



## Sarveshwar Foods Ltd. - IPO Note

Issue Details	
<b>Issue Opens</b>	5 <sup>th</sup> March, 2018
<b>Issue End</b>	7 <sup>th</sup> March, 2018
<b>Offer Price (at higher band)</b>	85
<b>Pre-issue Shares outstanding (cr)</b>	1.81
<b>Shares offered in IPO (entire OFS) (cr)</b>	0.6467
<b>Nos. of shares post issue (cr)</b>	2.4565
<b>IPO size (Rs.cr)</b>	55
<b>Promoter Holding pre-IPO</b>	100
<b>Promoter Holding post-IPO</b>	74
<b>FY17 PAT (Adj.)</b>	11.7
<b>TTM P/E at Upper Band</b>	11.87

### About the Company:

Sarveshwar is primarily engaged in the business of processing and marketing of branded and un-branded basmati and non-basmati rice in the domestic and international markets. This business contributes 90% of the sales. Its operations are based out of the Jammu Region in the State of Jammu and Kashmir. It is one of the few Indian companies with a presence across the entire rice value chain, which includes procurement, storage, milling, sorting, packaging, branding and distribution. The product portfolio comprises of Basmati and non-Basmati rice of various kinds including white raw rice, steam rice, broken rice, brown rice and parboiled rice. The brand is famous in North India and has significant market share there. Its presence is limited outside North India as that would require it to incur substantial marketing expense. Branded sales constitute half of revenues while unbranded sales constitute the balance. Conventional rice is sold under the brand name "Sarveshwar".

Along with conventional Basmati and non-Basmati rice, the product portfolio also includes organic Basmati and non-Basmati rice including a range of other organic products such as dry fruits and nuts, pulses, lentil, flours, porridge, spices, garam masalas and super foods like chia seeds, flax seeds, and quinoa seeds. This business segment contributes 10% of the revenues. The company markets and distributes these organic food products under its brand "Nimbark". The organic products are on average 30-40% more expensive than conventional products; for some products the price differential may be 80%.

Sarveshwar has recently launched its flagship retail store in the name of "Nimbark - Living the Satvik Way" at Channi Himmat, Jammu. The company is selling organic products through this store. Around 50% of the inventory in the store is procured in house through Sarveshwar's supply chain (Nimbark brand) and the rest is other brand products.

### Objectives of the issue:

The objectives of the issue to fund working capital requirements and for funding the growth of subsidiary, Himalayan Bio Organics Pvt Ltd. Around 30cr will be used to fund the long term working capital requirements of the firm; this need is currently financed via debt. Around 15cr will be pumped into the subsidiary which is responsible for organic products. The balance 10cr will be used for general corporate purposes including the cost of the issue

### Core strength and triggers of the company:

#### 1. Geographical Location

Rice paddy and other crops are cultivated in the plateau regions of J&K and the plains near River Chenab flowing with snow melted water. Unlike agricultural lands fed by rivers in other parts of the country where the water is contaminated by pesticides or fertilisers, the water in J&K is pure. Most farmers use ancient techniques to grow Basmati rice and use natural organic fertilizers. The climatic conditions of the State are ideal not only for conventional farming but also for organic farming. While the firm procures Basmati and non-Basmati paddy from Punjab, Haryana, Himachal Pradesh, Uttar Pradesh and Delhi, it primarily procures organic Basmati and non-Basmati paddy from the State of Jammu and Kashmir. The pure water and soil of J&K can be used in marketing campaigns to promote sales of both the organic products as well as conventional rice.

#### 2. Integrated Operations

It is one of the few Indian companies with a presence across the entire basmati rice value chain, which includes procurement, storage, milling, sorting, packaging, branding and distribution. Such integration provides it with several competitive advantages and allows it to benefit from economies of scale, maintain greater control on the quality of products, ensure smooth supply chain and inventory management.



Additionally, vertical integration allows it to use the entire Basmati paddy to increase revenue or reduce costs. Once processed, basmati paddy gets processed into basmati rice, bran and husk. In addition to selling whole grain basmati rice and broken basmati rice, firm uses the husk for producing steam in the boilers. This eliminates the requirement of other sources like coal to produce steam in processing plants. In addition to the internal use of husk, the company sells husk and steam for industrial use around the plant for power consumption requirements. It sells bran to edible oil extraction units and as cattle feed without any processing.

