

Parag Milk Foods

IPO Note

Parag Milk Foods (PMFL) is one of the leading manufacturers and marketers of dairy-based branded foods in India. The company has well recognized brands like "Gowardhan" and "Go" in its portfolio and has a pan-India network comprising of 15 depots, 104 super stockists and over 3,000 distributors. It has also been growing in the cheese segment where it currently has a market share of 32%.

Shift in market in favor of organized sector to aid growth: The Indian dairy industry is currently valued at ~₹4,061bn and is mainly dominated by the unorganized sector (accounting for 80% share). Industry reports indicate that the Indian dairy industry is expected to grow at a CAGR of 14.9% over FY2015-20E to ~₹9,397bn within which the organized segment is expected to grow at a faster pace than the unorganized segment. The share of organized players is expected to improve from 20% to ~26% in FY2020E, thus benefitting branded players like PMFL.

Low consumption of cheese in India presents opportunity for PMFL: The cheese segment is in its nascent stage with it accounting only for a fraction of the total dairy industry as household penetration of cheese in the country is very low compared to other developed countries. Going forward, we expect cheese consumption to increase on account of increase in home consumption due to increasing disposable incomes, sizable growth expected in the Indian fast food market, and shift in food consumption trends in tier II and III cities. Considering PMFL's strong branding (Go Cheese) and distribution network, we believe that the company will benefit from an increase in the overall consumption of cheese in India.

High-margin branded product sales to boost overall margins: The company derives approximately two-thirds of its revenue from sale of high margin branded consumer products like ghee, cheese, UHT, whey products etc. We believe the company will be able to continue its strong growth in the above products on the back of its strong branding and distribution network.

Outlook Valuation: At the upper end of the issue price band, the company is seeking a P/E multiple of 37.6x its 9MFY2016 annualized earnings based on pre-issue outstanding shares. This is lower than its close peer Prabhat Dairy's valuation, which is trading at a higher multiple of 49.8x its 9MFY2016 annualized earnings (despite of PMFL's better return ratios). Further, retail investors will be given a discount of ₹12/share. Considering the company has a diversified product basket, strong brands and wide distribution network, we believe that the company will continue to perform well on both the top-line and the bottom-line front. **Hence we recommend investors to Subscribe to the issue from a longer term perspective.**

Key Financial

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY16
Net Sales	900	925	1,088	1,439	1,231
% chg	36.7	2.8	17.6	32.2	-
Net Profit	19	21	16	26	32
% chg	-	9.9	(23.1)	62.6	-
OPM (%)	9.1	9.0	7.6	7.4	8.7
EPS (₹)	2.7	3.0	2.3	3.7	4.5
P/E (x)	84.6	76.9	100.1	61.6	-
P/BV (x)	27.6	19.7	16.4	13.0	-
RoE (%)	32.6	25.6	16.4	21.1	-
RoCE (%)	13.7	10.7	8.9	14.3	-
EV/Sales (x)	2.2	2.2	1.9	1.4	-
EV/EBITDA (x)	24.0	24.6	25.7	19.0	-

Source: Company, Angel Research; Note: Valuation ratios based on pre-issue outstanding shares and at upper end of price band

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Issue Open: May 4, 2016
 Issue Close: May 6, 2016

Issue Details

Face Value: ₹10
 Present Eq. Paid up Capital: ₹70.4cr
 Fresh Issue**: 1.33cr Shares
 Offer for sale: 2.06cr Shares
 Post Eq. Paid up Capital: ₹83.7cr

Market Lot: 65 Shares

Issue (amount): ₹750-765cr

Price Band: ₹220-227

Post-issue implied mkt. cap ₹1,851cr*-
 1,900cr**

Note:*at Lower price band and **Upper price band

Book Building

QIBs	75%
Non-Institutional	15%
Retail	10%

Post Issue Shareholding Pattern(%)

Promoters Group	47.7
MF/Banks/Indian FIIs/FII's/Public & Others	52.3

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Company background

PMFL is one of the leading manufacturers and marketers of dairy-based branded foods in India. The company has evolved from primarily being involved in collection and distribution of milk in 1992 to now being a branded foods player. Its operations span across the entire dairy chain from collection of milk to development and marketing of value added products like ghee, butter (under 'Gowardhan' brand), cheese and cheese products, UHT milk, curd and fruit yogurts (under 'Go' brand), premium cow milk (under 'Pride of Cows' brand) and flavored milks (under 'Topp Up' brand).

A significant portion of its product range includes long shelf-life food and beverage products that enable the company to cater to retail and institutional (QSR chains- Taco Bell, Domino's, etc) customers across India. The company has a pan India network of 15 depots, 104 super stockists and over 3,000 distributors (as of February 29, 2016).

