5 August 2019

1QFY20 Results Update | Sector: Consumer

Parag Milk Foods

BSE SENSEX	S&P CNX
36,700	10,863

Bloomberg	PARAG IN
Equity Shares (m)	84
M.Cap.(INRb)/(USDb)	17.4 / 0.2
52-Week Range (INR)	344 / 197
1, 6, 12 Rel. Per (%)	-14/-2/-32
12M Avg Val (INR M)	80
Free float (%)	54.0

Financials & Valuations (INR b)

Y/E Mar	2019	2020E	2021E
Net Sales	24.0	27.1	31.2
EBITDA	2.4	2.6	3.1
PAT	1.3	1.4	1.7
EPS (INR)	15.7	16.5	20.2
Gr. (%)	51.5	4.7	22.4
BV/Sh (INR)	98.5	112.1	127.6
RoE (%)	17.1	15.6	16.8
RoCE (%)	16.1	15.1	16.3
P/E (x)	13.2	12.6	10.3
EV/EBITDA (x)	8.1	7.1	5.9

Estimate change

TP change

Rating change

CMP: INR207 TP: INR255(+23%) Buy

Growth continues; Milk Inflation impacts operating performance

- **Consol. net sales grew sharply at 14.6%** to INR6.3b (v/s est. of INR6.5b). Skimmed milk powder (SMP) grew ~21%, followed by Milk products at ~16%, Fresh milk at ~7% and other segment by ~2% YoY. EBITDA declined 4.6% YoY to INR569m (v/s est. of INR598m), while adj. PAT declined 2.7% YoY to INR275m (v/s est. of INR289m).
- **Gross margins contracted 360bp YoY to 26.7%,** largely due to an increase in milk procurement prices. High staff costs as % of sales (up 50bp YoY to 4.2%) was offset by sharp decline in other expenses as % of sales (down 230bp YoY to 13.5%). EBITDA margin contracted -180bp YoY to 9%.
- **Key concall highlights**: (1) Average RM inflation for 1QFY20 was 12% QoQ, average price for the quarter stood at INR28/liter. Company does not expect further increase in RM prices. Seeing some improvement in RM prices due to good monsoons; further decrease in prices expected post season. (2) Company has taken an average price hike of 8-9% and reduced trade discounts. The full effect of this correction should come in from 2QFY20.
- **Valuation and view:** There is a minor cut to our EPS estimate for FY20/FY21, mainly led by the miss in 1QFY20. Raw material inflation impacted the company's performance during the quarter; however, measures taken by the company (price hike and reduction in discounts) coupled with no further inflation in raw milk prices should benefit the operating performance in the coming quarters. Company is confident of achieving its Vision 2020 target; thus, we have built in EPS CAGR of 13% over FY19-FY21E, which is still moderate for PARAG's size. We value PARAG at 12x June FY21 EPS (~65% discount to consumer staples universe) to arrive at a one-year target price of INR255. Maintain **Buy** with 23% upside from CMP.