### **3. Modern Equipment & Technology coupled with process innovations**

The processing technology offers high operational efficiency resulting in less percentage of broken rice and provides high yield. Its technology ensures that labour requirement is minimal and facilitates quick turnaround time. While processing the basmati paddy, a substantial portion of the processed rice gets normally broken. The company's high level of modernization, trained work force and managerial expertise results in a consistent high level of productivity.

### **4. Strong procurement capabilities for conventional and organic basmati paddy**

Firm has developed procurement capabilities through the long-standing association of promoter and management with procurement agents and farmers over a vast geography. As of June 30, 2017, firm had relationships with approximately 132 procurement agents, or pucca arityas. Through this extensive network of procurement from pucca arityas, firm is able to procure basmati paddy at lower prices from mandis in villages in which many smaller competitors are not present. Firm has developed strong relationships with basmati paddy farmers by using advanced payments, upfront payments and consistent purchases to inspire the faith and confidence of these farmers. Furthermore, the firm helps farmers by providing training, organic fertilisers and seeds. This enables firm to procure consistent supply of quality organic basmati paddy at low prices during procurement season.

### **5. Focus on Processing and Quality Control**

Firm has a well-established quality control system that spans the procurement, processing and delivery of conventional as well as organic basmati rice. Prior to procuring basmati paddy, firm conducts pre-harvest surveys through visual tests, and quality checks. After procurement, the basmati paddy is checked before loading and unloading into the transportation systems. Upon arrival of paddy at the facilities, the paddy is unloaded only upon checking its quality by fully equipped modern laboratory. Further, the In Process Quality Control (IPQC) laboratory keeps a check throughout the rice production process.

## **Risks and Concerns**

### **1. Capital intensive business**

The business is working capital intensive and failure to meet working capital requirements may adversely impact the business. In addition to expanding the existing business, firm wants to set up 70-100 retail stores. Each store would require an investment of around 25lac. This is a capital intensive process and may put a lot of strain on the balance sheet of the company.

### **2. Price limits for rice**

Sarveshwar buys the rice it needs from farmers. The government has recently announced that the price for Kharif crops has a Minimum Support Price (MSP) of 1.5 times the cost to farmer. Any further increases in MSP would put pressure on the margins of the company.

## **Valuation and Recommendation**

1. At upper price band of Rs. 85, the stock is valued at trailing P/E of 11.87X which is at a discount to its peer average of 25.7. However, a discount is justified as the peers have a stronger brand, are much larger in size, and have substantially higher EBITDA margins. Sarveshwar's EBITDA margin is 10.7% compared to peers' margins in high teens
2. Though the business appears attractively valued, it seems like a risky investment especially due to large capex plans in the future and government focus on increasing the income of farmers



Financials

Sarveshwar Foods- Balance Sheet (INR million)			
Particulars	31.03.2017	31.03.2016	31.03.2015
<b>ASSETS</b>			
Tangible assets	53.58	56.63	62.61
Capital work in progress	0.99		
Non-current investments	148.5	148.5	153.8
Deferred tax assets (net)	1.38	1.36	1.17
Other non-current assets	37.26		
<b>Total non-current assets</b>	<b>241.71</b>	<b>206.49</b>	<b>217.59</b>
Inventory	919.14	820.01	1,038.64
Trade receivables	392.02	385.6	143.35
Cash and cash equivalents	1.79	10.84	11.17
Other current assets	5.44	8.01	6.74
<b>Total current assets</b>	<b>1,318.39</b>	<b>1,224.45</b>	<b>1,199.90</b>
<b>LIABILITIES</b>			
Long term borrowings			
Other long term liabilities	11.08	3.8	11.6
<b>Total non-current liabilities</b>	<b>11.08</b>	<b>3.8</b>	<b>11.6</b>
Trade payables	306.56	225.79	281.96
Short term borrowings	741.13	840.36	809.52
Other current liabilities	23.83	13.71	17.15
Short term provisions	15.91	1.53	-2.06
<b>Total current liabilities</b>	<b>1,087.43</b>	<b>1,081.39</b>	<b>1,106.57</b>
Equity share capital	181	90.5	90.5
Reserves and surplus	312.16	255.25	208.81
<b>Net worth</b>	<b>493.16</b>	<b>345.75</b>	<b>299.31</b>

