July 11, 2019

Parag Milk Foods Limited: Ratings upgraded to [ICRA]A+(Stable)/[ICRA]A1 from [ICRA]A(Stable)/[ICRA]A2+, rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - term loan	91.00	90.04	[ICRA]A+(Stable); upgraded from [ICRA]A(Stable)
Fund-based - working capital facilities	200.00	200.00	[ICRA]A+(Stable); upgraded from [ICRA]A(Stable)
Non-fund based facilities	97.00	100.00	[ICRA]A1; upgraded from [ICRA]A2+
Total	**388.00**	**390.04**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has consolidated the financials of Parag Milk Foods Limited (PMFL) and its 100% subsidiary, Bhagyalaxmi Dairy Farms Private Limited (BDFPL), while arriving at the ratings, given the strong management, operational and financial linkages shared by them.

The ratings upgrade takes into account the healthy financial profile with improved accruals and coverage indicators, along with increasing scale of operations, strong brand position and expanding distribution network.

The ratings continue to factor in the strong track record of the promoters in the dairy industry of more than 25 years 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 ratings also account for the favourable growth prospects from value-added products (VADPs), which comprised 66-68% of the revenue profile, followed by liquid milk (18%) and skimmed milk powder (SMP, 14%). The diverse VADP profile includes clarified butter (*ghee*), cheese, butter, curd, cottage cheese (*paneer*), yoghurt, whey powder and traditional desert mixes. PMFL is the second largest institutional cheese supplier in the country with a market share of ~35%[1]. ICRA derives comfort from PMFL's wide retail market reach through its established brands - Gowardhan, Go, Topp Up, Pride of Cows, Slurp, Milkrich and Avvatar. The company is geographically diversified with a pan-India presence through its strong marketing and distribution network. ICRA believes that private dairy players will continue to benefit from the increasing consumption of branded processed milk products in the domestic market on the back of higher purchasing power, changing food habits and increasing health awareness. The ratings favourably factor in the company's healthy growth trajectory due to increase in volumes and realisations of its VADPs. The company's financial profile strengthened in FY2019 with TD/OPBDITA, interest coverage and TOL/TNW of 1.1 times, 6.3 times and 0.7 time, respectively, compared to 1.5 times, 5.5 times and 0.9 time, respectively, in FY2018.

The ratings are, however, constrained by the high working capital intensity on account of sizeable inventory of VADPs, especially cheese, which requires undergoing a certain ageing process. In FY2019, the operating margins declined to 9.4%

[1] *Source: Company*

from 10.1% in FY2018, as the Q4 FY2019 sales were dominated by SMP (lower gross margin product) in order to avail export benefits provided by the state and Central Governments. PMFL's profitability remains a function of milk procurement prices, which are governed by supply-demand scenario, Government regulations and agro-climatic conditions. However, the company passes on higher procurement prices to its end-consumers with a lag effect of one quarter. The company is also exposed to intense competition from organised co-operatives, private players and various unorganised players.

Outlook: Stable

ICRA expects PMFL to continue to benefit from its healthy financial profile, established brand presence and expanding distribution network, as well as the growing demand for modern VADPs (like cheese, whey, flavoured milk and yoghurt), where it is present in. The outlook may be revised to Positive with its increasing market share in VADPs, sustained growth in revenue and profitability, and better working capital management. The outlook may be revised to Negative if cash accrual is lower than expected, or if any stretch in the working capital cycle weakens liquidity.

Key rating drivers

Credit strengths

Established track record of promoters with strong procurement network - PMFL has a robust milk procurement network comprising local farmers known to the promoters, who have lived in Manchar (near Pune in Maharashtra) for more than four decades. This network of farmers 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 Palamaner (Andhra Pradesh). PMFL also has its own dairy farm under its 100% subsidiary, BDFPL, which supplies premium quality milk through the 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 with the primary unique selling point of all products being processed from 100% cow's milk. In FY2018, PMFL acquired an existing facility of Danone in Sonipat, Haryana to expand its presence in the fresh category in the northern regions. It 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. For other VADPs, PMFL utilises its network of 20 depots and over 200 super stockists, servicing more than 4 lakh retail counters. PMFL also sells products such as SMP, cheese and butter to institutional clients.

Diversified product profile with sizeable market share in *ghee* and cheese segments - PMFL derives ~18% of its sales (FY2019) from pouched milk, 14% from SMP and the remaining from VADPs, which includes *ghee*, butter, cheese, yoghurt, *paneer*, flavoured milk, ultra-high temperature (UHT) milk and whey powder. PMFL enjoys a sizeable market share in the cheese segment (~35%) and the *ghee* segment. In FY2019, PMFL introduced Suwarna *ghee* (to cater to the South Indian market) and Avvatar Isorich, a whey protein (targeted towards the sports industry). Previously, it had launched variants in the cheese segments (spiced cheese and cubed cheese), Slurp (flavoured milk category) and Go Protein Powder (a whey protein), to cater to a larger demographic of users.

