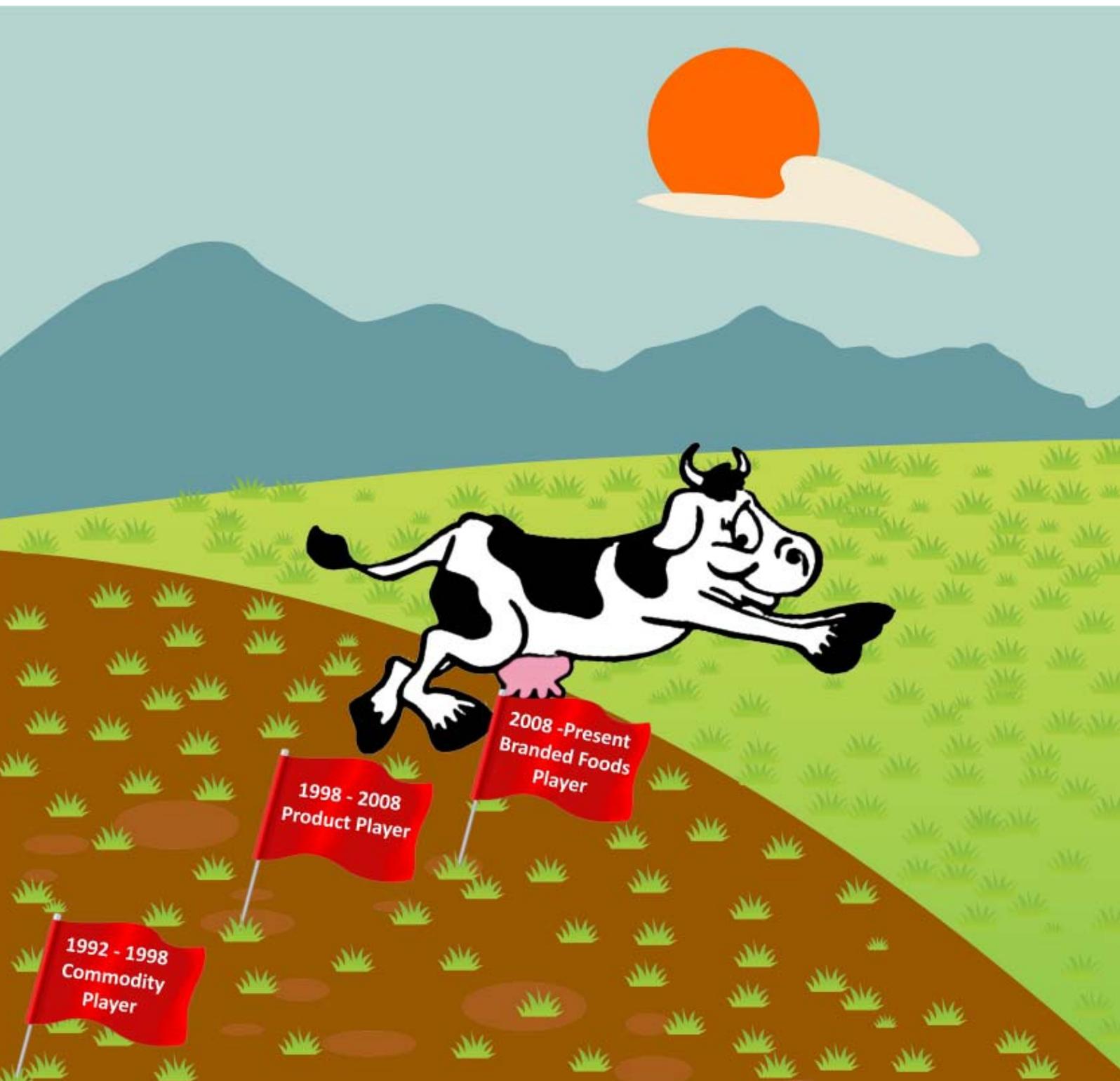


Parag Milk Foods



"GO"ing for greener pastures

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Investors are advised to refer through important disclosures made at the last page of the Research Report. Motilal Oswal research is available on www.motilaloswal.com/Institutional-Equities, Bloomberg, Thomson Reuters, Factset and S&P Capital.

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Parag Milk Foods

BSE Sensex
27,127S&P CNX
8,323

CMP: INR330

TP: INR340 (+3%)

Neutral

Motilal Oswal values your support in the Asiamoney Brokers Poll 2016 for India Research, Sales and Trading team. We request your ballot.

**Stock Info**

Bloomberg	PARAG IN
Equity Shares (m)	84.1
12-Week Range (INR)	334/202
1, 6, 12 Rel. Per (%)	28/-/-
M.Cap. (INR b)	27.9
M.Cap. (USD b)	0.4
Avg Val, INRm	345.0
Free float (%)	52.5

Financial Snapshot (INR b)

Y/E Mar	2016	2017E	2018E
Sales	16.5	19.2	23.1
EBITDA	1.5	1.8	2.2
Adj. PAT	0.5	0.8	1.1
Adj. EPS (INR)	6.7	9.5	12.6
EPS Gr. (%)	-66.7	41.1	32.5
BV/Sh.(INR)	51.4	89.6	102.1
RoE (%)	19.5	14.3	13.1
RoCE (%)	12.4	11.3	11.5

Valuation

P/E (x)	49.0	34.8	26.2
P/BV (x)	6.4	3.7	3.2
EV/EBITDA (x)	159.7	155.5	126.1

Shareholding pattern (%)

As On	May-15
Promoter	47.5
Public	52.5
Others	0.3

"GO"ing for greener pastures**A unique multi-year consumption play**

Parag Milk Foods is a leading manufacturer and marketer of branded dairy foods and beverages in India. It started off with collection and distribution of milk in 1992; over the years, it has developed a portfolio of dairy products under its four flagship brands *Gowardhan, Go, Topp Up & Pride of Cows*.

Key factors that underpin our long term bullishness on Parag's prospects are:

- Attractive dairy industry dynamics and shift from unorganized to organized segment.
- Parag's focus on driving value added dairy products (VADP) contribution.
- Long standing reputation as a category innovator especially in Value Added Products.
- Parag's unique positioning as a national branded dairy player focused on value added B2C segment in an industry populated by either regional players or players focused on B2B segment.
- Outstanding procurement strength constitutes a key competitive advantage.
- Distribution expansion led medium term opportunity.
- We are initiating coverage on Parag Milk Foods (Parag) with a Neutral rating. The stock has appreciated by 53% since its IPO two months ago, capping the near term upside at 3%. Nevertheless, from a medium term perspective, Parag offers a compelling three year play with potential 22% CAGR returns. Key to this is our assumption of 32% CAGR EPS improvement over the next 5 years and improvement in ROCE by 370 bps over this period.

Huge Size of Prize

India's dairy market at 146m tons and sales of INR4,061b (USD61b) has been growing at a CAGR of 15% in the last 5 years and is expected to grow to INR9,300b (USD140b) by 2020. The industry is not just growing rapidly in size but also improving from a profitability perspective due to significant increase in the proportion of value added dairy products, owing to a combination of factors like low base, favorable demographics, rise in aspiration & income levels and change in consumption habits.

Shift from unorganized to organized segment provides growth visibility

Of the 146m tons of milk produced in India, around half is consumed at source. Of the marketable portion of milk, only 30% is procured by organized players. The organized segment is growing at 20% CAGR, faster than the 14% CAGR growth of the unorganized segment and is expected to maintain this pace of growth thereby increasing in salience. Within the organized component, half of the milk is procured by cooperatives and the rest by private players. Private players are particularly strong (a) in states like Maharashtra, where the cooperatives are weaker and do not operate under a single umbrella which means that milk procurement prices are much lower than other states; (b) in value added products like cheese, where investment in capacities and branding require substantial investments and expertise, which is beyond the reach of cooperatives and (c) due to savvy marketing ability and technology investment in cold chain which aids shift towards organized and branded products.

Stock Performance (1-year)**Parag has a Right to Win**

Parag Milk Foods' focus on Value Added Dairy Products (VADP's) sets it apart even among the private players. The share of value added products (Milk products + SMP) has been improving and now forms 79% of the portfolio compared to 39% in FY12. Parag is particularly strong in Cheese (20% of revenues as on FY16) with the largest facility in India (40 MT per day) and with a market share of 32%, the second largest player after the cooperative Amul (~40% market share). Parag is the largest cow ghee brand in India and is also known as the category creator. Going forward, company aims to focus on UHT, whey protein (highest gross margin among VADP) and milk based beverages along with cheese and ghee to drive topline growth as well as profitability. In contrast, Parag's competitors have product profile heavily skewed in favor of commodity/B2B segments.

Parag enjoys several competitive advantages

Over the years it has developed strong relationships with the farmers in proximity to its facilities which aid in procurement of raw milk at competitive prices. The supply chain network includes cow milk procurement from 29 districts across Maharashtra, Andhra Pradesh, Karnataka, and Tamil Nadu. The company procures around 1m litres per day currently with the help of 4,300 village level collection centres, reaching 2,30,000+ farmers across its catchment areas and 114 chilling centres and bulk coolers across both its plants. The distribution strength of Parag has improved over the years and now has an established pan-India distribution network of 15 depots, 104 super stockists and over 3,000+ distributors which services its products to around 2,00,000+ retail outlets. Going forward, we expect Parag to build on this distribution network and expand its presence across country. It is targeting to increase direct distribution reach by ~15% per annum for next 3-5 years. Brand Parag (Go, Gowardhan) already enjoys good awareness and equity in South and West. Management is targeting to shift the profile of brand spends towards above the line activities. This, coupled with expanding product portfolio augurs well from top-line growth perspective.

