July 13, 2017

Parag Milk Foods Limited

Instruments*	Amount Rated	Rating Action
Long term: Fund based limits	Rs. 238.00 Crore	[ICRA]A- (Stable) assigned
Short term: Non fund based limits	Rs. 29.00 Crore	[ICRA]A2+ assigned

**Instrument details are provided in Annexure-1*

Rating Action

ICRA has assigned the long term rating of [ICRA]A- (pronounced ICRA A minus) to the Rs. 238.00 crore long term fund based limits of Parag Milk Foods Limited (PMFL). ICRA has also assigned the short term rating of [ICRA]A2+ (pronounced ICRA A two plus) to the Rs. 29.00 crore short term non-fund based limits of the company. The outlook on the long-term rating is stable.

Rationale

ICRA has taken a consolidated view of Parag Milk Foods Limited and its 100% subsidiary Bhagyalaxmi Dairy Farms Private Limited (together referred as PMFL) while arriving at the ratings given strong management, operational and financial linkages.

The assigned ratings favourably factors in strong track record of the promoters for more than 25 years in dairy industry with presence across the value chain through its dairy farm for milk procurement to retail market reach through its established brands such as “Gowardhan”, “Go” and “Pride of Cow”. ICRA also derives comfort from the established procurement base of PMFL among dairy farmers supplemented by network of bulk coolers and chilling centers which ensure a regular supply of raw milk. The company’s product profile is diversified with major presence in value added product segment which contributes ~75-80% of revenue share. The diverse product profile of the company includes cow milk, ghee, cheese, butter, skimmed milk powder (SMP), cottage cheese, yogurt, whey powder, flavoured milk, gulab janoom mix etc. PMFL is the second largest cheese supplier in India with ~38% market share (Source: Company). It has India’s largest single location cheese manufacturing facility with a capacity of 80 metric tonnes per day (MTPD). The assigned ratings also take into account Company’s robust capital structure owing to sizeable equity raised through Initial Public Offer (IPO) of Rs. 300.00 crore in May 2017. ICRA also derives benefit from the geographically well diversified operations with pan India presence through Company’s strong marketing and distribution network. ICRA believes that private dairy players will benefit from increasing consumption of branded processed milk products in domestic market on back of higher purchasing power, changing food habits and increasing healthy awareness.

The ratings are, however, constrained by deterioration in the profitability of the company during FY2017 on account of increase in raw material prices, increased selling and distribution expenses and onetime extraordinary loss incurred. In Q3 FY2017, the company reported losses at operating level on account of its inability to pass on the increase in raw milk prices to its consumers which went up 20% y-o-y and 14% q-o-q in Q3 FY2017. Though in January 2017, the company revised its MRPs by 8% on value added products resulting into improvement in operating margins in Q4 FY2017. The financial profile of the company is characterised by the moderately high working capital intensity on account of sizeable inventory of value added products especially cheese which require higher gestation period to develop the taste. Despite decrease in debt levels post equity infusion, the coverage indicator remained moderate with Interest coverage at 3.3x and TD/OPBDITA of 2.6x in FY2017 on account of deterioration in profitability. The ratings are also constrained by commoditized nature of operations, high competitive intensity from organized co-operatives, private players and unorganized players and vulnerability to external factors like weather, disease outbreak etc. Also the industry is exposed to government regulations and global demand supply scenario of milk products especially milk powder. Given the recent capex incurred to increase capacities in the milk processing plant and cheese plant, ensuring adequate capacity utilization for expanded capacities will remain critical for the profitability of the company. Going forward, Company's ability to improve its profitability while managing price volatility for milk products, sustained improvement in procurement base of milk and managing working capital requirement will remain key rating sensitivities.

Key rating drivers

Credit Strengths
- Strong track record of promoters in the dairy industry with presence across the value chain from milk sourcing to retailing
- Established procurement base ensuring regular supply of raw milk supplemented by network of bulk coolers and chilling centers
- Diversified product profile with major presence in value added products segment; sizeable market share (~38%) in Indian cheese market
- Geographically well diversified operations with pan India presence at; strong distribution network
- Robust capital structure with comfortable gearing owing to sizeable equity raised through IPO in FY2017

Credit Weakness
- Deterioration in profitability during FY2017 owing to increase in raw milk prices in Q3FY2017 and inability to pass on the same Relatively high working capital intensity on account of sizeable inventory; moderate coverage indicators though the same are expected to improve with improvement in margins
- Sizeable capex incurred in recent past for capacity expansion; maintaining healthy capacity utilization will be critical for company's profitability
- High competitive intensity from organized co-operatives, private players and unorganized players
- Industry exposed to government regulations and global demand-supply scenario for milk products especially milk powder
- Milk production is vulnerable to external factors such as weather conditions, cattle diseases etc.

