

PRABHAT DAIRY

Healthy volumes; focus on branding continues

India Equity Research | Dairy



Prabhat Dairy's (Prabhat) Q4FY18 revenue grew 7.4% YoY led by healthy ~30% YoY volume spurt driven by pouch milk, cheese & curd. Gross margin jumped ~400bps YoY to 23.3% YoY & EBITDA margin expanded ~200bps YoY to ~9.9%, leading to EBITDA growth of ~35% YoY. Under Vision 2020, the company is targeting INR20bn sales with B2C sales doubling to INR10bn (~45% CAGR; taking its share to 50% from 30% currently) riding 2x jump in retail reach to 200,000 outlets. We estimate adj. PAT CAGR of 35% over FY18-20. Maintain 'BUY' with TP of INR211.

Milk, cheese and curd power revenue spurt

Prabhat's revenue grew 7.4% led by healthy volume spurt (overall, up ~30% YoY) in pouch milk, cheese and curd. With the B2B segment accounting for ~70% of revenue, the company passed on lower milk prices (down 25.5% YoY). Gross margin expanded ~400bps to 23.3% and EBITDA margin expanded ~200bps to 9.9%, leading to EBITDA growth of ~35% YoY. The company reinvested benefits from gross margin expansion in brand building and expanding its B2C network. FY18 revenue grew ~10% YoY (milk powder up 14% YoY, Cheese ~2x, milk 63%) and EBITDA margin was flat at ~8.9%. Prabhat is targeting ~14% revenue CAGR over FY18-20, with B2C sales doubling to INR10bn (~45% CAGR), taking its contribution to 50% (30% currently). However, margin is expected to be range bound owing to its focus on brand building and expanding distribution network. Post FY20, management has guided for double digit margin led by higher contribution from higher-margin consumer products.

Key growth drivers ahead

Going forward, we expect revenue growth to be driven by: i) focus on growing the B2C business at ~45% CAGR over FY18-20 led by doubling of retail reach from 0.1mn to 0.2mn outlets & launch of new products such as dairy beverages, ice cream, etc. ii) increasing direct milk procurement from 1.1mn lpd to 1.4mn lpd by increasing the number of milk collection centres, milk chilling plants & bulk milk coolers; and iii) focus on high-growth potential HORECA segment for cheese/paneer products.

Outlook and valuations: Story intact; maintain 'BUY'

With Prabhat's shifting focus to value-added products and B2C segment, we estimate EBITDA/ adj. PAT CAGR of 24%/35% over FY18-20. Maintain 'BUY' with TP of INR211.

Financials (Consolidated)

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18E	FY19E	FY20E
Net rev.	4,049	3,772	7.4	4,039	0.3	15,543	17,810	20,872
EBITDA	402	298	34.8	375	7.3	1,381	1,746	2,107
Adj. PAT	222	-18	NA	148	50.5	513	751	937
Adj. Dil. EPS (INR)	2.3	(0.2)	NA	1.5	50.5	5.3	7.7	9.6
Diluted P/E (x)						32.9	22.5	18.0
EV/EBITDA (x)						12.8	10.4	8.5
ROAE (%)*						8.0	10.8	12.3

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: , B: PRABHAT IN)

CMP	: INR 176
Target Price	: INR 211
52-week range (INR)	: 258 / 93
Share in issue (mn)	: 97.7
M cap (INR bn/USD mn)	: 17 / 261
Avg. Daily Vol. BSE/NSE ('000)	: 303.8

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	50.1	50.1	48.9
MF's, FI's & BKs	3.0	4.2	3.5
FII's	7.6	7.0	4.6
Others	39.4	38.8	42.9
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(5.2)	(2.4)	2.8
3 months	(4.3)	0.8	5.0
12 months	7.8	46.3	38.6

