

# Parag Milk Foods


<b>BSE SENSEX</b>	<b>S&amp;P CNX</b>
37,091	11,148
<b>Bloomberg</b>	<b>PARAG IN</b>
Equity Shares (m)	84
M.Cap.(INRb)/(USDb)	19.7 / 0.3
52-Week Range (INR)	415 / 197
1, 6, 12 Rel. Per (%)	-2/-10/-28
12M Avg Val (INR M)	136
Free float (%)	54.0

## Financials & Valuations (INR b)

Y/E Mar	2019	2020E	2021E
Net Sales	24.0	27.3	31.4
EBITDA	2.4	2.6	3.2
PAT	1.3	1.4	1.7
EPS (INR)	15.7	16.7	20.4
Gr. (%)	51.5	6.3	22.1
BV/Sh (INR)	98.5	112.3	128.0
RoE (%)	17.1	15.9	17.0
RoCE (%)	16.1	15.3	16.5
P/E (x)	14.9	14.0	11.5
EV/EBITDA (x)	9.1	7.9	6.5

Estimate change 

TP change 

Rating change 

**CMP: INR235 TP: INR305(+30%)**

**Buy**

## Steadiness in top-line growth now visible

### Near-term margin to remain under pressure due to milk inflation

- Consol. net sales grew sharply by 29.8% to INR6.7b** (our estimate: INR6b) in 4QFY19. Milk Products continued growing robustly by 24.7% YoY to INR4.2b. Adjusting for one-offs, EBITDA increased 6.1% YoY to INR587m (our estimate: INR616m), while PAT was up 62.7% YoY to INR425m (our estimate: INR274m). EBITDA margin contracted 200bp YoY to 8.7% in the quarter.
- Gross margin shrank 240bp YoY to 29.6%**, largely due to an unfavorable product mix (the share of low-margin SMP expanded 500bp YoY to 19.3% of sales) and inflation in milk prices.
- FY19 performance:** Sales/EBITDA/adj. PAT grew 22.6%/23.4%/51.6%. EBITDA margin expanded 10bp to 10%.
- Key concall highlights:** (1) One-offs for the quarter stood at ~INR150m (PSI incentive reversal of ~INR70m and expected credit loss provisioning of ~INR80m). (2) Average milk procurement price was ~INR24-25 for FY19; PARAG expects a further increase in milk price (+6-7% for FY20). (3) Lower gross margin sequentially was attributable to higher SMP sales (2.5% impact) and increased milk prices (~1% impact).
- Valuation and view:** There is no material change to our EPS estimate for FY20/21. Estimated profit growth (EPS CAGR of 14% over FY19-FY21E) is moderate for PARAG's size, but the balance sheet improvement is taking place ahead of expectation. There has been a marked improvement on the working capital front, with NWC days down to 68 in FY19 from 72 in FY18. The overall return profile will also likely improve as capex requirement will largely pertain to maintenance over the next two years. We value PARAG at 15x FY21E EPS (at ~65% discount to our consumer staples universe) to arrive at a one-year TP of INR305 (30% upside). Maintain **Buy**.

