

PARAG MILK FOODS

RESULT UPDATE

KEY DATA

Rating	HOLD
Sector relative	Neutral
Price (INR)	108
12 month price target (INR)	108
Market cap (INR bn/USD bn)	9/0.1
Free float/Foreign ownership (%)	54.0/17.7
What's Changed	
Target Price	—
Rating/Risk Rating	—

QUICK TAKE

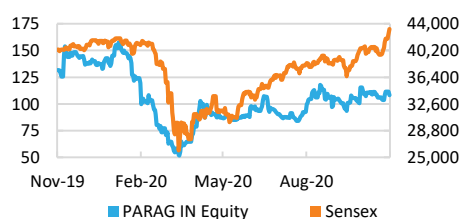
	Above	In line	Below
Profit	●		
Margins		●	
Revenue Growth		●	
Overall		●	

FINANCIALS

(INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Revenue	24,379	20,249	22,886	25,422
EBITDA	2,111	1,685	2,122	2,514
Adjusted profit	937	578	864	1,083
Diluted EPS (INR)	11.2	6.9	10.3	12.9
EPS growth (%)	(22.3)	(38.3)	49.6	25.4
RoAE (%)	10.8	6.2	8.6	9.9
P/E (x)	8.8	14.3	9.6	7.6
EV/EBITDA (x)	5.6	6.5	4.7	4.0
Dividend yield (%)	0.5	0.5	0.7	0.7

PRICE PERFORMANCE



Explore:



Financial model



Podcast



Corporate access



Video

Modern trade, HORECA sour recovery

Parag Milk Foods (Parag) reported a 22% YoY plunge in Q2FY21 revenue (in line with our estimate) owing to lower milk sales as the pickup in modern trade stayed slow while HORECA kept value-added sales subdued. Gross margin grew 135bps YoY on the back of the shift in focus to inventory liquidation accumulated during the lockdown and softer milk procurement prices. EBITDA slid in line with estimates, down 25% YoY.

The dislocation caused by HORECA and the loss of sales in modern trade imply a relatively slow recovery for Parag; we, therefore, expect sales to slide 17% in FY21, and are cutting FY21E EPS by 9%. Retain 'HOLD' with a TP of INR108, valuing the stock at 10x FY22E EPS.

HORECA and modern trade continue to sour revenue

Sales contracted 22% YoY in Q2FY21 (31% dip YoY in Q1) with the pandemic ravaging HORECA sales. Value-added, hence, slid 20% YoY. Milk sales shrunk 60% YoY as modern trade sales were impacted due to a change in consumer (purchase) behaviour. Gross margin improved 135bps YoY though as milk procurement costs remained soft with inventory liquidation in focus. EBITDA slid 25% YoY (margin down 34bps YoY) due to lower sales. PAT plunged 44% YoY owing to higher interest due to increased working capital.

Inventory liquidation to improve gross margins

Management anticipates the hit to be much milder in H2FY21 given the recovery in sales to 90–95% of pre-covid-19 driven by the reopening of HORECA. They expect a 10% dip in FY21 sales versus -17% expectation due to longer-than-expected recovery in HORECA and modern trade. While milk prices stayed subdued in Q2FY21, they are edging up owing to the festive season. Parag has cut prices by ~3% in light of lower milk prices. That said, gross margin should continue to improve as management focuses on inventory liquidation—targeting a release of INR1bn over the next two quarters. Management is hopeful of clocking an 8.7–9.2% EBITDA margin for FY21 (7.6% in H1FY21) driven by improved gross profit; we bake in an FY21 OPM of 8.3%.

Outlook and valuation: Neutral; maintain 'HOLD'

While HORECA will gradually improve, sales are likely to dip 17% in FY21E given the hit on out-of-home consumption and modern trade. Furthermore, we await details on the company's capex and NCD borrowing plan. All in all, we maintain 'HOLD' with a TP of INR108, valuing the stock at 10x FY22E EPS.

Financials

Year to March	Q2FY21	Q2FY20	% Change	Q1FY21	% Change
Net Revenue	4,982	6,400	(22.2)	4,356	14.4
EBITDA	415	555	(25.2)	297	39.6
Adjusted Profit	159	285	(44.2)	32	NM
Diluted EPS (INR)	1.9	3.4	(44.2)	0.4	NM