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Q4FY18 highlights

Revenue and margin

- Prabhat's Q4FY18 revenue grew ~7.5% YoY in line with estimates. Revenue increased in value terms on YoY basis despite 25.5% YoY decline in milk prices. For FY18, revenue grew ~10% YoY in value terms, despite soft milk prices, led by healthy volume growth across products.
- There was healthy volume growth of ~30% YoY on a blended basis, largely driven by increased sale of pouch milk, cheese and curd.
 - Share of value-added products and milk was 75% and 25%, respectively.
- Gross margin expanded ~400bps to 23.3% led by decline in milk prices. EBITDA margin expanded ~200bps to 9.9%, leading to EBITDA growth of ~35% YoY (15% above estimate). FY18 EBITDA margin was flat, leading to EBITDA growth of ~9% YoY.
- Relatively softer expansion in EBITDA margin was because of the company's strategy to consistently reinvest the benefits from improved gross margin in building and expanding its B2C network. Accordingly, there was an increase in manpower costs (up ~12% YoY), power & fuel cost, transport & forwarding cost, advertising & business promotion expense. Management reiterated that the trend will continue for the next two years and focus will be more on sales growth than margin expansion. Management has guided for double digit margin post FY20 led by increasing contribution from products like cheese.
- Adjusted PAT came at INR222mn versus loss of INR18mn in Q4FY17 due to higher effective tax rate. For FY18, adjusted PAT grew strongly by ~85% YoY to INR519mn.
- The company had done significant capital expenditure in the past three-four years and has guided for only maintenance capex in the next two years. It has guided for RoCE to expand to 20% plus over the next two-three years as capacity utilisation increases.

Sales mix

- Currently, ~65-70% comes from ingredients business (B2B), which operates on cost plus model (volatility in milk price is completely passed on) and the rest is from B2C.
- In FY18, milk powder contributed ~45% to overall revenue, liquid milk ~20%, ghee + butter ~14% and cheese ~4%.
- While products like milk powder and liquid milk have better asset turnover and cash churning cycle, margin is lower at ~7-8%. However, products like cheese have lower asset turn and stretched cash conversion cycle, but higher margin at ~10% plus.
- While B2C, at ~26%, fetches higher gross margin than B2B, at ~16-18%, EBITDA margin will be similar in both the segments ranging ~8-9% as operating cost, in terms of advertisement and promotional activities, is higher in B2C.

Vision 2020

- The company reiterated its target of increasing the share of B2C from the current ~30% (~INR4.5-5.0bn) of overall sales to ~50% (~INR10.0bn) by FY20. It implies ~45% CAGR in sales from B2C and ~13.5% CAGR in overall sales over FY19-20. Within B2B, the company intends to decrease contribution from wholesale business and increase contribution from corporate sales, thereby leading to flat growth in the segment.

Table 1: Expected product mix within B2C in FY20

Products	FY20E	% contribution
Liquid milk	INR4.5-5.0bn	~50.0
Cheese	INR1.5bn	~15.0
Ghee	INR1.5bn	~15.0
Curd	INR1.0bn	~10.0
Others (panner, ice cream, etc.)	INR1.0bn	~10.0
Total	INR9.5-10.0bn	

Source: Company

- Growth in B2C business will be driven by enriching the product portfolio with new products and new variants of existing products.
- The company also plans to increase the general retail reach from 100,000 to 200,000 stores and expand the modern trade presence in lucrative markets across India.

Others

- **Cheese:** Prabhat has around 30MT per day capacity for cheese processing (third largest in the country) and operates at ~40-45% utilization. The company generated around INR700mn from cheese in FY18, up ~200% plus YoY, and expects to grow at a similar rate in FY19. Within cheese, 50% comes from QSRs and 50% from food service distributors (who supply to other restaurants).
- **Ice-cream:** Volup is a new product with different dynamics (cold storage, etc), management wants to first build up understanding of the product before launching it pan-Maharashtra. Management expects it to be soft for next few quarters. The company expects the ice-cream category to be around ~INR1bn category over the next 3-4 years.
- **Launched milk beverages:** Prabhat recently launched milk beverages in Maharashtra. The beverages category contributes 8-9% to the Indian FMCG market and is growing at 20-23%. While the dairy beverage category is growing at 20%, milkshake category is growing at 54%. The company will cover pan Maharashtra in phase 1 and all metros & smart cities in phase 2.
- **Goodness zone:** The company launched an innovative concept for brand experience wherein exclusive stores are operated on 'Franchise Owned –Franchise Operated' model. Five-seven stores will be operational by end of this month and the company intends to open ~500 own outlets under franchise model over the next three years. Currently, the focus is on smaller towns where competition is limited and brand recognition is strong. These stores will also act as sub-distributors.

Procurement

- For FY18, average milk procurement per day stood at ~1.1mn litre, with ~65% directly sourced from farmers. Management targets to increase procurement to ~1.4mn litre by FY20.
- The company has increased the number of bulk milk coolers from 121 in FY17 to 230 in FY18 and milk collection centres from 475 to 550. The company plans to commission 100+ BMCs in Ahmednagar & Solapu in FY19.

