

PARAG MILK FOODS

RESULT UPDATE

KEY DATA

Rating	REDUCE
Sector relative	Underperformer
Price (INR)	135
12 month price target (INR)	127
Market cap (INR bn/USD bn)	13/0.2
Free float/Foreign ownership (%)	54.0/17.7
What's Changed	
Target Price	↑
Rating/Risk Rating	—

QUICK TAKE

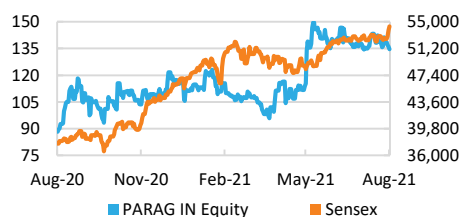
	Above	In line	Below
Profit	●		
Margins	●		
Revenue Growth		●	
Overall	●		

FINANCIALS

(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	18,418	21,196	24,453	27,457
EBITDA	1,248	1,561	2,065	2,393
Adjusted profit	207	543	989	1,258
Diluted EPS (INR)	2.5	5.7	9.4	10.9
EPS growth (%)	(77.9)	131.3	64.8	16.2
RoAE (%)	2.3	5.7	9.5	10.9
P/E (x)	54.5	19.0	11.5	9.9
EV/EBITDA (x)	11.7	8.0	5.3	4.4
Dividend yield (%)	0.4	0.4	0.4	0.4

PRICE PERFORMANCE



Explore:



Financial model



Podcast



Corporate access



Video

Sustainable uptick awaited

Parag Milk Foods' (Parag) Q1FY22 revenue grew in line--1% YoY on a low base of 31% decline--as milk sales picked up, while out-of-home (OOH) and HORECA remained slow. EBITDA grew 51% YoY (25% above estimate) with a dip in procurement prices as gross margin expanded.

While opening of lockdowns should prompt an increase in OOH consumption and HORECA, procurement prices are also likely to rise. Hence, we maintain earnings despite beat and await uptick in value-added sales. Debt reduction of INR1.5bn is on the anvil from the capital raise of INR3.8bn; however, the equity dilution of 25-37% remains a near-term concern. The stock seems fairly valued, maintain 'REDUCE' with revised TP of INR127, valuing it at 15x Q3FY23E.

Dip in procurement prices spurs profitability

Sales were largely flat (1% YoY) on a base quarter decline of 31%. This was led by growth of 4% YoY and 56% YoY in sales of milk and skimmed milk powder, respectively, while value-added products dipped 9% YoY on a base quarter decline of 24%. While milk prices softened during Q1FY22, realisation largely remained the same, leading to gross margin expansion of 563bps YoY and 727bps QoQ. Owing to the same, EBITDA grew 51% YoY and 144% QoQ and margin for Q1FY22 expanded to 10.2%. Parag estimates 8% EBITDA margin in FY22 as procurement prices pick up.

FY22 to see an uptick on a low base

While Q1FY22 remained challenging owing to the severity of the second wave, sales have picked up in July with rise in OOH consumption and HORECA opening up post localised lockdowns. However, as procurement prices bottomed out at INR27, we expect some pressure on gross margin as it is expected at INR30 for FY22. Parag had raised INR3.8bn during April 2021 via a variety of instruments, which will be utilised for working capital debt and to limit reduction. With debt reduction underway, interest costs dip is awaited. Management estimates revenue growth of 15-18% in FY22. Post 41% decline in EBITDA in FY21, we estimate 25% EBITDA growth in FY22, 29% CAGR over FY21-23E.

Outlook and valuations: Uptick awaited; maintain 'REDUCE'

Despite a challenging Q1FY22, Parag has seen benefits of dip in procurement prices flow through to profitability. We await sustainable uptick in sales and maintain 'REDUCE' with revised TP of INR127 (INR114 earlier) valuing the stock at 15x as we roll over to Q3FY23E. The stock trades at 24x/14x FY22/23E and seems fairly valued.

