

# Prabhat Dairy Limited

## IPO Note

Prabhat Dairy (Prabhat) is an integrated milk and dairy products company catering to institutional as well as retail customers. The company sells its products under retail consumer brands (which account for ~24% of the revenue) as well as ingredient products and co-manufactured products to a number of institutional and multinational companies (accounting for ~76% of total revenue). It procures majority of its milk from milk farmers and registered milk vendors; as of June 30, 2015, its milk collection facilities included more than 450 milk collection centers, over 15 milk chilling plants and over 85 bulk milk coolers with aggregate milk processing capacity of 1.5mn litres per day. The processing and production facilities are located at Shirampur (Ahmednagar) and at Navi Mumbai. The company has recently added production capacities for several new dairy products including mozzarella cheese, cheddar cheese, processed cheese, cottage cheese (paneer) and shrikhand and has commenced production of these products in FY2016.

**Robust milk procurement system:** Prabhat has built a strong relationship with local milk farmers, which enables it to procure a large portion of its raw milk requirement directly from milk farmers and registered milk vendors. Continuous engagement, knowledge, and infrastructure support have enabled Prabhat to secure supply of quality raw milk and contain procurement costs. Additionally, it has introduced automated milk testing facilities that provide transparency to the pricing of milk purchased by the company.

**Shift towards a balanced mix:** Historically, institutional sales have accounted for a major chunk of its business. However, this share has declined from 85.4% in FY2013 to 75.8% in FY2015. The company plans to focus on growing its retail consumer business by increasing its marketing expenditure, strengthening its existing brands, and introducing new products and brands amongst others. The new product launches like cheese, paneer and shrikhand have higher margins which will improve its profitability as well as reduce its dependence on the Institutional business.

**Outlook and Valuation:** Though the company has posted a CAGR of 27.5% and 30.3% in revenue and net profit respectively over FY2012-15, it is still expensive in terms of valuation. On pre-issue outstanding shares, the stock is valued at 47.5x its FY2015 EPS and at EV/EBITDA multiple of 13.7x on the lower end of the price band. Its peer Heritage Foods trades at 29.4x its FY2015 earnings and at EV/EBITDA multiple (FY2015) of 11.4x. **Hence on account of higher valuation we recommend to Avoid subscribing to the issue.**

## Key Financials

Y/E March (₹ cr)	FY2013	FY2014	FY2015
Net Sales	641	857	1,001
% chg	32.7	33.6	16.8
Adj. Net Profit	14	21	21
% chg	47.9	47.7	1.3
OPM (%)	11.4	10.6	10.1
EPS (Rs)	2.0	2.9	2.9
P/E (x)	71.1	48.1	47.5
P/BV (x)	4.2	3.1	3.0
RoE (%)	8.0	7.5	6.4
RoCE (%)	10.3	9.9	9.6
EV/Sales (x)	2.0	1.5	1.4
EV/EBITDA (x)	17.4	14.2	13.7

Source: Company, Angel Research; Note: \*The above numbers are considering subscription at the lower end of the price band and on pre-issue outstanding shares

## AVOID

Issue Open: August 28, 2014

Issue Close: September 1, 2015

### Issue Details

Face Value: ₹10

Present Eq. Paid up Capital: ₹71.4cr

Offer Size: 3.6cr Shares

Post Eq. Paid up Capital: ₹93.1cr

Issue size (amount)\*\*: ₹503cr - ₹514cr

Price Band\*\*: ₹140-147

Post-issue implied mcap\*\*: ₹1,304cr-1,354cr

Promoters holding Pre-Issue: 61.4%

Promoters holding Post-Issue: 43.7%

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

### Book Building

QIBs	At least 50%
Non-Institutional	At least 15%
Retail	At least 35%

### Post Issue Shareholding Pattern

Promoters Group	43.7
MF/Banks/Indian	
FIs/FII's/Public & Others	56.3

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## Company Background

Prabhat is an integrated milk and dairy products company in India catering to institutional as well as retail customers. The company sells its products under retail consumer brands (Prabhat, Milk Magic and Flava) as well as ingredient products and co-manufactured products to a number of institutional and multinational companies.