Solid earnings growth visibility both in near and medium term

We expect Parag to report robust EPS CAGR of 36%/32% respectively over the next 3 years/5 years. Large capacity investments in value added products ahead of peers, further expansion of distribution reach and focus on brand building will help Parag take advantage of the massive opportunity in the branded value added dairy products segment leading to a revenue growth of 19% CAGR over the next 3/5 years (broadly in line with the topline growth clocked over last five years). Driven by product mix improvement, we expect operating margins to expand by 110/200 bps respectively over the next 3/5 years leading to EBITDA CAGR of 24% from a three year and five year perspective. Reduction in debt/ equity from 1x in FY16 means that EPS CAGR is likely to be higher (INR 1b of IPO funds to be utilized for debt repayment). ROCE is also likely to increase gradually from 12.4% in FY16 to 16.1% in FY21.

Initiate with NEUTRAL; stock up 53% since listing in two months

Opportunity size in Dairy is huge and in-turn offers strong growth visibility for branded players. Parag, with its strengths on procurement, distribution, innovation

and management bandwidth is best placed among peers, in our view. While rest of the listed Dairy players are either regional in nature or have dominant B2B positioning, Parag offers a pan-national branded dairy play with B2C focus. The stock had a good run-up and is up 53% in less than two months post listing in May'16. At CMP of INR330, the stock trades at 24x June 2018 EPS. We value Parag at 25x June'18 EPS and arrive at a one year TP of INR 340, 3% upside. At 25x FY18, it will trade at 20% discount to consumer universe (30% discount to ex-ITC consumer universe). In our view, it is a fair multiple and balances the strong growth visibility of Parag and its demonstrated innovator credentials with relatively lower RoE/RoCE's and size vs. other consumer peers. Thus, given the limited near term upside, we initiate coverage with a Neutral rating. Key risks include: a) volatility in raw material prices b) potential price competition with co-operative giants and c) execution risks pertaining to portfolio and reach expansion.

Compelling three year consumption play

Notwithstanding the near term limited upside given the recent run-up, it still offers a very compelling three year play with an exciting 36%/32% EPS CAGR over 3/5 years. Our detailed workings suggest that over a three year period over FY18-21, the stock can deliver a healthy return of 22% CAGR in our view, even after assuming a modest de-rating from 25x P/E to 22x.

Indian dairy industry offers immense opportunities

Shift to organized sector and penetration of milk products set to drive growth

Industry dynamics

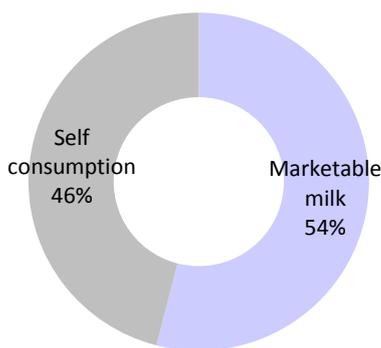
India produces 146m tons of milk (as of FY15), around half of which is consumed at source. Of the remaining marketable component, ~30% is procured by organized players. Even within the organized portion of the dairy industry, around half of the procurement is by cooperatives.

Gradual shift toward organized players

The INR4,061b Indian dairy market exhibited a CAGR of 15% from CY10-CY14, and is expected to grow at a similar rate to INR 9,300b by 2020. The organized component of the industry has grown at a faster CAGR of 20% (v/s 14% for the unorganized segment), which is expected to continue as a result of continued shift in consumer preference from loose milk to pasteurized packaged milk and value-added products.

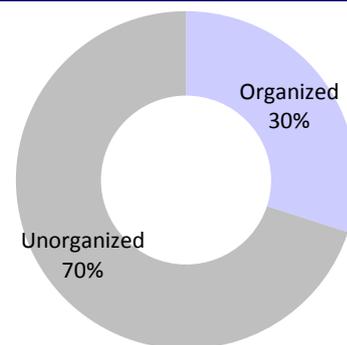
The gradual shift from unorganized to organized sector provides ample room for cooperatives and private players to grow. However, the opportunity is particularly strong for private players (a) in states like Maharashtra, where the cooperatives are weaker and do not operate under a single umbrella which means that milk procurement prices are much lower than other states; (b) in value added products like cheese, where investment in capacities and branding require substantial investments and expertise, which is beyond the reach of cooperatives and (c) due to savvy marketing ability and technology investment in cold chain which aids shift towards organized and branded products.

Exhibit 1: In India, around half of milk produced is consumed at source...

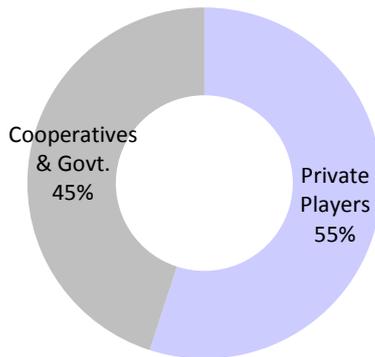


Source: NDDDB, Company, MOSL

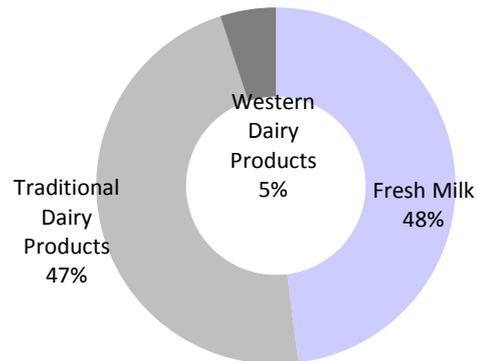
Exhibit 2: ...with only 30% of marketable milk being processed by organized players



Source: NDDDB, Company, MOSL

Exhibit 3: Private players form ~55% of organized segment

Source: NDDDB, Company, MOSL

Exhibit 4: Fresh milk and traditional dairy products still form largest part of the dairy market

Source: NDDDB Company, MOSL

Rising middle class/urban population, increase in working population and changing dietary pattern should drive consumption of milk & milk products

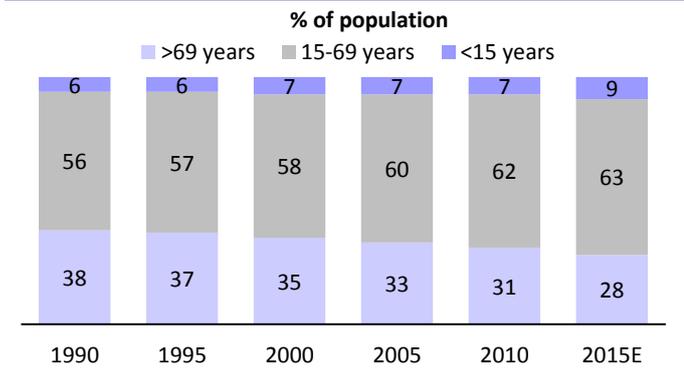
Consumption of milk as well as traditional milk products like dahi (curd) and lassi in loose form has been part of Indian dietary habits since many years. However, over the past few years, there have been increasing concerns about the quality of loose milk sold by unorganized players. This has helped propel the share of organized players in the Indian dairy industry.

Consumption of packaged liquid milk has increased from 21% of total liquid milk to 28% over the past five years, according to industry sources. The consumption trend has also changed over the years, with people shifting from home-made dahi to branded dahi due to convenience in buying and higher assurance of quality. People have also started including various milk & milk products in their daily dietary plans given the health benefits. Milk provides a useful source of protein to a large portion of the consumer base who are vegetarians.

The shelf life of various dairy products has also increased over years due to the development of processing/packaging technology, and an improvement in cold storage infrastructure at the logistics as well as retail level led by organized players.

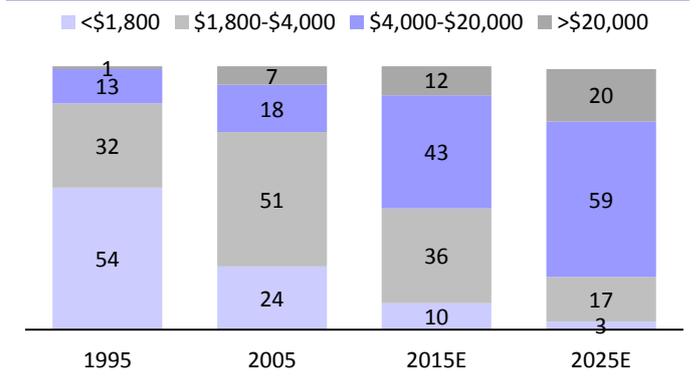
Growth in the middle class (expected to reach 586m by 2020) and an increase in the percentage of urban population (expected to be 34.5% by 2021) are expected to drive strong growth for milk and milk products.

Exhibit 5: Huge demographic demand in terms of growing share of working age group...