Financials

Year to March	Q1FY22	Q1FY21	% Change	Q4FY21	% Change
Net Revenue	4,384	4,356	0.7	4,344	0.9
EBITDA	449	297	51.2	184	143.5
Adjusted Profit	175	32	440.9	(96)	(281.8)
Diluted EPS (INR)	2.1	0.4	440.9	(1.1)	(281.8)

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	18,418	21,196	24,453	27,457
Gross profit	4,799	5,390	6,295	6,988
Employee costs	782	837	904	976
Other expenses	2,769	2,993	3,326	3,620
EBITDA	1,248	1,561	2,065	2,393
Depreciation	518	554	586	627
Less: Interest expense	458	385	252	194
Add: Other income	135	102	92	106
Profit before tax	407	724	1,319	1,678
Prov for tax	200	181	330	419
Less: Other adjustment	0	0	0	0
Reported profit	207	543	989	1,258
Less: Excp.item (net)	0	0	0	0
Adjusted profit	207	543	989	1,258
Diluted shares o/s	84	95	105	115
Adjusted diluted EPS	2	6	9	11
DPS (INR)	0.5	0.6	0.5	0.5
Tax rate (%)	49.2	25.0	25.0	25.0

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Milk (% of revenue)	10.0	10.7	11.2	11.1
VADP (% of revenue)	72.9	71.8	72.0	72.2
Gross margin (%)	26.1	25.4	25.7	25.5
EBITDA margin (%)	6.8	7.4	8.4	8.7
Net profit margin (%)	1.1	2.6	4.0	4.6
Revenue growth (% YoY)	(24.5)	15.1	15.4	12.3
EBITDA growth (% YoY)	(40.9)	25.1	32.3	15.9
Adj. profit growth (%)	(77.9)	162.2	82.2	27.2

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(8.0)	0	7.0	7.0
Repo rate (%)	4.0	4.0	4.3	5.3
USD/INR (average)	75.0	73.0	72.0	71.0
Procurement (INR/l)	27.9	28.9	28.9	29.2
Procurement (mn l/day)	1.0	1.2	1.5	1.7
B2C Sales (%)	68.4	68.9	68.8	68.3
B2B Sales (%)	31.6	31.1	31.2	31.7
Freight (% of sales)	3.9	3.9	3.8	3.8
Ad Spends (% of sales)	2.8	2.7	2.7	2.7

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	54.5	19.0	11.5	9.9
Price/BV (x)	1.2	1.0	1.0	1.0
EV/EBITDA (x)	11.7	8.0	5.3	4.4
Dividend yield (%)	0.4	0.4	0.4	0.4

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	838	950	1,050	1,150
Reserves	8,442	8,919	9,853	11,056
Shareholders funds	9,280	9,869	10,903	12,207
Minority interest	0	0	0	0
Borrowings	3,508	4,608	3,608	3,208
Trade payables	3,041	2,815	3,084	3,365
Other liabs & prov	922	1,066	1,235	1,390
Total liabilities	16,794	18,407	18,886	20,233
Net block	4,713	4,659	4,673	4,547
Intangible assets	19	19	19	19
Capital WIP	31	31	31	31
Total fixed assets	4,763	4,709	4,723	4,597
Non current inv	8	8	8	8
Cash/cash equivalent	187	1,278	1,803	1,730
Sundry debtors	1,589	3,368	3,685	4,137
Loans & advances	4	4	4	4
Other assets	10,243	9,039	8,664	9,756
Total assets	16,794	18,407	18,886	20,233

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	207	543	989	1,258
Add: Depreciation	518	554	586	627
Interest (net of tax)	458	385	252	194
Others	(1,209)	(824)	(2,325)	(970)
Less: Changes in WC	(193)	(658)	497	(1,109)
Operating cash flow	(220)	0	0	0
Less: Capex	0	0	0	0
Free cash flow	(220)	0	0	0

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	2.3	5.7	9.5	10.9
RoCE (%)	6.8	8.1	10.8	12.5
Inventory days	178	155	128	118
Receivable days	46	43	53	52
Payable days	80	68	59	57
Working cap (% sales)	42.6	40.1	32.7	33.2
Gross debt/equity (x)	37.8	46.7	33.1	26.3
Net debt/equity (x)	35.8	33.7	16.6	12.1
Interest coverage (x)	1.6	2.6	5.9	9.1

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	(77.9)	131.3	64.8	16.2
RoE (%)	2.3	5.7	9.5	10.9
EBITDA growth (%)	(40.9)	25.1	32.3	15.9
Payout ratio (%)	20.2	10.1	5.6	4.4