Financial Statements

Income Statement (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Total operating income	24,379	20,249	22,886	25,422
Gross profit	6,232	5,380	6,278	6,993
Employee costs	961	824	903	966
Other expenses	3,160	2,870	3,253	3,513
EBITDA	2,111	1,685	2,122	2,514
Depreciation	536	555	608	701
Less: Interest expense	381	447	489	536
Add: Other income	76	63	127	168
Profit before tax	1,270	745	1,152	1,445
Prov for tax	333	168	288	361
Less: Other adjustment	0	0	0	0
Reported profit	937	578	864	1,083
Less: Excp.item (net)	0	0	0	0
Adjusted profit	937	578	864	1,083
Diluted shares o/s	84	84	84	84
Adjusted diluted EPS	11	7	10	13
DPS (INR)	0.5	0.5	0.7	0.7
Tax rate (%)	26.2	22.5	25.0	25.0

Important Ratios (%)

Year to March	FY20A	FY21E	FY22E	FY23E
Milk (% of revenue)	17.8	12.4	13.2	13.4
VADP (% of revenue)	66.0	70.8	68.8	68.5
Gross margin (%)	25.6	26.6	27.4	27.5
EBITDA margin (%)	8.7	8.3	9.3	9.9
Net profit margin (%)	3.8	2.9	3.8	4.3
Revenue growth (% YoY)	1.8	(16.9)	13.0	11.1
EBITDA growth (% YoY)	(5.5)	(20.2)	26.0	18.5
Adj. profit growth (%)	(22.4)	(38.3)	49.6	25.4

Assumptions (%)

Year to March	FY20A	FY21E	FY22E	FY23E
GDP (YoY %)	4.8	(6.0)	7.0	6.0
Repo rate (%)	4.4	3.5	3.5	4.0
USD/INR (average)	70.7	75.0	73.0	72.0
Procurement (INR/l)	29.8	27.4	27.6	27.7
Procurement (mn l/day)	1.3	1.1	1.3	1.5
B2C Sales (%)	70.2	69.3	69.0	68.3
B2B Sales (%)	29.8	30.7	31.0	31.7
Freight (% of sales)	4.0	3.9	4.0	4.0
Ad Spends (% of sales)	2.8	2.8	3.0	3.0

Valuation Metrics

Year to March	FY20A	FY21E	FY22E	FY23E
Diluted P/E (x)	8.8	14.3	9.6	7.6
Price/BV (x)	0.9	0.9	0.8	0.7
EV/EBITDA (x)	5.6	6.5	4.7	4.0
Dividend yield (%)	0.5	0.5	0.7	0.7

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Share capital	838	838	838	838
Reserves	8,272	8,802	9,600	10,628
Shareholders funds	9,111	9,640	10,438	11,467
Minority interest	0	0	0	0
Borrowings	3,956	4,706	5,206	5,706
Trade payables	2,940	2,363	2,730	3,130
Other liabs & prov	852	693	795	892
Total liabilities	16,905	17,440	19,212	21,243
Net block	4,630	4,575	4,767	5,566
Intangible assets	27	27	27	27
Capital WIP	70	70	70	70
Total fixed assets	4,727	4,671	4,863	5,663
Non current inv	6	6	6	6
Cash/cash equivalent	424	2,089	3,545	3,904
Sundry debtors	3,035	3,329	3,135	3,343
Loans & advances	4	4	4	4
Other assets	8,709	7,341	7,658	8,323
Total assets	16,905	17,440	19,212	21,243

Free Cash Flow (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Reported profit	937	578	864	1,083
Add: Depreciation	536	555	608	701
Interest (net of tax)	381	447	489	536
Others	342	(1,918)	(2,307)	(1,945)
Less: Changes in WC	(2,550)	338	345	(375)
Operating cash flow	(354)	0	0	0
Less: Capex	8	0	0	0
Free cash flow	(346)	0	0	0

Key Ratios

Year to March	FY20A	FY21E	FY22E	FY23E
RoE (%)	10.8	6.2	8.6	9.9
RoCE (%)	13.9	8.7	10.9	12.1
Inventory days	110	142	116	111
Receivable days	44	57	52	47
Payable days	59	65	56	58
Working cap (% sales)	32.3	37.2	31.4	29.7
Gross debt/equity (x)	43.4	48.8	49.9	49.8
Net debt/equity (x)	38.8	27.1	15.9	15.7
Interest coverage (x)	4.1	2.5	3.1	3.4

Valuation Drivers

Year to March	FY20A	FY21E	FY22E	FY23E
EPS growth (%)	(22.3)	(38.3)	49.6	25.4
RoE (%)	10.8	6.2	8.6	9.9
EBITDA growth (%)	(5.5)	(20.2)	26.0	18.5
Payout ratio (%)	4.5	6.9	6.4	5.1

Key highlights

- Parag Milk Foods reported a 22% YoY contraction in revenue to INR5.0bn (in line with estimates) on account of a slower pickup in HORECA and a sharp decline in out-of-home consumption and modern trade.
- By segment: Value-added slid 20% YoY, hit by lower out-of-home consumption, and a delay in pickup of HORECA while milk sales were down 60% YoY owing to the hit in modern trade and institutional channels, which constitute ~50% of milk sales; SMP grew 30% YoY.