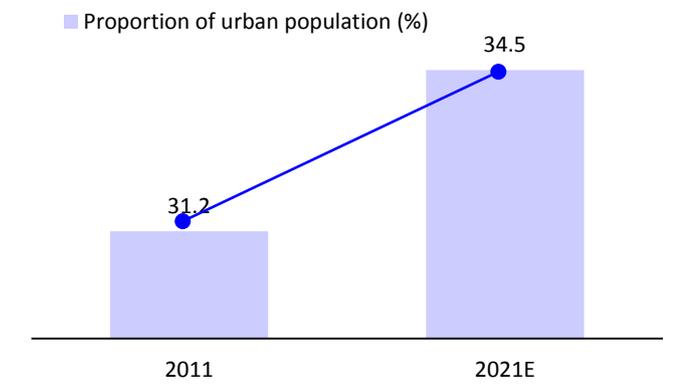
Source: Company, MOSL

Exhibit 6: ...rise in share of middle and affluent class



Source: Company, MOSL

Exhibit 7: ...expected increase in share of urban population



Source: Company, MOSL

Exhibit 8: ...along with shift in dietary patterns toward dairy products

Dairy products	2000	2010	2020	% gr. (2000-2020)
	MT	MT	MT	
Milk / Milk Products	64.1	106.4	165.8	159.0
Fruits / Vegetables	48.4	75.2	113.2	134.0
Meat & Fish	4.7	7.2	10.8	131.0
Edible Oils	5.3	7.7	10.9	107.0
Pulses	10.6	14.6	19.5	85.0
Rice	78.3	98.0	118.9	52.0
Wheat	54.2	72.1	92.4	70.0
Other Cereals	13.1	14.1	15.6	19.0

Source: India Vision 2020, Planning Commission of India, Company, MOSL

VADPs – a key differentiator

Focus on whey protein, UHT and milk-based beverages, along with ghee and cheese

Parag Milk Foods Limited is one of the leading manufacturers and marketers of milk-based branded foods in India targeting various consumer groups. The company is known for deriving all of its products from cow’s milk. It manufactures a diverse range of products, including fresh milk, ghee (clarified butter), cheese, whey protein, paneer, curd, yoghurt, milk powders and dairy milk-based beverages under the umbrella of four flagship brands: “Gowardhan”, “Go”, “Topp Up” and “Pride of Cows”.

At the premium end, it targets traditional consumption at home with its flagship brands “Gowardhan” (Ghee, Milk, Paneer, Dahi, Curd , Butter, Dairy Whitener and Gulab Jamun Mix) and “Topp Up” (flavoured milk), and also has brands “Go” (Cheese) and “Pride of Cows” (Premium fresh milk) targeting the urban affluent, youth and kids.

In the mass market segment, the company offers traditional products such as fresh pouch milk, curd, etc which are largely used for in-kitchen/household consumption, restaurants, eateries, etc., and also with western bulk consumption products such as SMP, block cheese and butter, which are targeted at institutional and smaller restaurant chains, etc.

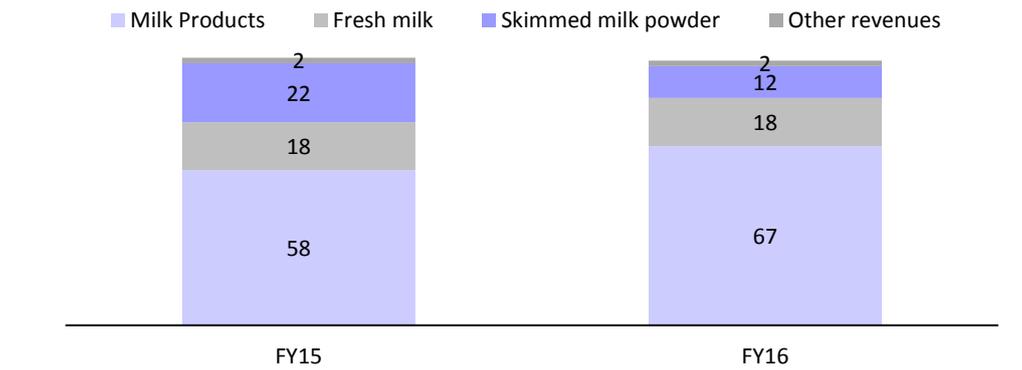
Exhibit 9: Formidable food brands portfolio with traditional as well as western products



Source: Company, MOSL

Within the entire dairy industry, there is significant potential in value-added dairy products (VADPs) as just 12-14% of total milk produced at the pan-India level gets converted into VADPs. Major part of revenues for Parag comes from milk products with a contribution of 67% as of FY16, followed by fresh milk (18%), SMP (12%) and other revenues (2%). The share of value-added products (milk products+SMP) has been improving (up to 79% of the portfolio, from 39% in FY12). Going forward, the company aims to focus on UHT, whey protein and milk-based beverages, along with cheese and ghee, to drive its top-line growth and profitability.

Exhibit 10: Revenue mix to improve further towards value added products

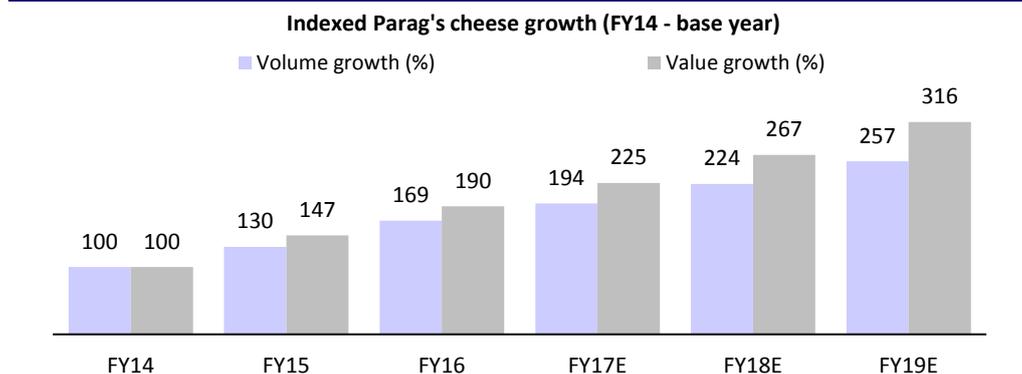


Source: Company, MOSL

Cheese – Large opportunity; Growth to sustain

- Parag is particularly strong in cheese (20% of revenues as on FY16) with the largest facility in India (40MT per day) and a market share of 32% (second largest player after the cooperative Amul that has ~40% market share). The cheese market hardly has any unorganized player, and is currently an INR12b market, growing at a CAGR of 24-25%.
- Parag’s cheese plant at Manchar is the only UHT facility for cheese in India, with a separate line for Mozzarella cheese. The plant has the capabilities to produce cheese in 75 stock-keeping units under a wide range, including cheddar, mozzarella, processed and gourmet cheese. The plant runs at 80-85% capacity utilization for cheese. Thus, in the current fiscal year, it will be expanding the cheese facility to 60MT per day with the help of IPO proceeds to cater to expanding retail and institutional demand. Retail forms about 50% of the overall cheese market and for Parag as well. A significant portion of institutional sales of cheese for Parag comes from hotels, restaurant and caterers (HoReCa), while the rest comes from QSR (Quick Service Restaurant) players like Domino’s and Pizza Hut. The company has also roped in Chef Ranveer Brar for brand communication related to cheese to gain further traction in the growing market.
- The cheese market in India is expected to grow at a 25-30% CAGR, driven by growth in the consumption of western dishes, increasing use of cheese in traditional dishes as well as premiumization. Thus, we expect Parag’s cheese revenue to grow at a 19% CAGR over FY16-FY19 to INR6b and 19% CAGR over FY16-21 to INR8.4b.

Exhibit 11: Parag’s cheese revenue to grow at a 19% CAGR over FY16-FY19



Source: Company, MOSL

Exhibit 12: Parag's extensive, innovative and growing cheese portfolio

Source: Company, MOSL

Whey protein – Niche, High growth and Superior gross margins

Whey is a component of milk protein that is obtained during the manufacturing of cheese. If 1kg of cheese is produced, then approximately 500g of raw whey as a byproduct is obtained, which needs to be processed and refined further to be sold as a branded product.

Parag is setting up a value-added whey processing facility (funded by IPO proceeds) in FY17 to cater to retail consumers with branded health supplements and beverages. At present, it sells whey only through B2B channel and is the leading supplier in India of whey protein powder to Nestle.

Whey protein contributes only 3.5% of total business (as of FY16). The product will act as a gross margin driver going forward as it commands the highest gross margin in value-added products. We note that gross margin for value-added products ranges from 25-40%.

Whey is currently an INR3b market, growing at a CAGR of 26%. Whey business for Parag is expected to occupy much larger share in the overall pie going forward. We expect Parag's whey protein revenue to grow at a 45% CAGR over FY16-FY19 to INR1.6b and 37% CAGR over FY16-21 to INR2.5b.

UHT (ultra heat treated) milk – High growth area

UHT is a form of milk that is treated at temperature of at least 135 degree celsius to kill the harmful bacteria. UHT milk is an INR26b market, growing exponentially off a small base. Amul is the largest player in UHT milk segment in India, while Parag is the largest private player. UHT milk market is expected to grow at a CAGR of 26% to INR104b by 2020. We expect Parag's whey protein revenue to grow at a 42% CAGR over FY16-FY19 to INR1.9b and 36% CAGR over FY16-21 to INR3b.