Consol. - Quarterly Earning Model **(INR Million)**

Y/E March	FY19				FY20				FY19	FY20E	FY20	Var.
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	(%)
Net Sales	**5,494**	**5,735**	**6,006**	**6,722**	**6,297**	**6,618**	**6,908**	**7,313**	**23,957**	**27,137**	**6,488**	-2.9
YoY change (%)	33.1	13.7	15.7	29.8	14.6	15.4	15.0	8.8	22.6	13.3	18.1	
Gross Profit	**1,668**	**1,768**	**1,957**	**1,990**	**1,684**	**1,793**	**1,988**	**2,142**	**7,383**	**7,608**	**1,889**	
Margin (%)	30.4	30.8	32.6	29.6	26.7	27.1	28.8	29.3	30.8	28.0	29.1	
EBITDA	**596**	**581**	**620**	**587**	**569**	**650**	**689**	**707**	**2,385**	**2,615**	**598**	-4.9
YoY change (%)	109.1	14.5	5.7	6.1	-4.6	11.9	11.1	20.4	23.3	9.6	0.1	
Margins (%)	10.9	10.1	10.3	8.7	9.0	9.8	10.0	9.7	10.0	9.6	9.2	
Depreciation	136	134	139	94	133	153	152	137	502	575	149	
Interest	101	76	102	78	93	63	84	56	358	296	85	
Other Income	18	15	7	63	28	17	8	47	103	100	20	
PBT	**377**	**386**	**387**	**478**	**371**	**451**	**460**	**561**	**1,628**	**1,843**	**385**	-3.7
Tax	94	82	79	53	96	113	115	137	308	461	96	
Rate (%)	25.0	21.1	20.5	11.1	25.8	25.0	25.0	24.5	18.9	25.0	25.0	
Adj PAT	**283**	**304**	**307**	**425**	**275**	**338**	**345**	**424**	**1,320**	**1,382**	**289**	-4.7
YoY change (%)	168.6	22.2	20.6	62.7	-2.7	11.2	12.3	-0.4	51.6	4.7	2.1	
Margins (%)	5.1	5.3	5.1	6.3	4.4	5.1	5.0	5.8	5.5	5.1	4.4	

E: MOFSL Estimates

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Key quarterly charts

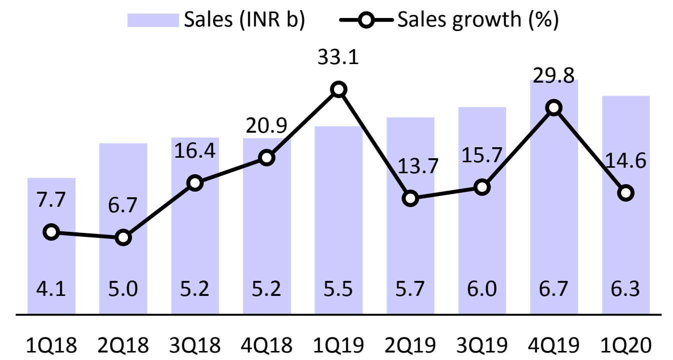
Exhibit 1: Product-wise revenue break-up

Consol. Revenue breakup (% share)	1Q19	2Q19	3Q19	4Q19	1Q20
Skimmed Milk Powder	13	12	13	19	13
Fresh Milk	19	18	17	16	18
Milk Products	66	69	67	63	67
Other Revenues	2	1	3	2	2
Total	**100**	**100**	**100**	**100**	**100**

Consol. Revenue breakup (YoY % growth)	1Q19	2Q19	3Q19	4Q19	1Q20
Skimmed Milk Powder	35.2	23.6	4.4	75.3	21.4
Fresh Milk	9.0	5.1	11.1	10.9	7.2
Milk Products	40.9	14.3	18.9	24.7	16.0
Other Revenues	69.4	31.7	27.7	62.5	2.0
Total	**33.1**	**13.7**	**15.7**	**29.8**	**14.6**