Description of key rating drivers highlighted above:
PMFL with more than 25 years of track record track record in dairy industry has forward and backward integration and presence across the value chain through its dairy farm for milk procurement and established brands for ensuring retail market reach. The company has a robust milk procurement network among local farmers who have strong loyalty with the promoters owing to its four decade long association. The promoters have over two decades of experience in the dairy business with strong connect with the local farmers in the milk procurement belt. PMFL has tie-ups with over 4,300 village level collection centres and ~2.3 lakhs farmers, 77 chilling centres (including 27 owned chilling centres) and 75 bulk cooling units across Manchar/Palamner. PMFL has set up a dairy farm under its subsidiary Bhagyalaxmi Dairy Farm Private Limited, which primarily supplies through group's "Pride of Cow" brand. The company has diversified product profile which includes pouched milk, ultra-heat treatment (UHT) milk, ghee, butter, cheese, yogurt, cottage cheese, milk powder, flavoured milk, cream, whey powder, gulab jamun mix etc.

The capital structure of the group improved significantly with a comfortable gearing of 0.4x in FY2017 on account of repayment of working capital debt of Rs. 100.00 crore from the IPO raised in May 2016. In

May 2016, the company has raised Rs. 300.00 crore of IPO from which, Rs. 21.59 crore used towards IPO expenses, Rs. 100.00 crore used to repay working capital debt and Rs. 28.41 crore used in managing company's working capital. The company plans to use balance amount of Rs. 150.00 crore for capacity expansion and installation of waste water treatment plant. As on June 2017, the company has already incurred ~Rs. 85 crore for capacity expansion in milk processing plant, cheese plant and cottage cheese plant and the balance capex is expected to be incurred in near term.

Analytical approach:

Links to applicable Criteria
Corporate Credit Rating Methodology

About the Company:
Incorporated in 1992, Parag Milk Foods Limited (PMFL) is Public limited company listed on the Bombay Stock Exchange and National Stock Exchange. PMFL is present across the supply chain of milk procurement, processing and marketing of liquid milk and milk products under its own brand names – Viz. 'Gowardhan', 'Go' and 'Pride of Cow'. The company also has presence in cow farming business through its wholly owned subsidiary Bhagyalaxmi Dairy Farms Private Limited. The dairy products manufactured and marketed by the group include pouched milk, ultra-heat treatment (UHT) milk, ghee, butter, cheese, yogurt, cottage cheese, milk powder, flavoured milk, cream, whey powder, gulab jamun mix etc. The company is majorly into high value added products which contribute ~75-80% of the total revenues with only 20-25% revenues coming from pouched milk. It has two milk processing plants, each located in Manchar, near Pune in Maharashtra and Palamner in Andhra Pradesh with total milk processing capacity of 12 lacs litres per day (LPD) and 8 lacs LPD respectively. Recently in June 2017, the daily milk processing capacity of Manchar plant has been increased to 16 lacs LPD with total 24 lacs LPD capacity for the company. The company also has a cheese manufacturing plant with a capacity of 80 MTPD (metric tonnes per day) and as per management it is the largest single location cheese plant in India. While assigning the ratings, ICRA has taken a consolidated view of Parag Milk Foods Limited and its 100% subsidiary Bhagyalaxmi Dairy Farms Private Limited (together referred as PMFL) considering strong management, operational and financial linkages.

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for the last year:
Table: Rating History

S. No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	Rated amount (Rs. Crore)	Month-year & Rating	Month-year & Rating in FY2017	Month-year & Rating in FY2016	Month-year & Rating in FY2015
				Jul-17	NA	NA	NA
1	Term Loan	Long Term	88.00	[ICRA]A- (Stable)	NA	NA	NA
2	Cash Credit	Long Term	150.00	[ICRA]A- (Stable)	NA	NA	NA
3	Bank Guarantee	Short Term	13.00	[ICRA]A2+	NA	NA	NA
4	Letter of Credit	Short Term	16.00	[ICRA]A2+	NA	NA	NA

Complexity level of the rated instrument:
ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

Annexure-1

Details of Instruments

Name of the instrument	Date of issuance	Interest rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Term Loan 1	-	-	Dec-17	1.19	[ICRA]A- (Stable)
Term Loan 2	-	-	Oct-18	13.89	[ICRA]A- (Stable)
Term Loan 3	-	-	Jun-20	2.52	[ICRA]A- (Stable)
Term Loan 4	-	-	Dec-21	70.40	[ICRA]A- (Stable)
Cash Credit 1	-	-	-	74.00	[ICRA]A- (Stable)
Cash Credit 2	-	-	-	46.00	[ICRA]A- (Stable)
Cash Credit 3	-	-	-	30.00	[ICRA]A- (Stable)
Non fund Limits – Bank Guarantee/ Letter of Credit				29.00	[ICRA]A2+

Source: The Company

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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.

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