Exhibit 1: VAP sales were hit 20% YoY

	Q2FY21	% of sales	Q2FY20	% of sales	% YoY	Q1FY21	% of sales	% QoQ
SMP	897	18.0	691	10.8	30%	619	14.2	45%
Liquid milk	483	9.7	1,216	19.0	-60%	423	9.7	14%
Milk products	3,473	69.7	4,359	68.1	-20%	3,223	74.0	8%
Others	129	2.6	134	2.1	-4%	92	2.1	41%
Total	4,982		6,400			4,356		

Source: Company, Edelweiss Research

- With raw material prices flat QoQ, gross margin expanded 123bps QoQ and 135bps YoY to 27%.
- While procurement has reduced in the wake of increasing milk prices, management expects to release INR1bn of inventory over the next few quarters.
- EBITDA margin slid marginally (down 34bps YoY) due to lower fixed cost coverage as other expenses declined 12% YoY versus a 22% decline in revenue. Thus, EBITDA dipped 25% YoY (8% above estimates).
- Led by cost control, management expects an 8.7–9.3% EBITDA margin for the full year versus 7.6% in H1FY21.
- Adjusted PAT dipped 55% YoY (14% above estimate) owing to lower taxes in the base quarter.
- Management anticipates sales decline to be lower in H2FY21 with sales at 90–95% of pre-covid levels, driven by the reopening of HORECA. They expect sales to dip 10% in FY21, versus -17% that we expect for the full year.
- While milk prices remained subdued for Q2FY21, there has been a slight pickup of late owing to the festive season. Further company has taken price cut of ~3% in light of lower milk prices. That said, gross margin would continue to improve as management focuses on inventory liquidation.
- PARAG reduced procurement of milk from 15LLPD in Q1 to 9LLPD, down 40%, to clear inventory (stood at INR 6.55bn in September vs INR 6.9bn in June) to lessen liquidity stress. Furthermore, they expects to release INR1bn of inventory over the next two quarters and bring inventory to INR5.5bn.
- The Board had approved to issue secured non-convertible debentures up to INR2.3bn, in tranches from time to time, on a private placement basis for working capital and capex requirements. Management plans to use this to substitute high cost working capital debt and plans to make announcements on the same in Q3FY21.

Exhibit 2: Quarterly financial snapshot (consolidated)

Year to March	Q2FY21	Q2FY20	% change	Q1FY21	% change	YTD FY21	FY21E	FY22E
Revenues	4,982	6,400	(22.2)	4,356	14.4	9,338	20,249	22,886
Raw material	3,636	4,757	(23.6)	3,233	12.5	6,869	14,869	16,608
Staff costs	199	259	(23.3)	196	1.6	395	824	903
Others	732	829	(11.6)	630	16.2	1,363	2,870	3,253
Total expenditure	4,567	5,845	(21.9)	4,059	12.5	8,626	18,564	20,763
EBITDA	415	555	(25.2)	297	39.6	712	1,685	2,122
Depreciation	134	130	3.0	132	1.4	266	555	608
EBIT	281	425	(33.9)	165	70.3	446	1,130	1,515
Interest	111	86	28.4	110		221	447	489
Other income	22	31	(27.2)	15	53.4	37	63	127
Add: Exceptional items	0	0		0				
Profit Before Tax	192	369	(47.9)	70	176.3	262	745	1,152
Less: Provision for Tax	33	84	(60.3)	37	(10.3)	71	168	288
Reported Profit	159	285	(44.2)	32	391.2	191	578	864
Adjusted Profit	159	285	(44.2)	32	391.2	191	578	864
Equity capital (FV INR 10)	839	839		839		839	838	838
No. of Diluted shares outstanding (mn)	84	84		84		84	84	84
Adjusted Diluted EPS	1.9	3.4	(44.2)	0.4	391.2	2.3	6.9	10.3
P/E (x)							14.3	9.6
EV/EBITDA (x)							6.5	4.7
ROAE(%)							6.2	8.6
As % of net revenues								
Raw material	73.0	74.3		74.2		73.6	73.4	72.6
Staff expenses	4.0	4.1	-0.06	4.5	(0.5)	4.2	4.1	3.9
Other expenses	14.7	13.0	1.75	14.5	0.2	14.6	14.2	14.2
EBITDA	8.3	8.7	-0.34	6.8	1.50	7.6	8.3	9.3
Net profit	3.2	4.5		0.7		2.0	2.9	3.8

Source: Company, Edelweiss Research

Exhibit 3: We have cut our FY21E EPS by 9%

(INR mn)	FY21E			FY22E		
	Old	New	% change	Old	New	% change
Revenue	21,680	20,249	-6.6	23,931	22,886	-4.4
EBITDA	1,752	1,685	-3.8	2,125	2,122	-0.1
PAT	634	578	-8.9	895	864	-3.5

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%. FY20 was a challenging year where sales grew 11%, with volume growth at mere 3-4%, due to sharp price hikes (~9- 10%). Gross margin plunged 520bps YoY as milk availability was impacted by prolonged monsoon, non-availability of fodder and delayed calving affecting the flush season.