Its manufacturing facilities are located at Manchar (Pune district, Maharashtra) and Palamaner (Chittoor district, Andhra Pradesh), with processing capacities of 1.2mn litres per day and 0.8mn litres per day, respectively. The Manchar facility has raw cheese production capacity of 40MT/day, which is the largest in India as per IMARC report.

The company has a wholly owned subsidiary Bhagyalaxmi Dairy Farm, which is a fully automated cow farm, housing over 2,000 Holstein breed cows delivering superior quality yields. The farm-to-home premium fresh milk is marketed and sold under the 'Pride of Cows' brand in Mumbai and Pune.

Issue details

The company is raising ₹300cr through a fresh issue of equity shares in the price band of ₹220-227. The fresh issue will constitute 15.9% of the post-issue paid-up equity share capital of the company assuming the issue is subscribed at the upper end of the price band. The retail participants will get a discount of ₹12/share. The company is offering 2.06cr shares of which 0.31cr shares are being sold by promoters, 1.43cr shares are being sold by investor shareholders, and the balance by other shareholders.

Exhibit 1: Shareholding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
Promoters	4,30,45,822	61.1	3,99,41,189	47.7
Others	2,73,70,065	38.9	4,37,64,320	52.3
Total	7,04,15,887	100.0	8,37,05,509	100.0

Source: Company, Angel Research

Objects of the offer

Of the total issue proceeds

- ₹148cr will be utilised towards expansion and modernisation of existing manufacturing facilities at Manchar and Palamaner and towards improving the marketing and distribution infrastructure.
- ₹2cr will be invested in its subsidiary Bhagyalaxmi Dairy Farm for its expansion and modernisation.
- ₹100cr for partial repayment of working capital consortium loan.
- The balance will be used for general corporate purposes.

Investment rationale

Well established brands and diversified product portfolio

The company has well recognized brands in its portfolio that include 'Gowardhan' and 'Go'. The company markets dairy products (milk, ghee, paneer, butter, etc) and processed cheese blocks under the 'Gowardhan' brand which targets the home consumption segment. Further, it has launched a wide range of cheese products, UHT, fresh cream etc, since 2008 under the 'Go' brand targeting younger generation and these products have gained good traction since their launch. Media and consulting agencies have recognized 'Gowardhan' as the most trusted brand in the food products category and 'Go' as the most promising brand in the FMCG category. 'Go' cheese has gained enormous momentum since its launch and has been competing with Amul, a name synonymous with cheese and butter in India for a long period of time. Its other brands include 'Pride of Cows'(premium quality cow milk) and 'Topp Up'(beverages).

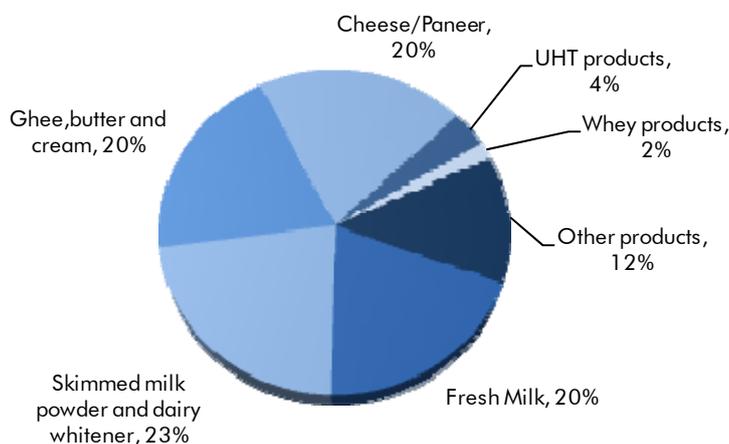
Exhibit 2: Diversified product portfolio

Brands	Products	Target Customer Groups
Gowardhan	Fresh Milk	Targeted at household consumption
	Curd	
	Ghee	
	Paneer	
	Butter	
	Milk powder	
	Whey proteins	
Go	Cheese Products	Targeted at children and the youth
	UHT milk	
	Curd	
	Fruit yoghurts	
	Fresh cream	
	Lassi, Buttermilk, Badam milk	
Pride of Cows	Premium Cow Milk	Targeted at household consumers seeking premium quality cow's milk
Topp Up	Flavoured milk	Targeted at youth and travelers as source of instant nourishment

Source: Company, Angel Research

Over the years, the company has introduced a range of value added products in the market to cater to retail as well as institutional customers. Its manufactured product mix comprises of fresh milk, skimmed milk powder, ghee, cheese/paneer, UHT products, whey products and other products which account for 19.8%, 22.6%, 19.8%, 20.1%, 3.5%, 1.7% and 12.5% of revenue, respectively.