Financial snapshot

(INR mn)

Year to March	Q4FY18	Q4FY17	% change	Q3FY18	% change	FY18	FY19E	FY20E
Net revenues	4,049	3,772	7.4	4,039	0.3	15,540	17,810	20,872
Raw material	3,107	3,065	1.4	3,114	(0.2)	12,084	13,763	16,121
Staff costs	108	96	11.9	113	(4.5)	435	500	570
Other expenses	433	313	38.4	438	(1.2)	1,644	1,800	2,075
Total expenditure	3,647	3,473	5.0	3,664	(0.5)	14,164	16,064	18,765
EBITDA	402	298	34.8	375	7.3	1,377	1,746	2,107
Depreciation	126	109	15.2	125	0.3	491	504	521
EBIT	277	189	46.1	250	10.8	886	1,242	1,585
Interest	70	76	(7.8)	84	(17.5)	329	271	294
Other income	12	5	144.6	5	158.4	26	37	38
Add: Prior period items								
Profit before tax	219	119	84.6	170	29.0	583	1,008	1,330
Provision for taxes	(3)	137	NA	22	NA	64	257	392
Minority interest								
Associate profit share								
Add: Exceptional items	(37)					(37)		
Reported net profit	176	(18)	(1,086.6)	148	19.1	473	751	937
Adjusted Profit	222	(18)	(1,346.1)	148	50.5	519	751	937
Diluted shares (mn)	98	98		98		98	98	98
Adjusted Diluted EPS	2.3	(0.2)	(1,346.1)	1.5	50.5	5.3	7.7	9.6
Diluted P/E (x)							22.5	18.0
EV/EBITDA (x)							10.4	8.5
ROAE (%)							10.8	12.3
Raw material	76.7	81.3		77.1		77.8	77.3	77.2
Employee cost	2.7	2.5		2.8		2.8	2.8	2.7
Other expenses	10.7	8.3		10.8		10.6	10.1	9.9
EBITDA	9.9	7.9		9.3		8.9	9.8	10.1
Reported net profit	5.5	(0.5)		3.7		3.3	4.2	4.5

Company Description

Prabhat, incorporated in 1998, is an integrated milk and dairy products player in India with aggregate milk processing capacity of 1.5mn litres per day. Over the years, the company has diversified into pasteurised milk, flavoured milk, sweetened condensed milk, ultra-pasteurised or ultra-high temperature (UHT) milk, yoghurt, dairy whitener, clarified butter (ghee), milk powder, ingredients for baby foods, lassi and chaas. It sells these products under retail consumer brands as well as ingredient products or as co-manufactured products to a number of institutional and multinational companies. Prabhat commenced commercial production of cheese, paneer and shrikhand in FY16.

Investment Theme

Coursing ahead to be a value-added player

Leveraging its strong track record as a specialty ingredients supplier to large global dairy players, Prabhat catapulted its gross block in value-added products >40% in FY16, to be the third largest cheese player in India. On the anvil is a 2-pronged strategy to scale up its value-added sales in HORECA and B2C segments via tier II/III cities with targeted ad spends at 1.3% of sales (0.8% in FY16).

Superior mix and utilisation: Margin and return ratio boosters

Prabhat's gross and EBITDA margins are likely to surge 79bps and 56bps over FY16-18E, respectively, led by: a) rising share of B2C & value-added products; and b) increasing utilisation. Ergo, we estimate adjusted pre-tax RoCE to catapult 386bps over the period to 15.0%.

Key Risks

Availability and price volatility of raw milk

Prabhat's business depends on its ability to procure sufficient good quality raw milk at commercially viable prices. Though the company has longstanding relationships with milk farmers and other suppliers, it has not entered into any formal supply agreements.

Overdependence on few institutional customers

In FY12, FY13, FY14, FY15, FY16 sales contribution from top-5 customers represented 44%, 41%, 41%, 36% and 38%, respectively, while sales to largest customers represented 33%, 27%, 21%, 18% and 16.5% of total revenues, respectively.

Trademark and brand infringement

Although Prabhat sells retail consumer products under its own trademarks and brands such as Prabhat, Flava and Milk Magic, these trademarks and brands have not yet been registered.

Financial Statements

Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
Company				
Capex (INR mn)	450	200	300	300

