December 27, 2022

Parag Milk Foods Limited: Ratings downgraded to [ICRA]BBB(Negative)/[ICRA]A3+

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Term loan	13.62	13.62	[ICRA]BBB(Negative) downgraded from [ICRA]BBB+ (Negative)
Fund-based working capital facilities	330.00	330.00	[ICRA]BBB(Negative) downgraded from [ICRA]BBB+ (Negative)
Non-fund-based facilities	33.00	33.00	[ICRA]A3+ downgraded from [ICRA]A2
Non-convertible Debenture Programme	150.00	150.00	[ICRA]BBB(Negative) downgraded from [ICRA]BBB+ (Negative)
Unallocated	36.69	36.69	[ICRA]BBB (Negative)/[ICRA]A3+ downgraded from [ICRA]BBB+ (Negative) /[ICRA]A2
Total	**563.31**	**563.31**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings downgrade reflects ICRA's expectation that the financial profile of Parag Milk Foods Limited (PMFL) is likely to weaken owing to ongoing pressure on its profitability margins and higher borrowing levels, leading to moderation in the company's debt protection metrics.

PMFL's operating margins have remained under pressure in H1 FY2023, because of elevated milk prices and the company's inability to completely pass-on the same to the end-markets. Moreover, despite the sizeable fund infusion, the company's debt levels have increased considerably to Rs. 643.9 crore as on September 30, 2022, from Rs. 534.1 crore as on March 31, 2022, due to elevated funding requirements for firming milk prices and shorter credit period from the suppliers. This is primarily due to some volatility in availability of milk in recent months. Further, ICRA has also observed the continued attrition at PMFL's senior management level, which can potentially impact its business operations, internal controls and implementation of its strategic roadmap to some extent.

The ratings continue to reflect the relatively high working capital intensity in PMFLs operations via-á-vis its peers in the dairy industry and risks from its vulnerability to agro-climatic and environmental factors prevalent in the dairy sector. Higher working capital requirement emanates from high stock holding period (average 75 days in FY2022) for its value-added dairy products (VADP) division. The Negative outlook on the long-term rating reflects ICRA's expectation that PMFL's earnings are expected to remain under pressure due to elevated raw material prices and business performance is likely to remain constrained to some extent due to managerial bandwidth issues. Improvement in accrual generation and deployment of funds, leading to reduced reliance on debt, will be key for improvement in PMFL's financial profile in the near term.

However, the ratings draw comfort from improvement in PMFL's liquidity profile and net worth owing to equity fund infusion of Rs. 195 crore in the current fiscal (till November 2022) in the form of equity and share warrants. The company's net worth had eroded considerably due to sharp inventory losses recognised in Q4 FY2022. The rating continues to factor in PMFL's sizeable scale of operations, its strong brand position in the processed cheese and clarified butter (*ghee*) segment, its expansive distribution network, and its diversified product profile with sizeable market share in certain VADP categories. The company's business profile is characterised by the 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 a 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[1], 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

Elevated debt levels led to moderate debt protection metrics – The company's debt level significantly increased to ~Rs. 644 crore as on September 30, 2022, from ~Rs. 534 crore as on March 31, 2022, due to elevated funding requirements for firming milk prices and shorter credit period from the suppliers, primarily due to some volatility in availability of milk in recent months. The elevated debt levels, coupled with lower cash accruals due to significant moderation in OPBTIDA margins (4.6% in H1 FY2023 over 10.1% H1 FY2022), led to moderate debt protection metrics with Total Debt/ OPBTIDA of 5.1x as on September 30,2022. The debt protection metrics are likely to remain moderated in the near term.

High working capital intensity of business –The company's 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 company's creditor days also reduced significantly in H1 FY2022 as the company either made advance payments or received shorter credit owing to lower supply of milk in the market. These factors led to high utilisation of working capital debt and 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 livestock disease outbreaks, 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: Adequate

PMFL's liquidity is adequate supported by internal accrual generation and healthy free cash and bank balance (including FCCB funds that can only be used for capex) of ~Rs. 155 crore as on September 30, 2022. PMFL's drawing power of its sanctioned

[1] *SMP: Skimmed milk powder*

working capital limits had deteriorated significantly after the announcement of its inventory write-off in Q4 FY2022, resulting in minimal cushion in the form of undrawn bank lines. However, the drawing power has improved subsequently, leading to some cushion in the form of undrawn bank lines. Moreover, fund infusion of Rs. 195.0 crore in 8M FY2023 from external investors and promoters have also resulted in an improvement in the company's liquidity position. 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.

Environment and Social Risk

Environmental concern: The dairy industry is exposed to physical climate risks, which could result in variations in the availability of fodder for cattle and impact their productivity. Extreme weather conditions like harsh summers or floods can also impact raw milk productivity. However, PMFL procures milk from a large network of farmers with strong procurement supply chains, which mitigate the environmental risks to an extent.

Social concern: PMFL procures milk from over two lakh farmers in the vicinity of its manufacturing units. To ensure the continuous availability of good quality of milk and to support farmers, PMFL assists them to improve milk productivity and quality through technical assistance, providing veterinary services, medicines and promotion of sustainable practices for improving the productivity and yield of their cattle. Overall, PMFL's exposure to social risks remains moderate.

Rating sensitivities

Positive factors – Given the negative outlook, a ratings upgrade is less likely in the near term. However, the outlook can be revised to Stable, if the company demonstrates timely improvement in its 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 3.0 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 (Maharashtra), Palamner (Andhra Pradesh) and Sonipat (Haryana). 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	H1 FY2023*
Operating income (Rs. crore)	1841.8	2071.8	1,355.8
PAT (Rs. crore)	20.7	-532.5	21.6
OPBDIT/OI	6.8%	-21.2%	4.6%
PAT/OI	1.1%	-25.7%	1.6%
Total outside liabilities/Tangible net worth (times)	0.8	1.5	1.3
Total debt/OPBDIT (times)	3.2	-1.2	5.2
Interest coverage (times)	2.7	-8.6	2.2

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Type	Amount rated (Rs. crore)	Amount outstanding as of March 31,2022 (Rs. crore)	Current rating (FY2023)		Chronology of rating history for the past 3 years					
					Date & rating in FY2023		Date & rating in FY2022			Date & rating in FY2021	Date & rating in FY2020	
					December 27, 2022	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]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]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]A3+	[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]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)				
5	Unallocated	Long-term/ Short term	36.69		[ICRA]BBB (Negative)/ [ICRA]A3+	[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: Click Here

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		Apr2024	0.65	
NA	Term Loan- II	Nov 2019		Oct 2024	1.53	
NA	Term Loan-III	Sep 2017	9.60%	Aug 2024	3.26	
NA	Term Loan-IV	Sep 2017	9.60%	Sep 2024	2.49	
NA	Term Loan-V	Mar 2019	9.64%	Sep 2025	5.69	
NA	Fund based Limits	-	-	-	330.0	
NA	Non-Fund Based Limits	-	-	-	33.0	[ICRA]A3+
NA	Unallocated				36.69	[ICRA]BBB(Negative)/[ICRA]A3+

Source: *Company; as of July 2022*

Please click here to view details of lender-wise facilities rated by ICRA

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

ANALYST CONTACTS

Shamsher Dewan
+91 124 4545 328
shamsherd@icraindia.com

Kinjal Shah
+91 22 6114 3442
kinjal.shah@icraindia.com

Deepak Jotwani
+91 124 4545 870
deepak.jotwani@icraindia.com

Pawan Mundhra
+91 20 6606 9918
Pawan.mundhra@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

Branches