## Consolidated - Quarterly Earning Model

Y/E March	(INR Million)											
	FY18				FY19				FY18	FY19	FY19	Var. (%)
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			4QE	
<b>Net Sales</b>	4,129	5,045	5,193	5,178	5,494	5,735	6,006	6,722	19,545	23,957	6,008	11.9
YoY Change (%)	7.7	6.7	16.4	20.9	33.1	13.7	15.7	29.8	12.9	22.6	16.0	
<b>Gross Profit</b>	1,199	1,415	1,596	1,656	1,668	1,768	1,957	1,990	5,866	7,383	1,973	
Margin (%)	29.0	28.1	30.7	32.0	30.4	30.8	32.6	29.6	30.0	30.8	32.8	
<b>EBITDA</b>	285	508	587	554	597	581	620	587	1,934	2,385	616	-4.6
YoY Change (%)	-10.4	50.2	LP	43.2	109.5	14.5	5.7	6.1	124.9	23.3	11.7	
Margins (%)	6.9	10.1	11.3	10.7	10.9	10.1	10.3	8.7	9.9	10.0	10.2	
Depreciation	116	129	136	125	136	134	139	94	506	502	144	
Interest	70	82	107	99	103	76	102	78	358	358	95	
Other Income	15	36	25	43	18	15	7	63	120	103	11	
<b>PBT</b>	115	333	368	374	377	386	387	478	1,190	1,628	387	23.5
Tax	9	84	114	112	94	82	79	53	319	308	114	
Rate (%)	8.1	25.3	30.8	30.0	25.0	21.1	20.5	11.1	26.8	18.9	29.3	
<b>Adj PAT</b>	105	249	255	262	283	304	307	425	871	1,320	274	55.4
YoY Change (%)	3.0	94.5	LP	8.6	168.6	22.2	20.6	62.7	405.2	51.6	4.6	
Margins (%)	2.5	4.9	4.9	5.0	5.1	5.3	5.1	6.3	4.5	5.5	4.6	

E: MOFSL Estimates

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**Investors are advised to refer through important disclosures made at the last page of the Research Report.**

Motilal Oswal research is available on [www.motilaloswal.com/Institutional-Equities](http://www.motilaloswal.com/Institutional-Equities), Bloomberg, Thomson Reuters, Factset and S&P Capital.

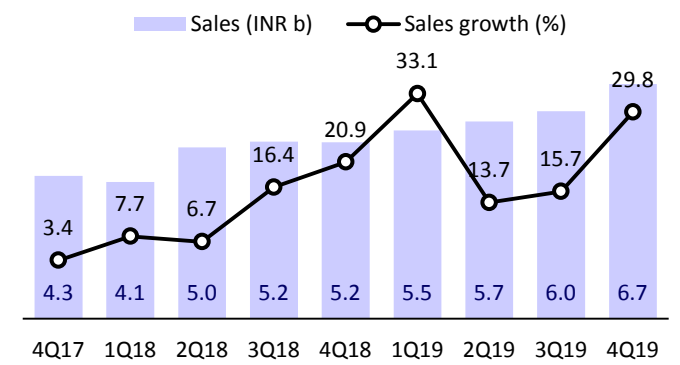
Key quarterly charts

Exhibit 1: Product-wise revenue breakup

Consol. Revenue breakup (INR m)		4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Skimmed Milk Powder		809	695	665	759	1,297
Fresh Milk		1,067	1,063	1,057	1,028	1,093
Milk Products		3,094	3,632	3,934	4,054	4,226
Other Revenues		75	105	79	166	104
<b>Total</b>		<b>5,044</b>	<b>5,495</b>	<b>5,735</b>	<b>6,007</b>	<b>6,720</b>
Consol. Revenue breakup (% share)		4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Skimmed Milk Powder		16	13	12	13	19
Fresh Milk		21	19	18	17	16
Milk Products		61	66	69	67	63
Other Revenues		1	2	1	3	2
<b>Total</b>		<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
Consol. Revenue breakup (% growth)		4QFY18	1QFY19	2QFY19	3QFY19	4QFY19
Skimmed Milk Powder		5.0	35.2	23.6	4.4	75.3
Fresh Milk		20.0	9.0	5.1	11.1	10.9
Milk Products		25.0	40.9	14.3	18.9	24.7
Other Revenues		(50.0)	69.4	31.7	27.7	62.5
<b>Total</b>		<b>17.8</b>	<b>33.1</b>	<b>13.7</b>	<b>15.7</b>	<b>29.8</b>

