July 09, 2021

Parag Milk Foods Limited: Ratings reaffirmed and removed from Watch with Developing Implications; Stable outlook assigned to long-term rating

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based- Term loan	103.00	43.31	[ICRA]A reaffirmed, rating removed from watch with developing implications and assigned Stable outlook
Fund -based- working capital facilities	400.00	270.00	
Non-fund-based facilities	100.00	100.00	[ICRA]A2+ reaffirmed, rating removed from watch with developing implications
Non-convertible Debenture Programme	-	150.00	[ICRA] A(Stable); assigned
Total	**603.00**	**563.31**	

**Instrument details are provided in Annexure-1*

Rationale

The resolution of the watch[1] on the rating assigned to Parag Milk Foods Limited (PMFL) factors in the completion of the fund-raising plan in May 2021. PMFL has raised equity capital of Rs. 125.0 crore from International Finance Corporation (IFC; ~Rs75 crore) and Sixth Sense Ventures Advisors LLP (Rs. 50 crore) in May 2021. Further, the company allotted convertible share warrants to promoters at a total consideration of Rs. 111 crore, of which the promoter infused 25% in May 2021 and will invest the rest over the next 18 months. Furthermore, the company has issued foreign currency convertible bonds (FCCBs) of $10.8 million (~Rs. 77.5 crore) to be used for capital expenditure and non-convertible debenture (NCD) of Rs. 150 crore as long-term source for working capital. The above fund-raising exercise will improve the liquidity profile of the company.

The rating reaffirmation reflects PMFL's widespread scale of operations, strong brand position, expansive distribution network and diversified product profile with sizeable market share in certain value-added products (VADPs). The ratings continue to factor in the strong track record of the promoters in the dairy industry, leading to an established procurement base of dairy farmers, supported by a network of bulk coolers and chilling centres, ensuring regular supply of raw milk. The company is geographically diversified with a pan India presence through its strong marketing and distribution network. The sizeable fund infusion in the form of equity, share warrants, FCCB and NCD will support its capital structure and coverage indicators in FY2022.

The ratings are, however, constrained by the high working capital intensity because of sizeable inventory levels and impact of Covid-19 on the company's financial performance. The company maintains high inventory of cheese, which requires a certain ageing process, and of butter, which is used as buffer raw material for the uninterrupted production of clarified butter (*ghee*).

PMFL's revenue declined by 24.5% in FY2021 impacted by slowdown in the hotels, restaurants and catering (HORECA) segment due to lockdown across the country during the year, coupled with low revenue from liquid milk to institutional customers through modern trade channels amid the pandemic. PMFL's profitability was impacted in FY2021 with an OPBITDA margin of 6.8% versus 8.7% in FY2020 due to significant decline in revenue, leading to low absorption of fixed overheads. The company's

[1] *ICRA had earlier placed the rating of PMFL on watch with developing implication following the announcement to raise Rs. 316.0 crore by preferential allotment of equity shares, FCCBs and convertible share warrants.*

performance in Q4 FY2021 was additionally impacted by rising milk prices in association with the above factors. ICRA expects PMFL's revenues and margins to improve in FY2022 supported by easing of restriction across the country; although any further lockdowns to curb the ongoing pandemic may negatively affect the company's performance.

The Stable outlook reflects ICRA's belief that PMFL will continue to benefit from its extensive track record of operations, strong brand, diverse product portfolio, robust distribution network and improved liquidity profile.

Key rating drivers and their description

Credit strengths

Established track record of promoters with strong procurement network - PMFL has a robust milk procurement network of local farmers, who have lived in Manchar (near Pune, Maharashtra) for more than four decades. This local network mitigates the inherent risk in the dairy business, given the highly fragmented farmer/supplier base and seasonality in milk production. PMFL has tie-ups with over two lakh farmers in 29 districts, supported by chilling centres and bulk milk units across Manchar and Palamner (Andhra Pradesh). PMFL also has its own dairy farm under its 100% subsidiary, Bhagyalaxmi Dairy Farms Private Limited(BDFPL), which supplies premium quality milk through its 'Pride of Cows' brand.