Milk-based beverages (classified under UHT segment) – Exciting opportunity

Milk based beverages is also one of the niche categories which the company has identified for driving medium-term growth. At present, the company only sells flavored milk under the brand "Topp Up", while it is looking to launch additional

milk-based beverages to benefit from consumers who are slowly moving from carbonated soft drinks to healthier beverages.

Ghee – Growth driven by shift from unorganized to organized

Ghee (clarified butter) is the largest consumed dairy product in India after liquid milk and curd. It is a key ingredient in Indian recipes. As of 2014, the ghee market stood at INR618b, growing at a CAGR of 17%, and is currently largely occupied by unorganized players. Amul is the largest player in the organized ghee market. Retail accounts for 55% of the total organized market. Parag is the largest cow ghee brand in India and is also known as the category creator. The market for ghee is expected to grow at a CAGR of 14% to INR1,367b by 2020. We expect Parag's ghee revenue to grow at a 14% CAGR over FY16-FY19 to INR4.8b and 13% CAGR over FY16-21 to INR5.9b.

Integrated Business Model

Strong procurement base + innovative product portfolio + expanding distribution network

Strong procurement base

Parag Milk Foods has developed a robust integrated business model, which encompasses the entire value chain of the dairy-based foods and beverage business. Over the years, it has developed strong relationships with farmers in proximity to its facilities, which aids in procurement of raw milk at competitive prices. The supply chain network includes cow milk procurement from 29 districts across Maharashtra, Andhra Pradesh, Karnataka and Tamil Nadu. The company procures around 1m liters per day currently with the help of 4,300 village-level collection centers, reaching 2,30,000+ farmers across its catchment areas and 114 chilling centers and bulk coolers across both its Manchar and Palamaner processing plants.

Exhibit 13: Parag's procurement areas are among the top milk producing states

State	Milk production (m MT's)	Milk production 10yr CAGR
Uttar Pradesh	25.2	4%
Rajasthan	16.9	7%
Andhra Pradesh	13.9	7%
Gujarat	11.7	6%
Madhya Pradesh	10.8	7%
Punjab	10.4	2%
Maharashtra	9.5	4%
Haryana	7.9	4%
Bihar	7.8	5%
Tamil Nadu	7.1	4%
Karnataka	6.1	5%

Source: Company, MOSL

The company has aggregate milk processing capacity of 2m liters per day, with manufacturing facilities strategically located in high dairy cow population areas of Manchar, Maharashtra (with milk processing capacity of 1.2m liters per day) and Palamaner, Andhra Pradesh (0.8 million liters per day).

Exhibit 14: Production capacity at Parag’s facilities

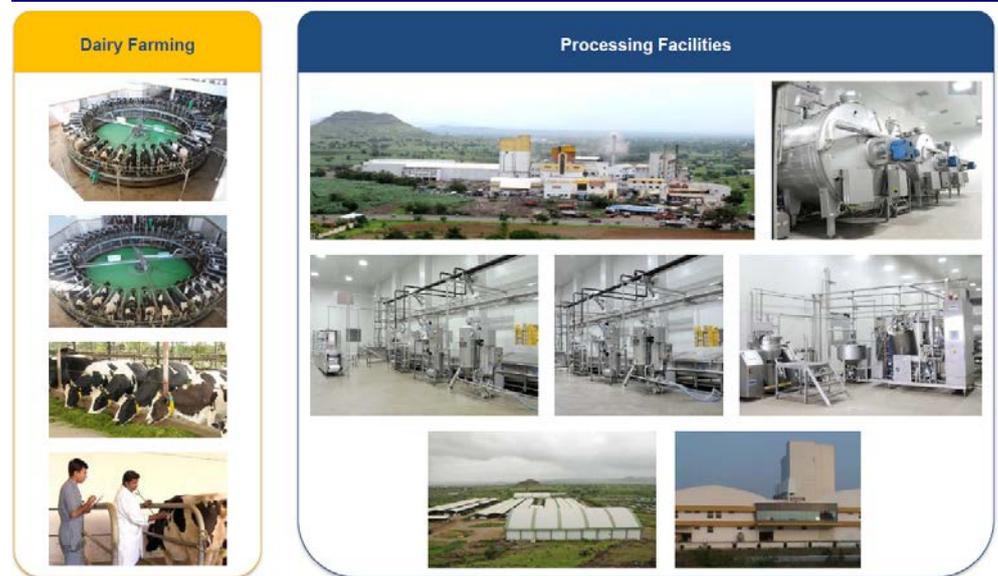
Product (units)	Production/Processing Capacity		
	Manchar	Palamaner	Total
Milk processing capacity (liters per day)	1,200,000	800,000	2,000,000
Milk powders (includes drying capacity for whey powders and dairy whiteners) (metric tons per day)	70	40	110
Liquid milk in pouches (liters per day)	200,000	175,000	375,000
Flavored milk (packs per day)	30,000	-	30,000
UHT Products* (liters per day)	-	165,000	165,000
Cheese/Paneer (metric tons per day)	40	-	40
Ghee (metric tons per day)	40	30	70
Butter (metric tons per day)	50	25	75
Curd (includes pouch curd, cup curd, fruit yoghurt and shrikhand) (metric tons per day)	20	40	60
Whey Processing (liters per day)	400,000	-	400,000

*Includes lassi and buttermilk

Source: Company, MOSL

- In 2005, Parag set up Bhagyalaxmi Dairy Farms at Manchar to educate farmers about best practices of breeding, feeding, animal management and improving productivity.
- The farm houses over 2,000 Holstein breed cows, as well as a fully automated rotary milking parlor to milk cows without human intervention and ensure that milk is not exposed to any impurities in the environment. The farm has average milk yield of 25 liters/day compared to the Indian average of 4-5 liters. The premium fresh milk produced by the farm is sold to around 13,000 customers in Mumbai and Pune under the “Pride of Cows” brand.

Exhibit 15: State-of-the-art processing facilities



Source: Company, MOSL

- The company is looking to raise its daily milk procurement via increasing the procurement base by setting up new collection centers, strengthening existing farmer relations, and installing 75 new bulk coolers and 100 automated collection systems.

Innovative product portfolio

With evolving customer trends and performances, research & development (R&D) is critical to maintain a company's competitive edge in the industry. Parag has built a dedicated team of eight people based out of Manchar to support its new product and process development initiatives, and has roped in Mr. B.M. Vyas (former managing director of the GCMMF) as advisor and director on the board.

Over the past few years, Parag has introduced many products to expand its consumer product offerings—with either changes in product composition, different packaging material or process development work—thus minimizing losses and reducing cycle time. All these efforts have helped the company earn a reputation in the dairy industry as a category innovator.

Exhibit 16: Slew of innovative launches over the last three years

Period	Product Launched
Jan-13	Emmental cheese
Apr-13	Consumer packs of mozzarella cheese
May-13	Yogurt in three new flavors of saffron, pink guava and vanilla
Jun-13	Topp-up in four flavors
Jul-13	Cheese spread in six flavors
Oct-13	Parmesan cheese
Oct-13	Cheezlets
Oct-13	Vital milk in all markets
Feb-14	New flavors in Topp-up of pistachio and butterscotch
Apr-14	Cheese sandwich slices
Jul-14	Cheese toppings for pizzas
Oct-14	Spiced buttermilk in UHT
Nov-14	Fresh cream in UHT
Dec-14	Spiced buttermilk in Fino pack
Feb-15	Whey proteins
Mar-15	Sachet packs of ghee
Apr-15	Buttermilk in southern spices variant
Oct-15	Go Badam Milk
Nov-15	Go Almette Creamed Cottage Cheese in two flavors
Nov-15	Go Chutney cheese slices

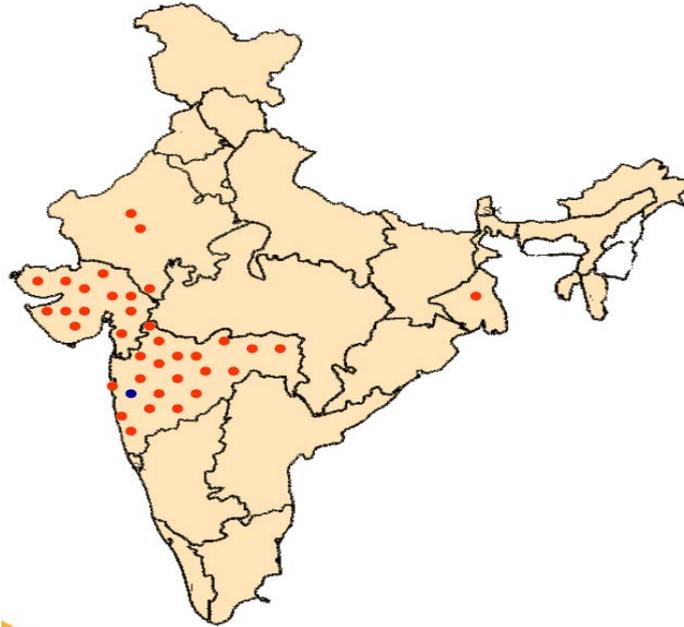
Source: Company, MOSL

The company will be setting up an R&D facility funded through IPO proceeds to enhance its capabilities in the industry. It will be focusing on health & nutrition in developing premium products. The launch of new products is likely to be margin-accretive as Parag aims to introduce products whose gross margins are higher than the company's prevalent gross margin. Advertisement spends, as a percentage sales, are expected to increase with 3-4 new launches planned every year, but will be adjusted by a reduction in below-the-line spends.