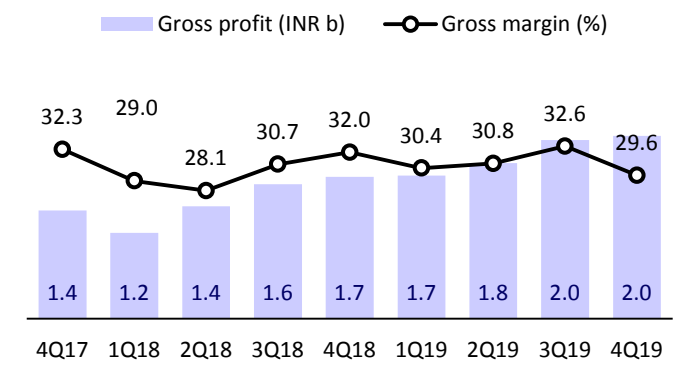
Source: Company, MOFSL

Exhibit 2: Consol. sales up 29.8% YoY in 4QFY19



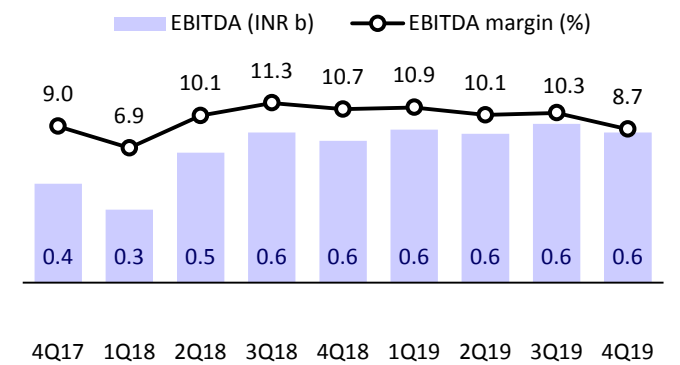
Source: Company, MOFSL

Exhibit 3: Gross margin contracts 240bp YoY to 29.6%



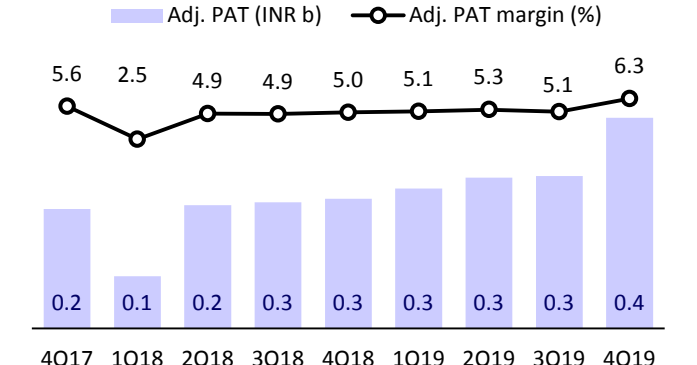
Source: Company, MOFSL

Exhibit 4: EBITDA margin shrinks 200bp YoY to 9%



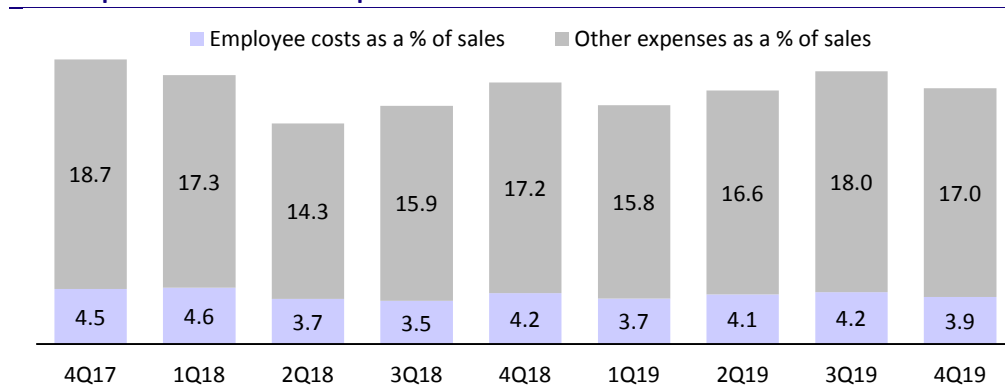
Source: Company, MOFSL

Exhibit 5: Consol. adj. PAT up 62.7% YoY to INR425m



Source: Company, MOFSL

**Exhibit 6: Employee costs as % of sales were down 30bp YoY; post adjusting for one-offs, other expenses were down 10bp YoY**