Its marquee clients include Mondelez India Foods Pvt Ltd (formerly known as Cadbury India Ltd) and Abbott Healthcare Private Ltd for specialty ingredient products and Britannia Industries Ltd, Mother Dairy Fruit & Vegetable Pvt Ltd and Heritage Foods Ltd for co-manufactured products. Retail consumer products are distributed in the Mumbai metropolitan area and nearby cities and towns to a large number of retail outlets through more than 350 distributors and 100 Prabhat mini stockists.

As of June 30, 2015, its milk collection facilities included more than 450 milk collection centers, over 15 milk chilling plants and over 85 bulk milk coolers with aggregate milk processing capacity of 1.5mn litres per day. The processing and production facilities are located at Shrirampur (Ahmednagar) and at Navi Mumbai.

## Institutional Products

Prabhat produces a range of milk and dairy products including milk-based specialty ingredient products and co-manufactured products for a large number of Indian and multinational companies.

**Specialty ingredient products:** The company's specialty ingredient products are used in the production of other milk and food products by its institutional customers. These agreements are typically for a term of one to two years and are subject to renewal either by such customer or as may be mutually agreed between parties.

### Exhibit 1: Specialty Ingredient Products

Customer	Products
Mondelez India Foods Private Limited	Partially skimmed milk sugar concentrate; skim milk powder; skimmed milk preparations; full cream milk powder
Abbott Healthcare Private Limited	Specialty milk powder for baby food
Other multinational and Indian companies	Specialty milk powder & sweetened condensed milk

Source: Company, Angel Research

**Co-Manufactured Products:** Prabhat is in an agreement with certain institutional customers for the production and packaging of various dairy products such as specialty milk powders, curd (dahi), clarified butter (ghee), dairy whiteners, yogurts, processed and concentrated milk, and ice creams, which are sold by institutional customers under their own brands.

**Exhibit 2: Co-Manufactured Products**

Customer	Products
Heritage Foods Limited	Dairy whitener; curd (dahi); butter milk
Britannia Industries Limited	Curd (dahi)
Britannia Dairy Private Limited	Clarified butter (ghee)
Mother Dairy Fruit & Vegetable Private Limited	Ice cream; milk ice; milk candies

Source: Company, Angel Research

**Retail consumer products**

The company's retail consumer products include pasteurized milk, UHT milk, flavoured milk, sweetened condensed milk, dairy whitener, milk powder, lassi, curd (dahi), chaas, and clarified butter (ghee), sold under the Prabhat, Flava and Milk Magic brands. Its long shelf life products such as UHT milk, dairy whiteners, skimmed milk powder and whole milk powder are sold in states outside of Maharashtra.

**Exhibit 3: Retail Product Portfolio**

Brand	Products
Prabhat	Pasteurized milk, UHT milk, clarified butter, dairy whitener, skimmed milk powder, whole milk powder, curd, lassi and chaas
Milk Magic	Sweetened condensed milk
Flava	Flavoured milk

Source: Company, Angel Research

The company has recently added production capacities for several new dairy products including mozzarella cheese, cheddar cheese, processed cheese, cottage cheese (paneer) and shrikhand and has commenced production of these products in FY2016. The company initially plans to focus on the Quick Service Restaurant (QSR) segment.

**Subsidiaries**

Prabhat has a wholly owned subsidiary ie Cheese Land Agro (India) Pvt Ltd (CLAIPL) and a step down subsidiary - Sunfresh Agro Industries Pvt Ltd (SAIPL).

CLAIPL is involved in the business of manufacturing and dealing in dairy products and incidental and ancillary activities while SAIPL is involved in the business of procurement and processing of milk and manufacturing and selling of various milk products including, sweetened condensed milk, skimmed milk powder, cream, and butter.

## Issue details

The issue comprises of fresh issue of equity shares of ₹10 each in the price band of ₹140-₹147 aggregating up to ₹300cr; and offer for sale by Nirmal Family Trust (Promoter), IABF, REAL and Proparco of 1.47cr shares aggregating to ₹206cr (at the lower end of the price band). The issue constitutes 38.4% of the post issue paid-up equity share capital of the company.

