July 20, 2022

Parag Milk Foods Limited: Ratings downgraded to [ICRA]BBB+(Negative)/[ICRA]A2

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loan	43.31	13.62	[ICRA]BBB+ downgraded from [ICRA]A; outlook revised to Negative from Stable
Fund -based- working capital facilities	270.00	330.00	[ICRA]BBB+ downgraded from [ICRA]A; outlook revised to Negative from Stable
Non-fund-based facilities	100.00	33.00	[ICRA]A2 downgraded from [ICRA]A2+
Non-convertible Debenture Programme	150.00	150.00	[ICRA]BBB+ downgraded from [ICRA]A; outlook revised to Negative from Stable
Unallocated	-	36.69	[ICRA]BBB+/[ICRA]A2 downgraded from [ICRA]A/[ICRA]A2+; outlook revised to Negative from Stable
Total	**563.31**	**563.31**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade and revision in outlook factors in the stretched liquidity profile of Parag Milk Foods Limited (PMFL) and expectations of the same continuing over the near term. PMFL's credit profile has also weakened materially due to the significant net loss of ~Rs. 592 crore in Q4 FY2022, resulting in weakening of its debt protection metrics. On July 18, 2022, the company has disclosed its plans to raise Rs. 112.5 crore by way of preferential allotment of equity to investors and Rs. 20 crore by way of convertible share warrants from a member of the promoter group. The fund infusion is subject to approval by the shareholders in the EGM[1] scheduled on August 10, 2022. ICRA has taken note of the company's plans to recapitalise and improve its liquidity position by infusion of long-term funds. However, restoration of the liquidity buffer through timely receipt of these funds and sustained business improvement over the near term will remain a key monitorable.

On June 30, 2022, the company published its Q4 FY2022 financial results, disclosing a sizeable inventory write-off and price settlement expense with milk aggregators cumulating to Rs. 628 crore. According to the management, the sizeable inventory write-off was triggered by a combination of factors including—a) ageing beyond permissible shelf life; b) contamination of certain value-added milk products; and c) change in Government policy on the formulation of infant food, thereby impacting offtake of existing inventory of whey powder. As per the management, as demand from the institutional/ HORECA segment did not scale up to expected levels, the company's inventory levels had increased with high milk procurement during the various pandemic waves. In addition, the company expensed Rs. 119 crore towards milk price settlement for milk procured in the last two fiscals. For this, the company had to compensate milk aggregators as per the support price announced by the state government [of Maharashtra]. Since these expenses were partly related to operations from previous quarters, adequate and timely provision of the same could have moderated the sizeable losses reported in a single quarter. However, the company did not make any disclosures and/or provisions for these two developments in previous quarters.

ICRA had reaffirmed PMFL's ratings last year, factoring in its steady business performance and considerable fund raising (~Rs. 380 crore through long-term debt and equity), resulting in significant improvement in its liquidity profile. Further, the company had reported steady revenue growth and profitability in 9M FY2022[2]. However, the unexpected and considerable losses reported in Q4 FY2022 have led to significant erosion of PMFL's net worth and weakening of its debt protection metrics, resulting in moderation in financial flexibility. Consequently, the liquidity position has also become stretched due to considerable reduction in its ability to borrow from its bankers' owing depletion in drawing power (against utilised working

[1] Extraordinary General Meeting

[2] *April 2021 to December 2021: Revenue of Rs. 1,509.5 crore and PAT of Rs. 59.3* ***crore***

capital limits) after its inventory write-off. Timely improvement in PMFL's liquidity profile, supported by steady internal accrual generation and increased cushion in the form of undrawn bank lines (against available drawing power) will, therefore, remain a key monitorable. The ratings also factor in the high working capital intensity required in the high stock holding for its value-added dairy products (VADP) division and risks from its vulnerability to agro-climatic and environmental factors prevalent in the dairy sector.

However, the ratings continue to draw comfort from PMFL's sizeable scale of operations, its strong brand position in the processed cheese (positioned as the second largest player) and clarified butter (*ghee*) segment, expansive distribution network and diversified product profile with sizeable market share in certain VADP categories. The company's business profile is characterised by extensive experience 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.