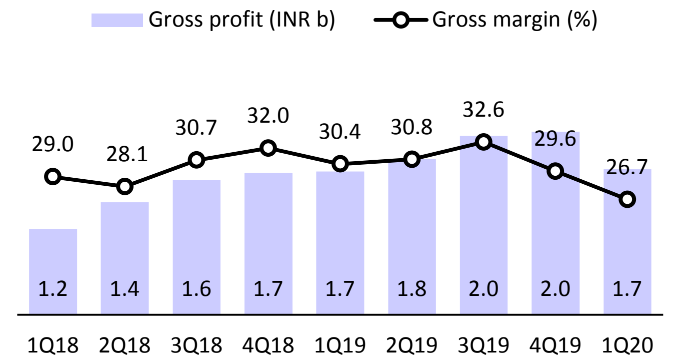
Source: Company, MOFSL

Exhibit 2: Consol. sales grew 14.6% YoY in 1QFY20



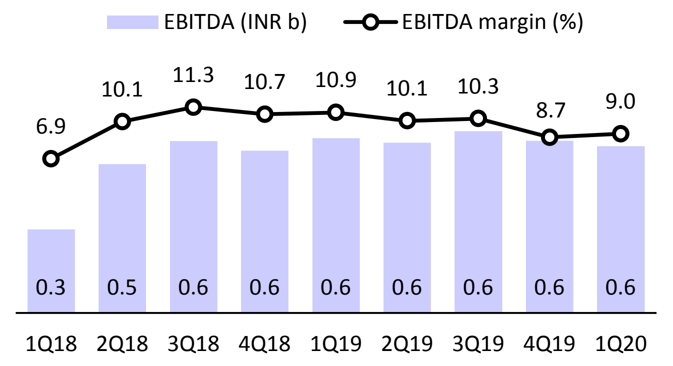
Source: Company, MOFSL

Exhibit 3: Gross margins contracted 360bp YoY to 26.7%



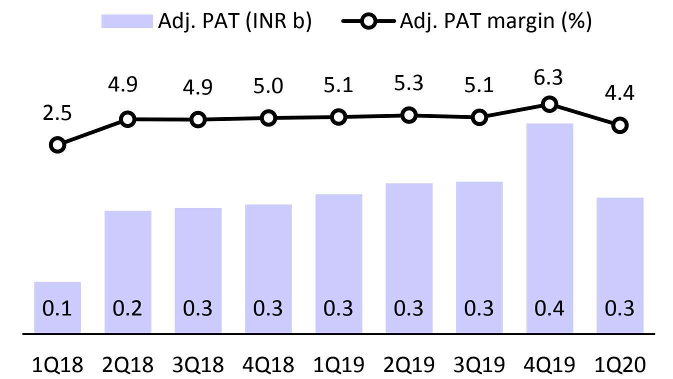
Source: Company, MOFSL

Exhibit 4: EBITDA margins contracted 180bp YoY to 9%



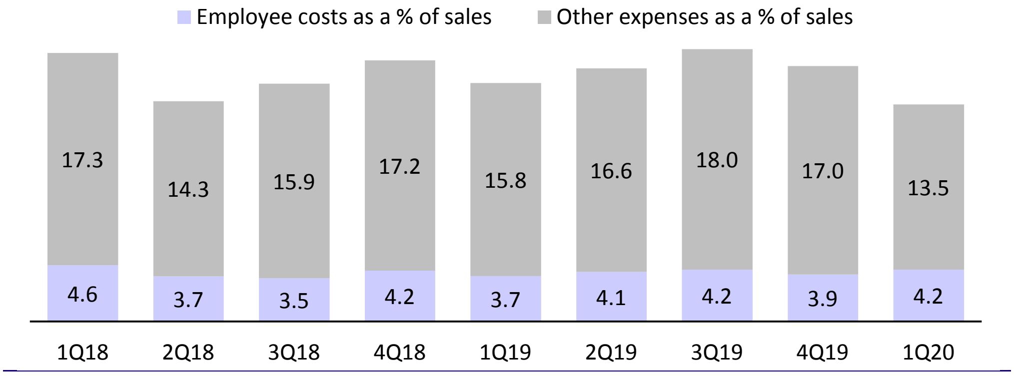
Source: Company, MOFSL

Exhibit 5: Consol. Adj. PAT grew 4.4% YoY to INR275m in 1QFY20



Source: Company, MOFSL

Exhibit 6: Employee costs as % of sales was up 50bp YoY; other expenses were down 230bp YoY



Source: Company, MOFSL

Standalone quarterly performance:

- Net sales grew 14.5% to INR6.2b.
- Gross margins contracted by 320bp YoY to 26.4%.
- EBITDA margin contracted by 140bp YoY to 9.3%.
- EBITDA declined 50% YoY to INR572m.
- Adj. PAT grew 2.7% YoY to INR272m.

Conference call highlights

Performance

- Volume growth was 9-10% for the quarter.
- Company has already passed on the price increase in raw milk by combination of increased consumer prices (average 8-9%; higher for value-added products) and reduced trade discounts. The full effect of this correction will come from 2QFY20.
- Operating cash flow for the quarter stood at INR50-60m.
- Procurement: 12-12.5llpd for 1QFY20.
- Cash on books: INR250-260m.
- INR70-80m GST write-off: Exceptional item.
- WC days in line with FY19 days.
- PSI incentive – INR520m pending as on 1QFY20 v/s INR470m (Mar'19).
- Maharashtra government subsidy: INR250m outstanding.