Source: Company, MOFSL

**Standalone quarterly performance:**

- Net sales grew 29.7% to INR6.6b.
- Gross margin contracted 120bp YoY to 29.3%.
- EBITDA margin shrank 90bp YoY to 9%.
- EBITDA grew 17.8% YoY to INR594m.
- Adj. PAT increased 80.1% YoY to INR398m.
- **FY19 performance:** Sales/EBITDA/adj. PAT grew 22.3%/25.1%/59.7%. EBITDA margin was up 20bp to 9.9%.

**Conference call highlights**

**Performance**

- Volume growth for FY19 stood at 25-26%.
- Lower gross margin during the quarter (3% impact on QoQ basis) was due to higher SMP sales (2.5% impact) and increased milk prices (~1% impact).
- There was INR1-1.5 increase in milk price during the quarter. Due to the lag in passing, the quarter saw a QoQ impact of ~1% on the gross margin. The company expects a further increase in milk price (6-7% rise in average procurement for FY20); to stay at INR26-27 on an annual basis. Average milk procurement price for FY19 was ~INR24-25.
- EBITDA margin contraction in 4QFY19 is temporary and will normalize in the subsequent quarters.
- Reason for higher other expenses: increase in ad spends, volumes linked variable expenses, and one-offs.
- Total one-offs for the quarter stood at ~INR150m. PSI incentive reversal of INR70m and expected credit loss provisioning of INR80m.

**Other highlights**

- Danone: Response from Delhi has been good; so expect INR70-80m run-rate on a monthly basis for FY20 (~INR1b for FY20). Sales from Danone unit stood at INR45m for 4QFY19.
- Doubled retail presence in Mumbai.
- Total retail touch points now at 0.35m.
- Procurement: 14-15l/pd for FY19.

- Key investments during the year: Investments on brand will lead to savings in other expenses (e.g. investment to generate own power and investments on reducing third party packaging costs), investment on distribution front.
- Inventory days for the year improved from 82 to 71; will see further improvement of 5-10 days in FY20.
- Capex for FY19 stood at INR800m: as per IPO (INR300m), Danone (INR220-230m) and rest was maintenance capex.
- To cater to South India, it introduced *Gowardhan Swarna* (different aroma and texture) and is priced at a premium (INR605/kg).
- O/s PSI incentive at start of FY19 was INR620m and as on 31<sup>st</sup> Mar'19 was INR520m. INR250m annual run-rate going forward.
- Milk subsidy from Maharashtra govt. o/s was INR380-400m (majority of which received in April).
- Govt. subsidy scheme of INR5 seems to have been taken off.
- 60% of SMP sales come from customized products now (Nestle, HUVR and Mondelez).

#### Outlook

- The company is on way to achieve the vision it had set last year for 2020.
- Ad spends to be in the range of 3-3.5% of sales.
- Net margins are expected in excess of 5% in FY20.
- Tax rate for FY20/21 to be at 24-25%.