### Exhibit 4: Share Holding pattern

Particulars	Pre-Issue		Post-Issue	
	No. of shares	(%)	No. of shares	(%)
<b>Promoter and Promoter Group</b>	<b>4,38,75,000</b>	<b>61.4</b>	<b>4,07,24,000</b>	<b>43.7</b>
Nirmal Family Trust	4,05,00,000		3,73,49,000	
Sarangdhar Ramchandra Nirmal	11,25,000		11,25,000	
Vivek Sarangdhar Nirmal	11,25,000		11,25,000	
Kishor Ramchandra Nirmal	11,25,000		11,25,000	
<b>IABF</b>	<b>1,62,38,895</b>	<b>22.7</b>	<b>96,58,895</b>	<b>10.4</b>
<b>REAL</b>	<b>57,030</b>	<b>0.1</b>	<b>34,030</b>	<b>0.0</b>
<b>Proparco</b>	<b>1,01,32,785</b>	<b>14.2</b>	<b>51,80,785</b>	<b>5.6</b>
			-	
Others	11,25,000	1.6	3,75,37,349	40.3
<b>Total</b>	<b>7,14,28,710</b>	<b>100</b>	<b>9,31,35,059</b>	<b>100</b>

Source: Company, Angel Research

## Objects of the Fresh Issue

- Part pre-payment of loans availed by the company and its wholly owned subsidiary, SAIPL amounting to ₹185cr.
- Utilize ₹35cr for meeting capital expenditure, subject to receipt of relevant approvals, consents, and licenses, for: (I) construction of 3 MW co-generation captive power facility by the subsidiary, SAIPL, and (II) enhanced automation of some of the existing manufacturing processes at the facilities of SAIPL.
- The balance, which is contingent upon the issue price will be utilised for general corporate purpose.

## **Investment Arguments**

### **Robust milk procurement system**

Prabhat has built a strong relationship with local milk farmers which enables it to procure a large portion of its raw milk requirement directly from milk farmers and registered milk vendors. It procures its raw milk requirement from Ahmednagar, Pune, Nashik and adjoining districts in the state of Maharashtra. It also sources from select contract milk suppliers at competitive prices. The proximity of the milk procuring belt to the processing center and its key clients and retail consumer market enables the company to curtail its transportation expenses and ensure easy raw milk availability. It continuously engages with milk farmers and provides assistance in terms of cattle breeding, nutrition and medication, veterinary and para-veterinary support, cattle insurance and financing and other welfare activities. These activities have enabled the company to build strong relationship with such farmers over the years, ensuring continued association and procurement of raw milk at competitive prices. Additionally, it has introduced automated milk testing facilities that provide transparency to the pricing of milk purchased by the company.

### **Increased focus on Retail business**

Historically, the Institutional business has accounted for a major chunk of its revenues. Although the share of the Institutional business has been declining over the past three years (from 85.4% in FY2013 to 75.8% in FY2015), it still accounts for a significant portion of the overall revenues. The company plans to focus on growing its retail consumer business by increasing its marketing expenditure, strengthening its existing brands, and introducing new products and brands amongst others. The Management indicated that EBITDA margins are currently in the range of 10.0% for both businesses (retail and institutional); while newer products like cheese, paneer and shrikhand will command higher margins. The Management foresees the mix to be more even in the longer run, thus reducing dependence on the Institutional business.

### **Lower Debt Quantum to add to bottom-line**

The company's main objective of coming out with the IPO is to reduce its debt level. As of FY2015, the net debt stood at ₹390cr while the interest expense was ₹41cr. Interest expense seems considerably high against EBIT of ₹67cr, eroding most of the operational profits. The company intends to utilize ₹185cr from the IPO proceeds to lower its debt, which will result in significant interest cost savings and result in higher bottom-line.

## Key risks/concerns

**Milk procurement and competition:** The company has laid out plans to grow its business by expanding its product portfolio for institutional as well as its retail business with slightly higher emphasis on the latter. The business performance will depend on the company's ability to procure sufficient good quality raw milk at commercially viable prices. Inability to do so may adversely impact the operation. Additionally, the dairy industry is highly competitive, which can also impact raw milk prices.