Sarveshwar Food- Income Statement (INR million)			
Particulars	FY17	FY16	FY15
Revenue	2,076.03	1,606.88	1,382.37
Other income	4.06	3.48	49.8
<b>Total revenue</b>	<b>2,080.08</b>	<b>1,610.36</b>	<b>1,432.17</b>
Cost of material consumed	1,056.25	689.57	1,127.64
Purchase of stock in trade	790.86	90.07	200.73
Change in inventory of FG	-165	468.02	-228.48
Employee expense	24.83	25.64	17.15
Depreciation and amortization	9.06	10.41	11.36
Finance cost	81.9	85.76	67.11
Other expenses	124.46	179.99	144.69
Total expenses	1,922.38	1,549.46	1,340.20
<b>PBT</b>	<b>157.71</b>	<b>60.9</b>	<b>91.97</b>
Current tax	42.43	14.06	12.96
Deferred tax	-0.42	-0.6	-0.72
<b>Profit</b>	<b>115.7</b>	<b>47.44</b>	<b>79.73</b>
Impact of change in accounting policy	1.95	1.48	0.25
Excess/short provision for taxation	0.4	0.41	0.08
Total impact of adjustment	1.56	1.07	0.17
Total impact net of tax adjustment	1.56	1.07	0.17
<b>Restated net profit</b>	<b>117.25</b>	<b>48.5</b>	<b>79.9</b>



Sarveshwar Foods Cash Flow - (INR million)			
DESCRIPTION	FY17	FY16	FY15
Profit Before Tax	159.66	62.38	91.99
Adjustment	90.10	96.40	38.13
Changes In working Capital	-111.32	-53.99	19.08
Cash Flow after changes in Working Capital	136.26	101.60	151.93
Tax Paid	-29.47	-12.53	-18.25
<b>Cash From Operating Activities</b>	<b>106.79</b>	<b>89.07</b>	<b>133.68</b>
<b>Cash Flow from Investing Activities</b>	<b>-42.19</b>	<b>2.52</b>	<b>-6.24</b>
<b>Cash from Financing Activities</b>	<b>-73.66</b>	<b>-91.93</b>	<b>-117.47</b>
Net Cash Inflow / Outflow	-9.05	-0.33	9.96
Opening Cash & Cash Equivalents	10.84	11.17	1.21
<b>Closing Cash &amp; Cash Equivalent</b>	<b>1.79</b>	<b>10.84</b>	<b>11.17</b>

Sarveshwar Foods Ltd. Financial Ratios			
Description	FY17	FY16	FY15
<b>Operational &amp; Financial Ratios</b>			
Earnings Per Share (Rs)	7.11	6.05	8.61
Book Value (Rs)	26.60	38.98	32.93
Tax Rate(%)	27.38	22.16	21.14
<b>Margin Ratios</b>			
PBIDTM (%)	9.36	8.76	11.84
EBITM (%)	8.76	7.75	10.57
Pre Tax Margin(%)	4.24	1.99	3.81
PATM (%)	3.08	1.55	3.00
<b>Performance Ratios</b>			
ROA (%)	4.30	1.95	3.11
ROE (%)	30.87	16.85	30.06
ROCE (%)	14.87	12.15	13.55
Asset Turnover(x)	1.39	1.26	1.04
Inventory Turnover(x)	2.18	1.82	1.32
Debtors Turnover(x)	5.52	6.61	11.24
Fixed Asset Turnover (x)	14.17	11.07	8.47
Sales/Working Capital (x)	9.95	9.06	6.25
<b>Efficiency Ratios</b>			
Fixed Capital/Sales(x)	0.07	0.09	0.12
Receivable days	66.10	55.24	32.47
Inventory Days	167.18	200.86	276.23
Payable days	38.88	62.60	38.18
Capital utilization (%)	63.64	92.95	81.48
Working capital cycle	194.40	193.50	270.52
<b>Growth Ratio</b>			
Net Sales Growth(%)	17.90	36.68	9.13
Core EBITDA Growth(%)	25.98	1.06	16.33
EBIT Growth(%)	33.11	0.24	17.14
PAT Growth(%)	134.81	-29.59	8.05
Adj. EPS Growth(%)	17.45	-29.68	8.05
<b>Financial Stability Ratios</b>			
Total Debt/Equity(x)	2.61	5.76	6.17
Current Ratio(x)	1.17	1.19	1.19
Interest Cover(x)	1.94	1.34	1.56



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