

Parag Milk Foods Limited

July 04, 2018

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based: Term Loan	88.00	91.00	[ICRA]A (stable) upgraded from [ICRA]A- (stable)
Fund-based: Working Capital Facilities	150.00	200.00	[ICRA]A (stable) upgraded from [ICRA] A- (stable)
Non-fund Based: Working Capital Facilities	29.00	97.00	[ICRA]A2+; reaffirmed
Total	267.00	388.00	

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating of the fund-based facility of Rs. 291 crore (enhanced from Rs. 238.0 crore) to [ICRA]A (pronounced ICRA A) from [ICRA]A- (pronounced ICRA A minus) of Parag Milk Foods Limited (PMFL or the company)¹. ICRA has also reaffirmed the short-term rating of [ICRA]A2+ (pronounced ICRA A two plus) to the non-fund based bank facilities of Rs. 97 crore (enhanced from Rs. 29 crore) for PMFL. The outlook on the long-term rating is Stable.

Rationale

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

The rating upgrade takes into account improved profitability led by economies of scale with higher share of value added products. Improved profitability has led to higher than expected accruals and improved capital structure.

The rating continues to factor in the strong track record of the promoters in the dairy industry for more than 25 years. PMFL has an established procurement base among dairy farmers, supported by a network of bulk coolers and chilling centres, that ensure a regular supply of raw milk. ICRA derives comfort from its wide retail market reach through its established brands, 'Gowardhan', 'Go', 'Topp Up' and 'Pride of Cow'. The company's product profile is diversified with a major presence in the Value-Added Products (VADP) segment that contributes ~75–80% to the revenue share. The diverse product profile of the company includes cow's milk, clarified butter (*ghee*), cheese, butter, curd, skimmed milk powder (SMP), cottage cheese, yogurt and whey powder, etc. PMFL is the second largest cheese supplier in the country with a market share of ~38% (source: company). PMFL is geographically well diversified with a pan India presence through the company's strong marketing and distribution network. ICRA believes that private dairy players will benefit from 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.

¹ For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications

The ratings also take into account the above average margins supported by higher share of value added products. The capital structure remains comfortable owing to sizeable equity raised through Initial Public Offering (IPO) in FY2017 leading to reduction in debt levels.

The ratings are, however, constrained by the moderately high working capital intensity on account of sizeable inventory of VADP, especially cheese, which requires undergoing a certain ageing process. The ratings are also constrained by the high competitive intensity from organised co-operatives, private players and unorganised players. The ratings also remain vulnerable to external factors like climatic conditions leading to volatility in milk prices. Moreover, the industry is exposed to Government regulations and the global demand–supply scenario for milk products, especially SMP. A sustained improvement in procurement of milk, stabilisation of new products, such as whey, and management of working capital requirements remain the key rating sensitivities.

Outlook: Stable

ICRA believes PMFL will continue to benefit from its established brand presence and growing demand for modern VADP like cheese, whey, flavoured milk and yoghurt that the company is present in. The outlook may be revised to Positive with increasing market share in value added products, 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 - The company has a robust milk procurement network among local farmers known to promoters who have lived in Manchar for more than four decades. This network with farmers mitigates the inherent risk in the dairy business due to the highly fragmented farmer/supplier base and seasonality in milk production. PMFL has tie-ups with over ~2.3 lakh farmers in 29 districts supported by chilling and bulk cooling units across Manchar and Palamner. PMFL has also set up its own dairy farm under its 100% owned subsidiary, Bhagyalakshmi Dairy Farms Private Limited (BDFPL), which primarily supplies premium quality milk through the 'Pride of Cow' brand.

