

PARAG MILK FOODS

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Underperformer
Price (INR)	134
12 month price target (INR)	158
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

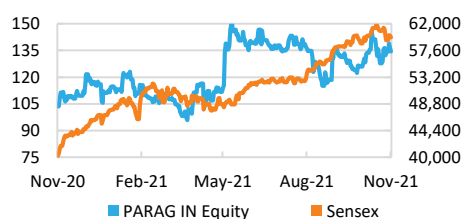
	Above	In line	Below
Profit	•		
Margins		•	
Revenue Growth	•		
Overall	•		

FINANCIALS

(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	18,418	20,245	23,133	25,941
EBITDA	1,248	1,825	2,218	2,560
Adjusted profit	207	704	1,073	1,379
Diluted EPS (INR)	2.5	7.4	10.2	12.0
EPS growth (%)	(77.9)	199.9	38.0	17.4
RoAE (%)	2.3	7.3	10.1	11.6
P/E (x)	54.4	18.2	13.2	11.2
EV/EBITDA (x)	11.7	7.6	5.7	4.7
Dividend yield (%)	0.4	0.4	0.4	0.4

PRICE PERFORMANCE



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Financial model



Podcast



Corporate access



Video

Sales uptick; margins better

Parag Milk Foods (Parag) posted a revenue uptick of 7% YoY in Q2FY22 off a low base (-22% YoY) as core categories reverted to pre-pandemic levels, up 23% YoY in H1. EBITDA grew 28% YoY (18% above estimate) on lower procurement prices while gross margins expanded 101bps.

With normalcy returning, Parag outlined its Vision 2.0 encompassing a 6C framework: Cows, Consumers, Cash, Cost, Corporate Governance and Community. Management hence announced expansion across milk and distribution along with focus on strengthening core, balance sheet and ESG. Given better-than-expected margins, we are raising FY22/23E EPS by 30/9% and upgrading Parag to 'BUY' with a TP of INR158 (INR127 earlier), valuing the stock at 15x FY23E.

Procurement prices dip improves profitability

Sales were up 7% YoY on a base quarter decline of 22% YoY. This was led by growth of 9% YoY and 13% YoY in sales of value-added products and skimmed milk powder, respectively, while liquid milk sales dipped 1% YoY. Core categories grew 23% in H1FY22. Procurement prices remained soft during Q2FY22, while realisation largely remained the same, leading to gross margin expansion of 101bps YoY. Consequently, EBITDA shot up 28% YoY, and with Q2FY22 margin expanding to 10%. The company expects EBITDA margin to sustain at 9–10% as sales and procurement pick up.

New vision to aid growth pickup

During Q2FY22, management saw a pickup as HORECA displayed growth from pre-pandemic levels. With reversion to normalcy, management announced the new Vision 2.0 covering expansion across procurement: This involves setting up the largest dairy farm in South East Asia increasing the number of cows to 6x, milk production to 140,000 liters and focusing on core categories, along with improvement in efficiencies and modernisation to lower costs. Improved profitability should result in strengthening of balance sheet as cash flows expand. Hence, management envisages a 15% revenue CAGR over coming years with growth of 20% in core categories of ghee, cheese, paneer and proteins.

Outlook and valuation: Growth uptick; upgrade to 'BUY'

With Parag announcing Vision 2.0 outlining long-term targets, and margin improvement being stronger than expected, we are raising FY22/23E EPS by 30/9% and upgrading the stock to 'BUY' with a revised TP of INR158, valuing it at 15x FY23E (17% discount to Heritage Foods' 18x). The stock is trading at 19x FY22E/13x FY23E.

Financials

Year to March	Q2FY22	Q2FY21	% Change	Q1FY22	% Change
Net Revenue	5,323	4,982	6.8	4,384	21.4
EBITDA	530	415	27.8	449	18.0
Adjusted Profit	228	159	43.3	175	30.1
Diluted EPS (INR)	0.0	1.9	(100.0)	2.1	(100.0)

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	18,418	20,245	23,133	25,941
Gross profit	4,799	5,542	6,317	7,006
Employee costs	782	829	895	967
Other expenses	2,769	2,888	3,203	3,479
EBITDA	1,248	1,825	2,218	2,560
Depreciation	518	557	597	645
Less: Interest expense	458	490	321	218
Add: Other income	135	161	131	143
Profit before tax	407	938	1,431	1,839
Prov for tax	200	235	358	460
Less: Other adjustment	0	0	0	0
Reported profit	207	704	1,073	1,379
Less: Excp.item (net)	0	0	0	0
Adjusted profit	207	704	1,073	1,379
Diluted shares o/s	84	95	105	115
Adjusted diluted EPS	2	7	10	12
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	9.5	9.4	9.4
VADP (% of revenue)	72.9	72.7	73.0	73.2
Gross margin (%)	26.1	27.4	27.3	27.0
EBITDA margin (%)	6.8	9.0	9.6	9.9
Net profit margin (%)	1.1	3.5	4.6	5.3
Revenue growth (% YoY)	(24.5)	9.9	14.3	12.1
EBITDA growth (% YoY)	(40.9)	46.3	21.5	15.4
Adj. profit growth (%)	(77.9)	239.9	52.5	28.5