Exhibit 1: Liquid milk and SMP sales picked up in Q1FY22

(INR mn)	Q1FY22	Q1FY21	% YoY	Q4FY21	% QoQ
SMP	965	619	56%	726	33%
Liquid milk	438	423	4%	424	3%
Milk products	2,938	3,223	-9%	3,116	-6%
Others	44	91	NM	76	NM
Total	4,384	4,356		4,344	

Source: Company, Edelweiss Research

Exhibit 2: Quarterly financial snapshot

Year to March	Q1FY22	Q1FY21	% change	Q4FY21	% change	FY21	FY22E	FY23E
Revenues	4,384	4,356	0.7	4,344	0.9	18,418	21,196	24,453
Raw material	3,007	3,233	(7.0)	3,295	(8.7)	13,619	15,806	18,158
Staff costs	202	196	3.1	192	5.1	782	837	904
Others	726	630	15.3	672	8.1	2,769	2,993	3,326
Total expenditure	3,935	4,059	(3.0)	4,159	(5.4)	17,170	19,636	22,388
EBITDA	449	297	51.2	184	143.5	1,248	1,561	2,065
Depreciation	132	132	(0.2)	124	6.1	518	554	586
EBIT	317	165	92.4	60	428.4	730	1,007	1,478
Interest	113	110	2.7	121		458	385	252
Other income	31	15	112.4	68	(54.5)	135	102	92
Add: Exceptional items	0	0		0				
Profit Before Tax	235	70	238.0	7	3,335.8	407	724	1,319
Less: Provision for Tax	60	37	61.9	103	(41.5)	200	181	330
Reported Profit	175	32	440.9	-96	(281.8)	207	543	989
Adjusted Profit	175	32	440.9	-96	(281.8)	207	543	989
Equity capital (FV INR 10)	839	839		839		838	950	1,050
No. of Diluted shares outstanding (mn)	84	84		84		84	95	105
Adjusted Diluted EPS	2.1	0.4	440.9	(1.1)	(281.8)	2.5	5.7	9.4
P/E (x)						54.7	23.6	14.3
EV/EBITDA (x)						11.7	10.4	7.7
ROAE(%)						2.3	5.7	9.5
As % of net revenues								
Raw material	68.6	74.2		75.9		73.9	74.6	74.3
Staff expenses	4.6	4.5		4.4		4.2	3.9	3.7
Other expenses	16.6	14.5		15.5		15.0	14.1	13.6
EBITDA	10.2	6.8	3.42	4.2	6.00	6.8	7.4	8.4
Net profit	4.0	0.7		(2.2)		1.1	2.6	4.0

Source: Company, Edelweiss Research

Company Description

Parag, incorporated in 1992 with operations in just collection and distribution of milk, has now developed into a FMCG dairy company. It has diversified its product portfolio with 170 plus SKUs to cater to a wide range of customers via 6 brands—Gowardhan, Go, Pride Of Cows, ToppUp, Milkrich and Avvatar. The company has recently ventured into the whey consumer protein powder segment with Avvatar brand and fruit beverages category with Slurp brand.

The company's aggregate milk processing capacity stands at 2mn ltr per day. Its cheese plant boasts of one of the largest production capacities in India with raw cheese capacity of 60MT per day.

Investment Theme

Parag Milk Foods (Parag) has made a commendable leap in a short span by capturing leading market share in high-margin value-added products (VADP)—No. 2 in cheese (32% market share) and largest cow ghee brand in India. Parag boasts of strongest value-added portfolio contributing 64% to sales, way ahead industry's 34%.

FY21 was a challenging year where in sales declined 25% led by hit in modern trade and HORECA segments. EBITDA declined 41%. While HORECA sales are gradually improving, company expects sales recovery from Q2FY22 and reach FY20 level in sales leading to 15% growth. Gross margins may take a hit, owing to procurement prices inching up. Led by reduced working capital over two years with the funds raised we expect ~80% PBT growth in FY22. But we maintain a Reduce as we build in recovery and value at 15x Q2FY23.

