August 17, 2020

Parag Milk Foods Limited: Ratings downgraded to [ICRA] A/Negative/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	90.04	103.00	[ICRA]A (negative); downgraded from [ICRA] A+ (negative)
Fund-based - working capital facilities	200.00	400.00	[ICRA]A (negative); downgraded from [ICRA] A+ (negative)
Non-fund based facilities	100.00	100.00	[ICRA]A2+; downgraded from [ICRA] A1
Total	**390.04**	**603.00**	

**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 revision in ratings takes into account the stretched working capital cycle led by sizable inventory levels. The inventory levels were high in March 2020 owing to high raw milk prices. While the milk prices and procurement levels have reduced after the Covid-19 induced lockdown in March 2020, the procurement levels for PMFL remained elevated in relation to uncertain and lower demand consumption during Q1 FY2020, leading to a stretched working capital cycle. ICRA notes that PMFL reduced its daily procurement quantity of milk from June 2020 to prevent further build-up of inventory. Despite increase in working capital debt, the financial profile remained healthy supported by adequate accruals. The TD/OPBDITA, interest coverage and TOL/TNW stood at 1.9 times, 5.6 times and 0.8 time, respectively, in FY2020, compared to 1.1 times, 6.3 times and 0.7 time, respectively, in FY2019.

PMFL has opted for the moratorium on bank lines permitted by the Reserve Bank of India (RBI) due from March 2020 as part of the ‘Covid-19 – Regulatory Package’ announced by the RBI on March 27, 2020. The RBI circular did not permit banks to provide moratorium on non-fund based facilities. However, banks could sanction additional ad-hoc limits to companies in order to alleviate their liquidity pressures. While the company formally applied to its bankers for sanctioning additional ad-hoc limits and waited for their response, when the approval was not received, the dues were subsequently cleared by PMFL. ICRA has not considered the overdues in non-fund based facilities as default since they have arisen out of operating issues amid Covid-19 as per the guidance provided by the SEBI circular, SEBI/ HO/ MIRSD/ CRADT/ CIR/ P/ 2020/ 53, dated March 30, 2020.

ICRA expects financial performance in FY2021 to be impacted by lower demand consumption; although PMFL will benefit from lower milk prices that may be passed on to end-users with a lag effect. The margins are vulnerable to milk procurement prices, which are governed by the demand–supply scenario, agro-climatic conditions and Government regulations. ICRA will, therefore, continue to monitor the movement in operating margins as well as liquidity position, which will remain a key monitorable.

The outlook on the rating is Negative led by stretched a working capital cycle and lower demand offtake owing to the Covid-19 related lockdown in Q1FY2021. The company's ability to avail additional sanctioned limits will be critical in maintaining its financial profile.

ICRA derives comfort from the widespread scale of operations, strong brand position, expansive distribution network and diversified product profile with sizeable market share in certain value-added product (VADP) segments. 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 company is geographically diversified with a pan India presence through its strong marketing and distribution network. ICRA believes that in the medium to long-term, 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.

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, who have lived in Manchar (near Pune, Maharashtra) for more than four decades and enjoy established relationships with the promoters. 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.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. PMFL had acquired a Danone facility (fresh category) in Sonipat, Haryana, in FY2018 and has been expanding its presence in the northern region. 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 skimmed milk powder (SMP) and cheese to institutional clients.

Diversified product profile with sizeable market share in clarified butter and cheese segments – The Group derives ~18.6% of its revenues from pouched milk in FY2020, 12.8% from SMP and the rest from VADPs, such as clarified butter (*ghee*), butter, cheese, yoghurt, cottage cheese (*paneer*), flavoured milk, ultra-high temperature (UHT) milk and whey (Avataar). PMFL enjoys a sizeable market share in the cheese (~35%) and *ghee* segments. The company's past launches include variants of cheese in terms of flavours and shapes, Suwarna *ghee* (for the South Indian market) and Avvatar Isorich, a whey protein (targeted towards the sports industry), in addition to Avataar Rapid, an absorbing carbohydrate formula for instant energy and replenishment of electrolytes.

Healthy capitalisation and coverage indicators - PMFL availed additional working capital limits in FY2020 to support increase in working capital intensity and liquidity from sustained increase in raw material prices. The company's capitalisation and coverage indicators remained healthy despite the increase in working capital lines in FY2020 with TD/OPBDITA, interest coverage and TOL/TNW of 1.9 times, 5.6 times and 0.8 time, respectively, compared to 1.1 times, 6.3 times and 0.7 time, respectively, in FY2019.

Credit challenges

High working capital intensity requirement impacts liquidity - The company receives payments from its traders and institutional customers within 45-48 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 inventory value increased in March 2020 as a result of increase in milk procurement prices and unsold volumes due to the lockdown in the last few days of March 2020. In April–May 2020, the company continued to procure large quantities of milk at lower costs that led to a build-up in inventory levels (reduced consumption demand) during the quarter, resulting in increased working capital intensity and temporary liquidity mismatches for the company. Thereafter, in June 2020, PMFL reduced its daily procurement quantity of milk to prevent further build-up of inventory.

