

28 August 2023

India | Equity research | Sector update

Dairy

Milk procurement prices likely to remain stable/ lower in near term

Key observations for milk prices based on our discussions with dairy companies and channel checks are: (1) wholesale milk prices have risen YoY in Aug'23; (2) there is a steady deceleration in milk price inflation in south India; inflation has declined from 12.8% in Dec'22 to 9.6% in Aug'23 (but inflated on MoM basis); (3) milk procurement prices are likely to remain stable/ slightly lower till end of CY23. The onset of a healthy flush season, normal monsoon, reducing impact of lumpy skin diseases, and stabilising global supplies are likely to act as key triggers for stable milk procurement prices. We maintain the thesis of a cyclical recovery in the dairy sector in H2FY24E-FY25E.

We remain constructive on the sector due to its strong return ratios (> cost of capital) across cycles and likely recovery in margins in H2FY24. We have a **BUY** rating on Heritage Foods, **ADD** on Dodla Dairy and **HOLD** on Hatsun Agro.

Wholesale milk prices rising MoM and YoY

Pan-India wholesale milk prices have increased 10.5% YoY and 0.6% MoM in Aug'23-TD. Milk prices in south India are up 9.6% YoY. North and east India milk prices are up 9.5% and 11.5% respectively YoY.

Deceleration in inflation in south India

We note that milk wholesale prices in south India have been witnessing steady deceleration since the beginning of CY23. Prices in the region were up 12.8% YoY in Dec'22. In Aug'23, inflation was 9.6%. However, prices have inflated on MoM basis.

Correction in global SMP prices & stability in cattle feed prices

We note global SMP prices have corrected 31.1% YoY in Aug'23-TD. Cattle feed prices have stabilised with stable food grain prices. We believe costs for Indian farmers will likely reduce with stable cattle feed prices.

Milk prices to remain stable

Milk procurement prices are on the correction path in south India since May'23. The key triggers are advent of a healthy monsoon, weakening impact of lumpy skin disease and stabilising global supply. It lowers the probability of milk procurement price inflation in the near term. We model milk procurement prices to correct in H2FY24E due to the commencement of flush season and normal monsoon.

Dairy sector likely to see cyclical revival

We note the margins of dairy companies tend to be cyclical when milk procurement prices are volatile. We model the margins of these companies to be in an upcycle mode in H2FY24E-FY25E post weakness in FY23-H1FY24E.

Profitability likely to improve in H2FY24E

We model dairy companies under our coverage to report EBITDA margin expansion in H2FY24E. Key factors for the same are: (1) lower RM prices leading to improved gross margin, (2) benefit of carry-over of price hikes, (3) operating leverage kicking in, and (4) favourable base.

Sector view and top picks

We remain positive on the dairy sector on the back of structural growth triggers such as: (1) migration from the unorganised sector to the organised sector, (2) growing consumption of margin-accretive value-added products, and (3) strong return ratios and growth potential. We prefer Heritage Foods (**BUY**) and Dodla Dairy (**ADD**). We have a **HOLD** rating on Hatsun.

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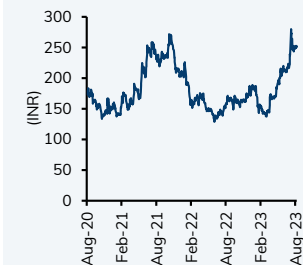
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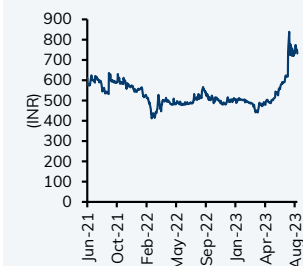
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Heritage Foods (BUY)



Dodla Dairy (ADD)



Hatsun Agro (HOLD)