Expanding distribution network

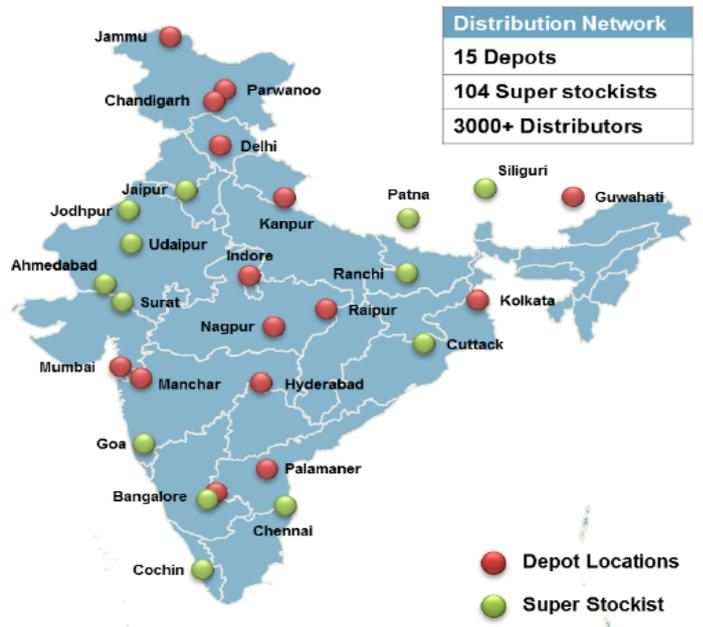
The distribution strength of Parag has improved over the years; it now has an established pan-India distribution network of 15 depots, 104 super stockists and over 3,000+ distributors which service its products to around 2,00,000+ retail outlets. Parag has a marketing team of 560 people based in their key distribution centers.

Exhibit 17: Distribution as on 2005



Source: Company, MOSL

Exhibit 18: Distribution as on 29th Feb 2016



Source: Company, MOSL

Exhibit 19: Region-wise distribution network in India

Region	Depots	Super Stockists	Distributors
Mumbai	1	2	250
North	5	31	450
East	2	17	300
West	4	28	800
South	3	26	1,200
Total	15	104	3,000

Source: Company, MOSL

For Parag, the key markets include the state of Maharashtra, Gujarat, Delhi NCR, Tamil Nadu, Karnataka, Assam, West Bengal and J&K. The company also exports (only 2% of total revenues) its products to 36 countries across the world, majorly in South-East Asia, the Middle East and Africa.

Parag has a seven route-to-markets strategy, addressing different product groups and consumer segments.

Exhibit 20: Pan-India distribution infrastructure targeted at different product/consumer segments

Seven route-to-market	Channel type
#1	Fresh milk
#2	Fresh products
#3	Milk products- General trade
#4	Milk products- Modern trade
#5	Milk products- Large Institutions & HoReCa
#6	Beverages
#7	Rural

Source: Company, MOSL

“Pride of Cows”, which is premium milk sold through Bhagyalaxmi dairy farms, has a separate distribution network of around 8 depots in Mumbai and 4 depots in Pune which cater to around 13,000 customers.

Exhibit 21: Pride of Cows - distribution

City	Depots	Delivery Routes	No. of Customers
Mumbai	8	134	10,058
Pune	4	50	2,897
Total	12	184	12,955

Source: Company, MOSL

The company will try to expand its product reach by strengthening its distributor and stockist base to achieve higher retail penetration. It is aiming to add 6 more depots in FY17. It also intends to increase its rural penetration by introducing low unit packs (LUPs) in tier III cities to drive incremental growth. Besides, it is identifying specific states and regions in India to focus on its sales efforts.

Financials: Healthy track record

Better-than-peer margins and returns – likely to improve further

Expect robust revenue CAGR of 19% over FY16-19: We expect Parag to post 19% revenue CAGR over FY16-19, driven by:

- a) a shift from unorganized to organized segment, underpinned by rising middle class and urban population, an increase in working population as well as changing dietary pattern,
- b) increasing distribution reach, and
- c) launching of innovative products.

EBITDA margin likely to improve to 10.1% by FY19: Parag’s gross margin has been improving for the last three years, led by a) an increase in the mix of high gross margin milk products, b) favorable milk prices, c) introduction of innovative products, and d) scale benefits. Going forward, gross margins might see a steady improvement due to a better mix as well as the introduction of high gross margin products (e.g. whey protein, which has the highest gross margin among VADPs).

Operating margins have stayed in the 7.5-9% range. Apart from increase in gross margins, we believe that lower other expenses led by operating efficiencies should lead to operating margin expansion of 110bp over FY16-19.

Exhibit 22: Net Sales to grow at a CAGR of 19% over FY16-19

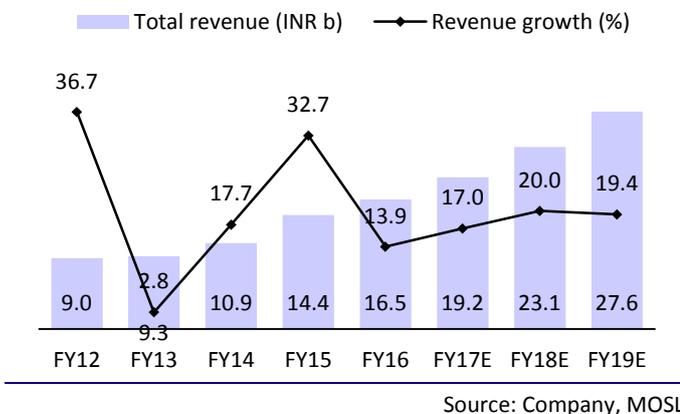


Exhibit 23: Gross margin to expand 120bps over FY16-19

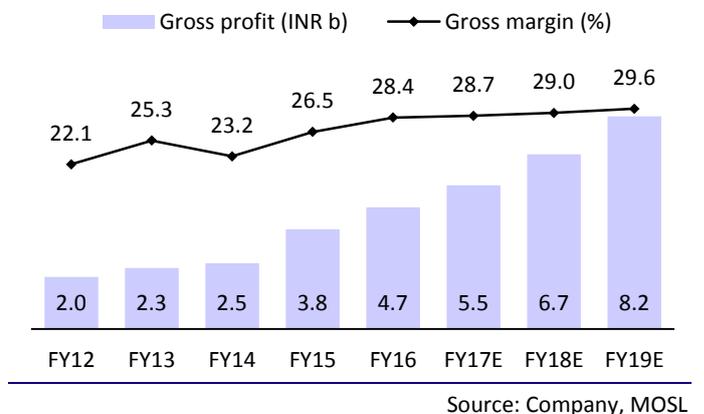


Exhibit 24: EBITDA to see 24% CAGR over FY16-19..

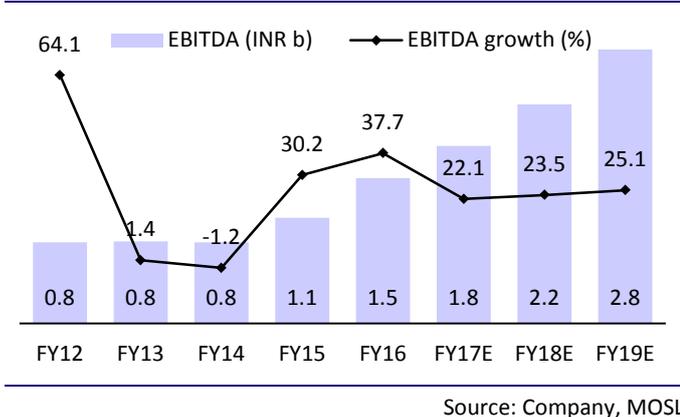


Exhibit 25: ..led by EBITDA margin expansion of 110bps

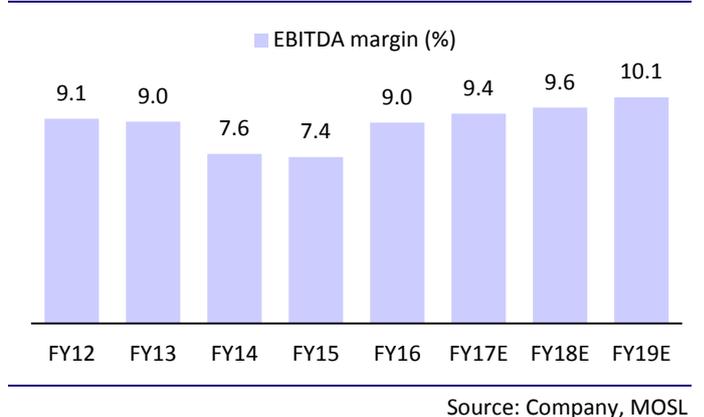
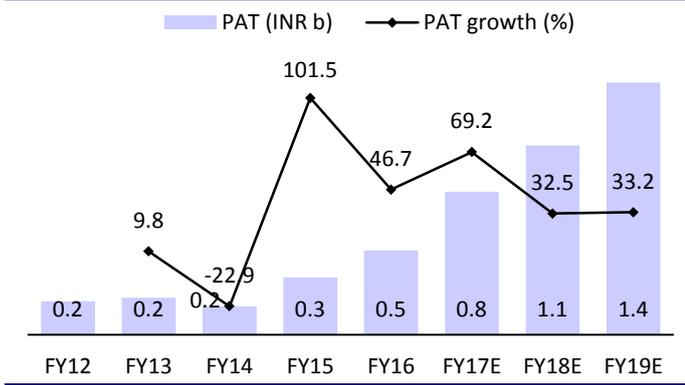
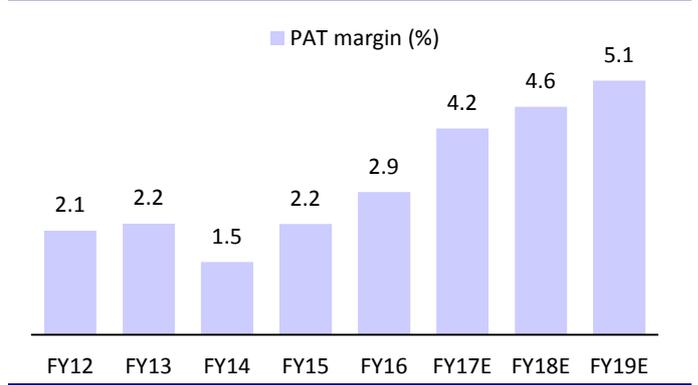


Exhibit 26: PAT to grow at 44% CAGR over FY16-19..



