

# Parag Milk Foods Limited

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VP Goa Meet

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# Business - What does it do?

Parag Milk Foods manufactures and markets milk and value added dairy products. Company has three manufacturing facilities at Manchar (Maharashtra), Palamaner (Andhra Pradesh) and Sonipat (Haryana), 9 milk processing and packaging units, 1 State of the Art dairy farm. As per AR 2018 they have 250000+ retail touch points, 3000+ distributors, 140+ super stockists and 17 depots. Company's focus on value added products and branding has helped them in attaining leadership position in Cheese market (33% share in B2B Cheese market in India) and creation of valuable brands like Go, Gowardhan, Pride of Cows, Avvatar, Topp-Up.

| <b>Product</b>                 | <b>Capacity (As per AR 2018)</b> |
|--------------------------------|----------------------------------|
| Milk (Mn Litres/Day)           | 2.9                              |
| Cheese (MT/Day)                | 60                               |
| Paneer (MT/Day)                | 20                               |
| Ghee (MT/Day)                  | 110                              |
| Whey Protein (Lakh Litres/Day) | 6                                |

# Milk Procurement Process

## Complicated Logistics

- Village collection centre procure milk from farmers twice a day.
- Milk is then transported to nearby chilling centre and chilled at 4°C.
- The chilled milk is then transported in tanks to dairy plant where the milk is quality tested and standardised.

Company has great operation efficiencies as they manage such complicated logistics while competing with Cooperatives ( who share profits with farmers) and still maintain/increase their margins.

# Brief History

**1992:** PMFL was founded by Mr. Devendra Shah.

**1998:** Commissioned the Manchar (Maharashtra) plant and began manufacturing Butter and Ghee under brand “Gowardhan”.

**2005:** Birth of Bhagyalakshmi dairy farm. India’s first state of the art modern dairy farm.

**2008:** Commissioned India’s largest cheese plant with a capacity of 40 MT/day.

**2010:** Commissioned 2nd plant at Palamaner (Andhra) with a world class UHT facility.

**2011:** Birth of “Pride of Cows” first of it’s kind premium Farm to Home milk brand.

**2016:** IPO and Listing. Raised Rs. 300 cr. (1.37 cr shares at Rs. 219)

**2017:** Entered the juice drink market by launching “Slurp” and absolute Whey Protein under brand “Avvatar”.

**2018:** Established 3rd manufacturing facility at Sonipat (Haryana) by acquiring Danone’s facility.

# Dairy Industry - Long Runway Ahead

- India's dairy industry is worth Rs. 5.4 tn by value, having grown at 15% CAGR during 2010- 16. Going ahead, the dairy industry is expected to maintain 15% CAGR over 2016-20, and attain value of Rs. 9.4 tn on rising consumerism.
- India's per capita milk consumption has been increasing at 3% CAGR versus 1% CAGR globally. Further, at 97 litres per year it significantly trails its global peers.
- The organized segment is expected to grow at a CAGR of 20% over 2016-20 outpacing the overall industry (growing at 15%), and enhancing its share in the Indian dairy industry to 26% from ~22% currently.
- Currently, commodity dairy products like liquid milk and SMP contribute ~66% of total dairy industry, followed by traditional dairy products (ghee, paneer, curd, buttermilk, butter and ice-cream) forming ~32%, and emerging VADP (cheese, whey, UHT, flavoured milk, yogurt) accounting for mere ~2% of market. Ergo, there is humongous growth opportunity in traditional milk products like ghee, curd and paneer due to large industry size and unorganised presence, which we expect will lead to strong 20% CAGR in organised players in these segments over 2016-20E. Emerging VADP like UHT milk, flavoured milk, cheese and whey have highly organised market presence, but are hugely underpenetrated (small market size) which we believe will lead to strong 25% CAGR in growth for these segments over 2016-20E.