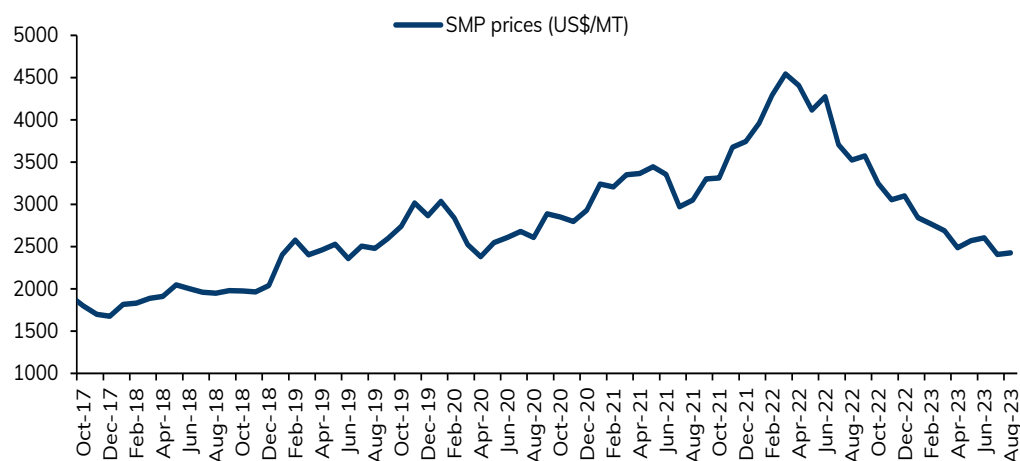


Exhibit 1: Wholesale milk prices

	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23
Region (INR/ltr)						
North zone	54.4	55.1	55.3	55.6	55.4	55.6
West zone	50.1	50.7	50.8	51.2	51.4	51.8
East zone	49.8	50.8	51.4	51.6	52.1	51.9
North-East zone	64.4	64.2	64.7	64.9	64.9	65.7
South zone	47.7	47.6	48.3	48.8	48.9	50.0
Pan-India	52.8	53.2	53.7	54.1	54.2	54.6
Growth rates (YoY) (%)						
North zone	10.6	10.4	10.3	9.8	10.1	9.5
West zone	7.3	8.3	6.3	6.8	4.9	5.3
East zone	8.5	9.9	10.7	11.0	11.7	11.5
North-East zone	2.7	0.8	1.6	4.0	3.3	4.2
South zone	9.5	7.6	8.4	7.5	7.4	9.6
Pan-India	11.2	10.7	10.7	10.6	10.4	10.5

Source: Industry data, I-Sec research

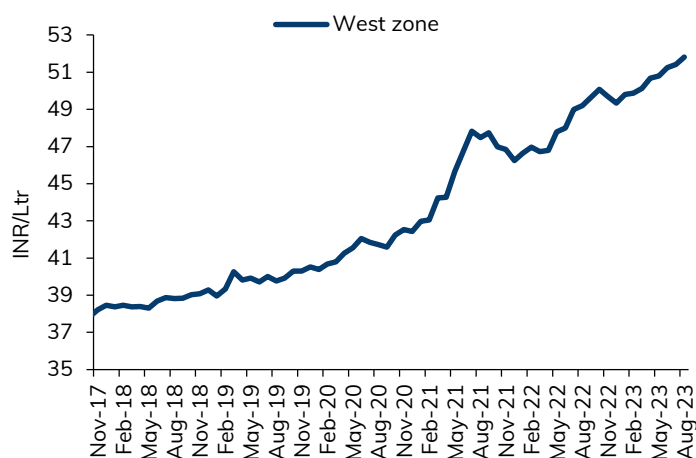
Exhibit 2: Skimmed milk powder (SMP) prices have corrected YoY