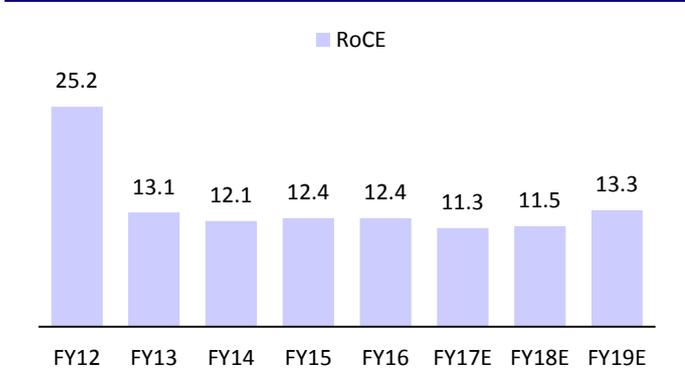
Source: Company, MOSL

Exhibit 27: ..with PAT margin to reach 5.1% by FY19



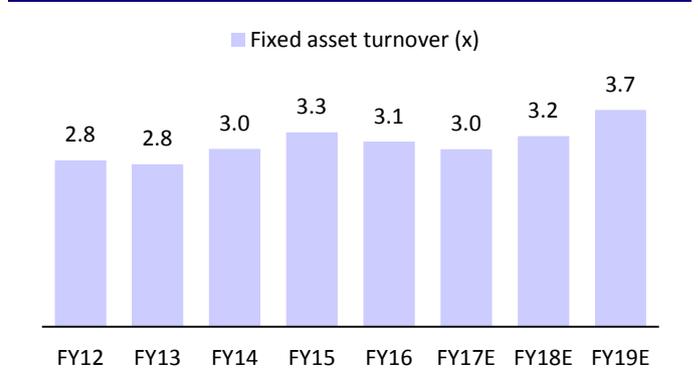
Source: Company, MOSL

Exhibit 28: RoCE to show gradual improvement



Source: Company, MOSL

Exhibit 29: Fixed asset turnover to improve from 3.1x to 3.7x over FY16-19



Source: Company, MOSL

Valuation & View

Initiate with NEUTRAL; stock up 53% since listing in two months

- Opportunity size in Dairy is huge and in-turn offers strong growth visibility for branded players. Parag, with its strengths on procurement, distribution, innovation and management bandwidth is best placed among peers, in our view.
- While rest of the listed Dairy players are either regional in nature or have dominant B2B positioning, Parag offers a pan-national branded dairy play with B2C focus. The stock had a good run-up and is up 53% in less than two months post listing in May'16. At CMP of INR330, the stock trades at 24x June 2018 EPS. We value Parag at 25x June'18 EPS and arrive at a one year TP of INR 340, 3% upside. At 25x FY18, it will trade at 20% discount to consumer universe (30% discount to ex-ITC consumer universe). In our view, it is a fair multiple and balances the strong growth visibility of Parag and its demonstrated innovator credentials with relatively lower RoE/RoCE's and size vs. other consumer peers.
- Thus, given the limited near term upside, we initiate coverage with a Neutral rating. Key risks include: a) volatility in raw material prices b) potential price competition with co-operative giants and c) execution risks pertaining to portfolio and reach expansion.

Compelling three year consumption play

Notwithstanding the near term limited upside given the recent run-up, it still offers a very compelling three year play with an exciting 36%/32% EPS CAGR over 3/5 years. Our detailed workings suggest that over a three year period over FY18-21, the stock can deliver a healthy return of 22% CAGR in our view, even after assuming a modest de-rating from 25x P/E to 22x.

Exhibit 30: Returns attractive for 3 year investment perspective

	June'18	FY21
EPS (INR)	13.6	27.3
Target PE (x)	25	22
Target price (INR)	340	601
Current market price	330	330
Potential return (annual, %)	3	22

Source: Company, MOSL

Analyzing the three year potential returns

The opportunity in the sector is immense and we believe Parag's metrics will only improve over the longer term as a result of strengths over peers. Parag's earnings momentum is not just between FY16-19 but will sustain beyond FY19. RoCE is expected to swing upwards by 370bps to 16% over FY16-21 compared to 90bps over FY16-19.

Exhibit 31: Exciting 32% EPS CAGR over 5 years over FY16-21

INR m	FY16	FY17E	FY18E	FY19E	FY20E	FY21E
Total Revenues	16,451	19,249	23,094	27,570	32,703	38,642
<i>% Growth</i>	<i>13.9%</i>	<i>17.0%</i>	<i>20.0%</i>	<i>19.4%</i>	<i>18.6%</i>	<i>18.2%</i>
Gross Profit	4,676	5,517	6,705	8,160	9,861	11,874
<i>Gross margin (%)</i>	<i>28.4%</i>	<i>28.7%</i>	<i>29.0%</i>	<i>29.6%</i>	<i>30.2%</i>	<i>30.7%</i>
EBITDA	1,476	1,802	2,225	2,784	3,451	4,262
<i>EBITDA margin (%)</i>	<i>9.0%</i>	<i>9.4%</i>	<i>9.6%</i>	<i>10.1%</i>	<i>10.6%</i>	<i>11.0%</i>
PAT after MI	473	801	1,061	1,413	1,819	2,308
EPS	6.7	9.5	12.6	16.7	21.6	27.3
<i>EPS growth (%)</i>	<i>-67%</i>	<i>41%</i>	<i>32%</i>	<i>33%</i>	<i>29%</i>	<i>27%</i>

Source: Company, MOSL

Key Risks

Seasonality Risk

Parag's manufacturing operations are largely dependent on the supply of cow milk, which is the primary raw material for all the dairy products. Given the seasonal nature of the dairy industry, cattle farming patterns and no formal agreements with the farmers, availability of raw milk keeps on fluctuating which thereby could adversely impact the running of its operations.

New Product Risk

Over the years Parag has been able to anticipate and respond to changing consumer preferences which helped in building strong consumer franchisee for its brands. However continuous investment in research and development along with introduction of new products and different variants of existing products, based on consumer preferences and demand, is the key for smooth running of the business.

Brand Equity Risk

The products manufactured by Parag are subject to risks such as contamination, adulteration and product tampering during their manufacture, transport or storage. Any real or perceived contamination in products, could subject it to regulatory action, damage its brand equity and thereby impact its business.

