Business Standrard

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Dairy sector becomes a sweet spot for PE funds

Sector raised Rs 366 crore during May-November

After a brief lull, private equity (PE) firms are back to investing in India's $70-billion (about Rs 3.5 lakh crore) Dairy sector. After Carlyle's $22-million (Rs 119.4 crore) investment in Tirumala Milk Products in May 2010, no big deals happened for the rest of 2010 and all of 2011. However, between May and November 2012, the sector attracted $67.5 million (Rs 366 crore) from PE funds, according to Venture Intelligence data.

This year's deals include Ambit Pragma's investment in Neo Anurena Tristar Food Products for an undisclosed amount, IDFC PE's $29-million (Rs 157.4 crore) investment in Parag Milk, the $18.5-million (Rs 100.4 crore) investment by Abraaj Capital and Rabo Equity in Prabhat Dairy, and Cargill Ventures' $20-million (Rs 108.5 crore) fund infusion in Dodla Dairy.

What explains the sudden surge in investment flow towards the dairy sector? The general food and agricultural sectors have been on the radar of PE players for the past four years, says Rajesh Srivastava, chairman and managing director of Rabo Equity Advisors, a subsidiary of Rabobank

PE DEALS IN THE DAIRY SPACE SINCE 2010

Date	Buyer	Target	Amount (Rs cr)
May '10	Carlyle	Tirumala Milk Products	22
May '12	Ambit Pragma	Neo Anurena Tristar	NA
Sep '12	IDFC PE	Parag Milk	29
Sep '12	Abraaj Capital, Rabo#	Prabhat Dairy	18.5
Nov '12	Cargill Ventures	Dodla Dairy	20

** Food Products # Equity* *Source : Venture Intelligence*

PE players have now turned their attention to the dairy sector. With the rising incomes of the health-conscious middle class, the demand for both milk and value-added dairy products is on the rise. Assocham said the domestic dairy sector would grow to Rs 5 lakh crore by 2015, with the output estimated to rise to 190 million tonnes from the current 123 million tonnes.

India is the world's largest producer of dairy goods, accounting for nearly 20 per cent of global milk output.

According to experts, the country needs to raise milk output by around five million tonnes a year to meet the growing demand, compared with the average annual growth of 3.2 million tonnes in the past 15 years. This additional capacity would require huge funds. And the entrepreneurs, who are largely seen as conservative, closely-held and unorganised, have realised this, and been exploring avenues for funds. This is another reason for the uptick in PE investment in the sector.

"For a company like Parag, growing at 35 per cent in the past 10-15 years, heavy investment is required to maintain this growth and for that, outside investment is required. Besides bringing money, these investors are also helping to attract good talents, in process and systems," says Shirish Upadhyay, senior vice-president (planning), Parag Milk.

Parag will use the proceeds from IDFC fund to build capacities in various product lines, strengthen procurement and provide a part-exit to existing investors, Motilal Oswal Private Equity, which invested in the company in 2008.

The key differentiation of the companies that raised money from the PE funds and those didn't is value-added quality products, backed by strong branding and robust distribution systems. Take, for instance, Parag Milk Foods. It distributes its products under Gowardhan, GO and Pride of Cows brands. Parag generates 60 per cent of its revenue coming from value-added products such as cheese, ghee and yoghurt, growing at 20 per cent per annum.

According to Satish Mandhana, managing partner and CIO at IDFC Alternatives, the dairy sector has the potential to build the rural economy. "We believe that companies like Parag's excitement blend of traditional values and modern outlook, mirror their brands and have the potential to achieve that," he said in a statement.

According to Srivastava, the margins will be better in companies that are offering value-added products. While milk production alone will not be profitable, the margins can be increased to five-six per cent from the current level of three per cent, by increasing volumes and adding more value added products.

According to Keshav Misra, partner (fast moving consumer goods) at Baring Private Equity Partners India, the dairy sector is consumer-driven, offering good returns. And for funds, the consumption story is a key attraction, he adds. For a company wanting to go public, raising money from the PE is the first step, because the PE funds will make sure the company's books are clean, he says.

Kunal Bhakta, partner & head of research, Lastaki Advisors Pvt Ltd, agrees.He says that the return on capital employed in dairy business is higher than most traditional businesses. According to industry sources, the return on capital by a dairy firm is around 35-40 per cent.

Bhakta, however, adds that the sector doesn't have a great track record in terms of corporate governance and therefore, investors need to tread cautiously.

On the flip side, PE players feel that while there are more investment opportunities available, some regulatory issues kept the sector from realising its true potential.

Besides, high government intervention in the sector, especially in pricing and procurement, has also made India seen as an unreliable overseas supplier even though it is the largest producer of milk.