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Net revenue	14,099	15,543	17,810	20,872
Materials costs	11,358	12,082	13,763	16,121
Gross profit	2,740	3,460	4,047	4,751
Employee costs	347	435	500	570
Other Expenses	1,126	1,644	1,800	2,075
Operating expenses	1,472	2,079	2,301	2,645
Total operating expenses	12,831	14,162	16,064	18,765
EBITDA	1,268	1,381	1,746	2,107
Depreciation	432	491	504	521
EBIT	836	890	1,242	1,585
Less: Interest Expense	294	329	271	294
Add: Other income	12.65	26.1	36.95	38.21
Profit Before Tax	743	541	1,008	1,330
Less: Provision for Tax	274	58	257	392
Add: Exceptional items	189	(46)	-	-
Reported Profit	469	482	751	937
Exceptional Items	119	(31)	-	-
Adjusted Profit	350	513	751	937
Shares o /s (mn)	98	98	98	98
Adjusted Basic EPS	3.6	5.3	7.7	9.6
Diluted shares o/s (mn)	98	98	98	98
Adjusted Diluted EPS	3.6	5.3	7.7	9.6
Adjusted Cash EPS	7.0	10.2	12.6	14.7
Dividend per share (DPS)	0.4	0.7	1.0	1.2
Dividend Payout Ratio(%)	10.0	16.7	15.6	15.6

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Gross margin	19.4	22.3	22.7	22.8
EBITDA margins	9.0	8.9	9.8	10.1
EBIT margins	5.9	5.7	7.0	7.6
Interest Expense	2.1	2.1	1.5	1.4
Net Profit margins	2.5	3.3	4.2	4.5

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	20.7	10.2	14.6	17.2
EBITDA	10.0	8.9	26.5	20.6
PBT	103.0	(27.3)	86.5	31.9
Adjusted Profit	51.2	46.7	46.4	24.8
EPS	51.2	46.7	46.4	24.8

Balance sheet		(INR mn)			
As on 31st March	FY17	FY18	FY19E	FY20E	
Share capital	977	977	977	977	
Reserves & Surplus	5,905	6,301	6,917	7,689	
Shareholders' funds	6,882	7,278	7,894	8,666	
Long term borrowings	386	336	336	336	
Short term borrowings	3,197	1,650	1,850	2,000	
Total Borrowings	3,583	1,986	2,186	2,336	
Long Term Liabilities	14	86	86	86	
Def. Tax Liability (net)	159	92	92	92	
Sources of funds	10,638	9,442	10,258	11,180	
Gross Block	4,957	5,157	5,457	5,757	
Net Block	4,143	4,507	3,648	3,427	
Capital work in progress	265	113	260	260	
Intangible Assets	7	3	3	3	
Total net fixed assets	4,415	4,623	3,912	3,690	
Non current investments	-	-	-	-	
Cash and Equivalents	1,656	1,255	863	1,225	
Inventories	1,333	1,324	1,841	2,374	
Sundry Debtors	2,711	2,221	3,198	3,444	
Loans & Advances	530	252	252	252	
Other Current Assets	841	779	1,100	1,200	
Current Assets (ex cash)	5,415	4,576	6,391	7,271	
Trade payable	538	674	566	614	
Other Current Liab	310	338	342	392	
Total Current Liab	848	1,012	908	1,006	
Net Curr Assets-ex cash	4,567	3,564	5,483	6,265	
Uses of funds	10,638	9,442	10,258	11,180	
BVPS (INR)	70.5	74.5	80.8	88.7	

Free cash flow		(INR mn)			
Year to March	FY17	FY18	FY19E	FY20E	
Reported Profit	469	482	751	937	
Add: Depreciation	432	491	504	521	
Interest (Net of Tax)	197	221	182	197	
Others	292	83	53	59	
Less: Changes in WC	1,192	(1,003)	1,919	782	
Operating cash flow	200	2,279	(429)	933	
Less: Capex	329	48	447	300	
Free Cash Flow	(129)	2,232	(876)	633	

Cash flow metrics		FY17	FY18	FY19E	FY20E
Year to March					
Operating cash flow	200	2,279	(429)	933	
Financing cash flow	1,659	(1,987)	(170)	(271)	
Investing cash flow	(884)	(44)	(447)	(300)	
Net cash Flow	975	249	(1,046)	361	
Capex	(329)	(48)	(447)	(300)	
Dividend paid	(47)	(79)	(114)	(143)	

Profitability and efficiency ratios		FY17	FY18	FY19E	FY20E
Year to March					
ROACE (%)	9.9	10.0	14.2	16.4	
ROAE (%)	5.8	8.0	10.8	12.3	
Inventory Days	36	40	42	48	
ROA	3.7	5.1	7.6	8.7	
Debtors Days	64	58	56	58	
Payable Days	17	18	16	13	
Cash Conversion Cycle	83	80	81	92	
Current Ratio	8.3	5.8	8.0	8.4	
Debt/EBITDA (x)	2.8	1.4	1.3	1.1	
Debt/Equity (x)	0.5	0.3	0.3	0.3	
Adjusted Debt/Equity	0.5	0.3	0.3	0.3	
Interest Coverage Ratio	2.8	2.7	4.6	5.4	
LT debt /Cap empl. (%)	33.7	21.0	21.3	20.9	
Debt / Cap employed (%)	43.1	32.7	31.1	30.7	

