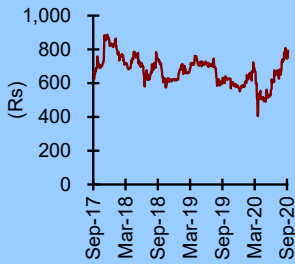
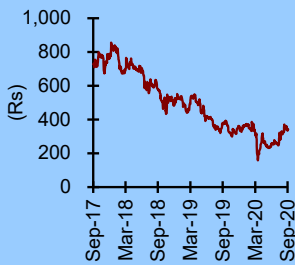


Sector update

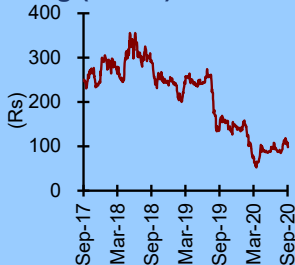
Hatsun Agro (HOLD)



Heritage (BUY)



Parag (HOLD)



Dairy

Aavin; key competitor of Hatsun losing market share

Takeaways from Aavin's financials: (1) Its milk procurement has grown at CAGR of 6.1% vs 9.6% for Hatsun over FY11-19 indicating market share gains for Hatsun, (2) Hatsun has increased its realizations at rate higher than Aavin but still outperformed Aavin in volume growth over FY11-19, (3) Aavin has reported losses in 8 out of 12 years over FY08-19 whereas superior financials of Hatsun has allowed it to invest more in brand building and strengthen the moats, (4) Aavin has invested aggressively in animal feed business and volume CAGR of animal feed business is 45.3% over FY11-19. We believe this investment has helped Aavin to strengthen its relationship with the farmers and (5) Other dairies (Heritage and Parag) have limited presence in Tamil Nadu and are not material competitor to Hatsun or Aavin. **Stock calls: retain BUY on Heritage, HOLD on Hatsun and Parag.**

- ▶ **Aavin, Tamil Nadu based Dairy co-operative:** Aavin operates in Tamil Nadu as its major Dairy co-operative and has generated revenues of Rs60bn and procured milk 3.3mn liter per day in FY19. The products are largely sold under the brand Aavin and its sub brands. Aavin has introduced milk, curd (multiple variants), ghee, butter milk, paneer, ice cream (multiple variants) and sweets (mithai).
- ▶ **Hatsun's milk procurement growing faster than Aavin:** Aavin's milk procurement has increased at CAGR of 6.1% over FY11-19 whereas Hatsun's milk procurement increased at CAGR of 9.6% over same time. Considering milk production in Tamil Nadu has increased at CAGR of 2.6% over FY11-19, we note Hatsun has gained market share.
- ▶ **Hatsun's revenues growing faster than Aavin:** Hatsun reported revenue CAGR of 16.8% over FY08-19 compared to Aavin's revenue CAGR of 11.7%. Hatsun has not only outperformed in milk procurement, it has also reported higher realization CAGR compared to Aavin. We believe Hatsun was able to improve realizations at CAGR of 6.8% over FY11-19 due to (1) improving brand strength and (2) launch of premium products like Ibaco ice cream.
- ▶ **Negligible profits/losses limit Aavin's ability to compete:** Aavin has reported cumulative profit of just Rs176mn over FY08-19 whereas Hatsun reported cumulative profit of Rs6,419mn over FY08-19. We also note Aavin has reported losses in eight out of twelve years over FY08-19. Superior financials have helped Hatsun to better invest in brand building and also strengthen moats in the business.
- ▶ **Other dairies in Tamil Nadu:** Heritage has smaller presence in Tamil Nadu. We believe Tamil Nadu accounts for 7-9% of Heritage's revenues. Parag sells some value added products in Tamil Nadu but the revenue share of Tamil Nadu is less than 5%.
- ▶ **Stock call:** We maintain Heritage as our top pick in the dairy sector with a **BUY** rating. While we remain structurally positive on Hatsun, we need more comfort on valuations to turn bullish. Hence, we give a **HOLD** rating for Hatsun. Parag is likely to be impacted in the near term due to: (1) higher share of value-added products, and (2) higher B2B / HoReCa sales. Hence, we maintain our **HOLD** rating on Parag too.

