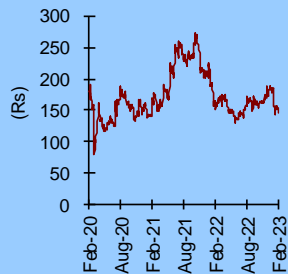
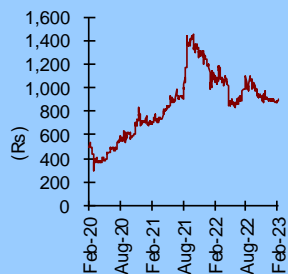


Sector update

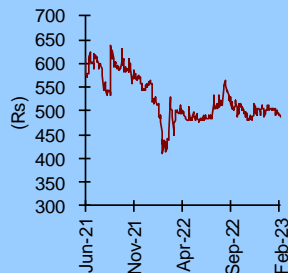
Heritage (BUY)



Hatsun (HOLD)



Dodla (BUY)



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Dairy

Early signs of emerging stability in milk prices

Global SMP prices have corrected 35% YoY in Feb'23. Even after adjusting for benefits of INR depreciation, we believe the profitability in SMP exports is very weak. Lower SMP exports will likely reduce the mismatch between demand and supply of milk in India. Though the cattle feed prices are still in inflationary zone, we model them to correct with correction in food grain prices. These data points indicate that the milk procurement prices are expected to stabilize in next two quarters. However, we believe the dairy companies are likely to report muted profitability even in H1CY23. Dairy companies may resort to at-least one round of prices before the input prices start correcting by Q3FY24.

We remain positive on Dairy sector due to strong return ratios and likely recovery in FY24. Maintain BUY on Heritage Foods, Dodla Dairy; and HOLD on Hatsun Agro.

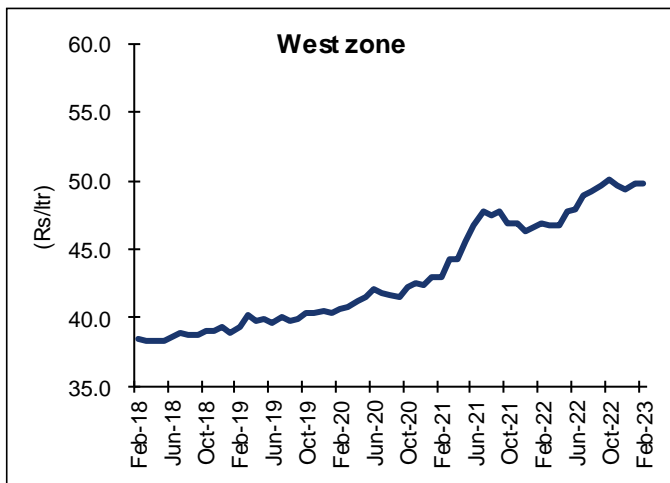
- **Wholesale milk prices rising MoM and YoY:** Pan-India wholesale milk prices have increased 10.9% YoY and 0.5% MoM in Feb'23. Milk prices in south India are up 10.3% YoY. We believe the rise in wholesale prices is attributable to: (1) inflation in animal feed prices, and (2) increasing consumption and weak flush season.
- **Correction in global SMP prices:** We note global SMP prices have corrected 35.5% YoY and 2.6% MoM in Feb'23. Even after considering benefit of INR depreciation, the SMP exports are likely to result in very low profitability. We believe lower exports will likely help to control the steep increase in milk procurement prices.
- **Higher food-grain prices resulting in higher animal feed prices:** While there is some deflation on QoQ basis, we note the food-grain prices remain at elevated levels and it is resulting in higher cattle feed prices for the farmers. We model higher cattle feed prices to push farmers to sell at higher prices.
- **Expect profitability to be down YoY in H1CY23E:** All the dairy companies under our coverage reported YoY lower gross margin in 9MFY23, despite price hikes of ~10% in past 12 months. However, rising milk procurement prices still remain a key concern. We model all dairy companies to report lower YoY margins in H1CY23E.
- **Sector view and top picks:** Considering the strong return ratios and growth potential, we remain positive on the dairy sector. We also expect migration from unorganised to organised sector to steadily generate value. Heritage Foods and Dodla Dairy are our top picks. **Key risks:** Higher-than-expected rise in milk prices, delay in price hikes, and irrational competition.

