

French Lactalis Group Acquires India's Prabhat Dairy

¹Varma Ashish & ²Kapoor Rajat

¹Assistant Professor, Accounting and Finance, Institute of Management Technology, (IMT) Raj Nagar, Ghaziabad(India)

²Institute of Management Technology (IMT), Raj Nagar, Ghaziabad(India)

ARTICLE DETAILS

Article History

Published Online: 15April2019

Keywords

Animal Feed, Animal Nutrition, Shared Values, Company Strategy.

*Corresponding Author

Email:avarma[at]imt.edu

ABSTRACT

Mergers and acquisitions are a popular choice for inorganic growth. Driven by the philosophy of enhancing shareholder value, they offer rapid growth in the competitive economic, social and cultural environment. This route enables strong companies to grow at a faster pace than the competitors and provides investors a reward for the risks undertaken. Lactalis Group used M&A as a way to grow and this study discusses how it is growing its presence in India through the inorganic growth route.

This case study uses data from secondary sources and published sources to discuss a cross border deal. The case study does not represent the opinion of any of the companies mentioned in the case or any of any of their employees or management. The case also does not show the effective / ineffective handling of a managerial situation. The case is intended solely to provided material for class discussion.

1. Introduction

A few years after acquiring Chennai, India based Tirumala Milk Products in 2014, Lactalis International had opened up enormous opportunities in the biggest and the most challenging dairy products market in the world. Lactalis International top officials, in 2016, had admitted to the plans to further increase their presence in the Indian dairy space by the way of acquisitions and mergers. Lactalis International in 2016 itself had started to scout for potential target companies in the North Indian market which already had a strong presence in the southern part of the country. On January 21st, 2019 Prabhat Dairy revealed that it had entered into a final agreement with Tirumala Milk Products, a wholly-owned subsidiary of the French Dairy Multinational Lactalis International for the sale of their dairy business.

The transaction between Lactalis International's local arm, Tirumala Milk Products and Prabhat Dairy involved the sale of their dairy business, an undertaking of Prabhat, by way of slump sale for INR 472.81 Crores, along with the sale of 100% shareholding in Sunfresh Agro Industries Pvt. Ltd. (a step-down subsidiary) for INR 1227.18 Crores. On the day of the announcement 1 EUR was equal to 80.944 INR. Earlier in the year, Prabhat Dairy had also signed an agreement with the Denmark-based DLG Group, as part of its plans to get involved in the animal nutrition business. Prabhat Dairy intended to share the major portion of the proceeds from the sale with the shareholders after completing its tax and transaction cost obligations. After closing out the deal, Prabhat Dairy Limited intended to further enhance its cattle feed business in the various regions of the country, as well as expand into similar businesses like animal nutrition and animal genetics.

2. Company History

2.1 Lactalis International

Lactalis International (<https://www.lactalis-international.com/en/>), a French based multinational

organisation and the world's biggest dairy products group had initiated their operations in 1933 in France, which included food products as well the dairy business. They own a range of global brands and products like Galbani, Société, Bridel, Parmalat, President amongst others. Lactalis International was also the European leader in the cream and butter segment amongst the dairy products and the world's number one cheese manufacturer. Lactalis International has 237 production sites in nearly 43 different countries and employs over 75000 people worldwide.

Lactalis International's history and trends clearly indicated the company's strategy of growing by mergers and acquisitions. Using this strategy company was able to achieve the rapid growth in mature markets as well as developing countries. Its business model included a part of its long-term development strategy consisting of continuous acquisitions to grow its business externally whilst developing its own portfolio which included more than a hundred brands. It aimed to acquire dairy companies with shared values and similar lines of products and to help them grow, through industrial investment, marketing and human resources. The Lactalis International's brand development strategy had been based on increasing the global presence of three key global brands, Président, Galbani and Parmalat, while continuing to invest in local brands. Lactalis had always followed the way of growing inorganically ever since the late 1960's. The company had regularly acquired key players and competitors in different markets to grow as a worldwide leader in the dairy products segment.

2.2 Tirumala Milk Products

Tirumala Milk Products Pvt. Ltd. (<http://www.tirumalamilk.com/>), a dairy company in South India was founded in the year 1996. Since then, Tirumala had been maintaining its position as one of the fastest growing brands mainly in the southern region of India. Tirumala produced dairy products across nine state-of-the-art manufacturing plants

spread across southern states of India. In 2014, Lactalis International acquired Tirumala Milk Products.