Valuation summary

Company	Reco	CMP (Rs)	TP (Rs)	EPS (Rs)			P/E (x)			RoE (%)		
				FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Hatsun	HOLD	817	650	6.9	10.1	15.0	117.6	80.8	54.3	12.3	16.7	22.6
Heritage	BUY	338	370	12.5	24.3	24.6	26.9	13.9	13.7	8.9	21.2	18.1
Parag	HOLD	105	104	11.2	10.4	13.1	9.4	10.1	8.0	11.0	9.2	10.6

Source: Company data, I-Sec research

Please refer to important disclosures at the end of this report

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Aavin; competitor of Hatsun losing market share

Tamil Nadu Co-operative Milk Producers' Federation Limited (TCMPF) is the state dairy co-operative in Tamil Nadu. It sells its products under the brand Aavin and sells multiple products like milk, ready-to-drink beverages, paneer, lassi, yoghurt, ice cream, whey drinks, butter milk, mithai products (Rasgulla, Gulabjamun, Mysore pak, Milk peda, Khoa). It is key competitor of Hatsun but we note Aavin continues to lose market share and is also reporting negligible profits / losses.

Chart 1: Key products under Aavin brand

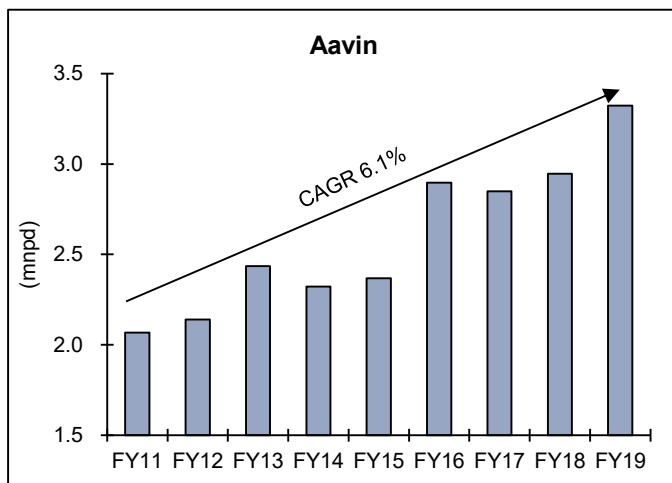


Source: Company, Industry, I-Sec research

Growth in milk procurement slower than Hatsun

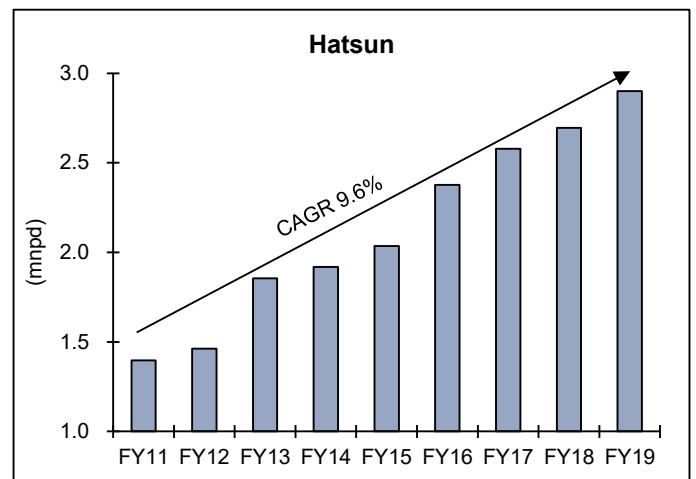
The milk production in Tamil Nadu has grown at CAGR of 2.6% over FY11-19. We note Aavin's milk procurement has grown at CAGR of 6.1% over FY11-19 whereas Hatsun's milk procurement has grown at CAGR of 9.6% over same timeframe. Hatsun has gained market share from Aavin.

Chart 2: Aavin milk procurement



Source: Company, Industry, I-Sec research *Total milk procurement

Chart 3: Hatsun milk procurement*



Revenue growth slower than Hatsun

Hatsun has not just grown the volumes higher than Aavin, it has also increased its selling prices at higher pace than Aavin indicating strength of the brand. As Hatsun has introduced some premium products (e.g. Ibaco ice cream), it has also helped to increase realizations and revenues.