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(8.0)	9.0	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	27.9	28.0	28.3
Procurement (mn l/day)	1.0	1.2	1.4	1.6
B2C Sales (%)	68.4	68.6	67.8	67.2
B2B Sales (%)	31.6	31.4	32.2	32.8
Freight (% of sales)	3.9	3.8	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)	54.4	18.2	13.2	11.2
Price/BV (x)	1.2	1.3	1.3	1.2
EV/EBITDA (x)	11.7	7.6	5.7	4.7
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	9,080	10,098	11,422
Shareholders funds	9,280	10,030	11,148	12,573
Minority interest	0	0	0	0
Borrowings	3,508	4,608	3,608	3,208
Trade payables	3,041	2,618	2,856	3,113
Other liabs & prov	922	1,017	1,166	1,312
Total liabilities	16,794	18,320	18,832	20,265
Net block	4,713	4,756	4,858	4,814
Intangible assets	19	19	19	19
Capital WIP	31	31	31	31
Total fixed assets	4,763	4,806	4,908	4,864
Non current inv	8	8	8	8
Cash/cash equivalent	187	2,014	2,353	2,401
Sundry debtors	1,589	3,217	3,486	3,909
Loans & advances	4	4	4	4
Other assets	10,243	8,270	8,072	9,079
Total assets	16,794	18,320	18,832	20,265

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	207	704	1,073	1,379
Add: Depreciation	518	557	597	645
Interest (net of tax)	458	490	321	218
Others	(1,209)	(1,768)	(2,308)	(1,214)
Less: Changes in WC	(193)	16	317	(1,028)
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	7.3	10.1	11.6
RoCE (%)	6.8	10.4	11.9	13.5
Inventory days	178	159	126	118
Receivable days	46	43	53	52
Payable days	80	70	59	58
Working cap (% sales)	42.6	38.7	32.5	32.9
Gross debt/equity (x)	37.8	45.9	32.4	25.5
Net debt/equity (x)	35.8	25.9	11.3	6.4
Interest coverage (x)	1.6	2.6	5.1	8.8

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	(77.9)	199.9	38.0	17.4
RoE (%)	2.3	7.3	10.1	11.6
EBITDA growth (%)	(40.9)	46.3	21.5	15.4
Payout ratio (%)	20.2	7.8	5.1	4.0

Exhibit 1: Milk products sales rose on re-opening

(INR mn)	Q2FY22	Q2FY21	% YoY	Q1FY22	% QoQ
SMP	1,011	897	13%	965	5%
Liquid milk	479	483	-1%	438	9%
Milk products	3,779	3,473	9%	2,938	29%
Others	53	130	NM	44	NM
Total	5,323	4,982		4,384	

Source: Company, Edelweiss Research

Exhibit 2: Quarterly financial snapshot (INR mn)

Year to March	Q2FY22	Q2FY21	% change	Q1FY22	% change	YTD FY22	FY22E	FY23E
Revenues	5,323	4,982	6.8	4,384	21.4	9,708	20,245	23,133
Raw material	3,831	3,636	5.4	3,007	27.4	6,838	14,703	16,816
Staff costs	211	199	6.0	202	4.5	413	829	895
Others	751	732	2.6	726	3.4	1,478	2,888	3,203
Total expenditure	4,793	4,567	4.9	3,935	21.8	8,728	18,420	20,915
EBITDA	530	415	27.8	449	18.0	979	1,825	2,218
Depreciation	129	134	(3.9)	132	(2.4)	261	557	597
EBIT	401	281	42.9	317	26.5	719	1,268	1,621
Interest	126	111	13.9	113		239	490	321
Other income	39	22	75.6	31	26.9	70	161	131
Add: Exceptional items	0	0		0		0		
Profit Before Tax	315	192	63.5	235	33.6	550	938	1,431
Less: Provision for Tax	87	33	159.8	60	43.9	147	235	358
Reported Profit	228	159	43.3	175	30.1	403	704	1,073
Adjusted Profit	228	159	43.3	175	30.1	403	704	1,073
No. of Diluted shares outstanding (mn)	95	84		95		95	95	105
Adjusted Diluted EPS	2.4	1.9	26.4	1.8	30.1	4.2	7.4	10.2
P/E (x)							18.5	13.4
EV/EBITDA (x)							8.6	7.1
ROAE(%)							7.3	10.1
As % of net revenues								
Raw material	72.0	73.0		68.6		70.4	72.6	72.7
Staff expenses	4.0	4.0		4.6		4.3	4.1	3.9
Other expenses	14.1	14.7		16.6		15.2	14.3	13.8
EBITDA	10.0	8.3		10.2		10.1	9.0	9.6
Net profit	4.3	3.2		4.0		4.1	3.5	4.6