#### Valuation & view

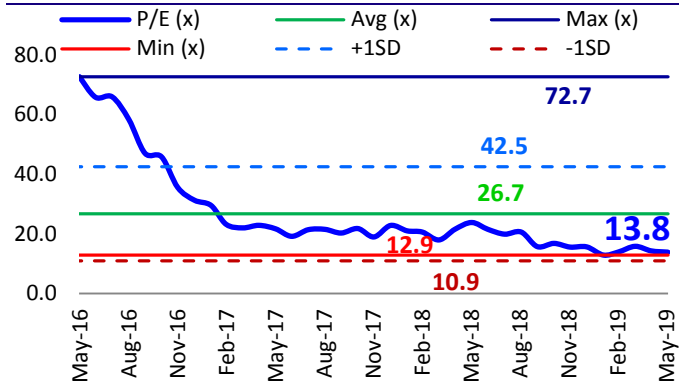
- There is no material change to our EPS estimate for FY20/21. For FY20/21, we estimate a lower margin compared to FY19 as milk prices are expected to go up.
- Aggressive distribution expansion and new launches over the last one year, along with its recent foray in north India, mean that the company can easily deliver 14.5% sales CAGR over FY19-21. Raw milk prices will be inflationary compared to the last few years, and thus, margins will be under pressure as the company continues to spend on distribution expansion and marketing of its newer brands.
- We estimate EPS CAGR of 14% over FY19-21, as the company is generating healthy cash flows to pay of its debts gradually. While profit growth is moderate, balance sheet improvement is taking place ahead of expectation. There has been a marked improvement on the working capital front, with NWC days down to 68 in FY19 from 72 at the end of FY18.
- Overall return profile will also improve, as capex requirement will largely pertain to maintenance over the next two years.
- We value PARAG at 15x FY21E EPS (~65% discount to consumer staples universe) to arrive at a one-year TP of INR305. We, thus, maintain our Buy rating with a 30% upside from current levels.
- The key monitorable going ahead will be: (1) inflation in milk procurement prices (estimated at 6-7% by the company for FY20). (2) The performance of recent new launches (especially in health & nutrition). (3) Possible competition from large players.

**Exhibit 7: There is no material change to our EPS estimate for FY20/21**

	New		Old		Change	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sales	27,322	31,405	26,877	30,843	1.7%	1.8%
EBITDA	2,643	3,165	2,713	3,217	-2.6%	-1.6%
PAT	1,403	1,714	1,388	1,717	1.1%	-0.2%