Key Risks

Volatility in raw milk prices

Any material and sudden rise in milk prices may impact Parag's margin. Milk procurement prices jumped 27% in FY17, which Parag was able to absorb due to premiumisation as demonstrated by 39bps rise in gross margin.

Competitive pressure

The domestic dairy products industry is highly competitive with presence of large multinational companies as well as regional and local players. The company also competes with large dairy cooperatives; incentives offered by central or state governments to these could benefit such entities. Any steep increase in competitive pressure—Amul getting aggressive in the HORECA segment—may impact Parag's revenue growth prospects.

Failure of launches

Parag is steadily launching new products. If these products are not successful it may lead to increased expenses with no proportionate sales.

Additional Data

Management

Chairman	Devendra Shah
MD	Pritam Shah
CFO	Shashikant Dalmia
CS & Compliance Officer	Rachana Sangneria
Auditor	Sharp & Tannan

Holdings – Top 10*

	% Holding		% Holding
Stitching Depository	4.70	American Century	0.01
Somerset EM Small	2.16	Manulife Financial	0.00
Quant Money Man	0.72	Norges Bank	0.00
Macquarie EM Fund	0.45	Legato Capital	0.00
Dimensional Fund	0.37		

*Latest public data

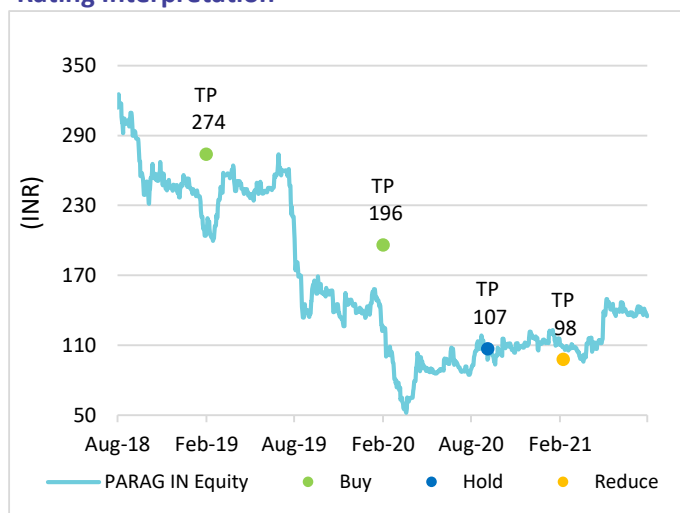
Recent Company Research

Date	Title	Price	Reco
15-Jun-21	Recovery lagging peers; <i>Result Update</i>	109	Reduce
11-Feb-21	Recovery still distant; <i>Result Update</i>	109	Reduce
10-Nov-20	Modern trade, HORECA sour recovery; <i>Result Update</i>	98	Hold

Recent Sector Research

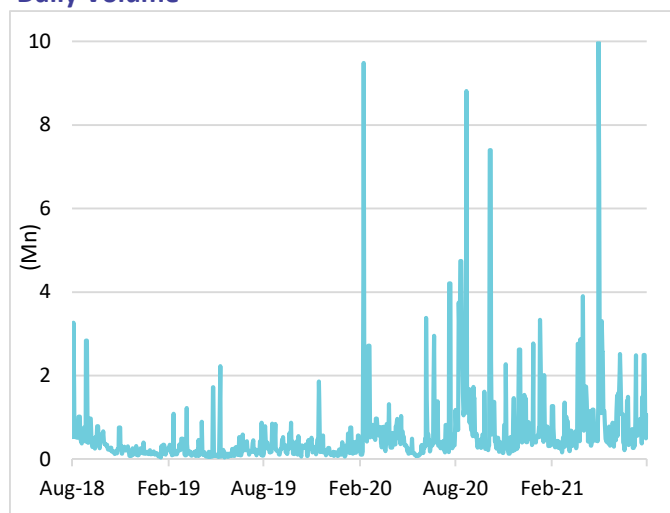
Date	Name of Co./Sector	Title
30-Jul-21	Heritage Foods	Strong strategic moves ; <i>Result Update</i>
21-May-21	Heritage Foods	Spreads dip sequentially; <i>Result Update</i>
01-Feb-21	Heritage Foods	Strong spreads sustain; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	173	54	19	247
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	215	40	4	259

*1 stocks under review

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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