Source: Company, Edelweiss Research

Exhibit 3: We have raised our FY22/23E PAT by 30/9%

(INR mn)	Old		New		% change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	21,196	24,453	20,245	23,133	-4.5	-5.4
EBITDA	1,561	2,065	1,825	2,218	17.0	7.4
PAT	543	989	704	1,073	29.6	8.5

Source: 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. EBIDTA declined 41% pandemic levels. With reversion of normalcy, management announced the new Vision 2.0 covering expansion across procurement by setting up the largest dairy farm in South East Asia increasing cow nos 6x, milk production to 1.4 lac liters, focusing on core categories and improvement in efficiencies and modernisation to yield lower costs. Improved profitability should result in strengthening of balance sheet as cash flows expand. Thus, management envisages a 15% revenue CAGR over the upcoming years with growth of 20% in core categories of ghee, cheese, paneer and proteins. We upgrade to BUY as we build in revenue growth of 12% CAGR over FY21-24E.

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 Depos	4.70	American Centur	0.01
Somerset EM Sma	1.27	Manulife Financ	0.00
Quant Money Man	0.72	Norges Bank	0.00
Macquarie EM	0.45		
Dimensional Fun	0.35		

*Latest public data

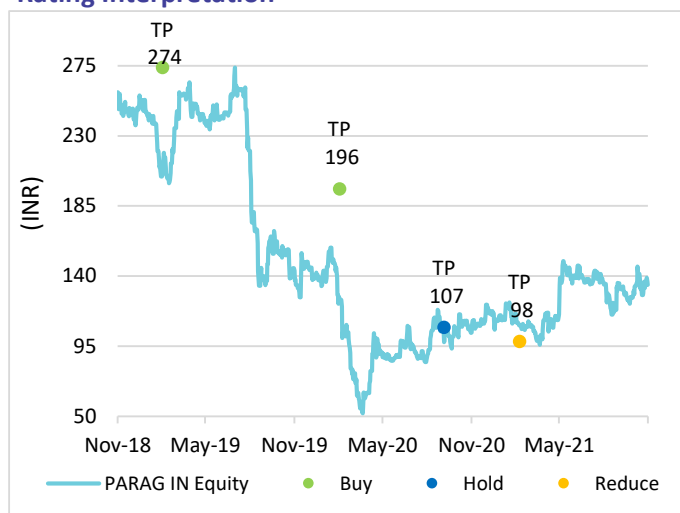
Recent Company Research

Date	Title	Price	Reco
04-Aug-21	Sustainable uptick awaited; <i>Result Update</i>	135	Reduce
15-Jun-21	Recovery lagging peers; <i>Result Update</i>	109	Reduce
11-Feb-21	Recovery still distant; <i>Result Update</i>	109	Reduce

Recent Sector Research

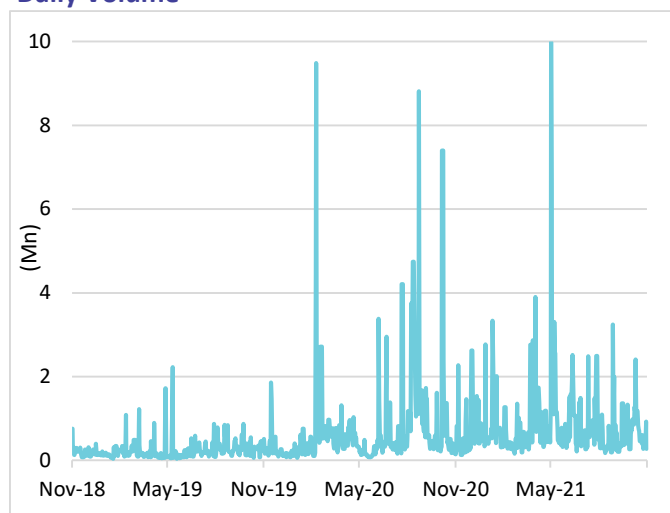
Date	Name of Co./Sector	Title
22-Oct-21	Heritage Foods	Procurement picks up ; <i>Result Update</i>
30-Jul-21	Heritage Foods	Strong strategic moves ; <i>Result Update</i>
21-May-21	Heritage Foods	Spreads dip sequentially; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	179	57	18	255
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	230	40	3	273

*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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