RM and Margins

- The compression in gross margins was mainly due to an increase in milk procurement prices.
- Due to drought effect of last year and delayed monsoons, feed availability was severely constrained leading to stress at farmer level. Therefore, raw milk prices paid to farmers increased sequentially during the quarter.
- Average RM inflation for 1QFY20 was 12% QoQ (peak increase was 20%); INR28/liter average price for the quarter. Don't see further increase in prices. Seeing some improvement in RM prices due to good monsoon, will see further decrease in prices post season.

Recent management changes
- Mr. Venkat Shankar was appointed as Chief Executive Officer of the Company w.e.f. 4th Jul’19.
- Mr. Vimal Agarwal (CFO) has left the company for a better opportunity w.e.f 19th Jul’19, and Mr. Shashikant Dalmia (having around 6-7 years of work experience in Parag) was appointed as Chief Financial Officer (CFO).
- Mr. Harshad Joshi (COO) and Mr. Amrendra Sathe (CCO) have also left the organization recently.

Other key highlights
- Retail presence in Mumbai has been doubled.
- INR2.6b gross debt and INR2.3b net debt.
- Pride of cows (POC): Will supply to 40-45 cities in India. Want to double the POC business in the next two years.
- 34% overall market share in cheese; Amul has 41% share in the market.
- 65% capacity utilization on Sonipat; INR1b sales expected from Sonipat in FY20.
- Acquired *Proliva* for a total consideration of INR8.6m. *Proliva* is a protein-based nutrition brand with 15 SKUs and annual sales of INR20m.

Outlook
- No change in Vision 2020 target – Revenue: INR27-30b, EBITDA margins (including other income): 11-12%, ROCE: 18-20%.
- Other expenses as % sales should be 14-15%.

Valuation & view
- There is minor cut to our EPS estimate for FY20/FY21 mainly led by the miss in 1QFY20. Raw material inflation impacted company’s performance during the quarter but measures taken by company (price hike and reduction in discounts) as well as no further inflation in raw milk prices will benefit the operating performance in the coming quarters.
- Company is confident of achieving its Vision 2020 target; we have thus built EPS CAGR of 13% over FY19-FY21E which is still moderate for PARAG’s size.
- We value PARAG at 12x June FY21 EPS (~65% discount to consumer staples universe) to arrive at a one year target price of INR255 and thus maintain Buy with 23% upside from CMP.
- The key monitorable going ahead will be: **1)** inflation in milk procurement prices (company expects no major inflation going forward), **2)** the performance of recent new launches (especially in health & nutrition), **3)** possible competition from large players.

Exhibit 7: We cut our EPS estimates by 1.5%/ 1.3% for FY20/FY21E

	New		Old		Change	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Sales	27,137	31,199	27,322	31,405	-0.7%	-0.7%
EBITDA	2,615	3,135	2,643	3,165	-1.1%	-1.0%
PAT	1,382	1,692	1,403	1,714	-1.5%	-1.3%