2.3 Prabhat Dairy

Prabhat Dairy (<http://www.prabhatdairy.in/>), a Mumbai based company was founded in 1998. The company's market mainly covered the northern parts of the country. Prabhat Dairy known for its quality milk products, which catered to retail as well as institutional customers in India. Procurement and selling of milk were one of their main business operations. Prabhat Dairy's brand name, Goodness Zone operates in a franchise owned as well as franchise retail stores manner. The company was also involved in international export of their products to a range of countries like Bhutan, Nepal, Bangladesh, Sri Lanka etc. Prabhat Dairy had issued their IPO (Initial Public Offering) in September 2015 with the face value of INR 10 per share and a price range of issue of around INR 115- INR 126 per equity share. After the news of acquisition by

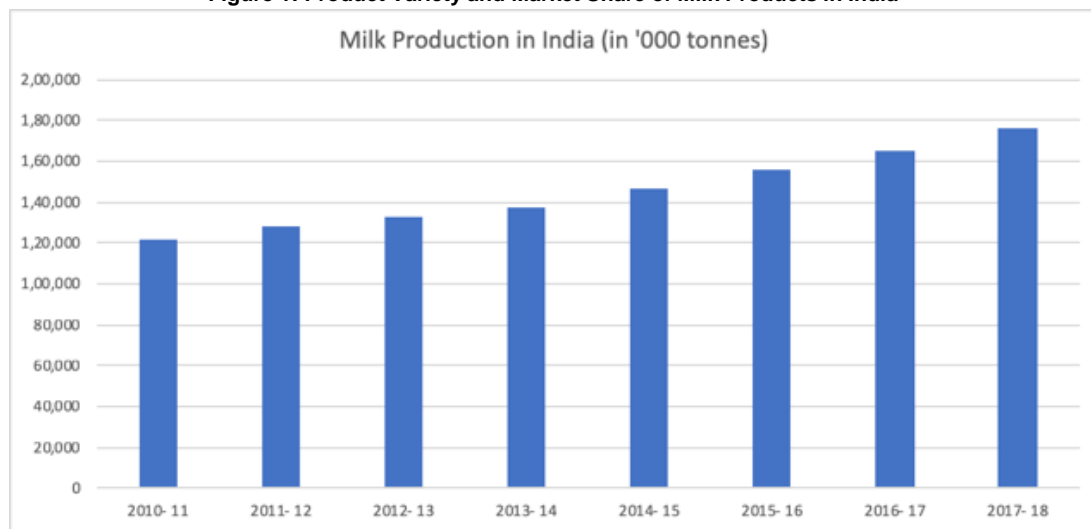
Lactalis broke out in market, Prabhat Dairy shares fell up to 16%, reaching a 52-week low of INR 78.15 on the National Stock Exchange, India.

3. Dairy industry in India

The milk revolution ("Operation Flood"), initiated by the National Dairy Development Board (NDDB) in the year 1970, had transformed India from being milk deficient country to the largest milk producer surpassing USA in 1988, according to NDDB data.

The dairy industry in India had grown significantly over the years. According to the NDDB data, India ranked first in milk production, achieving an annual output of 176.3 million tonnes in the FY18 which was approximately 1.75 times of production in the US and 3 times that of China.