# Financials

5 years CAGR - Sales: 14.56%. PAT: 30.47%.

|                | 2011   | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   |
|----------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| SALES          | 658    | 900    | 925    | 1088   | 1443   | 1645   | 1731   | 1955   | 2396   |
| EBITDA         | 51     | 83     | 83     | 83     | 113    | 151    | 92     | 197    | 224    |
| PAT            | 0.63   | 19     | 21     | 16     | 32     | 47     | 5      | 87     | 121    |
| CFO            | 11     | 34     | 16     | 46     | 88     | 59     | -17    | 75     | 119    |
|                |        |        |        |        |        |        |        |        |        |
| EBITDA %       | 7.75%  | 9.22%  | 8.97%  | 7.63%  | 7.83%  | 9.18%  | 5.31%  | 10.08% | 9.35%  |
| PAT %          | 0.10%  | 2.11%  | 2.27%  | 1.47%  | 2.22%  | 2.86%  | 0.29%  | 4.45%  | 5.05%  |
|                |        |        |        |        |        |        |        |        |        |
| FA             | 205    | 246    | 243    | 242    | 291    | 345    | 334    | 397    | 440    |
| FA Turns       |        | 3.99   | 3.78   | 4.49   | 5.41   | 5.17   | 5.10   | 5.35   | 5.73   |
|                |        |        |        |        |        |        |        |        |        |
| Debt           | 325.00 | 413.00 | 491.00 | 556.00 | 545.00 | 389.00 | 261.00 | 337.00 | 286.60 |
| Debt to Equity | 8.33   | 7.12   | 6.06   | 5.73   | 4.40   | 1.08   | 0.42   | 0.47   | 0.35   |

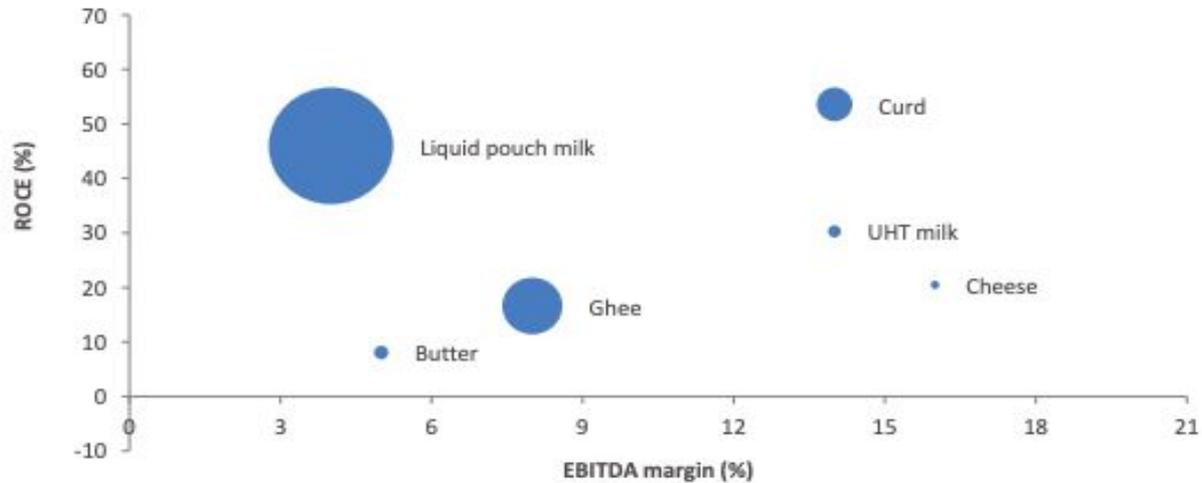
# Value Added Products

- 66.15 % of it's sale comes from VAPD. Sales of the company grew by 14.56% cagr from 2015 to 2019 whereas VAPD sales grew by 17.72% cagr.
- Cheese and Ghee are the two major products of the company in VAPD segment. They together form 38% of total sales of Co. in FY17. They have lowest asset turnover ratio in VAPD of 1.6 times and 2.5 times resp. and higher working capital days of 95 days leading to high working capital requirements.

|                  | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   |
|------------------|--------|--------|--------|--------|--------|--------|--------|
| Sales            | 925    | 1088   | 1443   | 1645   | 1731   | 1955   | 2396   |
| VAPD Sales       | 506    | 607    | 834    | 1095   | 1108   | 1282   | 1585   |
| VAPD % of Sales  | 54.70% | 55.79% | 57.80% | 66.57% | 64.01% | 65.58% | 66.15% |
| VAPD Growth Rate |        | 19.96% | 37.40% | 31.29% | 1.19%  | 15.70% | 23.63% |