Diversified product profile with sizable market share in clarified butter (*ghee*) and cheese segments - PMFL derives ~20% of its sales (FY2018) from pouched milk and the remaining from its value-added portfolio (VADP), which includes UHT milk, clarified butter (*ghee*), butter, cheese, yogurt, cottage cheese, SMP, flavored milk, cream and whey powder. PMFL enjoys a sizeable market share in the clarified butter-*ghee* (~20%) and cheese segment (~38%). The company has diversified its product portfolio by introducing new variations in cheese (spiced cheese and cubed cheese), launching Slurp (flavoured milk) and Avatar, a consumer-oriented whey protein product targeted towards the sports and nutrition industry. In the current year the company is introducing 'Go Protein Powder', a whey protein to cater to a larger demographic and a premium variant of its flagship product, 'Gowardhan Ghee'.

Established strong distribution network and brand recognition - PMFL has established brands of 'Gowardhan', 'Go', 'Topp Up' and 'Pride of Cow' that are widely 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 Northern regions. It has a strong distribution network for pouched milk in Mumbai, Nagpur and Pune district of Maharashtra as well as parts of Andhra Pradesh, Tamil Nadu and Karnataka. For other value-added products, PMFL utilises its network of 18 depots, over 140 super stockists, servicing around 1.5 lakh retail counters. The company also sells products such as SMP, cheese and butter to its well-known institutional clients,

including Mother Dairy, Nestle India Limited, Avenue Supermarts Limited (D-Mart), and Jubilant Food Works Limited (Dominos), etc.

Healthy margins with higher share of VADP – The company derives ~75-80% of revenue from value added products that yield higher margins compared to pasteurised milk segment which is highly competitive with low margins. The company has undertaken expansion of its milk processing capacity and capacity of other value-added product such as cheese, clarified butter (*ghee*), whey and curd. The operating and net margins of the company have improved to 10.0% and 4.5% respectively led by economies of scale (FY2017: operating and net margins 6% and 0.8% respectively). In FY2017 the margins were affected by the sudden increase in prices of procured milk and inability to immediately transfer the cost to the consumer. Going forward, increased production of high demand value added products such as cheese, whey, paneer and expansion in the Northern region via its acquisition in Sonipat, Haryana is expected to provide stability to its margins.

Improved capital structure and coverage indicators owing to improved profitability - The capital structure of the group maintained a gearing of 0.4 times in FY2018 similar to that of FY2017. The coverage indicators improved to 1.5 times in FY2018 versus 2.5 times in the previous year aided by increased profitability and higher accruals. PMFL will benefit from higher accruals from capacity expansions and refund of taxes for projects done in the past under the mega-project expansion scheme by the Government of Maharashtra.

Credit challenges

High working capital intensity resulting from high inventory levels impacts liquidity - The company receives payment from its institutional customers like ITC, Jubilant and Nestle within 45 days whereas SMP customers pay with 3-4 months period. The inventory days are high which is mainly due to high cheese inventory that is aged over months as a part of manufacturing process. PMFL also maintains high butter inventory as buffer raw material to maintain uninterrupted flow of clarified butter (*ghee*) etc. The creditors are mostly milk aggregators as well as packaging material suppliers which offer average credit period on the range of 45-60 days and 180 days respectively.

Profitability remains vulnerable to agro-climatic conditions and Government regulation - The profitability of PMFL is largely affected by the raw material price fluctuation owing to adverse agro-climatic conditions as well as Government regulation in increasing the minimum support price. Any adverse movement in the price of raw materials owing to lower milk supplies during flush season (September-March) could have an adverse impact on its margins. This was witnessed during FY2017 when PMFL had limited ability to pass on the price hike immediately owing to high competitive intensity. Further, the state government controls the milk purchase price in Maharashtra. All the companies dealing in milk procurement have to adhere to the prescribed prices.

Intense competition from other players - This industry faces high competition from the unorganised industry comprises 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 value-added segment, the intensity is marginally mitigated.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

[Corporate Credit Rating Methodology](#)

About the company:

Parag Milk Foods Limited was incorporated in 1992 as Parag Milk & Milk Products Pvt. Ltd., promoted by members of 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 first Initial Public Offering (IPO) of Rs. 300.00 crore. Parag has two milk processing plants, one each at Manchar, near Pune in Maharashtra, and at Palamaner in Andhra Pradesh, with a total milk processing capacity of 20 lakh litres per day (LPD) and 14 lakh LPD, respectively. The company also has a cheese (including *paneer*) manufacturing plant with a capacity of 80 metric tonnes per day (MTPD) and as per the management, it is the largest single location cheese plant in India.