Established distribution network and brand - PMFL has established brands, such as 'Gowardhan', 'Go', 'Topp Up', 'Avvatar' and 'Pride of Cows', which are recognised across the country. Moreover, the primary unique selling point (USP) of all its products is that they are processed from 100% cow's milk. PMFL has a strong distribution network for pouched milk in Mumbai, Nagpur and Pune districts of Maharashtra, as well as parts of Andhra Pradesh, Tamil Nadu and Karnataka. PMFL had acquired a Danone facility in Sonipat, Haryana, in FY2018 to expand its presence in the northern region. For other VADPs, PMFL utilises its network of 22 depots and over 140 super stockists, servicing more than 3.5 lakh retail counters. PMFL also sells products such as skimmed milk powder (SMP) and cheese to institutional clients.

Diversified product profile with sizeable market share in clarified butter and cheese segments – In FY2021, PMFL derives ~10.0% of its revenues from liquid milk, 15.0% from SMP and 73.0% from VADPs, such as clarified butter (*ghee*), butter, cheese, yoghurt, cottage cheese (*paneer*), flavoured milk, ultra-high temperature (UHT) milk, whey and other milk products. PMFL is the second largest player in cheese in India with 35% market share and a healthy share in cow *ghee* segments in the organised market.

Sizeable fund infusion in FY2022 to support capital structure and improve liquidity profile – PMFL has raised Rs. 125.0 crore in the form of equity from IFC (~Rs. 75 crore) and Sixth Sense Ventures Advisors LLP (Rs. 50 crore) in May 2021. The company also issued convertible share warrants to promoters at a total consideration of Rs. 111.0 crore, of which the promoter infused 25% in May 2021 and will invest the rest over the next 18 months. Furthermore, the company has issued FCCBs of $10.8 million and NCDs of Rs. 150 crore to IFC. The FCCB funds will be used to fund the capex and the remaining funds will be used to fund the company's working capital and prepay some of its term loans.

ICRA notes the impact of significant decline in accruals on the company's coverage indicators in FY2021 with TD/OPBITDA of 3.1 times versus 1.9 times in FY2020 and Interest coverage of 2.7 times versus 5.6 times in FY2020, because of lower revenues. ICRA expects the fund infusion, coupled with recovery in revenues and accruals, to support the capital structure and improve coverage indicators over the medium term.

Credit challenges

Demand slowdown because of the pandemic impacted revenue profile – The company's revenue declined by about 24.5% in FY2021 impacted by slowdown in HORECA segment due to the nationwide lockdown during the year, coupled with low revenue from liquid milk to institutional customers through modern trade channels. Modern trade channels were significantly impacted by the pandemic induced lockdown. The company's sale of SMP also reduced in FY2021 due to its strategy to not sell SMP to the trading community and focus instead on large institutional customers alone. PMFL's profitability was impacted in FY2021 with OPBITDA margin of 6.8% in FY2021 versus 8.7% in FY2020 due to significant decline in revenue leading to lower absorption of fixed overheads. The company's performance in Q4 FY2021 was additionally impacted by rising milk prices along with the above factors. ICRA expects PMFL's revenue to recover in FY2022 supported by easing of lockdown restrictions across the country. Any further restrictions or lockdowns due to the pandemic can negatively affect the company's revenue and profitability.

High working capital requirements impact liquidity – The company receives payments from its traders and institutional customers within 45-48 days. Its inventory days are high, primarily due to cheese, which is aged over months as a part of the manufacturing process. PMFL also maintains a high inventory of butter, which is used as buffer raw material for ensuring an uninterrupted flow of *ghee*. The inventory value increased in March 2021 due to significant increase in milk procurement prices. The funds raised through equity, share warrants, NCD will support the working capital requirement of the company in the short to medium term.

Intense competition from other players - PMFL faces intense competition from the unorganised sector, comprising a staggering 70% of the industry, with further competition from cooperatives and other private dairies from the organised sector (30% of total market size). Since PMFL's presence is mostly in the VADP segment, the competitive intensity is marginally mitigated.

Liquidity position: Adequate

PMFL's liquidity is expected to remain **adequate**, supported by fund infusion of Rs. 125 crore in the form of equity, Rs. 27.75 crore in the form of convertible share warrants in May 2021. The company has also raised long-term funds in the form of FCCBs worth $10.8 million (~Rs. 77.5 crore), which will be used for future capex plans and issued NCDs of Rs. 150 crores in May 2021.