Source: Company, MOFSL

Financials and Valuations

Income Statement							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Total Income	**14,441**	**16,452**	**17,307**	**19,545**	**23,957**	**27,137**	**31,199**
Growth (%)	27.0	13.9	5.2	12.9	22.6	13.3	15.0
COGS	10,616	12,030	12,588	13,679	16,574	19,529	21,731
Gross Profit	**3,825**	**4,422**	**4,719**	**5,866**	**7,383**	**7,608**	**9,468**
Gross Margin (%)	26.5	26.9	27.3	30.0	30.8	28.0	30.3
Operating expenses	2,753	2,940	3,842	3,933	4,998	4,993	6,333
EBITDA	**1,072**	**1,482**	**877**	**1,933**	**2,385**	**2,615**	**3,135**
Change (%)	-18.1	38.3	-40.8	120.5	23.4	9.6	19.9
Margin (%)	7.4	9.0	5.1	9.9	10.0	9.6	10.0
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
Profit before Taxes	**343**	**668**	**183**	**1,190**	**1,628**	**1,843**	**2,317**
Change (%)	-43.8	94.9	-72.6	549.3	36.9	13.2	25.7
Margin (%)	2.4	4.1	1.1	6.1	6.8	6.8	7.4
Tax	21	195	3	319	308	461	626
Tax Rate (%)	6.0	29.2	1.8	26.8	18.9	25.0	27.0
Adjusted PAT	**322**	**473**	**180**	**870**	**1,320**	**1,382**	**1,692**
Change (%)	-50.1	46.9	-62.0	383.7	51.6	4.7	22.4
Margin (%)	2.2	2.9	1.0	4.5	5.5	5.1	5.4
Non-rec. (Exp)/Income	0	0	-132	0	-113	0	0
Reported PAT	**322**	**473**	**48**	**870**	**1,207**	**1,382**	**1,692**

Balance Sheet							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Share Capital	160	704	839	839	839	839	839
Reserves	1,079	2,915	5,410	6,283	7,432	8,574	9,873
Net Worth	**1,239**	**3,619**	**6,249**	**7,122**	**8,271**	**9,413**	**10,712**
Loans	4,409	3,787	2,264	2,695	2,144	1,744	1,444
Deferred Liability	60	110	-92	-75	-167	-167	-167
Capital Employed	**5,708**	**7,516**	**8,421**	**9,741**	**10,248**	**10,990**	**11,989**
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
Curr. Assets, L&A	**6,043**	**6,184**	**8,983**	**9,270**	**9,563**	**10,659**	**12,208**
Inventory	2,119	2,724	4,285	4,379	4,629	4,888	5,712
Account Receivables	1,709	2,360	1,750	2,517	2,786	3,087	3,580
Cash & Bank	53	77	1,009	496	120	490	446
Others	522	411	1,804	1,778	1,893	2,061	2,337
Long term advances	665	157	135	99	133	133	133
Curr. Liab. and Prov.	**3,531**	**2,394**	**4,357**	**3,999**	**4,005**	**4,285**	**4,680**
Account Payables	1,931	1,678	3,119	3,033	2,971	3,349	3,832
Other Liabilities	1,591	668	1,208	917	980	882	794
Provisions	9	48	31	49	55	55	55
Net Current Assets	**2,511**	**3,790**	**4,626**	**5,271**	**5,557**	**6,374**	**7,529**
Application of Funds	**5,708**	**7,516**	**8,421**	**9,741**	**10,248**	**10,990**	**11,990**