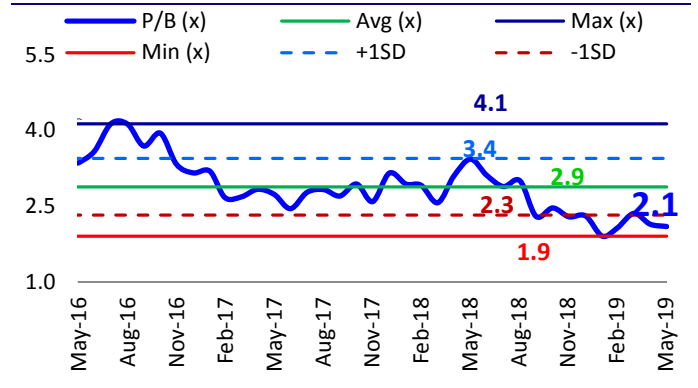
Source: Company, MOFSL

**Exhibit 8: One year forward PE**



Source: MOFSL

**Exhibit 9: One year forward PB**



Source: MOFSL

## Financials and Valuations

Income Statement							(INR Million)	
Y/E March	2015	2016	2017	2018	2019	2020E	2021E	
<b>Total Income</b>	<b>14,441</b>	<b>16,452</b>	<b>17,307</b>	<b>19,545</b>	<b>23,957</b>	<b>27,322</b>	<b>31,405</b>	
Growth (%)	27.0	13.9	5.2	12.9	22.6	14.0	14.9	
COGS	10,616	12,030	12,588	13,679	16,574	19,188	21,864	
<b>Gross Profit</b>	<b>3,825</b>	<b>4,422</b>	<b>4,719</b>	<b>5,866</b>	<b>7,383</b>	<b>8,135</b>	<b>9,540</b>	
Gross Margin (%)	26.5	26.9	27.3	30.0	30.8	29.8	30.4	
Operating expenses	2,753	2,940	3,842	3,933	4,998	5,492	6,375	
<b>EBITDA</b>	<b>1,072</b>	<b>1,482</b>	<b>877</b>	<b>1,933</b>	<b>2,385</b>	<b>2,643</b>	<b>3,165</b>	
Change (%)	-18.1	38.3	-40.8	120.5	23.4	10.8	19.8	
Margin (%)	7.4	9.0	5.1	9.9	10.0	9.7	10.1	
Depreciation	275	334	490	506	502	575	655	
Int. and Fin. Charges	469	496	333	357	358	296	253	
Financial Other Income	15	15	129	120	103	100	90	
<b>Profit before Taxes</b>	<b>343</b>	<b>668</b>	<b>183</b>	<b>1,190</b>	<b>1,628</b>	<b>1,871</b>	<b>2,348</b>	
Change (%)	-43.8	94.9	-72.6	549.3	36.9	14.9	25.5	
Margin (%)	2.4	4.1	1.1	6.1	6.8	6.8	7.5	
Tax	21	195	3	319	308	468	634	
Tax Rate (%)	6.0	29.2	1.8	26.8	18.9	25.0	27.0	
<b>Adjusted PAT</b>	<b>322</b>	<b>473</b>	<b>180</b>	<b>870</b>	<b>1,320</b>	<b>1,403</b>	<b>1,714</b>	
Change (%)	-50.1	46.9	-62.0	383.7	51.6	6.3	22.1	
Margin (%)	2.2	2.9	1.0	4.5	5.5	5.1	5.5	
Non-rec. (Exp)/Income	0	0	-132	0	-113	0	0	
<b>Reported PAT</b>	<b>322</b>	<b>473</b>	<b>48</b>	<b>870</b>	<b>1,207</b>	<b>1,403</b>	<b>1,714</b>	

Balance Sheet							(INR Million)	
Y/E March	2015	2016	2017	2018	2019E	2020E	2021E	
Share Capital	160	704	839	839	839	839	839	
Reserves	1,079	2,915	5,410	6,283	7,432	8,591	9,907	
<b>Net Worth</b>	<b>1,239</b>	<b>3,619</b>	<b>6,249</b>	<b>7,122</b>	<b>8,271</b>	<b>9,431</b>	<b>10,747</b>	
Loans	4,409	3,787	2,264	2,695	2,144	1,744	1,444	
Deferred Liability	60	110	-92	-75	-167	-167	-167	
<b>Capital Employed</b>	<b>5,708</b>	<b>7,516</b>	<b>8,421</b>	<b>9,741</b>	<b>10,248</b>	<b>11,007</b>	<b>12,024</b>	
Gross Block	4,367	5,279	4,077	5,256	5,893	6,393	6,893	
Less: Accum. Depn.	1,456	1,832	490	995	1,497	2,073	2,727	
Net Fixed Assets	2,911	3,447	3,588	4,261	4,395	4,320	4,165	
Capital WIP	283	278	207	204	290	290	290	
Investments	3	0	0	5	5	5	5	
<b>Curr. Assets, L&amp;A</b>	<b>6,043</b>	<b>6,184</b>	<b>8,983</b>	<b>9,270</b>	<b>9,563</b>	<b>10,720</b>	<b>12,247</b>	
Inventory	2,119	2,724	4,285	4,379	4,629	4,953	5,716	
Account Receivables	1,709	2,360	1,750	2,517	2,786	3,127	3,584	
Cash & Bank	53	77	1,009	496	120	446	476	
Others	522	411	1,804	1,778	1,893	2,061	2,337	
Long term advances	665	157	135	99	133	133	133	
<b>Curr. Liab. and Prov.</b>	<b>3,531</b>	<b>2,394</b>	<b>4,357</b>	<b>3,999</b>	<b>4,005</b>	<b>4,328</b>	<b>4,684</b>	
Account Payables	1,931	1,678	3,119	3,033	2,971	3,392	3,836	
Other Liabilities	1,591	668	1,208	917	980	882	794	
Provisions	9	48	31	49	55	55	55	
<b>Net Current Assets</b>	<b>2,511</b>	<b>3,790</b>	<b>4,626</b>	<b>5,271</b>	<b>5,557</b>	<b>6,392</b>	<b>7,563</b>	
<b>Application of Funds</b>	<b>5,708</b>	<b>7,516</b>	<b>8,421</b>	<b>9,741</b>	<b>10,248</b>	<b>11,008</b>	<b>12,024</b>	