**Regulatory Risk:** The company is subject to various regulations relating to product liability, particularly relating to safety of its products. Product contamination or similar occurrences can result in regulatory actions against the company. This may also result in loss of institutional business and damage to reputation, thus adversely impacting the company.

**Relationship with institutional customers:** Although the share of institutional business has come down to 75.8% of total revenue in FY2015, it still accounts for a giant chunk of its business. The company's top five customers accounted for close to 36% of total revenues while its largest client accounted for 18.2% of total revenue, in FY2015. The company's supply agreements with its institutional customers are typically for terms that vary between one and three years, and may be terminated with immediate effect for breach of contractual terms, including in relation to product quality and specification. These agreements may be terminated without cause on relatively short notice of three months thus resulting in lower volumes and lower profitability.

## Outlook and Valuation

The company has exhibited strong revenue CAGR of 27.5% over FY2012-15 while posting net profit CAGR of 30.3% over the same period. At the lower end of the price band, the FY2015 P/E comes up to 47.5x and EV/EBITDA multiple comes up to 13.7x based on pre-issue outstanding shares. We believe that the valuations are expensive in comparison to its peer Heritage Foods which trades at 29.4x its FY2015 earnings and at EV/EBITDA multiple (FY2015) of 11.4x. **Hence on account of higher valuation we recommend to Avoid subscribing to the issue.**

### Exhibit 5: Valuations

	Mcap (₹)	Sales (₹)	OPM (%)	PAT (₹)	EPS (₹)	ROE (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)	EV/Sales (x)
Prabhat Dairy*	1,000	1,001	10.1	21	2.9	6.4	47.5	3.0	13.7	1.4
Heritage Foods	833	2,073	3.9	28	12.2	14.7	29.4	4.3	11.4	0.5

Source: Company, Angel Research, Note\*FY2015 numbers are on pre-issue outstanding shares and based on lower end of the price band

**Profit and Loss (Consolidated)**

Y/E March (₹ cr)	FY2013	FY2014	FY2015
Net Sales	641	857	1,001
Other operating income	-	-	-
<b>Total operating income</b>	<b>641</b>	<b>857</b>	<b>1,001</b>
% chg	32.7	33.6	16.8
Net Raw Material	504	673	776
% chg	31.9	33.5	15.4
Personnel	12	19	26
% chg	13.8	66.5	32.2
Other Expenses	53	74	97
% chg	25.6	39.5	31.6
Total Expenditure	568	766	899
<b>EBITDA</b>	<b>73</b>	<b>91</b>	<b>102</b>
% chg	49.6	24.7	11.9
(% of Net Sales)	11.4	10.6	10.1
Depreciation & Amortisation	24	33	34
<b>EBIT</b>	<b>48</b>	<b>57</b>	<b>67</b>
% chg	50.2	18.4	17.3
(% of Net Sales)	7.5	6.7	6.7
<b>Interest &amp; other Charges</b>	<b>30</b>	<b>33</b>	<b>41</b>
Other Income	1	1	1
(% of Net Sales)	0.1	0.1	0.1
<b>Recurring PBT</b>	<b>19</b>	<b>24</b>	<b>26</b>
% chg	35.4	29.9	6.9
Exceptional items	-	-	-
<b>PBT (reported)</b>	<b>20</b>	<b>25</b>	<b>27</b>
Tax	5	4	6
(% of PBT)	27.9	17.8	21.9
<b>PAT (reported)</b>	<b>14</b>	<b>21</b>	<b>21</b>
Extraordinary Expense/(Inc.)	-	-	-
<b>ADJ. PAT</b>	<b>14</b>	<b>21</b>	<b>21</b>
% chg	47.9	47.7	1.3
(% of Net Sales)	2.2	2.4	2.1
<b>EPS (₹)</b>	<b>2.0</b>	<b>2.9</b>	<b>2.9</b>

