3.2x), while interest cover remained comfortable at 4.0x in FY09.



With both businesses being working capital-intensive, cash from operations (CFO) has been negative from FY06-FY09, and Fitch expects it to remain that way in the medium term. With the company also incurring capex in the last three years, liquidity gets stretched further – with free cash flows (FCF) being negative. This is mainly attributed to the seasonality aspect where significant raw material inventories need to be maintained during the peak season, and also due to the retail products of the company where sufficient finished good stock of various product lines needs to be maintained with various dealers.



Expansion plans -Substantial Investment in Refining Capacity

The company has investment plans of INR1,298m over FY11. The entire fundraising requirement of funds is proposed from the proceeds of the IPO; and shortfalls, if any, would be financed through internal accruals.

Estimated Funding Requirement

Particular	(INRm)
300 TPD Edible Oil Refining Plant at current location	1253.18
250 TPD expansion of cattle feed plant at current location	45.20
Augmenting Long Term Working Capital Requirement	389.60
Total	1688.00

Source: DRHP

The major portion of this capex for the edible oil refining capacity and the fund deployment schedule will be as follows:

Funds Deployment Schedule

Particulars (INRm)	FY11				Total
	Q1	Q2	Q3	Q4	
Edible Oil Refining Plant	345.27	30.22	385.8	491.89	1253.18
Cattle Feed Plant	14.22	16.08	14.91	0	45.21
Total	359.49	46.3	400.71	491.89	1298.39

Source: DRHP

Annex 1

Financial Summary (INRm)

	FY09	FY08	FY07
Income Statement			
Revenues	1951.8	1012.2	314.0
Revenue Growth	92.8	222.3	349.1
EBIT	277.4	143.0	23.0
Interest Expense Net of Interest Income	76.4	27.6	8.1
Net Income	170.0	90.1	14.2
Balance Sheet			
Cash and Equivalents	39.7	10.3	2.2
Total Assets	1613.0	893.7	267.0
Short-term Debt	721.4	219.8	97.9
Senior Long-Term Debt	224.4	262.5	50.1
Subordinated Debt	0.0	0.0	0.0
Total Debt	945.8	482.3	148.0
Off-Balance Sheet Debt	0.0	0.0	0.0
Total Adjusted Debt	945.8	482.3	148.0
Preferred Stock + Minority Interests	0.0	0.0	0.0
Common Equity	541.4	333.6	82.4
Total Adjusted Capitalisation	1487.2	815.9	230.3
Cash Flow			
Operating EBITDAR ("Op. EBITDAR")	304.1	151.6	26.1
Cash Interest Paid, Net of Interest Received	76.4	27.6	8.1
Cash Tax Paid	21.0	14.7	1.5
Associate Dividends	0.0	0.0	0.0
Other Changes before Funds From Operations****	0.5	0.6	-0.1
Funds from Operations	207.2	109.9	16.4
Working Capital	-592.1	-328.7	-89.7
Cash Flow from Operations	-384.9	-218.9	-73.3
Non-Operational Cash Flow***	0.0	0.0	0.0
Capital Expenditure	85.6	267.4	77.6
Dividends Paid	0.0	0.0	0.0
Free Cash Flow	-470.5	-486.2	-150.9
Receipts from Asset Disposals	0.0	0.0	0.0
Business Acquisitions	0.0	0.0	0.0
Business Divestments	0.0	0.0	0.0
Exceptional & Other Cash Flow Items	0.0	0.0	0.0
Net Cash In/Outflow	-470.5	-486.2	-150.9
Equity Issuance/(Buyback)	36.4	160.0	41.5
FX movement	0.0	0.0	0.0
Other Items Affecting Cash Flow****	0.0	0.0	0.0
Net Cash Flow Available for Financing	-434.1	-326.2	-109.4
Closing Net Debt	906.1	472.0	145.8
Profitability			
Op. EBITDAR/Revenues (%)	15.6	15.0	8.3
EBIT/Revenues (%)	14.2	14.1	7.3
FFO Return on Adjusted Capital (%)	19.1	16.9	10.4
Credit Ratios			
Funds From Operations/Gross Interest Expense (x)	3.7	5.0	3.0
FFO Fixed Charge Cover (x)	3.7	5.0	3.0
Op. EBITDAR/Net Fixed Charges (x)	4.0	5.5	3.2
Adjusted Leverage/FFO (x)	3.3	3.5	6.2
Total Adjusted Debt Net of Cash/Op. EBITDAR (x)	3.0	3.1	5.7
Total Adjusted Debt/Total Adjusted Capitalisation (%)	63.6	59.1	64.2

Source: DRHP

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