Figure 1: Product Variety and Market Share of Milk Products in India



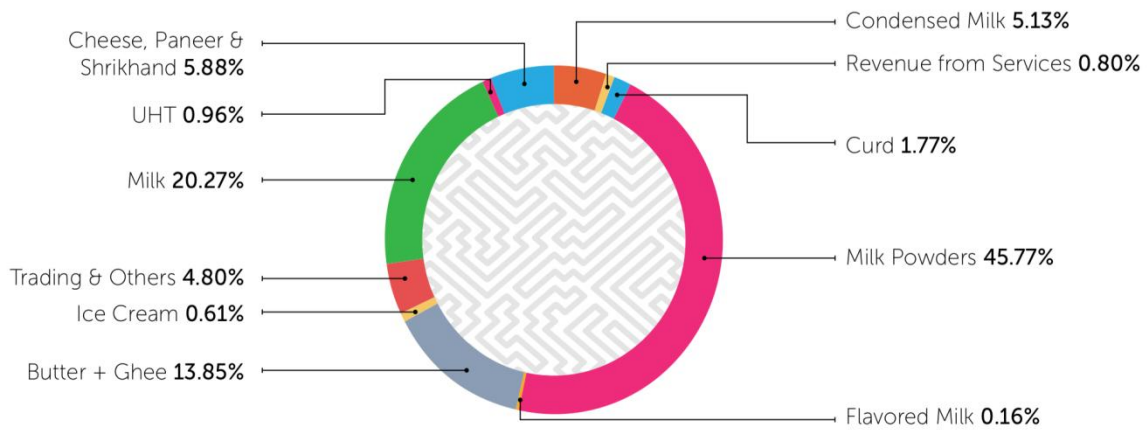
4. Competitive landscape in India

The combined value-added products contributed to 35% of the total dairy industry in India and commodity products together contributed to almost 65% of market share. A key characteristic of the emerging value-added products like the UHT milk, flavoured milk, cheese and whey was that all of these products were sold through organized market. The value-added products industry was under-penetrated in India, and thus had a tremendous scope for growth and was expected to grow at much higher rate than the commodity market. Considering the high growth potential, the private companies had been adding capacities in their value-added

product categories such as cheese, curd, flavoured milk, while enhancing their milk procurement capacities. The private players were also continuously investing in brand building exercises and were aiming to add more B2C businesses in their portfolio.

India's dairy industry was worth INR 5.4 trillion in value, having grown at a 15 per cent CAGR during the 2010-16 period. Going ahead, the dairy market was expected to maintain at least 15 per cent CAGR over 2016-20 and achieve value of INR 9.4 trillion on rising consumption, Edelweiss Securities had said in a report.

Figure 2 Milk Products in India



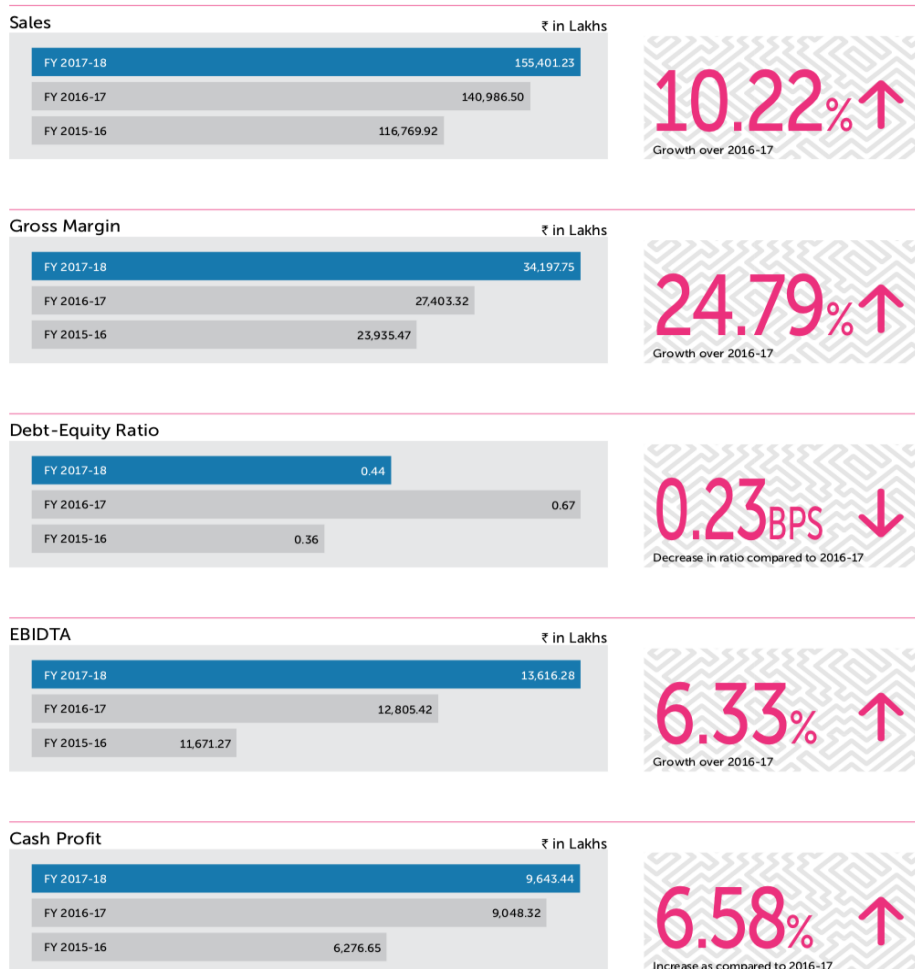
5. Limitations of the Indian dairy industry

The dominance of unorganized sector posed a big hurdle for the organised players in the milk industry. The per capita consumption of milk in India stood at 97litres per year which was well below that of other major milk markets, except for China. The milk prices in India also varied from state to state and region to region within a particular state. Weather conditions and environmental factors also played an important factor in milk production.