Key rating drivers and their description

Credit strengths

Extensive experience 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 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 brand and distribution network – PMFL has established brands, such as 'Gowardhan', 'Go', '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 of 21 depots, 200 super stockists, over 3,000 distributors servicing more than 3.5 lakh retail counters. The company has a dedicated sales and marketing team of over 800 personnel. It also has reputed institutional and HORECA customers for various product such as cheese, SMP[3], and whey.

Diversified product profile with sizeable market share in clarified butter and cheese segments – In FY2022, ~9.5% of PMFL's revenues were generated from liquid milk, followed by SMP (19.0%) and VADPs (68.0%), such as clarified butter, butter, cheese, yoghurt, ultra-high temperature (UHT) milk, and other milk products. PMFL is the second largest player in the cheese segment in India with ~35% market share and a healthy share in the cow *ghee* segment in the organised market.

Credit challenges

Weakened credit profile owing to significant losses in Q4 FY2022 – PMFL reported an unexpected and considerable net loss of Rs 592 crore in Q4 FY2022, on account of inventory write off of Rs 509 crore and price settlement expense of Rs 119 crore with milk aggregators. This resulted in a loss of Rs. 532.5 crore in FY2022 as against a net profit of Rs. 59.3 crore in 9MFY2022 and Rs. 20.7 crore in FY2021. The sizeable inventory write off was triggered by a combination of factors including a) ageing beyond permissible shelf life, b) contamination of certain value-added milk products like Butter, Cheese and SMP and c) change in Government's policy with regards to formulation of infant food, thereby impacting offtake of existing inventory of whey. As per the management, the inventory levels increased owing to high milk procurement during the various pandemic waves, while demand from institutional/HORECA segment (accounts for ~50-60% of PMFL's revenue) did not scale up in line with expected levels. The milk price settlement amount of Rs 119 crore relates to the milk procured in last two fiscals, for which the company had to compensate milk aggregators in line with support price announced by state Government. Given these expenses are also partly related operations carries out in previous quarters, adequate and timely provision of the same could

[3] SMP- Skimmed Milk Powder

have moderated the sizeable losses reported in single quarter. However, the company did not make any disclosures and provisions relating to these two developments in the previous quarters.

The losses have led to significant erosion of PMFL's net worth (Rs. 554 crore as on March 31, 2022 versus Rs 1,180 crore as on September 30, 2021, and Rs 928 crore as on March 31,2021) and weakening of debt protection metrics, resulting in moderation of the company's financial flexibility.

High working capital intensity of business – The company receives payments from its traders and institutional customers within 45-48 days. Its inventory days are high, primarily due to cheese, which typically needs to be aged over months. PMFL also maintains a high inventory of butter, which is used as a buffer raw material for ensuring an uninterrupted flow of *ghee*. The need to maintain high inventory leads to high utilisation of working capital debt and provides lower liquidity cushion to the company.

Intense competition from other players – PMFL faces intense competition from the unorganised sector, which forms 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 is mainly present in the VADP segment, the competitive intensity is marginally mitigated.

Vulnerability to external factors such as adverse weather conditions and disease outbreaks – PMFL's revenues and earnings are susceptible to agro-climatic factors such as droughts and any disease outbreak leading to increase in cattle diseases, which may adversely impact milk production. Further, the margins are susceptible to changes in climatic conditions, with deficient supply of milk during the flush seasons, resulting in a rise in procurement prices.