# Dairy Products Return Profile

EBITDA margin and returns profiling for dairy products; Milk scores on RoCE



# Parag's Brand Profile



# Competitive Advantage

- Stickiness: 33% market share in cheese market in india (While Amul dominates the retail segment, Parag is the leader in the institutional segment.). Difficult to lose this business as the Companies buying from it will not take the risk of changing the supplier. As they have set Taste and Quality. Switching costs comes into play when benefits of changing from Company A's product to Company's B product is smaller than the cost of doing so. Parag's product form very small part of total cost of it's customers. For e.g. Total R.M. cost of Jubilant Foodworks is 25% of sales. In this 25% cheese will form some part. So the customer won't take the risk of changing the supplier for small monetary benefit.
- 66-67% share of value added products. This leads to higher margins. Liquid milk and SMP are commodity businesses, but it's necessary for a company to have a presence in liquid milk. With the liquid milk product company will not be able to sell value added products in small retail outlets. New products keep coming. Helps in gaining market share in growing market.
- Direct milk procurement from farmers. (Backward Integration). 60% from farmers. 20% from plant operators and 20% from third party. Direct milk procurement brings cost advantages and make them competitive to the cooperative dairy players.

# Competitive Advantage

- First mover advantage: Company has been pioneer in many products. It moved into cheese when no one was thinking about it and made a leadership position. They set up 40 MT/Day cheese plant in 2008 by taking funding from Motilal Oswal group. At that time Amul was the only player in the cheese market and India's Cheese making capacity was 40 MT/Day.  
Bhagyalakshmi farms a concept of direct farm to home milk (though it's relatively small right now).  
Whey Proteins (Avataar): only indian company to get into Rs. 1500 cr whey protein market.
- Brand: Milk is a commodity product so it doesn't necessarily give the company pricing power. Brand is valuable in this case as it reduces customer's search cost and increase acceptance of VAPD.

|                 | 2015  | 2016  | 2017  | 2018  |
|-----------------|-------|-------|-------|-------|
| SALES           | 1443  | 1645  | 1731  | 1955  |
| Sales Promotion | 8.02  | 18.92 | 26.46 | 40.38 |
| Marketing       | 16.74 | 19.19 | 25.16 | 12.37 |
| Total           | 24.76 | 38.11 | 51.62 | 52.75 |
| % of sales      | 1.72% | 2.32% | 2.98% | 2.70% |

# Promoter and Management Quality

| Insight                     | Attribute  | Evidence   |
|-----------------------------|--|--|
| Consistent Performance      | Growing sales and stable margins                     | <ul style="list-style-type: none"> <li>● Sales grew by 14.56% cagr and Net Profit by 30.47% cagr in the past 5 years from 2015 to 2019.</li> <li>● Very consistent Operating margins in the range of 8-10% in the past 9 years, except for one FY2017 (5%).</li> </ul>   |
| Pioneer/ Ahead of the curve | New Product Launches in limited competition segment. | <ul style="list-style-type: none"> <li>● <b>Cheese:</b> Commissioned India's largest cheese plant with a capacity of 40MT/day.</li> <li>● <b>Whey protein under Avvatar brand.</b> Whey is a component of milk protein. It is generated as a by-product during the manufacture of cheese. 1 kg cheese generates 50% (i.e 500 gms) of whey. Till now, the company was selling whey in crude form to the institutional segment. However, it has recently launched whey protein in retail under the Avvatar brand, which is sold directly to end consumers.</li> <li>● <b>Bhagyalakshmi Farms:</b> "Pride of Cows" brand launched in 2011. A concept of direct farm to home milk supply.</li> <li>● <b>Gowardhan Paneer</b> as a fresh paneer category with a <b>shelf life of 75 days</b>. It is unadulterated and despite of 75 days of shelf life, it is free from preservatives and additives. This is the only product which has used ESL (extended shelf life) technology.</li> </ul> |