Chart 4: Revenue growth of Aavin

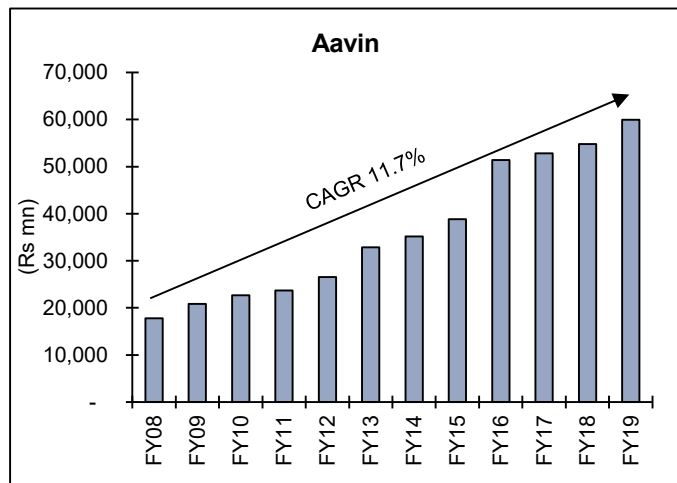
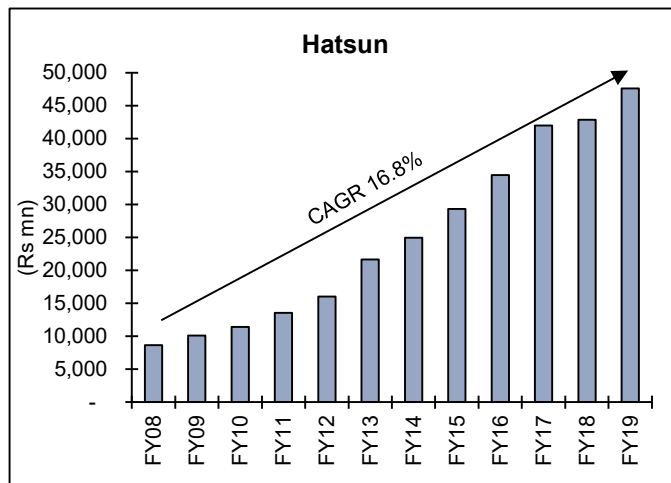


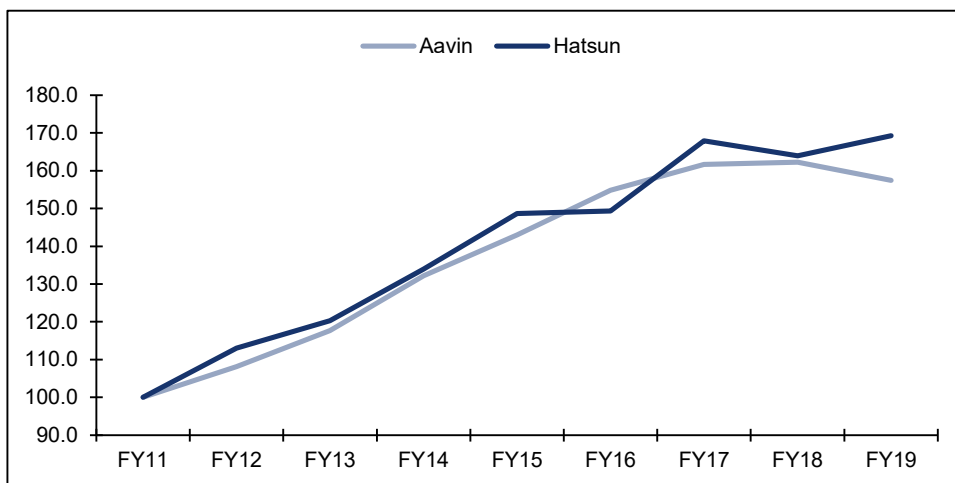
Chart 5: Revenue growth of Hatsun



Source: Company, Industry, I-Sec research

Hatsun's average realization has increased at faster pace than Aavin due to higher investments in brand building activities.