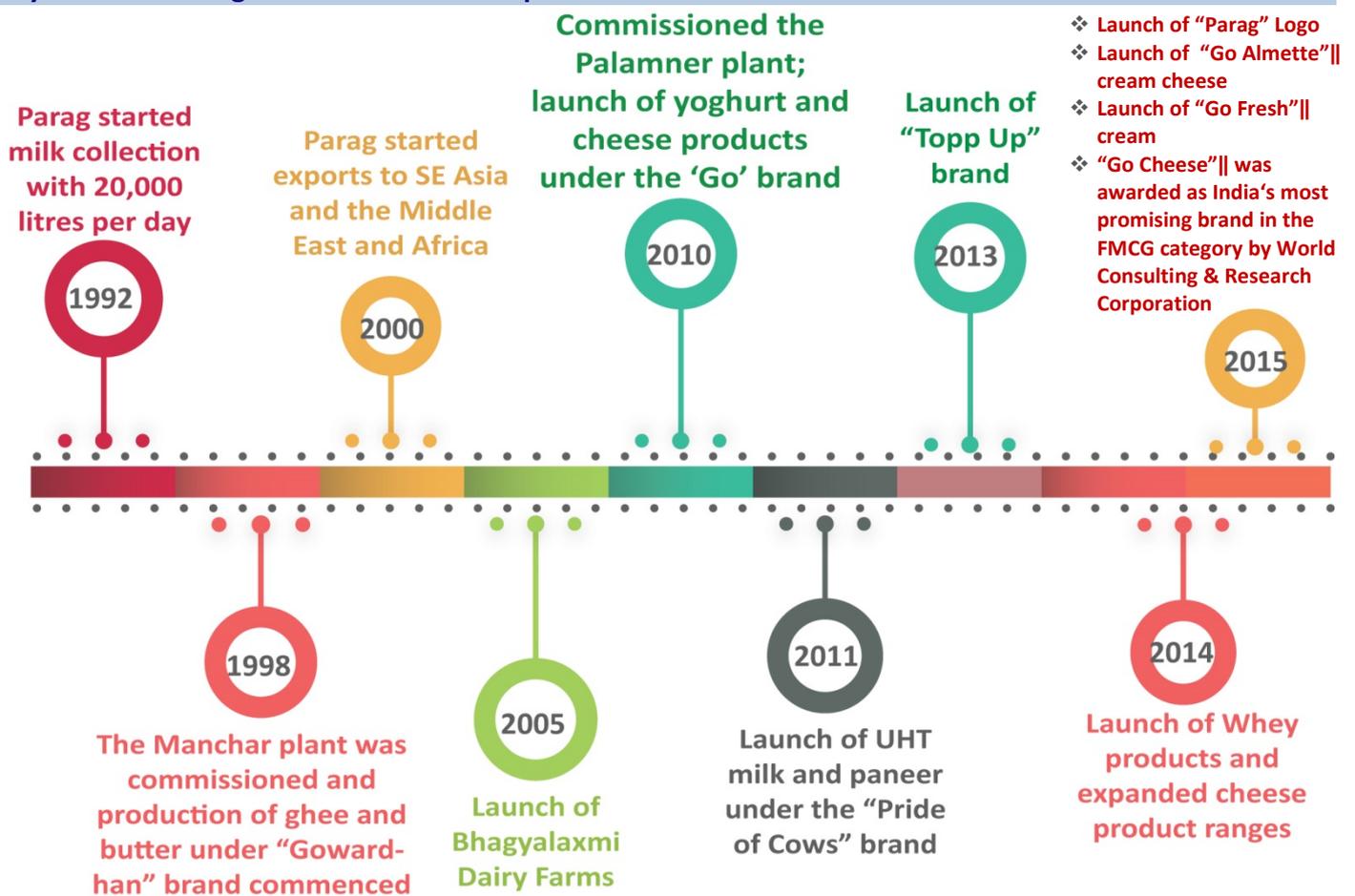
Execution Risk

Risks related to execution of its expansion plans.

About: Parag Milk Foods

Parag Milk Foods is a leading manufacturer and marketer of dairy based branded foods and beverages in India. It commenced business in 1992 with collection and distribution of milk, and over the years it has developed a product portfolio of branded dairy products with high brand equity. Parag is promoted by Mr Devendra Shah, Mr Pritam Shah and Mr Parag Shah, who have over 20 years of dairy industry experience and have well established relationships with various stakeholders namely farmers, distributors and institutional customers.

Key events at Parag Milk Foods since inception



Source: Company, MOSL

Exhibit 32: Profile of Board of Directors

Name	Role	Age	Details
Devendra Shah	Whole-time Director and Chairman of Board	51 years	■ He has an experience of 23 years in the dairy industry
Pritam Shah	Managing Director	45 years	■ He has an experience of 23 years in the dairy industry
B.M. Vyas	Non- Executive Director on Board	65 years	■ He is currently an independent dairy consultant ■ He has vast experience of 44 years in the dairy industry with previously being an integral part of GCMMF Ltd
Sunil Goyal	Independent Director on Board	47 years	■ He has rich experience (20 years) in corporate activities such as Management Consultancy, Business Structuring, Capital Markets, Turnaround Strategies and Corporate Governance.
Narendra Ambwani	Independent Director on Board	66 years	■ He has held various positions and previously worked as Managing Director of Johnson & Johnson's consumer group.
Nitin Dhavalikar	Independent Director on Board	45 years	■ He has an experience of 20 years in Corporate Audits for varied sectors and Consultancy for raising Debts for corporate & SMEs.
Radhika Pereira	Independent Director on Board	45 years	■ Currently she is the Partner at Shardul Amarchand Mangaldas & Co ■ April 2005: Restarted Dudhat Pereira & Associates ■ 1996-2005: Partner of M/s Udwardia & Udeshi, Solicitors & Advocates

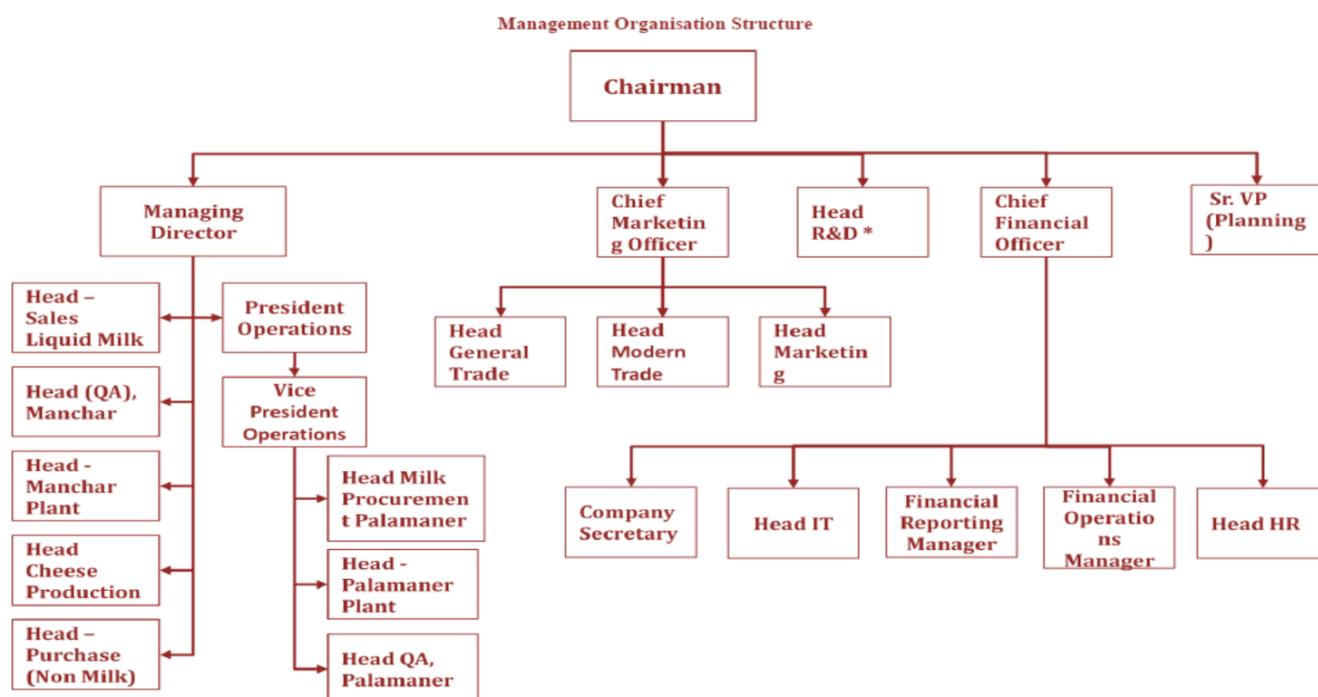
Source: Company, MOSL

Exhibit 33: Details of Key Management Personnel

Name	Role	Details
Devendra Shah	Whole-time Director and Chairman of Board	■ He has an experience of 23 years in the dairy industry.
Pritam Shah	Managing Director	■ He has an experience of 23 years in the dairy industry.
Bharat Kedia	Chief Financial Officer	■ CA, CS by qualification, he has an experience of 23 years in the corporate sector
Mahesh Israni	Chief Marketing Officer	■ He has an experience of 29 years in the corporate sector
Shirish Upadhyay	Senior Vice President (SVP)-Planning	■ He has an experience of 17 years in the dairy industry.
Rachana Sanganageria	Company Secretary and Compliance Officer of Company	■ CS by qualification, she has an experience of 20 years in the corporate sector

Source: Company, MOSL

Exhibit 34: Organization Structure



Source: Company, MOSL

Exhibit 35: Shareholding Pattern (as on May'2016)

Category	No of Shares Held	% Holding
Total Foreign	21,705,567	25.8
Total Institutions	3,757,520	4.5
Total Govt Holding	-	0.0
Total Non-Promoter Corporate Holding	5,369,069	6.4
Total Promoters	39,941,189	47.5
Total Public & Others	13,341,237	15.9
Totals	84,114,582	100.0

Source: Company, MOSL

Financials and Valuations

Income Statement						(INR Million)		
Y/E March	2012	2013	2014	2015	2016	2017E	2018E	2019E
Total Income	8,998	9,250	10,883	14,442	16,451	19,249	23,094	27,570
Growth (%)	36.7	2.8	17.7	32.7	13.9	17.0	20.0	19.4
COGS	7,006	6,907	8,359	10,616	11,776	13,732	16,388	19,410
Gross Profit	1,992	2,343	2,524	3,826	4,676	5,517	6,705	8,160
Gross Margin (%)	22.1	25.3	23.2	26.5	28.4	28.7	29.0	29.6
Operating expenses	1,169	1,509	1,701	2,753	3,200	3,715	4,480	5,376
EBITDA	823	834	823	1,072	1,476	1,802	2,225	2,784
Change (%)	64.1	1.4	-1.2	30.2	37.7	22.1	23.5	25.1
Margin (%)	9.1	9.0	7.6	7.4	9.0	9.4	9.6	10.1
Depreciation	225	261	275	275	334	383	456	494
Int. and Fin. Charges	400	403	437	469	490	294	252	234
Financial Other Income	8	21	12	15	16	18	20	22
Profit before Taxes	205	191	123	343	668	1,144	1,537	2,078
Change (%)	110.1	-6.8	-35.4	177.9	94.7	71.2	34.4	35.2
Margin (%)	2.3	2.1	1.1	2.4	4.1	5.9	6.7	7.5
Tax	16	-16	-37	21	195	343	476	665
Tax Rate (%)	7.9	-8.6	-29.6	6.0	29.2	30.0	31.0	32.0
Adjusted PAT	189	208	160	322	473	801	1,061	1,413
Change (%)	LTP	9.8	-22.9	101.5	46.7	69.2	32.5	33.2
Margin (%)	2.1	2.2	1.5	2.2	2.9	4.2	4.6	5.1