Exhibit 3: Manufactured products revenue mix FY2015



Source: Company, Angel Research

Integrated business model

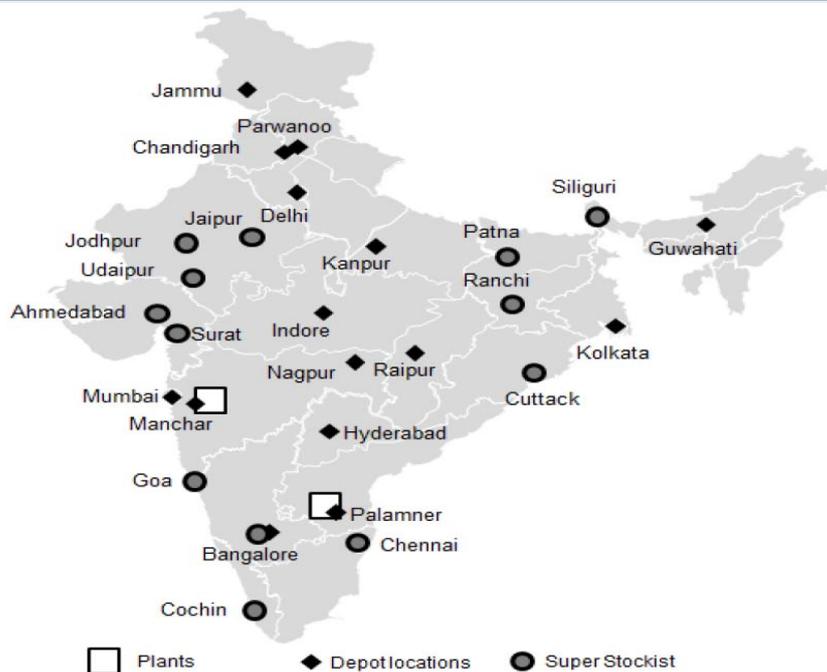
The company has an integrated business model which is present across the entire value chain ranging from manufacturing and processing to branding and distribution of a wide variety of products. It has a robust milk procurement network with 3,400 village level collection centers that are present in 29 districts across the states of Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu. It has built strong relationships with milk farmers through continuous engagement and its milk

procurement belt lies in close proximity to its facilities at Manchar and Palamaner. This enables the company to procure quality milk at reasonable costs, reduce transportation time and costs, and reduce wastages.

Growing pan-India distribution network

The company has a pan-India distribution network comprising of 15 depots, 104 super stockists and over 3,000 distributors (as of February 29, 2016). Its depots are present in 13 states and union territories in India. It also has a dedicated sales and marketing team comprising 560 personnel (~35% of total workforce) based at key distribution centers. Its products with shorter life (fresh milk and milk products) are sold in the western and southern regions of India, in proximity to its manufacturing facilities. The company has established a separate route-to-market to focus on the distribution of low unit price products including ghee, flavored milk, UHT milk, dairy whiteners and gulab jamun mix in Tier 3 cities and rural areas in India. Going forward, the company intends to appoint additional distributors and super stockists to increase the availability of products in smaller towns in India and introduce new low unit price products in Tier 3 cities and rural areas.