Source: Company data, I-Sec research

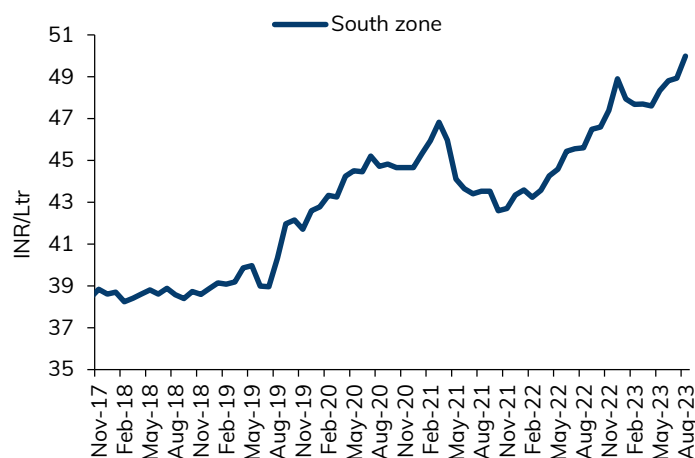
Wholesale milk prices across India

Exhibit 3: Milk prices in west India

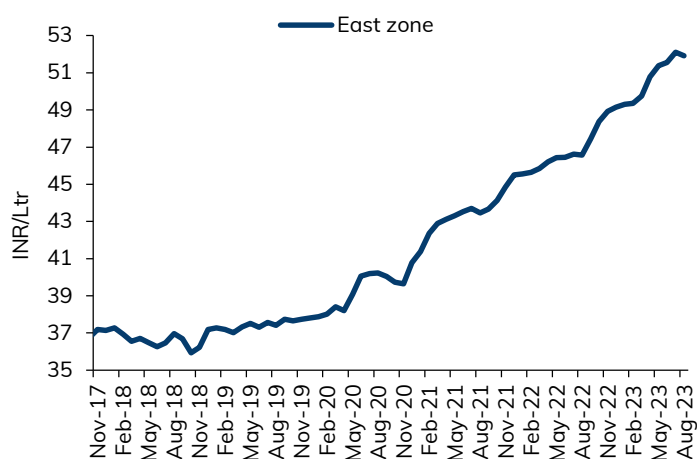


Source: Industry data, I-Sec research

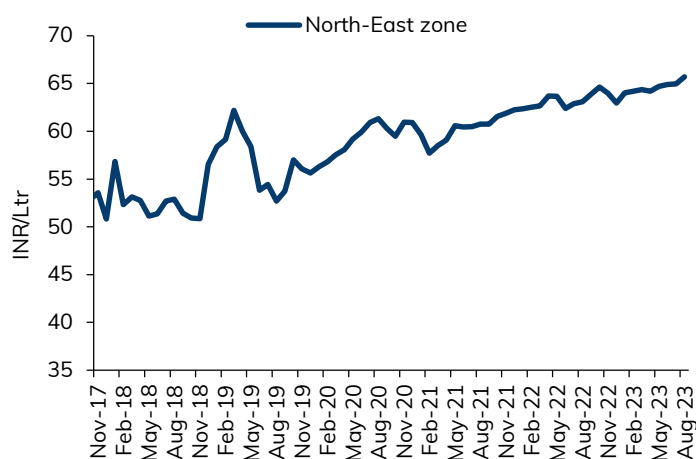
Exhibit 4: Milk prices in south India



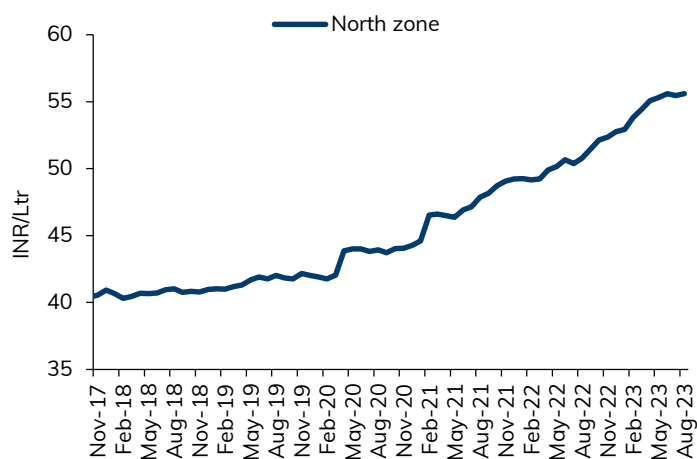
Source: Industry data, I-Sec research

Exhibit 5: Milk prices in east India

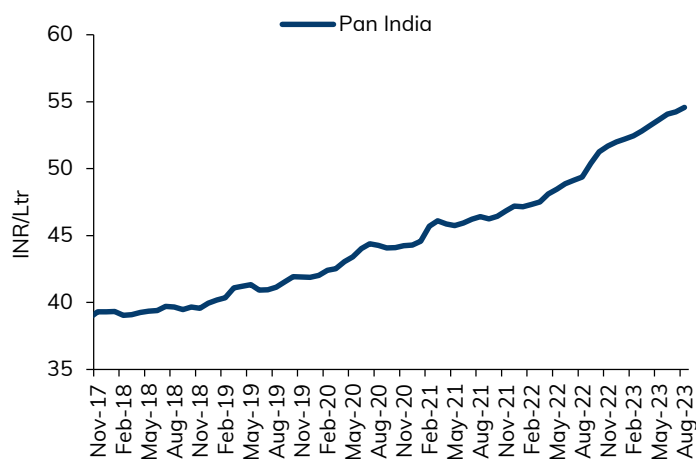
Source: Industry data, I-Sec research

Exhibit 6: Milk prices in northeast India

Source: Industry data, I-Sec research

Exhibit 7: Milk prices in north India

Source: Industry data, I-Sec research

Exhibit 8: Milk prices pan-India

Source: Industry data, I-Sec research

Risks

Sharp increase in input prices

Any major increase in commodity prices will likely result in downside to our estimates.

Supply-chain disruption

Any major disruption in the supply-chain of milk products may lead to downside to our estimates.

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