Healthy growth supported by established brand presence and growing distribution network - The operating income grew by 22.6% YoY in FY2019 with a growth of 18% in net sales and 204.16% in other operating revenues (primarily comprising one-time milk subsidy). The company's focus remains on VADPs and expanding its distribution network across India. It is strengthening its brand position and has launched product extensions to cater to indigenous preferences. PMFL also expanded its footprint in the northern market by acquiring a plant in Sonipat and starting the supply of the Pride of Cows milk from its farm in Manchar. Going forward, growth is expected from its established presence and distribution network, along with increasing overall demand for VADPs.

Healthy capitalisation and coverage indicators owing to healthy accruals - PMFL maintained a healthy capital structure with a gearing of 0.3 time in FY2019 compared to 0.4 time in FY2018. The coverage indicators improved to 1.1 times in FY2019 versus 1.5 times in FY2018 aided by higher accruals. Interest coverage and TOL/TNW remained healthy at 6.3 times and 0.7 time, respectively, in FY2019 compared to 5.5 times and 0.9 time, respectively, in FY2018. PMFL will also continue to benefit from the refund of state GST taxes for past projects under the mega-project expansion scheme by the Government of Maharashtra.

Credit challenges

High working capital intensity due to high inventory levels - The company receives payments from its institutional customers within 45 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* etc. The creditors are mostly milk aggregators, packaging vendors and transportation carriers. Some of the milk aggregators use LCs, which are paid after an extended credit period while other milk suppliers are paid within 23-35 days. PMFL also provides corporate guarantee for bill discounting facility to its suppliers.

Profitability remains vulnerable to agro-climatic conditions, Government regulations and product mix - The company's operating and net margins were at 9.4% and 5.0%, respectively, in FY2019 versus 10.1% and 4.5%, respectively, in the previous year. Though the margins reduced, the absolute OPBDITA improved by 13.7%. The Q4 FY2019 sales were dominated by SMP sales at lower gross margins for availing export benefits provided by the state and Central Governments and de-stocking of SMPs. The margins are also vulnerable to milk procurement prices, which are dependent on agro-climatic conditions and Government regulations. However, the company passes on the increased costs to consumers with a lag effect of one quarter. Therefore, the margins are expected to recover going forward, though the same will remain a function of milk procurement prices, product mix and Government regulations.

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

Liquidity position

The liquidity profile remains adequate supported by healthy accruals and positive FFOs. In the near term, PMFL's ability to generate healthy cash accruals will lead to lower creditor days, improving its financial profile. The utilisation of working capital limits reduced to 91% in FY2019 from 98% in the previous year. It also maintained a cash and bank balance of Rs. 12.0 crore as on March 31, 2019.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of PMFL. As on March 31, 2019, 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. In FY2017, the company was renamed as Parag Milk Foods Limited after raising its initial public offering (IPO) of Rs. 300.00 crore. It has three milk processing plants, at Manchar, Palamaner and Sonipat. The company also has a cheese (including *paneer*) manufacturing plant with a capacity of 80 metric tonne per day (MTPD).

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, Avvatar, flavoured milk and traditional desert 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 produced without any human interference using latest technology and best global practices. BDFPL has also started selling cattle feed to farmers, in addition to introducing a range of certified organic fertilisers by commercialising cow manure.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	1,954.5	2,395.7
PAT (Rs. crore)	87.1	120.7
OPBDIT/OI (%)	10.1%	9.4%
RoCE (%)	17.1%	18.5%
Total Debt/TNW (times)	0.4	0.3
Total Debt/OPBDIT (times)	1.5	1.1
Interest Coverage (times)	5.5	6.3

Status of non-cooperation with previous CRA

The company had an outstanding rating of [IND-Ra]BBB+(Issuer not cooperating)/[IND-Ra]A2(Issuer not cooperating) for Rs. 409.34-crore bank lines as on November 30, 2018.

Any other information: None

Rating history for last three years

Instrument	Current Rating (FY2020)				Chronology of Rating History for the Past 3 Years		
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating July 2019	Date & Rating in FY2019 July 2018	Date & Rating in FY2018 July 2017	Date & Rating in FY2017 -
Fund-based - term loan	Long Term	90.04	**81.03**	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	**-**
Working capital facilities	Long Term	200.00	**-**	**[ICRA]A+ (Stable)**	**[ICRA]A (Stable)**	**[ICRA]A- (Stable)**	
Non-fund based facilities	Short Term	100.00	**-**	**[ICRA]A1**	**[ICRA]A2+**	**[ICRA]A2+**	**-**

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: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Term Loan 1	Sept 2013		Dec 2021	50.15	[ICRA]A+(Stable)
NA	Term Loan 2	Sept 2017		Feb 2023	9.40	[ICRA]A+(Stable)
NA	Term Loan 3	Sept 2017		Feb 2023	7.05	[ICRA]A+(Stable)
NA	Term Loan 4	Feb 2019		Jan 2024	6.90	[ICRA]A+(Stable)
NA	Term Loan 5	Jun 2018 July 2018 Aug 2018 Dec 2018		May 2023 Jun 2023 Aug 2023 Dec 2023	16.54	[ICRA]A+(Stable)
NA	Working Capital Loan	-	-	-	200.00	[ICRA]A+(Stable)
NA	Non-fund Based Limit	-	-	-	100.00	[ICRA]A1

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

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