6. Company Analysis - Prabhat Dairy

In the year under consideration, the company had reported revenue from operations of INR 144,191.18 Lakhs as compared to INR 113,115.89 Lakhs in the earlier year, showing a growth of 27.47%. The gross margin for the company was 12.12% in the year. The operating profit was INR 3727.00 Lakhs as against INR 4,475.52 Lakhs compared to the previous year. The net profit stood at INR 1,890.40 Lakhs against INR 2,730.00 Lakhs as compared to the previous year.

Figure 3 Prabhat Dairy Financial Overview



The volume of the cheese business had also increased during the year. In addition to cheese, the company also saw a growth in curd sales. The company had also witnessed a significant jump in the quantity of milk sales, however due to reduction in milk prices, the said quantity increase was not being reflected by way of increase in revenues.

7. Advantages from the merger

7.1 Advantages for Tirumala Milk Products

With the acquisition of Prabhat Dairy, Lactalis International had an increased presence in the North Indian Markets. The acquisition also helped Lactalis International reduce its dependence on home markets within Europe, where it got the bulk of its revenue. Lactalis Group also sensed huge upcoming opportunities in the Indian Market with a predicted CAGR of 15% during 2016-2020. Along with this, the industry saw a trend in increase in the per capita consumption of the dairy products in the upcoming years in India. All these factors influenced the decision of Lactalis International to buy Prabhat Dairy. The acquisition also helped Lactalis International to use their technical know-how and expertise to enhance the efficiency of production methods and also increase the quality of products being produced. The acquisition also played to Lactalis International's strength of inorganic growth model.

7.2 Advantages for Prabhat Dairy

The acquisition helped Prabhat Dairy increase their focus on the cattle feed business in various regions of the country and expand into similar businesses such as animal nutrition and animal genetics. The transaction also provided the most suitable strategic value proposition and attractive monetization to Prabhat Dairy and their shareholders. The deal represented

a meaningful opportunity for the company to pursue their long-term growth objectives. It also helped the company strengthen their balance sheet by bringing in global expertise in product and technology and also offered global institutional relationships that can be leveraged to strengthen Prabhat's existing business.

7.3 Advantages for Lactalis International

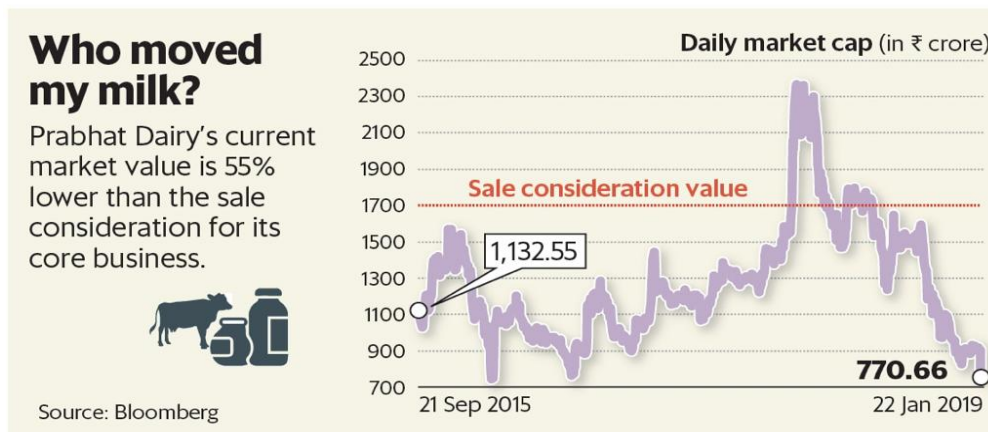
The deal fitted into the growth model for Lactalis International. It provided opportunities for a significant market share in India with competitors such as Amul, Parag Dairy, Mother Dairy etc.