Balance Sheet						(INR Million)		
Y/E March	2012	2013	2014	2015	2016	2017E	2018E	2019E
Share Capital	158	160	160	160	704	844	844	844
Reserves	394	638	761	1,079	2,915	6,715	7,776	9,189
CCD's	550	1,250	1,250	0	0	0	0	0
Net Worth	1,102	2,048	2,171	1,239	3,619	7,559	8,620	10,033
Loans	3,220	3,314	4,369	4,409	3,787	2,609	2,433	2,258
Deferred Liability	100	75	52	60	110	110	110	110
Capital Employed	4,422	5,437	6,592	5,708	7,516	10,278	11,163	12,401
Gross Block	3,180	3,348	3,600	4,367	5,229	6,379	7,129	7,479
Less: Accum. Depn.	718	914	1,181	1,456	1,789	2,172	2,628	3,122
Net Fixed Assets	2,462	2,434	2,419	2,911	3,439	4,207	4,500	4,357
Capital WIP	70	62	371	283	286	286	286	286
Investments	7	13	3	3	0	0	0	0
Curr. Assets, L&A	3,485	4,393	5,408	6,043	6,184	7,920	9,022	10,163
Inventory	1,394	1,395	1,903	2,119	2,724	3,077	4,136	4,777
Account Receivables	1,187	1,473	1,673	1,709	2,360	2,492	2,949	3,093
Cash & Bank	18	22	42	53	77	540	115	24
Loans & Advances	86	215	437	974	455	500	550	605
Others	230	351	335	522	411	811	971	1,164
Long term advances	570	938	1,019	665	157	500	300	500
Curr. Liab. and Prov.	1,602	1,464	1,614	3,531	2,394	2,135	2,646	2,405
Account Payables	850	922	1,254	1,931	1,678	1,486	2,057	1,871
Other Liabilities	562	528	349	1,591	668	601	541	487
Provisions	189	14	10	9	48	48	48	48
Net Current Assets	1,883	2,928	3,795	2,511	3,790	5,786	6,376	7,758
Application of Funds	4,422	5,437	6,592	5,708	7,516	10,278	11,163	12,401

E: MOSL Estimates

Financials and Valuations

Ratios						(INR Million)		
Y/E March	2012	2013	2014	2015	2016	2017E	2018E	2019E
Basic (INR)								
EPS	12.0	13.0	10.0	20.2	6.7	9.5	12.6	16.7
Cash EPS	26.2	29.4	27.3	37.5	44.9	65.8	84.3	106.0
BV/Share	69.7	128.3	135.9	77.6	51.4	89.6	102.1	118.9
Valuation (x)								
P/E				16.3	49.0	34.8	26.2	19.7
Cash P/E				8.8	7.3	5.0	3.9	3.1
EV/Sales				3.9	14.3	14.6	12.1	10.2
EV/EBITDA				53.1	159.7	155.5	126.1	100.7
P/BV				4.2	6.4	3.7	3.2	2.8
Return Ratios (%)								
RoE	17.1	13.2	7.6	18.9	19.5	14.3	13.1	15.2
RoCE (post-tax)	25.2	13.1	12.1	12.4	12.4	11.3	11.5	13.3
RoIC	25.8	13.3	12.6	13.2	13.1	12.1	12.2	13.8
Working Capital Ratios								
Debtor (Days)	48	52	53	43	45	46	43	40
Asset Turnover (x)	2.0	1.7	1.7	2.5	2.2	1.9	2.1	2.2
Leverage Ratio								
Debt/Equity (x)	6.8	5.7	5.9	3.3	1.0	0.3	0.3	0.2

Cash Flow Statement						(INR Million)		
Y/E March	2012	2013	2014	2015	2016	2017E	2018E	2019E
OP/(loss) before Tax	823	834	823	1,072	1,476	1,802	2,225	2,784
Direct Taxes Paid	-16	16	37	-21	-195	-343	-476	-665
(Incr)/Decr in WC	-1,865	-1,041	-846	1,295	-1,256	-1,532	-1,016	-1,473
CF from Operations	-1,059	-191	14	2,347	26	-73	733	646
(Incr)/Decr in FA	-2,758	-225	-570	-679	-866	-1,150	-750	-350
Free Cash Flow	-3,816	-416	-556	1,668	-840	-1,223	-17	296
(Pur)/Sale of Investments	-7	-6	10	0	3	0	0	0
CF from Invest.	-2,765	-230	-560	-679	-863	-1,150	-750	-350
Change in Equity	913	738	-37	-1,255	1,907	3,140	0	0
(Incr)/Decr in Debt	3,220	94	1,055	40	-622	-1,178	-176	-175
Dividend Paid	0	0	0	0	0	0	0	0
Others	-292	-407	-451	-442	-425	-276	-232	-212
CF from Fin. Activity	3,841	426	567	-1,657	860	1,686	-408	-387
Incr/Decr of Cash	18	4	20	11	23	463	-425	-91
Add: Opening Balance	0	18	22	42	53	77	540	115
Closing Balance	18	22	42	53	76	540	115	24

E: MOSL Estimates

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RECENT INITIATING COVERAGE REPORTS

MOTILAL OSWAL Initiating Coverage | 24 June 2016
Sector: Consumer

Manpasand Beverages



Juicing it up

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Motilal Oswal research is available at www.motilal.com Institutional Equities, Research, Thomson Reuters, Reuters and Bloomberg.

MOTILAL OSWAL Initiating Coverage | 25 April 2016
Sector: Consumer

P&G Hygiene and Health Care



Large opportunity; high barriers to entry

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Motilal Oswal research is available at www.motilal.com Institutional Equities, Research, Thomson Reuters, Reuters and Bloomberg.

MOTILAL OSWAL Initiating Coverage | 21 January 2016
Sector: Healthcare

Alkem

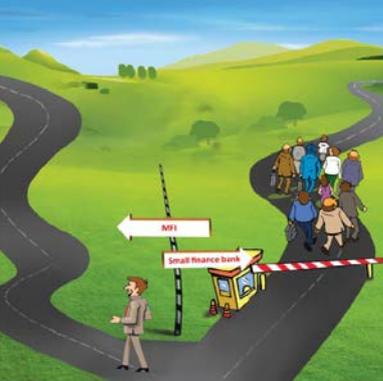


Potent mix of growth and sustainability

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MOTILAL OSWAL Initiating Coverage | 28 December 2015
Sector: Financial | NBFC

SKS Microfinance

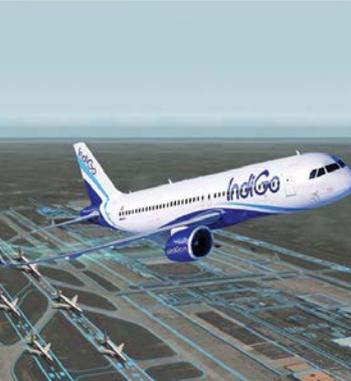


Not the end of road

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MOTILAL OSWAL Initiating Coverage | 18 December 2015
Sector: Aviation

InterGlobe Aviation



Aiming for higher altitudes

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MOTILAL OSWAL Initiating Coverage | 18 December 2015
Sector: Consumer

Eveready

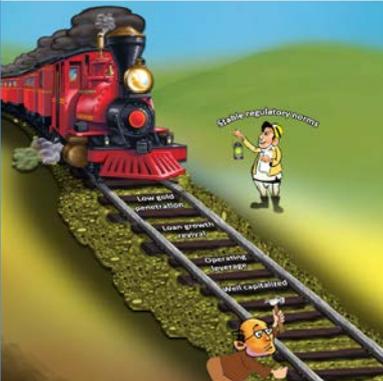


Recharged to glow

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MOTILAL OSWAL Initiating Coverage | 9 October 2015
Sector: Financials

Muthoot Finance



Getting back on track

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MOTILAL OSWAL Initiating Coverage | 21 September 2015
Sector: Automobiles

Bosch

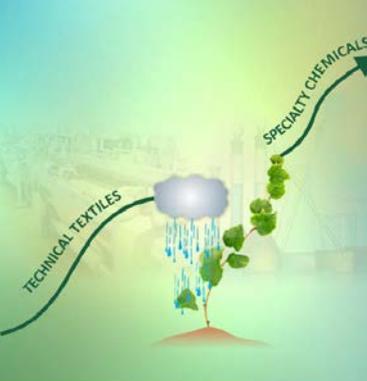


Heart of vehicles

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MOTILAL OSWAL Initiating Coverage | 10 September 2015
Sector: Chemicals

SRF



Growth Renewed

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NOTES

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