Exhibit 4: Pan-India presence

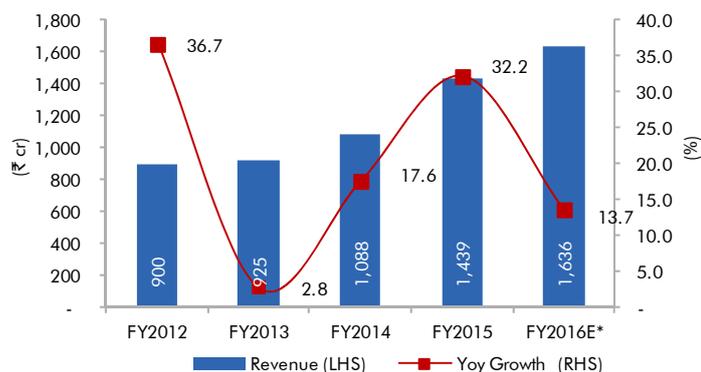


Source: Company, Angel Research

Established track record of growth and financial performance

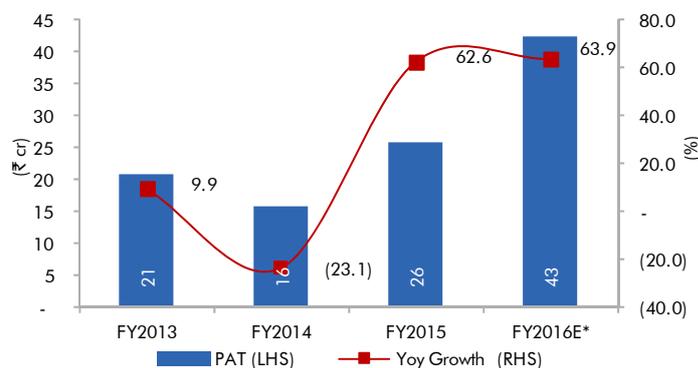
Aided by growing popularity of its brands, the company has posted a revenue CAGR of ~22% over FY2011-2015 to ₹1,439cr. This has largely been on the back of robust sales growth in consumer driven products like cheese/paneer and UHT. Going forward, we expect the company to be able to maintain its growth on the back of shift in share from unorganized market to organized market for products like ghee, paneer, curd, etc. Further, we expect the cheese segment to grow and we believe that the company will be able to report a strong growth in the segment where it currently has a 32% market share in India, on back of its strong branding.

Exhibit 5: 21.6% Revenue CAGR over FY2011-15



Source: Company, Angel Research; Note: - 9MFY2016 annualised number

Exhibit 6: Net Profit CAGR of 11.2% over FY2012-15



Source: Company, Angel Research; Note: - 9MFY2016 annualised number

The company posted a net profit CAGR of 11.2% over FY2011-15E on the back of strong growth in top-line and stable margins. Going forward, we expect the company to be able to report healthy top-line and bottom-line numbers on the back of growth momentum, favorable product mix and reduction in working capital loans.

Outlook Valuation

At the upper end of the issue price band, the company is seeking a P/E multiple of 37.6x its 9MFY2016 annualized earnings based on pre-issue outstanding shares. This is lower than its close peer Prabhat Dairy's valuation, which is trading at a higher multiple of 49.8x its 9MFY2016 annualized earnings (despite of PMFL's better return ratios). Further, retail investors will be given a discount of ₹12/share. Considering the company has a diversified product basket, strong brands and wide distribution network, we believe that the company will continue to perform well on both the top-line and the bottom-line front. **Hence we recommend investors to Subscribe to the issue from a longer term perspective.**

Risks

Milk procurement: The company relies on procuring raw milk at competitive rates from milk farmers in the milk procurement belt. Inability to procure sufficient good quality raw milk at commercially viable prices may adversely impact the company's operation as raw milk is key raw material for all dairy products.

Intense competition: The dairy industry is highly competitive, with multiple players sourcing milk from the same region. Such competition can have an impact on raw milk prices.

Regulatory risk: The company is subject to various regulations relating to product liability, particularly relating to food safety of its products. Product contamination or similar occurrences can result in regulatory actions against the company and impact the business performance.

Threat of Patanjali: Indian and multinational FMCG companies are expected to face stiffer competition from the Patanjali brand. Patanjali has significant presence in the ghee segment, thus posing competition to PMFL.

Profit & Loss (consolidated)

Y/E March (₹cr)	FY2012	FY2013	FY2014	FY2015	9MFY16
Total operating income	900	925	1,088	1,439	1,231
% chg	36.7	2.8	17.6	32.2	-
Total Expenditure	818	842	1,006	1,332	1,123
Raw Material	701	691	836	1,101	921
Employee Cost	30	40	48	57	51
Other Expenses	87	111	122	174	151
EBITDA	82	83	82	106	107
% chg	64.1	1.4	(1.3)	29.2	
(% of Net Sales)	9.1	9.0	7.6	7.4	8.7
Depreciation & Amortisation	23	26	28	28	24
EBIT	60	57	55	79	84
% chg	86.4	(4.1)	(4.4)	43.9	
(% of Net Sales)	6.6	6.2	5.0	5.5	6.8
Interest & other Charges	40	40	44	49	35
Other Income	1	2	1	2	1
(% of PBT)	3.8	11.1	10.1	5.8	1.2
Recurring PBT	21	19	12	31	49
% chg	110.1	(6.7)	(35.7)	153.9	
Prior Period & Extra-ord. Exp.(Inc.)	-	-	-	-	-
PBT (reported)	21	19	12	31	49
Tax	2	(2)	(4)	5	18
(% of PBT)	7.9	-	-	16.9	35.5
PAT before MI & Adj. reported)	19	21	16	26	32
Extraordinary Items	-	-	-	-	-
Less: Minority interest (MI)	-	-	-	-	-
Less: Share of Associates	-	-	-	-	-
ADJ. PAT	19	21	16	26	32
% chg	-	9.9	(23.1)	62.6	
(% of Net Sales)	2.1	2.2	1.5	1.8	2.6
Basic EPS (₹)	2.7	3.0	2.3	3.7	4.5
Fully Diluted EPS (₹)	2.7	3.0	2.3	3.7	4.5
% chg	-	9.9	(23.1)	62.6	22.9