E: MOFSL Estimates

## Financials and Valuations

Ratios						(INR Million)	
Y/E March	2015	2016	2017	2018	2019E	2020E	2021E
<b>Basic (INR)</b>							
<b>EPS</b>	<b>20.2</b>	<b>6.7</b>	<b>2.1</b>	<b>10.4</b>	<b>15.7</b>	<b>16.7</b>	<b>20.4</b>
Cash EPS	37.4	11.5	8.0	16.4	21.7	110.0	131.7
BV/Share	77.6	51.4	74.5	84.9	98.5	112.3	128.0
DPS			0.5	0.8	1.0	2.5	4.1
Payout %			83.7	7.2	6.4	15.0	20.0
<b>Valuation (x)</b>							
P/E	11.6	34.9	109.3	22.6	14.9	14.0	11.5
Cash P/E	6.3	20.5	29.4	14.3	10.8	2.1	1.8
EV/Sales	0.6	1.2	1.2	1.1	0.9	7.3	6.3
EV/EBITDA	7.6	13.6	23.9	11.3	9.1	7.9	6.5
P/BV	3.0	4.6	3.1	2.8	2.4	2.1	1.8
<b>Return Ratios (%)</b>							
RoE	18.9	19.5	3.6	13.0	17.1	15.9	17.0
RoCE (post-tax)	12.4	12.5	6.4	12.5	16.1	15.3	16.5
RoIC	13.2	13.2	7.1	13.9	17.1	16.2	17.6
<b>Working Capital Ratios</b>							
Debtor (Days)	43	45	43	40	40	40	39
Asset Turnover (x)	2.5	2.2	2.1	2.0	2.3	2.5	2.6
<b>Leverage Ratio</b>							
Debt/Equity (x)	3.3	1.0	0.3	0.4	0.3	0.2	0.1

Cash Flow Statement						(INR Million)	
Y/E March	2015	2016	2017	2018	2019E	2020E	2021E
OP/(loss) before Tax	1,154	1,642	1,012	2,146	2,385	2,643	3,165
Direct Taxes Paid	-25	-136	-168	-129	-308	-468	-634
(Incr)/Decr in WC	-249	-918	-1,011	-1,262	-662	-509	-1,141
<b>CF from Operations</b>	<b>880</b>	<b>587</b>	<b>-166</b>	<b>755</b>	<b>1,303</b>	<b>1,666</b>	<b>1,390</b>
(Incr)/Decr in FA	-304	-274	-944	-778	-723	-500	-500
<b>Free Cash Flow</b>	<b>576</b>	<b>313</b>	<b>-1,109</b>	<b>-24</b>	<b>580</b>	<b>1,166</b>	<b>890</b>
(Pur)/Sale of Investments	0	-1	14	9	0	0	0
Others	11	-25	629	-374	37	100	90
<b>CF from Invest.</b>	<b>-293</b>	<b>-299</b>	<b>-301</b>	<b>-1,144</b>	<b>-686</b>	<b>-400</b>	<b>-410</b>
Change in Equity	0	57	3,000	0	1	0	0
(Incr)/Decr in Debt	-129	234	-1,081	287	-551	-400	-300
Dividend Paid	0	0	0	-51	-84	-244	-398
Others	-447	-555	-520	-359	-358	-296	-253
<b>CF from Fin. Activity</b>	<b>-576</b>	<b>-264</b>	<b>1,399</b>	<b>-123</b>	<b>-992</b>	<b>-941</b>	<b>-950</b>
<b>Incr/Decr of Cash</b>	<b>11</b>	<b>24</b>	<b>932</b>	<b>-513</b>	<b>-376</b>	<b>325</b>	<b>30</b>
Add: Opening Balance	42	53	77	1,009	496	120	446
<b>Closing Balance</b>	<b>53</b>	<b>77</b>	<b>1,009</b>	<b>496</b>	<b>120</b>	<b>446</b>	<b>476</b>

