March 17, 2020

Parag Milk Foods Limited: Rating reaffirmed; Outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - term loan	90.04	90.04	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Fund-based - working capital facilities	200.00	200.00	[ICRA]A+ reaffirmed; outlook revised to negative from stable
Non-fund based facilities	100.00	100.00	[ICRA]A1; reaffirmed
Total	**390.04**	**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 negative outlook factors in the reduced financial flexibility due to the sharp decline in its share prices coupled with high level of pledged shareholding, wherein ~48.1% of the promoters' shareholding in PMFL is pledged. The negative outlook also takes into account the reduction in operating margins to 9.0% in 9M FY2020 compared to 10.4% in 9M FY2019. The decline is on account of significant increase in milk procurement prices and subsequent lag in passing on these increases to end-customers. Going forward, the Group expects to derive majority of its revenue growth from an increase in realisations of products as volumes are expected to be muted amid a lean procurement season. PMFL availed additional working capital limits in FY2020 to support business operations and liquidity from sustained increase in raw material prices. ICRA will continue to monitor the movement in pledged shareholding, operating margins as well as liquidity position, which remains a key monitorable.

Despite increase in working capital debt, the financial profile remained healthy with TD/OPBDITA, interest coverage and TOL/TNW of 1.7 times, 5.9 times and 0.6 time, respectively for 9M FY2020 (provisional), compared to 1.1 times, 6.3 times and 0.7 time, respectively, in FY2019. However, the ratings remain constrained by the high working capital requirement on account of sizeable inventory of value added products (VADPs), especially cheese, which requires a certain ageing process. The Group is also exposed to intense competition from organised co-operatives, private players and various unorganised players.

ICRA derives comfort from the widespread scale of operations, strong brand position and expansive distribution network of PMFL. 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 ratings also account for the favourable growth prospects from VADPs, which comprised 67.5% of the revenue profile, followed by liquid milk (18.5%) and skimmed milk powder (SMP, 12.3%) in 9M FY2020. 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 realisations of its VADPs.

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 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 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 with the primary unique selling point of all its products being that they are processed from 100% cow's milk. PMFL acquired an existing facility of Danone (fresh category) in Sonipat, Haryana, in FY2018 and has been expanding its presence in the northern region. 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 19 depots and over 140 super stockists, servicing more than 3.5 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 – The Group derives ~18.5% of its sales (9M FY2020) from pouched milk, 12.9% from SMP and the rest from VADPs, such as *ghee*, butter, cheese, yoghurt, *paneer*, flavoured milk, ultra-high temperature (UHT) milk and whey powder. PMFL enjoys a sizeable market share in the cheese (~35%) and *ghee* segments. The company's past launches include variants in of cheese, Suwarna *ghee* (for the South Indian market) and Avvatar Isorich, a whey protein (targeted towards the sports industry) in addition to Slurp (flavoured milk category) and Go Protein Powder (whey protein), to cater to a larger consumer demography.

Healthy capitalisation and coverage indicators - PMFL availed additional working capital limits in FY2020 to support business operations and liquidity from sustained increase in raw material prices. The company's

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[1] *Source: Company*

capitalisation and coverage indicators remained healthy despite the increase in working capital lines in 9M FY2020 (provisional) with TD/OPBDITA, interest coverage and TOL/TNW of 1.7 times, 5.9 times and 0.6 time, respectively, compared to 1.1 times, 6.3 times and 0.7 time, respectively, in FY2019.

Credit challenges

High working capital intensity due to high inventory levels - The Group 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*. 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.

Revenue growth and profitability remain vulnerable to agro-climatic conditions, supply and demand metrices and product mix - In 9M FY2020, the operating margins declined to 9.0% from 10.4% in 9M FY2019, due to significant increase in milk procurement prices (~29.0% YoY in 9M FY2020) and subsequent lag in passing on price increases to customers. Going forward, the company expects to derive majority of its revenue growth from an increase in realisations of products as volumes are expected to be muted amid a lean procurement season. The margins are vulnerable to milk procurement prices, which are governed by the ongoing demand–supply scenario, agro-climatic conditions 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: Adequate

The liquidity profile remains adequate supported by healthy accruals of Rs. 147.9 crore and Rs. 123.5 crore as on March 31, 2019 and December 31, 2019, respectively. It maintained a cash and bank balance of Rs. 28.8 crore as on September 30, 2019. The company has high utilisation of working capital limits with average utilisation of 94.4% of sanctioned limits and 68.9% of drawing power for the 12 months ended January 2020. PMFL availed additional working capital limits in FY2020 to support business operations and liquidity.

Rating sensitivities

Positive triggers – ICRA could remove the ratings negative outlook on complete resolution of pledged shares and if the company maintains a healthy revenue growth and operating margins of approximately 10% in the near term. In addition, the company should also maintain TD/OPBITDA below 1.5 times on a sustained basis and interest coverage in excess of 7.0 times.

Negative triggers – Negative pressure on PMFL's rating could arise in case of continued promoter pledge at high levels or release of pledge in favour of a third-party leading to reduced financial flexibility. Further, a decline in revenue or margins, a weakening in debt protection metrics and inability to improve the liquidity position will impact the ratings. Specific credit metrics that could lead to negative pressure include TD/OPBITA rising above 2.3 times on a sustained basis or interest coverage dropping below 6.0 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, 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. It has three milk processing plants - one each at Manchar, Palamaner 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, 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 processed without any human interference using latest technologies 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)	1954.5	2395.7
PAT (Rs. crore)	87.1	120.7
OPBDIT/OI (%)	10.1%	9.4%
RoCE (%)	17.1%	18.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.9	0.7
Total Debt/OPBDIT (times)	1.5	1.1
Interest Coverage (times)	5.5	6.3
DSCR	2.0	3.0

Status of non-cooperation with previous CRA: Not Applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2020)					Rating History for the Past 3 Years		
		Type	Amount Rated	Amount Outstanding	Rating		FY2019	FY2018	FY2017
					17-Mar-2020	11-Jul-2019	04-Jul-2018	13-Jul-2017	-
1	Fund-based - term loan	Long Term	90.04	**76.34**	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	
2	Working capital facilities	Long Term	200.00		[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)	
3	Non-fund based facilities	Short Term	100.00		[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+	

Amount in Rs. crore

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+(Negative)
NA	Term Loan 2	Sept 2017		Feb 2023	9.40	[ICRA]A+(Negative)
NA	Term Loan 3	Sept 2017		Feb 2023	7.05	[ICRA]A+(Negative)
NA	Term Loan 4	Feb 2019		Jan 2024	6.90	[ICRA]A+(Negative)
NA	Term Loan 5	Jun 2018 July 2018 Aug 2018 Dec 2018		May 2023 Jun 2023 Aug 2023 Dec 2023	16.54	[ICRA]A+(Negative)
NA	Working Capital Loan	-	-	-	200.00	[ICRA]A+(Negative)
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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About ICRA Limited:

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