May 10, 2023

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]A3+
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]A3+
Total	**563.31**	**563.31**	

**Instrument details are provided in Annexure-I*

Rationale

The rating action on Parag Milk Foods Limited (PMFL) considers its weaker than expected financial performance in FY2023 as marked by modest operating margins and elevated debt levels, leading to moderation in the company's liquidity profile and debt protection metrics; and ICRA's expectation that PMFL's credit metrics are likely to remain moderated in FY2024.

PMFL's operating margins have remained under pressure in FY2023, because of elevated milk prices, which the company was unable to fully pass-on to the end-consumers. Moreover, PMFL has extended sizeable advances to its suppliers to secure the supply of milk/ butter in recent years and there has been a considerable increase in the same in FY2023, amid volatility in milk availability during the year. Accordingly, elevated funding requirements translated into higher reliance on debt (Rs. 589.4 crore as of March 31, 2023, against Rs 517.7 crore as of March 31, 2022), leading to weakening of debt protection metrics (Total Debt/OPBITDA of 4.6x for FY2023) and liquidity profile, despite sizeable fund infusion of ~Rs 200 crore in FY2023[1]. Also as highlighted earlier, there has been continued attrition at the senior management level, which the company has not been able to fully address thus far. Given the scale of operations, inability to strengthen the senior management bandwidth in a timely manner can potentially impact PMFL's business operations, internal controls and implementation of its strategic roadmap to some extent.

The Negative outlook on the long-term rating reflects ICRA's expectation that PMFL's earnings are expected to remain under pressure due to high raw material prices. Coupled with elevated debt levels, this is likely to result in moderate debt protection metrics for FY2024 as well. Improvement in accrual generation and reduction in working capital intensity, leading to reduced reliance on debt and improvement in the liquidity profile, along with strengthening of management team in timely manner will be key for improvement in PMFL's financial profile in the near term.

The ratings also continue to factor in 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 for its value-added dairy products (VADP) division.

However, the ratings draw comfort from PMFL's sizeable scale of operations, established 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. Leveraging on the same, PMFL has reported healthy revenue growth in FY2023. The

[1] *Through preferential issue of equity and share warrants in August 2022 and November 2022, respectively.*

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's business profile is characterised by the extensive experience of the promoters of around three decades, leading to a robust milk procurement network of local farmers, in Manchar (near Pune, Maharashtra). 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 five 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 29 depots, more than 500 super stockists, over 4,500 distributors servicing more than 4.6 lakh retail touchpoints. 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[2], and whey.

Diversified product profile with sizeable market share in clarified butter and cheese segments – In FY2023, ~9.9% of PMFL's revenues were generated from liquid milk, followed by SMP (21.1%) and VADPs (65.4%), such as clarified butter, butter, cheese, yoghurt, ultra-high temperature (UHT) milk, and other milk products. PMFL is a dominant 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 coupled with lower-than-expected improvement in operating margins led to moderation in debt protection metrics. – The company's debt levels increased to Rs. 589.4 crore as on March 31, 2023, from ~Rs. 517.7 crore as on March 31, 2022, due to elevated funding requirements. This was driven by considerable increase (Rs. 135.1 crore as on March 31, 2022 to Rs. 264.6 crore as on March 31, 2023) in advances extended to its suppliers for securing the supply of milk/ butter in the last fiscal, amid volatility in milk availability during the year. PMFL's OPBITDA margins also remained lower than expected level at ~4.6% in FY2023, due to elevated milk prices, which the company was unable to fully pass-on to its end-consumers. The elevated debt levels along with lower operating margins, led to moderation in debt protection metrics with Total Debt/ OPBTIDA of 4.6x as on March 31, 2023. Moreover, the debt protection metrics are likely to remain moderated in the near term on account of continued pressure on operating margins and no major reduction in debt levels.

Weaker than expected liquidity position despite sizeable equity infusion in FY2023 – The company's liquidity position has weakened as reflected by moderate cash and liquid investment of around Rs. 24.2 crore (excluding FCCB funds earmarked for capex) and high utilisation of its working capital limits. This is despite the sizeable fund infusion of ~Rs. 200 crore in FY2023, which has mostly been consumed for working capital requirements of the business, against earlier expectations of deleveraging to some extent.

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

[2] *SMP: Skimmed milk powder*

ensuring an uninterrupted flow of *ghee*. The company's creditor days also reduced significantly in FY2023 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: Stretched

PMFL's liquidity is stretched as evidenced by high utilisation of its working capital limits (average utilisation of ~93% in H2 FY2023) and moderate free cash and liquid investments (excluding FCCB funds that can only be used for capex) of Rs. 24.2 crore as on March 31, 2023. The company's liquidity moderated in FY2023, despite sizeable fund infusion of ~Rs. 200 crore in FY2023, as it has mainly utilised funds for elevated working capital requirements. Timely improvement in PMFL's liquidity profile, supported by steady internal accrual generation and increased cushion in the form of undrawn bank lines will remain a key monitorable. The company has consolidated debt repayment of ~Rs. 28-29 crore in FY2024 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 rating upgrade is unlikely 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 and liquidity profile.

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 3.5 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, 2023, 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	FY2022	FY2023
Operating income (Rs. crore)	2071.8	2892.6
PAT (Rs. crore)	-532.5	53.3
OPBDIT/OI	-21.2%	4.6%
PAT/OI	-25.7%	1.8%
Total outside liabilities/Tangible net worth (times)	1.5	1.1
Total debt/OPBDIT (times)	-1.2	4.6
Interest coverage (times)	-8.6	2.4

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

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2024)				Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding as on march 31,2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023		Date & rating in FY2022			Date & rating in FY2021
					May 10, 2023	December 27, 2022	July 20, 2022	Dec 10, 2021	July 09, 2021	Apr 13, 2021	August 17, 2020
1	Fund-based - Term loan	Long-term	13.62	4.89	[ICRA]BBB-(Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A &	[ICRA]A (Negative)
2	Working capital facilities	Long-term	330.00	-	[ICRA]BBB-(Negative)	[ICRA]BBB (Negative)	[ICRA]BBB+ (Negative)	[ICRA]A (Stable)	[ICRA]A (Stable)	[ICRA]A &	[ICRA]A (Negative)
3	Non-fund-based facilities	Short term	33.00	-	[ICRA]A3	[ICRA]A3+	[ICRA]A2	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+&	[ICRA]A2+
4	Non-Convertible Debenture	Long Term	150.00	150.00	[ICRA]BBB-(Negative)	[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]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	11.05%	Aug 2024	3.26	
NA	Term Loan-IV	Sep 2017	11.05%	Sep 2024	2.49	
NA	Term Loan-V	Mar 2019	11.05%	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;*

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

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About ICRA Limited:

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