Operating ratios		FY17	FY18	FY19E	FY20E
Year to March					
Total Asset Turnover	1.5	1.5	1.8	1.9	
Fixed Asset Turnover	3.4	3.6	4.4	5.9	
Equity Turnover	2.1	2.2	2.3	2.5	

Valuation parameters		FY17	FY18	FY19E	FY20E
Year to March					
Adj. Diluted EPS (INR)	3.6	5.3	7.7	9.6	
Y-o-Y growth (%)	51.2	46.7	46.4	24.8	
Adjusted Cash EPS (INR)	7.0	10.2	12.6	14.7	
Diluted P/E (x)	49.1	33.5	22.9	18.3	
P/B (x)	2.5	2.4	2.2	2.0	
EV / Sales (x)	1.3	1.1	1.0	0.9	
EV / EBITDA (x)	15.1	13.0	10.6	8.7	
Dividend Yield (%)	0.2	0.4	0.6	0.7	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		Price/ Adj. BV (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Prabhat Dairy Ltd	261	22.9	18.3	-	-	10.8	12.3
Heritage Foods Limited	472	33.4	24.4	-	-	25.3	28.1
Parag Milk Foods Limited	441	28.2	21.6	-	-	13.6	15.6
Median	-	28.2	21.6	-	-	13.6	15.6
AVERAGE	-	28.1	21.4	-	-	16.6	18.7

Source: Edelweiss research

Additional Data

Directors Data

Mr. Sarangdhar R. Nirmal	Chairman & Managing Director	Mr. Vivek S. Nirmal	Joint Managing Director
Mr. Ashok Sinha	Independent Director	Mrs. Seemantinee Khot	Independent Director
Mr. Hareesh Shah	Additional Independent Director	Mr. Soundararajan Bangarusamy	Independent Director
Mr. Rajesh Srivastava	Independent Director		

Auditors - B S R & Associates LLP

**as per last available data*

Holding Top -10

	Perc. Holding		Perc. Holding
Indian Agribusiness Fund	14.37	Stryrax Commodities	1.88
Societe Prom & Part Econom	8.68	Payone Enterprises Pvt Ltd	1.07
Vistra Itcl India Limited	7.57	Alquity Investment Management	0.75
Wasatch Advisors Inc	5.34	Sundaram Asset Management Co Ltd	0.72
Dsp Blackrock Investment Manager	3.02	Dimensional Fund Advisor	0.27

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Dairy

Heritage Foods Limited, Parag Milk Foods Limited, Prabhat Dairy Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
14-May-18	Parag Milk Foods	VADP drives robust growth; potent growth drivers in place; <i>Result Update</i>	337	Buy
15-Feb-18	Prabhat Dairy	Healthy volumes; focus on branding continues; <i>Result Update</i>	179	Buy
10-Feb-18	Parag Milk Foods	Value added back on track; <i>Result Update</i>	296	Buy

Distribution of Ratings / Market Cap

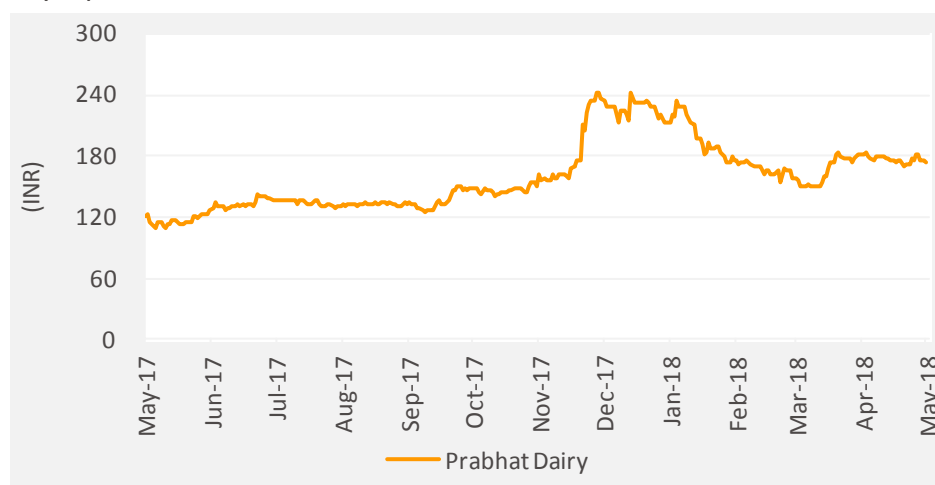
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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