Demand slowdown as a result of the pandemic impacts the revenue profile - The FY2020 revenue profile was supported by increase in blended realisations of 9.1% YoY offset by a degrowth in volumes by 2.5% YoY. As a result of the pandemic induced lockdowns, the demand from institutional and HoReCa (hotels, restaurants and café) customers has declined significantly (~30% YoY in Q1FY2021). While there has been a partial recovery in demand from some customers, the revenue profile is likely to be impacted in FY2021. The decline in institutional sales is compensated to some extent by an increase in end-consumer sales (direct consumer). Therefore, the company is focussed on growing its end-consumer distribution network and expand its brand presence for long shelf life consumer products like *ghee*, cheese and *paneer*.

Deterioration in FY2020 profitability; remains vulnerable to agro-climatic conditions, supply and demand metrices and product mix - In FY2020, the operating profits declined owing to increase in milk procurement by 20.0% YoY in FY2020. While the realisations for liquid milk and VADPs were passed on to consumers it was not in the same proportion as increase in milk procurement prices that led to a contraction in margins. The Q1 FY2021 margins are likely to be impacted by lower consumption demand and inventory devaluations. Going forward, while the operating margins are likely to benefit because of lower milk prices, which may be passed on to end-users with a lag effect, the FY2021 absolute operating profit could be impacted because of a lower revenue base amid the pandemic induced disruptions. 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 of the company is **adequate**, supported by healthy accruals of Rs. 144.9 and fund flow from operations of Rs. 148.7 crore in FY2020. The liquidity is supported by healthy accruals and unencumbered cash and cash equivalents of Rs. 21.6 crore as on March 31, FY2020 (Rs. 12.0 crore in FY2019). The average utilisation of working capital limits for the 12-month period ended June 2020 is 97.0% of disbursed limits and 76.9% of drawing power. The company has additional sanctioned limits of Rs. 100 crore that are pending disbursement.

PMFL has a consolidated capex commitment of ~Rs. 180 crore in FY2021-FY2022 to be financed by its internal accruals and long-term debt, of which Rs. 67.5 crore has been sanctioned. The remaining capex will be financed by its internal accruals.

Rating sensitivities

Positive triggers – ICRA could revise the outlook to Stable if the company maintains healthy revenue growth and operating margins of approximately 10% in the near term. The ratings will be positively impacted by the company's ability to improve its working capital cycle from current levels and an improvement in the liquidity profile. 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 an increase in promoter pledge or release of pledge in favour of a third-party, leading to reduced financial flexibility. Further, 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 5.0 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, 2020, 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, whey powder, flavoured milk and traditional dessert 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 introduced a range of certified organic fertilisers by commercialising cow manure.

Key financial indicators (audited)

	FY2019	**FY2020**
Operating Income (Rs. crore)	2395.7	2437.9
PAT (Rs. crore)	120.7	93.7
OPBDIT/OI (%)	9.4%	8.7%
PAT/OI (%)	5.0%	3.8%
Total Outside Liabilities/Tangible Net Worth (times)	0.7	0.8
Total Debt/OPBDIT (times)	1.1	1.9
Interest Coverage (times)	6.3	5.6

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019	FY2018
					17-Aug-2020	17-Mar-2020	11-Jul-2019	04-Jul-2018	13-Jul-2017
1	Fund-based - term loan	Long Term	103.0	103.0	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
2	Working capital facilities	Long Term	400.0	-	[ICRA]A (Negative)	[ICRA]A+ (Negative)	[ICRA]A+ (Stable)	[ICRA]A (Stable)	[ICRA]A- (Stable)
3	Non-fund based facilities	Short Term	100.0	-	[ICRA]A2+	[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	27.38	[ICRA]A (Negative)
NA	Term Loan 2	Sept 2017		Feb 2023	7.20	[ICRA]A (Negative)
NA	Term Loan 3	Sept 2017		Feb 2023	5.40	[ICRA]A (Negative)
NA	Term Loan 4	Feb 2019		Jan 2024	8.78	[ICRA]A (Negative)
NA	Term Loan 5	Jun 2018 July 2018 Aug 2018 Dec 2018		May 2023 Jun 2023 Aug 2023 Dec 2023	17.70	[ICRA]A (Negative)
NA	Term Loan 6	Apr 2020		Mar 2022	31.00	[ICRA]A (Negative)
NA	Term Loan 7	Apr 2020		Mar 2022	5.50	[ICRA]A (Negative)
NA	Working Capital Loan	-	-	-	400.00	[ICRA]A (Negative)
NA	Non-fund Based Limit	-	-	-	100.00	[ICRA]A2+

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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