**Balance Sheet (Consolidated)**

Y/E March (₹ cr)	FY2013	FY2014	FY2015
<b>SOURCES OF FUNDS</b>			
Equity Share Capital	17	27	71
Reserves & Surplus	221	291	267
<b>Shareholders' Funds</b>	<b>237</b>	<b>318</b>	<b>339</b>
Total Loans	273	296	412
Long Term Provisions	0	1	1
Deferred Tax Liability (net)	15	18	18
<b>Total Liabilities</b>	<b>526</b>	<b>633</b>	<b>769</b>
<b>APPLICATION OF FUNDS</b>			
<b>Net Block</b>	<b>303</b>	<b>319</b>	<b>293</b>
Capital Work-in-Progress	39	92	159
Investments	0	0	0
Long Term Loans and advances	102	59	68
Other Non-current asset	-	-	0
Current Assets	132	236	330
Cash	6	4	22
Loans & Advances	6	33	28
<b>Inventory</b>	<b>36</b>	<b>44</b>	<b>63</b>
Debtors	80	156	208
Other current assets	4	0	8
Current liabilities	49	73	81
<b>Net Current Assets</b>	<b>82</b>	<b>163</b>	<b>249</b>
Misc. Exp. not written off	-	-	-
<b>Total Assets</b>	<b>526</b>	<b>633</b>	<b>769</b>



**Cash flow statement (Consolidated)**

Y/E March (₹ cr)	FY2013	FY2014	FY2015
Profit before tax	20	25	27
Depreciation	24	33	34
Change in Working Capital	(28)	(83)	(69)
Direct taxes paid	(5)	(4)	(6)
Others	(1)	(1)	(1)
<b>Cash Flow from Operations</b>	<b>10</b>	<b>(29)</b>	<b>(14)</b>
(Inc.)/Dec. in Fixed Assets	(38)	(69)	(41)
(Inc.)/Dec. in Investments	(0)	(0)	(0)
(Incr)/Decr In LT loans & adv.	(44)	43	(9)
Others	1	1	1
<b>Cash Flow from Investing</b>	<b>(81)</b>	<b>(26)</b>	<b>(49)</b>
Issue of Equity	16	10	44
Inc./(Dec.) in loans	(11)	27	115
Dividend Paid (Incl. Tax)	(0)	(0)	(1)
Others	69	16	(79)
<b>Cash Flow from Financing</b>	<b>74</b>	<b>53</b>	<b>81</b>
Inc./(Dec.) in Cash	3	(2)	17
<b>Opening Cash balances</b>	<b>3</b>	<b>6</b>	<b>4</b>
<b>Closing Cash balances</b>	<b>6</b>	<b>4</b>	<b>22</b>

**Key Ratios (Consolidated)**

Y/E March	FY2013	FY2014	FY2015
<b>Valuation Ratio (x)</b>			
P/E (on FDEPS)	71.1	48.1	47.5
P/CEPS	26.0	18.4	18.0
P/BV	4.2	3.1	3.0
Dividend yield (%)	0.0	0.0	0.0
EV/Net sales	2.0	1.5	1.4
EV/EBITDA	17.4	14.2	13.7
EV / Total Assets	2.4	2.0	1.8
<b>Per Share Data (₹)</b>			
EPS	2.0	2.9	2.9
Cash EPS	5.4	7.6	7.8
DPS	0.0	0.0	0.1
Book Value	28.9	37.4	37.4
<b>DuPont Analysis</b>			
EBIT margin	7.5	6.7	6.7
Tax retention ratio	0.7	0.8	0.8
Asset turnover (x)	1.5	1.7	1.8
ROIC (Post-tax)	8.2	9.3	9.3
Cost of Debt (Post Tax)	7.6	9.5	9.1
Leverage (x)	1.1	0.9	1.2
Operating ROE	8.8	9.0	9.6
<b>Returns (%)</b>			
ROCE (Pre-tax)	10.3	9.9	9.6
Angel ROIC (Pre-tax)	11.4	11.3	11.9
ROE	8.0	7.5	6.4
<b>Turnover ratios (x)</b>			
Asset TO (Net Fixed Assets)	2	3	3
Inventory / Net sales (days)	17	17	20
Receivables (days)	701	50	66
Payables (days)	37	29	31
Working capital cycle (ex-cash) (days)	35	50	70
<b>Solvency ratios (x)</b>			
Net debt to equity	1.1	0.9	1.2
Net debt to EBITDA	3.7	3.2	3.8
Int. Coverage (EBIT/ Int.)	1.6	1.7	1.6

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