E: MOFSL Estimates

Financials and Valuations

Ratios							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Basic (INR)							
EPS	**20.2**	**6.7**	**2.1**	**10.4**	**15.7**	**16.5**	**20.2**
Cash EPS	37.4	11.5	8.0	16.4	21.7	108.9	130.5
BV/Share	77.6	51.4	74.5	84.9	98.5	112.1	127.6
DPS			0.5	0.8	1.0	2.5	4.0
Payout %			83.7	7.2	6.4	15.0	20.0
Valuation (x)							
P/E	10.3	30.8	96.6	20.0	13.2	12.6	10.3
Cash P/E	5.5	18.1	26.0	12.6	9.5	1.9	1.6
EV/Sales	0.5	1.1	1.1	1.0	0.8	6.5	5.6
EV/EBITDA	7.1	12.3	21.3	10.1	8.1	7.1	5.9
P/BV	2.7	4.0	2.8	2.4	2.1	1.8	1.6
Return Ratios (%)							
RoE	18.9	19.5	3.6	13.0	17.1	15.6	16.8
RoCE (post-tax)	12.4	12.5	6.4	12.5	16.1	15.1	16.3
RoIC	13.2	13.2	7.1	13.9	17.1	16.0	17.5
Working Capital Ratios							
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
Leverage Ratio							
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**	**2019**	**2020E**	**2021E**
OP/(loss) before Tax	1,154	1,642	1,012	2,146	2,385	2,615	3,135
Direct Taxes Paid	-25	-136	-168	-129	-308	-461	-626
(Incr)/Decr in WC	-249	-918	-1,011	-1,262	-662	-447	-1,199
CF from Operations	**880**	**587**	**-166**	**755**	**1,303**	**1,707**	**1,310**
(Incr)/Decr in FA	-304	-274	-944	-778	-723	-500	-500
Free Cash Flow	**576**	**313**	**-1,109**	**-24**	**580**	**1,207**	**810**
(Pur)/Sale of Investments	0	-1	14	9	0	0	0
Others	11	-25	629	-374	37	100	91
CF from Invest.	**-293**	**-299**	**-301**	**-1,144**	**-686**	**-400**	**-409**
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	-241	-392
Others	-447	-555	-520	-359	-358	-296	-253
CF from Fin. Activity	**-576**	**-264**	**1,399**	**-123**	**-992**	**-937**	**-945**
Incr/Decr of Cash	**11**	**24**	**932**	**-513**	**-376**	**370**	**-44**
Add: Opening Balance	42	53	77	1,009	496	120	490
Closing Balance	**53**	**77**	**1,009**	**496**	**120**	**490**	**446**

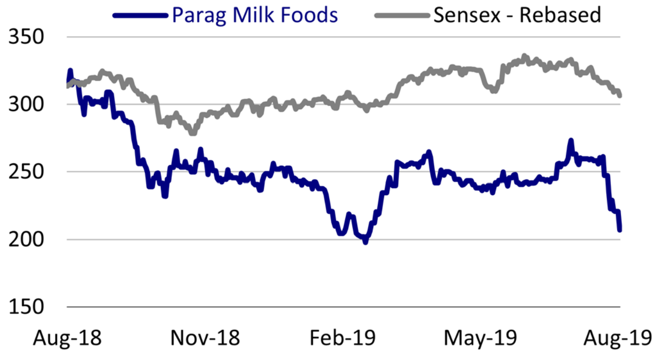
E: MOFSL Estimates

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 1st 100% vegetarian whey protein).

Exhibit 1: Sensex rebased



Source: MOFSL/Bloomberg

Exhibit 2: Shareholding pattern (%)

	Jun-19	Mar-19	Jun-18
Promoter	46.0	46.0	46.0
DII	7.2	12.3	12.3
FII	17.6	14.8	14.8
Others	29.2	27.0	27.0

Note: FII Includes depository receipts Source: Capitaline

Exhibit 3: Top holders

Holder Name	% Holding
IDFC TRUSTEE CO. LTD A/C IDFC INFRASTRUCTURE FUND	6.0
STICHTING DEPOSITARY APG EMERGING MARKETS EQUITY P	5.8
PRAZIM TRADING AND INVESTMENT CO. PVT. LTD.	3.7
GOVERNMENT PENSION FUND GLOBAL	3.0
GOLDMAN SACHS INDIA LIMITED	2.4
NEW HORIZON OPPORTUNITIES MASTER FUND	1.8
MUKUL MAHAVIRPRASAD AGRAWAL	1.2

Source: Capitaline

Exhibit 4: Top management

Name	Designation
Devendra Shah	Chairman
Pritam Shah	Managing Director
Rachana Sanganeria	Company Secretary

Source: Capitaline

Exhibit 5: Directors

Name	Name
B M Vyas	Radhika C Pereira
Narendra Ambwani	Ramesh Chandak
Nitin Dhavalikar	SUNIL BADRIPRASAD GOYAL

*Independent

Exhibit 6: Auditors

Name	Type
Haribhakti & Co LLP	Statutory
Harshad S Deshpande & Associates	Cost Auditor
KPMG	Internal

Source: Capitaline

Exhibit 7: MOSL forecast v/s consensus

EPS (INR)	MOSL forecast	Consensus forecast	Variation (%)
FY20	16.5	16.9	-2.5
FY21	20.2	20.8	-2.9

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

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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