# Promoter and Management Quality

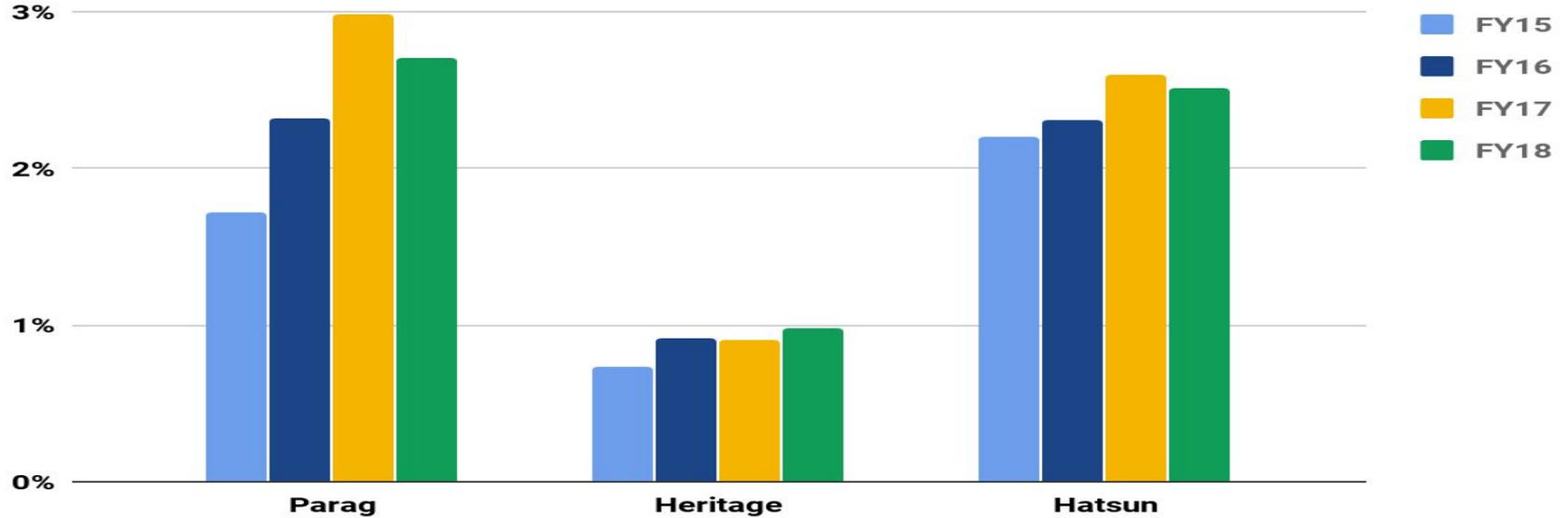
| Insight            | Attribute  | Evidence  |
|--------------------|--|---|
| Capable Management | Experienced and Qualified people on board and in senior management team. | <ul style="list-style-type: none"> <li>● Mr. Devendra Shah - Chairman - is in this business from 1992 and built this business from scratch. Experience of around 27 years.</li> <li>● Mr. B. M. Vyas, advisor to the board, who held the position of MD for 17 years at GCMF (Amul), was instrumental in growing the sales from a mere Rs 600 crore to Rs 8,800 crore during his tenure between 1994-2010.</li> <li>● Mr. Vimal Agarwal - CFO - Experience of 17+ years and latest stint with Pepsi.</li> <li>● Mr. Amarendra Sathe - Chief Commercial Officer - Experience of 24+ years in new product launches and brand promotions. Earlier worked with Kimberly Clark Liver Pvt. Ltd. as Director Sales India and SAARC.</li> <li>● 29% increase in Employee Cost from Rs. 73.5 cr in FY18 to Rs. 94.9 cr in FY19.</li> </ul> |
| Balance Sheet      | Strong Balance Sheet   | <ul style="list-style-type: none"> <li>● Reduced debt from Rs. 556 cr in 2014 to Rs. 214 cr in 2019 through IPO and internal accruals. Instead of leverage management went for equity sharing to fund capex.</li> </ul>   |