ICRA expects PMFL to generate net cash accruals of ~Rs. 100-120 crore in FY2022. PMFL has capex commitments of ~Rs. 120 crores in FY2022. The capex will be financed by undrawn term loan sanction of Rs. 62.8 crore and FCCBs of ~Rs. 77.5 crore. The company has debt repayments of Rs. 41.4 crore in FY2022, including prepayment of some term loans. ICRA expects PMFL to meet its near-term commitments through internal accruals and fund infusion in May 2021.

Rating sensitivities

Positive factors – ICRA could upgrade PMFL's rating if the company demonstrates a sustained improvement in revenue and profitability while maintaining healthy debt protection metrics. Specific credit metrics that could lead to a rating upgrade include TD/OPBITDA below 1.5 times on a sustained basis.

Negative factors – Negative pressure on the ratings may arise if any significant decline in revenue and profitability weakens its debt protection metrics and liquidity position. Specific credit metrics that could lead to a rating downgrade include TD/OPBDITA above 2.3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	ICRA has considered the consolidated financials of PMFL. As on March 31, 2021, the company had one subsidiary, which is enlisted in Annexure-2.

About the company

PMFL is promoted by the Shah family, who have been in the dairy business for more than two decades. It has three milk processing plants—one each at Manchar, Palamner and Sonipat. PMFL is present across the supply chain of procurement, processing and marketing of liquid milk and milk products under its brands—Gowardhan, Go, Pride of Cows, Avvatar, Slurp and Topp Up. The dairy products manufactured and marketed by the company include cow's milk, *ghee*, cheese, butter, SMP, *paneer*, curd, whey powder, yoghurt, UHT milk, whey powder, flavoured milk and traditional dessert mixes. PMFL has a diversified portfolio with seven brands and over 170 stock keeping units (SKUs).

BDFPL's (wholly-owned subsidiary of PMFL) unique farm-to-home initiative, branded as Pride of Cows, allows customers to access milk processed without any human interference using latest technologies and best global practices. BDFPL has also introduced a range of certified organic fertilisers by commercialising cow manure.

Key financial indicators (audited)

LTHL Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	2437.9	1841.8
PAT (Rs. crore)	93.7	20.7
OPBDIT/OI (%)	8.7%	6.8%
PAT/OI (%)	3.8%	1.1%
Total Outside Liabilities/Tangible Net Worth (times)	0.8	0.8
Total Debt/OPBDIT (times)	1.9	3.1
Interest Coverage (times)	5.6	2.7

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)					Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in	Date & Rating in	Date & Rating in FY2021	Date & Rating in FY2020		Date & Rating in FY2019
					July 9, 2021	Apr 13, 2021	August 17, 2020	March 17, 2020	July 11, 2019	July 4, 2018
1	Fund-based - term loan	Long-term	43.31	43.31	[ICRA] A (Stable)	[ICRA]A &	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)
2	Working capital facilities	Long-term	270.0	--	[ICRA] A (Stable)	[ICRA]A &	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)
3	Non-fund-based facilities	Short term	100.0	-	[ICRA] A2+	[ICRA]A2+&	[ICRA]A2+	[ICRA]A1	[ICRA]A1	[ICRA]A2+
4	Non-Convertible Debenture	Long Term	150.0	-	[ICRA] A (Stable)					

&= Under watch with developing implications

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based- Term loan	Simple
Fund -based- working capital facilities	Simple
Non-fund-based facilities	Very Simple
Non-convertible Debenture Programme	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analyzing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
INE883N07011	Non-Convertible Debenture	May 2021	7.5%	May 2028	150.0	[ICRA]A(Stable)
NA	Term Loan-I	Sep 2017		Feb 2023	5.26	[ICRA]A(Stable)
NA	Term Loan-II	Sep 2017		Feb 2023	3.99	[ICRA]A(Stable)
NA	Term Loan-III	Feb 2019		Jan 2024	7.99	[ICRA]A(Stable)
NA	Term Loan-IV	Sep 2013		Dec 2021	8.85	[ICRA]A(Stable)
NA	Term Loan-V	April 2020		Mar 2022	17.22	[ICRA]A(Stable)
NA	Working capital Loan	-	-	-	270.0	[ICRA]A (Stable)
NA	Non-Fund Based Limits	-	-	-	100.0	[ICRA]A2+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Bhagyalaxmi Dairy Farms Private Limited	100.00%	Full Consolidation

Source: *Company*

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About ICRA Limited:

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