PMFL is present across the supply chain of milk procurement, processing and marketing of liquid milk and milk products under its brands—'Gowardhan', 'Go', 'Pride of Cow' 'Avvatar' and 'Topp Up'. The dairy products manufactured and marketed by the company include cow's milk, clarified butter (*ghee*), cheese, butter, skimmed milk powder (SMP), cottage cheese (*paneer*), curd, whey powder, yoghurt, Ultra High Temperature (UHT), milk and flavoured milk, traditional desert mixes, etc. The company derives only ~20% revenue from pouched milk in FY2018 and the rest from high value-added product (mainly, cheese, clarified butter (*ghee*), butter, cottage cheese, curd, SMP, UHT milk). The company has a pan India presence with 17 depots, 3,000 distributors, over 140 stockists and 2.5 lakh retail touch points. It procures milk from over two lakh farmers across 29 districts, supported by a network of bulk milk coolers and chilling centres. PMFL has a diversified portfolio with seven brands and over 170 Stock Keeping Units (SKUs).

Bhagalaxmi Dairy Farms (BDF) is a wholly-owned subsidiary in the cow farming business. The unique farm-to-home initiative branded as, 'Pride of Cows', allows customers to access milk produced without any human interference using the latest technology and best global practices. BDF's bioscience division has also introduced a range of certified organic fertilisers by commercialising cow manure into additional value-added products.

Key financial indicators (audited)

	FY2016	FY2017	FY2018
Operating Income (Rs. crore)	1645.1	1730.7	1952.3
PAT (Rs. crore)	47.3	14.6	87.1
OPBDIT/OI (%)	9.0%	6.0%	10.0%
RoCE (%)	17.1%	5.4%	17.0%
Total Debt/TNW (times)	1.1	0.4	0.4
Total Debt/OPBDIT (times)	2.8	2.5	1.5
Interest coverage (times)	3.0	3.5	5.5

Status of non-cooperation with previous CRA:

The company has an outstanding rating of [IND-Ra] BBB+(Issuer not cooperating)/[IND-Ra] A2 (Issuer not cooperating) for Rs. 292.34 crore bank lines since September 2017.

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)			Chronology of Rating History for the Past 3 Years		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating July 2018	Date & Rating in FY2018 July 2017	Date & Rating in FY2017	Date & Rating in FY2016
1 Term Loan 1	Long Term	6.46	6.46	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
2 Term Loan 2	Long Term	11.80	11.80	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
3 Term Loan 3	Long Term	8.85	8.85	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
4 Term Loan 4	Long Term	62.9	62.04	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
5 Term Loan 5	Long Term	1.85	1.85	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
6 Cash Credit	Long Term	200.00	200.00	[ICRA] A (stable)	[ICRA] A- (stable)	-	-
8 Letter of Credit & Bank Guarantee	Short Term	97.00	97.00	[ICRA] A2+	[ICRA] A2+	-	-

Source: Company, Sanction Letters

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 2012	13.0%	Sept 2018	6.46	[ICRA] A (stable)
NA	Term Loan 2	Sept 2017	10.6%	Sept 2022	11.80	[ICRA] A (stable)
NA	Term Loan 3	Sept 2017	10.6%	Sept 2022	8.85	[ICRA] A (stable)
NA	Term Loan 4	Sept 2013	7% (4.33%+LIBOR)	Sept 2021	62.04	[ICRA] A (stable)
NA	Term Loan 5	Dec 2015	12.98%	Dec 2020	1.85	[ICRA] A (stable)
NA	Working Capital Loan	NA	NA	NA	200.00	[ICRA] A (stable)
NA	Non-Fund based Limit	NA	NA	-	97.00	[ICRA] A2+

Source: Company, Sanction Letters

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