Balance Sheet (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY16
SOURCES OF FUNDS					
Equity Share Capital	16	16	16	16	66
Reserves & Surplus	42	65	81	107	211
Equity Application Money	-	-	-	-	-
Shareholders' Funds	58	81	97	123	278
Minority Interest	0	0	0	-	-
Total Loans	377	456	520	430	365
Long-term provisions	0	0	0	0	1
Other long term liabilities	0.4	0.4	11.2	16.1	17.0
Total Liabilities	445	545	633	575	669
APPLICATION OF FUNDS					
Gross Block	318	335	360	437	482
Less: Acc. Depreciation	72	91	118	146	169
Net Block	246	243	242	291	313
Capital Work in Progress	7	6	37	26	29
Goodwill	-	-	-	-	-
Investments	0	0	0	0	0
Current Assets	294	347	439	537	580
Inventories	139	139	190	212	227
Sundry Debtors	119	147	163	171	246
Cash	2	2	4	6	25
Loans & Advances	9	21	42	98	51
Other Assets	26	36	38	51	31
Current liabilities	160	146	190	348	301
Net Current Assets	134	200	249	190	279
Long term loans and adv.	57.0	93.8	103.0	66.5	46.9
Other Non Current Assets	0.7	1.0	1.6	1.8	1.1
Mis. Exp. not written off	-	-	-	-	-
Total Assets	445	545	633	575	669

Cash Flow Statement (consolidated)

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	9MFY16
Profit before tax	21	19	12	31	49
Depreciation	23	26	28	28	24
Change in Working Capital	(48)	(62)	(40)	(42)	(55)
Interest / Dividend (Net)	40	40	43	46	35
Direct taxes paid	(3)	(13)	(0)	(1)	(6)
Others	2	5	3	3	6
Cash Flow from Operations	34	16	46	66	52
(Inc.)/ Dec. in Fixed Assets	(70)	(56)	(59)	(23)	(40)
(Inc.)/ Dec. in Investments	1	(1)	(1)	0	1
Cash Flow from Investing	(69)	(57)	(59)	(22)	(39)
Issue of Equity	-	3	-	-	6
Inc./(Dec.) in loans	76	79	65	12	36
Dividend Paid (Incl. Tax)	-	-	-	-	-
Interest / Dividend (Net)	(40)	(41)	(50)	(54)	(36)
Cash Flow from Financing	36	41	15	(42)	6
Inc./(Dec.) in Cash	0	(0)	2	1	19
Opening Cash balances	1	2	1	3	4
Acquisition/(sale) of business	-	-	-	-	-
Closing Cash balances	2	1	3	4	23

Key Ratios

Y/E March	FY2012	FY2013	FY2014	FY2015
Valuation Ratio (x)				
P/E (on FDEPS)	84.6	76.9	100.1	61.6
P/CEPS	38.6	34.1	36.8	29.9
P/BV	27.6	19.7	16.4	13.0
Dividend yield (%)	0.0	0.0	0.0	0.0
EV/Sales	2.2	2.2	1.9	1.4
EV/EBITDA	24.0	24.6	25.7	19.0
EV / Total Assets	3.3	3.0	2.6	2.2
Per Share Data (Rs)				
EPS (Basic)	2.7	3.0	2.3	3.7
EPS (fully diluted)	2.7	3.0	2.3	3.7
Cash EPS	5.9	6.7	6.2	7.6
DPS	0.0	0.0	0.0	0.0
Book Value	8.2	11.5	13.8	17.5
Returns (%)				
ROCE	13.7	10.7	8.9	14.3
Angel ROIC (Pre-tax)	14.0	10.8	9.5	15.1
ROE	32.6	25.6	16.4	21.1
Turnover ratios (x)				
Asset Turnover (Gross Block)	2.8	2.8	3.0	3.3
Inventory / Sales (days)	57	55	64	54
Receivables (days)	48	58	55	44
Payables (days)	34	36	42	46
WC cycle (ex-cash) (days)	70	77	77	52

Note: Valuation ratios based on pre-issue outstanding shares and at upper end of the price band

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