Chart 6: Hatsun's average realization* has increased faster than Aavin

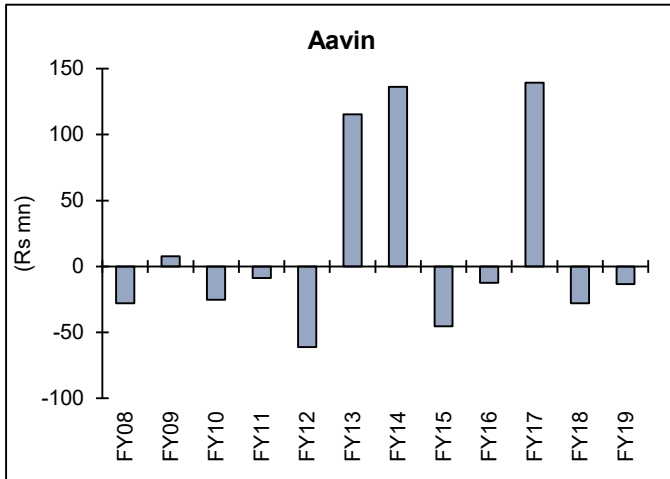


Source: Company, Industry, I-Sec research *Realizations rebased to 100

Business losses limit Aavin's ability to compete

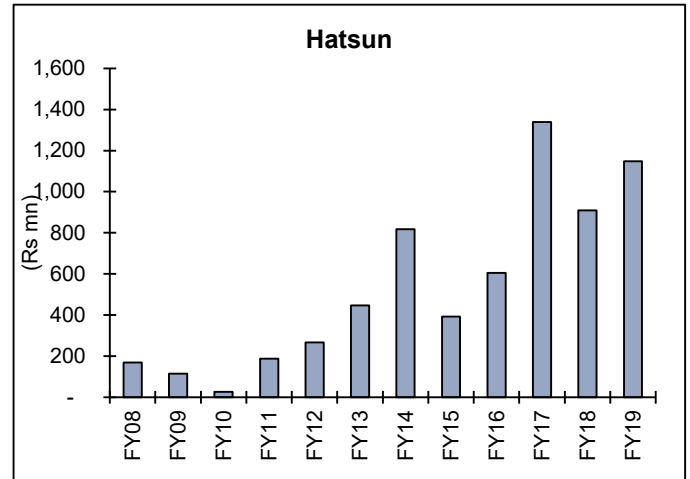
Aavin has generated total net profit of just Rs176mn over FY08-19 whereas Hatsun has generated total net profit of Rs6,419mn over same timeframe. Focus on branding, efficiency gains and cost management have helped Hatsun to generate higher profitability.

Chart 7: Profitability of Aavin



Source: Company, Industry, I-Sec research

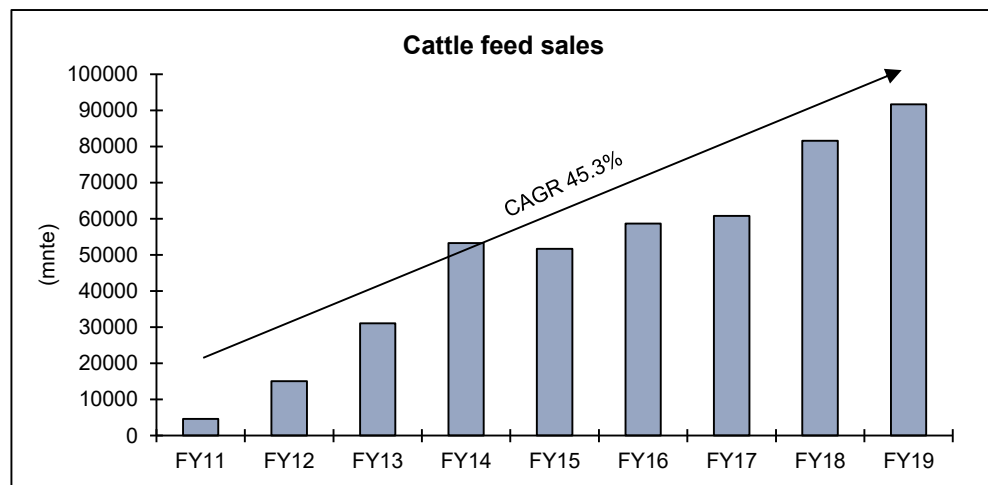
Chart 8: Profitability of Hatsun



Steady growth in animal feed sales

On positive side, we note Aavin has strengthened its investments in animal feed business. We believe higher investments and sales of cattle feed division would have strengthened the relations with the farmers and the moat in milk procurement.

Chart 9: Growth in Animal feed revenues



Source: Company, I-Sec research

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