# Peer Comparison

| As per 2018 AR | SALES (cr)        | GP MARGIN       | EBITDA MARGIN | PAT MARGIN | D/E RATIO  | ROE      |
|----------------|-------------------|-----------------|---------------|------------|------------|----------|
| HERITAGE FOODS | 2345              | 23%             | 5.68%         | 2.58%      | 0.18       | 7.76%    |
| HATSUN AGRO    | 4287              | 28%             | 9%            | 2.12%      | 3.5        | 25%      |
| PARAG MILK     | 1955              | 30%             | 9.90%         | 4.50%      | 0.36       | 13%      |
|                |                   |                 |               |            |            |          |
|                | Sales 5 year CAGR | PAT 5 year CAGR | WC Days       | VADP %     | MARKET CAP | PE RATIO |
| HERITAGE FOODS | 3.67%             | 24.28%          | 12            | 22.43%     | 1950       | 24       |
| HATSUN AGRO    | 10.17%            | 24.14%          | 15            | 36.74%     | 11500      | 100      |
| PARAG MILK     | 10.67%            | 30.47%          | 68            | 65.58%     | 2070       | 17       |

# Peer Comparison

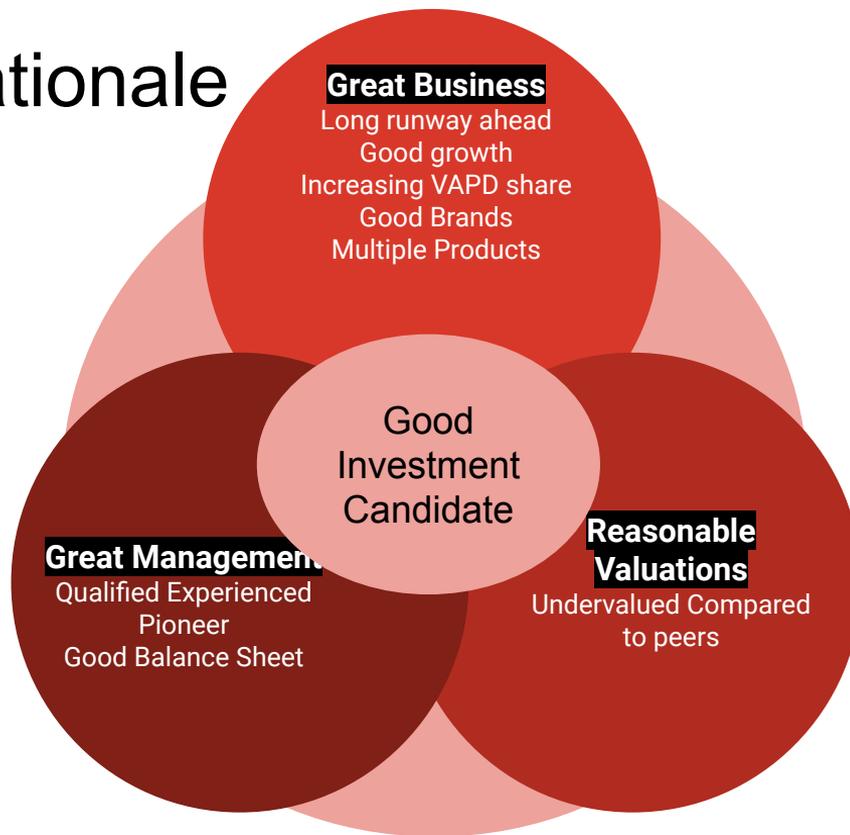
## Ad spend to sales ratio



# Risks

- Operating margins are in high single digits. Raw materials form 70-75% of sales. Any major fluctuation in the raw material prices can affect the performance of the company. E.g. In December 2016 Qtr raw milk procurement prices increased by 20% in Maharashtra region and company reported negative earnings.
- Government regulation on raw material side. MSP kind of thing on purchase from farmers.
- Tough Competition from Cooperatives and Private players. Difficult to make inroads in new states as established players already commanding the market.
- Inclination of farmers towards Cooperatives as they tend to offer better prices for milk and direct procurement from farmers is essential for survival.
- Promoter holding pledged at 21.73% as on March 2019.

# Investment Rationale



Thank You