Management expects sales to dip 7% in FY21 (versus -11% that we expect) owing to a longer-than-expected recovery in HORECA. While milk prices subsided 25% QoQ in Q1FY21, milk procurement shot up 40% QoQ. That said, gross margin will improve ahead as inventory is likely to decrease as sales pick up. Management expects to release INR1.5bn of inventory over the next few quarters and achieve a 30% gross margin for FY21 (25.8% in Q1FY21). They are hopeful of a 10% EBITDA margin for FY21 (6.8% in Q1FY21) driven by cost control; we have baked in an OPM of 7.9% for FY21.

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
Govt. Pension Fund	2.97	Macquarie EM	0.52
Norges Bank	2.97	Trinetra Investment	0.21
Somerset EM Fun	2.69	Legato Capital	0.08
New Horizon Opp	1.79	Canara Robeco MF	0.05
Dimensional Fund	0.90	Nomura Holdings	0.02

*Latest public data

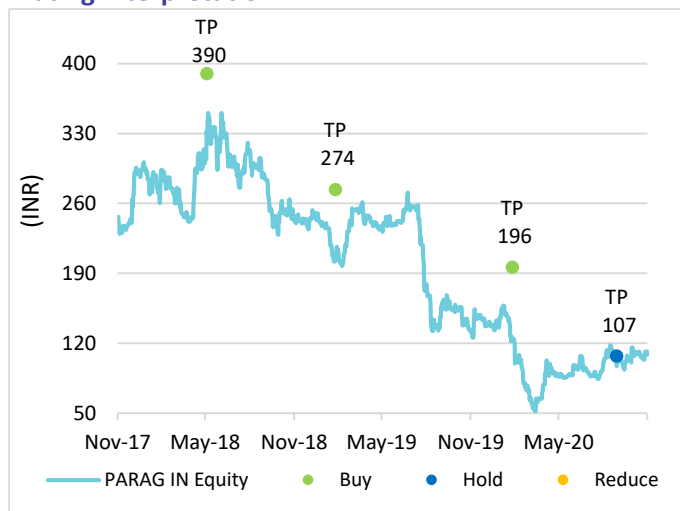
Recent Company Research

Date	Title	Price	Reco
08-Sep-20	Out-of-home, Horeca sour recovery; <i>Result Update</i>	98	Hold
30-Jun-20	COVID hits; future fluid; <i>Result Update</i>	96	Buy
05-Feb-20	Delayed flush season; <i>Result Update</i>	124	Buy

Recent Sector Research

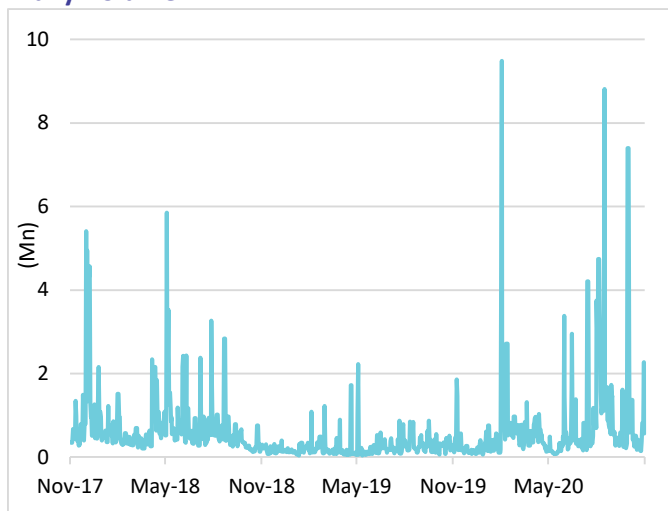
Date	Name of Co./Sector	Title
30-Oct-20	Heritage Foods	Core: Structurally and cyclically strong; <i>Result Update</i>
28-Oct-20	Heritage Foods	Stellar EBITDA performance; <i>Over fresh</i>
04-Sep-20	Heritage Foods	Heritage Foods - Stable core: Structural; <i>Company Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	162	62	14	238
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	176	60	10	246

* stocks under review

Rating Rationale

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

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