8. Investors Reaction

The dairy business sale to Group Lactalis along with all the specified tangible and the intangible assets, contracts, rights, personnel and the employee's data and records, inventory and other assets and liabilities to Tirumala Dairy appeared to be a negative for the minority shareholders, due to the company's exit from the main dairy business. This was mainly because of the following reasons:

- It planned to use the cash proceeds from the transaction to invest in the expansion of its animal nutrition business.
- Investors showed a positive attitude towards the Prabhat Dairy shares and it rocketed approximately 18% in early trading on January 22, 2019.
- Prabhat would be left with just the insignificant animal nutrition and genetics business which was only 1% of the FY18 sales.

Figure 4 Market Reaction to the announcement



9. Way Forward For Prabhat Dairy

Prabhat dairy had entered into the animal nutrition segment by a joint development with Denmark-based DLG Group. Prabhat Dairy aimed to produce mineral pre-mixes that helped improve cattle milk productivity. Prabhat Dairy was already in the cattle feed business, and mineral pre-mixes not only extends into the animal feed business but also gives a relatively higher margin business. At the time of the report, the company aimed to run a pilot program for a period of 4-6 months.

Management of Prabhat Dairy expected the animal feed industry to be around USD 30 billion by 2020. Within the industry, the animal feed business was also undergoing a transformation in terms of incorporating the global best practices. To participate in this enhancement, foraying into animal nutrition was a critical step.

Broadly, the cattle nutrition market comprised of the natural antibiotics, nutritional additives along with anti-fungal additives. As per CRISIL Research, this industry was expected to grow in double digits in the medium term on account of the

expansion of the food processing industry and a rising awareness about healthy end consumer products.

10. Animal Feed Business In India

Internationally, the animal feed business had witnessed a number of M&A activities. Archer Daniels Midland (ADM), Tyson and Cargill had taken over Neovia, Proteins Inc and Integral Nutricao and were looking at the growth opportunities India had to offer. DLG's alliance with Prabhat Dairy was an attempt to venture in the Indian market.

11. Stock Outlook

Though still in its early stages for Prabhat dairy, moving to animal nutrition was a new growth driver and would likely offer more margins.

The stock price of Prabhat Dairy had corrected itself by about 60 percent from its all-time high and was trading at a level closer to what was prevailing in end CY16. In the last few quarters of 2018, stock price performance had remained weak across the dairy sector in India due to a higher supply of milk resulting in a price correction. In the case of Prabhat Dairy, Q2 sales growth were 8.5 percent year-on-year (YoY) despite 26 percent volume growth. For the Q2 period, milk prices had corrected by 17 percent YoY on average.

The stock was trading at 14x FY20e (estimated) earnings. Key trends that made it a stock worth watching for were a higher share of value-added products of 45 percent (excluding

milk powder) and rapid improvement in retail reach. The company also planned to more than double its retail revenue (B2C segment) in the next two years.

12. Conclusion

The synergy from the deal is expected to be successful because of the expertise that Lactalis International had in acquiring companies. The acquired company, Prabhat Dairy also fitted perfectly in the products portfolio of Lactalis International. Both the companies had similar products in their portfolios and hence complimented each other perfectly. Both the companies also shared similar customer satisfaction values. Lactalis International used their expertise in technology to provide Prabhat Dairy a competitive advantage in their business. With presence in both the northern and southern regions in India, Lactalis International was able to give competition to already existing major brands in the country. Lactalis International President Butter also introduced their product to the Indian market and was receiving good sales from it.

The deal also gave an opportunity to Prabhat Dairy to focus on their animal feed and nutrition business, as the management of the company had deemed necessary for the long-term growth of the company. Prabhat Dairy's deal with DLG Group also provided it an expertise in doing business and building their portfolio for the animal feed business.

References

1. <http://www.prabhatdairy.in/investor-desk/annual-report.html>
2. <https://www.businesstoday.in/current/corporate/lactalis-acquires-prabhat-dairy-milk-business-rs-1700-crore/story/312396.html>
3. <https://www.bseindia.com/xml-data/corpfiling/AttachLive/6c0098e6-af09-4af5-be42-c1eafa800252.pdf>
4. <http://www.ventureintelligence.com/maluginip.php>
5. <http://www.lactalis.fr/en/the-group/overview/>
6. <https://www.nddb.coop/information/stats/milkprodstate>
7. <https://economictimes.indiatimes.com/industry/cons-products/food/lactalis-eyes-more-buyouts-in-indian-dairy/articleshw/51905304.cms?from=mdr>