Liquidity position: Stretched

PMFL's liquidity is now stretched, evidenced by almost full utilisation of its working capital limits (as against available drawing power) and modest free cash and bank balance (excluding FCCB funds that can only be used for capex) as on March 31, 2022. PMFL's drawing power of its sanctioned working capital limits has deteriorated significantly after the announcement of its inventory write-off, resulting in minimal cushion in the form of undrawn bank lines. The company has also reported sizeable losses in Q4 FY2022 from these inventory write-offs and milk price settlement pay-outs which has led to significant net worth erosion and moderation of its financial flexibility. Timely improvement in PMFL's liquidity profile, supported by steady internal accrual generation and increased cushion in the form of undrawn bank lines will remain a key monitorable. The company has consolidated debt repayment of ~Rs. 17-18 crore in FY2023 and its internal accruals are expected to be sufficient to service the same. ICRA also notes the expected fund infusion of ~Rs 112.5 crore (preferential allotment of equity) and Rs 5 crore (25% for convertible share warrant to be issued in August 2022) and by August 2022 and Rs 83 crore (75% balance of share warrants issued in May 2021) from the promoters by November 2022, which will be essential to support PMFL's liquidity profile to an extent.

Rating sensitivities

Positive factors – Given the negative outlook, a ratings upgrade is less likely in the near future. However, the outlook can be revised to Stable, if the company demonstrates timely improvement in its liquidity profile and steady business performance, leading to an improvement in its debt protection metrics.

Negative factors – Negative pressure on PMFL's ratings may arise if any significant decline in internal accrual generation or stretch in working capital cycle weakens its debt protection metrics and liquidity position further. Specific credit metrics that could lead to a rating downgrade include Total Debt/OPBDITA above 2.7 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, 2022, 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 clarified butter, cheese, butter, SMP, curd, whey powder, yoghurt, UHT milk, flavoured milk and traditional dessert mixes.

Its wholly owned subsidiary, BDFPL's 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)

PMFL Consolidated	FY2021	FY2022
Operating income (Rs. crore)	1841.8	2071.8
PAT (Rs. crore)	20.7	-532.5
OPBDIT/OI	6.8%	-21.2%
PAT/OI	1.1%	-25.7%
Total outside liabilities/Tangible net worth (times)	0.8	1.5
Total debt/OPBDIT (times)	0.4	1.0
Interest coverage (times)	2.7	-8.6

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2023) Type	Amount rated (Rs. crore)	Amount outstanding as of March 31,2022 (Rs. crore)	Date & rating in FY2023	Chronology of rating history for the past 3 years Date & rating in FY2022			Date & rating in FY2021	Date & rating in FY2020	
					July 20, 2022	Dec 10, 2021	July 09, 2021	Apr 13, 2021	August 17, 2020	March 17, 2020	July 11, 2019
1	Fund-based - Term loan	Long-term	13.62	13.62	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A &	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)
2	Working capital facilities	Long-term	330.00	--	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A &	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)
3	Non-fund-based facilities	Short term	33.00		[ICRA]A2	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+&	[ICRA]A2+	[ICRA]A1	[ICRA]A1
4	Non-Convertible Debenture	Long Term	150.00	150.0	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)				
5	Unallocated	Long-term/ Short term	36.69		[ICRA]BBB+ (Negative)/ [ICRA]A2						

&= 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
Unallocated	NA

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 analysing 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 are available on ICRA's website: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
INE883N07011	Non-Convertible Debenture	May 2021	8.24%	May 2028	150.00	[ICRA]BBB+(Negative)
NA	Term Loan -I	May 2021		Apr-2024	0.65	[ICRA]BBB+(Negative)
NA	Term Loan- II	Nov 2019		Oct 2024	1.53	[ICRA]BBB+(Negative)
NA	Term Loan-III	Sep 2017	9.60%	Aug 2024	3.26	[ICRA]BBB+(Negative)
NA	Term Loan-IV	Sep 2017	9.60%	Sep 2024	2.49	[ICRA]BBB+(Negative)
NA	Term Loan-V	Mar 2019	9.64%	Sep 2025	5.69	[ICRA]BBB+(Negative)
NA	Fund based Limits	-	-	-	330.0	[ICRA]BBB+(Negative)
NA	Non-Fund Based Limits	-	-	-	33.0	[ICRA]A2
NA	Unallocated				36.69	[ICRA]BBB+(Negative)/[ICRA]A2

Source: *Company*

Annexure II: 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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