E: MOFSL Estimates

## Corporate profile

### Company description

Parag Milk Foods is a leading manufacturer and marketer of branded dairy foods and beverages in India. It started off with collection and distribution of milk in 1992; over the years, it has developed a portfolio of dairy products under its four flagship brands *Gowardhan*, *Go*, *Topp Up* & *Pride of Cows*. The company also entered the B2C segment for Whey Protein with the brand *Avvatar* (India's 1<sup>st</sup> 100% vegetarian whey protein).

Exhibit 1: Sensex rebased

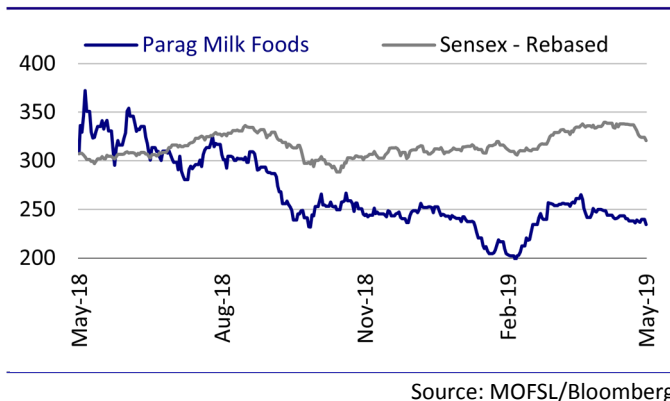


Exhibit 2: Shareholding pattern (%)

	Mar-19	Dec-18	Mar-18
Promoter	46.0	46.0	48.7
DII	12.3	12.1	13.4
FII	14.8	13.7	15.3
Others	27.0	28.2	22.6

Note: FII Includes depository receipts

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Devendra Shah	Chairman
Pritam Shah	Managing Director
Vimal Agarwal	Chief Financial Officer
Harshad Joshi	Chief Operations Officer

Source: Capitaline

Exhibit 6: Auditors

Name	Type
Haribhakti & Co LLP	Statutory
Harshad S Deshpande & Associates	Cost Auditor
KPMG	Internal
N L Bhatia & Associates	Secretarial Audit

Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
IDFC TRUSTEE CO. LTD A/C IDFC INFRASTRUCTURE FUND	6.0
GOVERNMENT PENSION FUND GLOBAL	3.0
GOLDMAN SACHS INDIA LIMITED	2.9
INVESCO TRUSTEE PRIVATE LIMITED - A/C INVESCO INDIA EQUITY SAVINGS FUND	2.7

Source: Capitaline

Exhibit 5: Directors

Name	Name
B M Vyas	Radhika C Pereira*
Narendra Ambwani*	Ramesh Chandak*
Nitin Dhavalikar*	Sunil Badriprasad Goyal

\*Independent

Exhibit 7: MOFSL forecast v/s consensus

EPS (INR)	MOFSL forecast	Consensus forecast	Variation (%)
FY20	16.7	16.6	0.9
FY21	20.4	19.8	3.1

Source: Bloomberg



## NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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Parag Milk Foods

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