Table 1: Wholesale milk prices

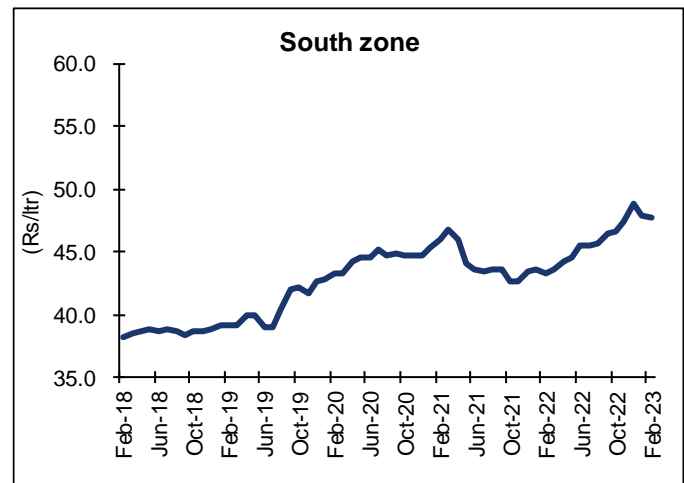
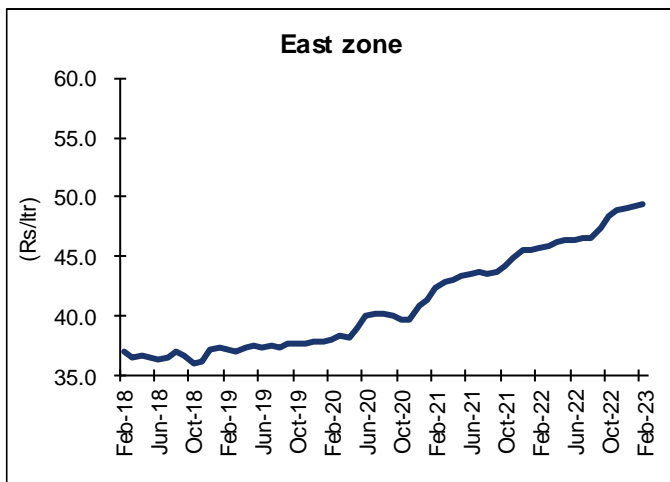
(Rs/ltr)	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
North zone	51.5	52.1	52.4	52.8	52.9	53.8
West zone	49.6	50.1	49.7	49.3	49.8	49.9
East zone	47.4	48.4	48.9	49.2	49.3	49.4
North-East zone	63.8	64.6	64.0	63.0	64.0	64.2
South zone	46.5	46.6	47.4	48.9	47.9	47.7
Pan-India	50.4	51.3	51.7	52.0	52.2	52.5
Growth rates (% YoY)						
North zone	6.9	7.0	6.7	7.2	7.4	9.5
West zone	4.0	6.6	6.1	6.7	6.8	6.2
East zone	8.7	9.6	9.1	8.0	8.2	8.1
North-East zone	5.1	5.0	3.4	1.1	2.7	2.7
South zone	6.8	9.4	11.0	12.8	10.0	10.3
Pan-India	9.0	10.3	10.3	10.2	10.7	10.9

Source: Department of consumer prices, I-Sec research

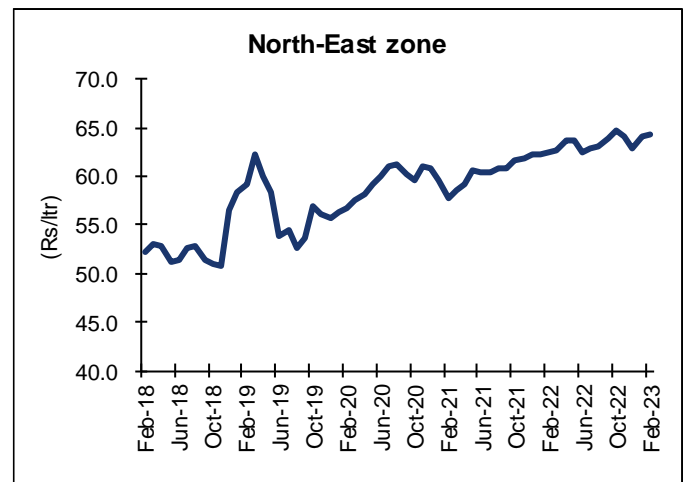
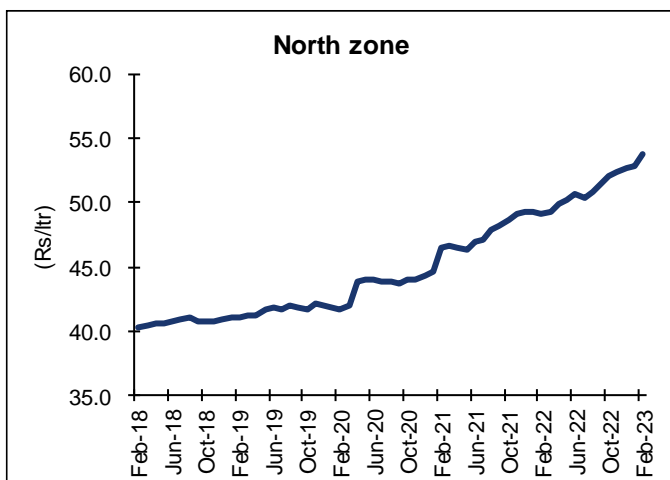
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Wholesale milk prices are rising across India**Chart 1: Milk prices in west India**

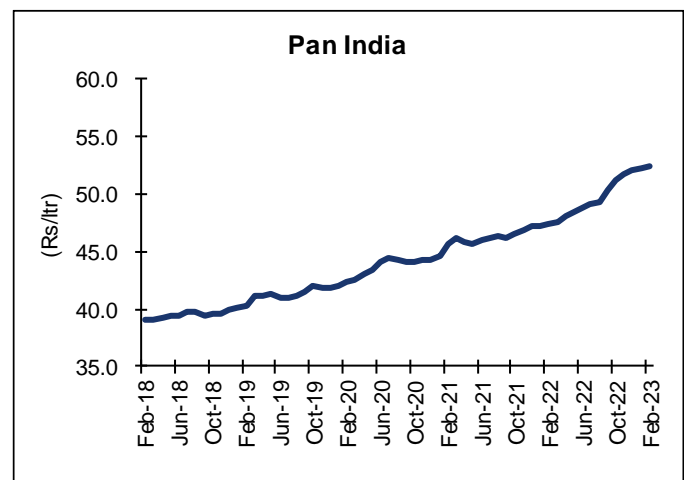
Source: Department of consumer prices, I-Sec research

Chart 2: Milk prices in south India**Chart 3: Milk prices in east India**

Source: Department of consumer prices, I-Sec research

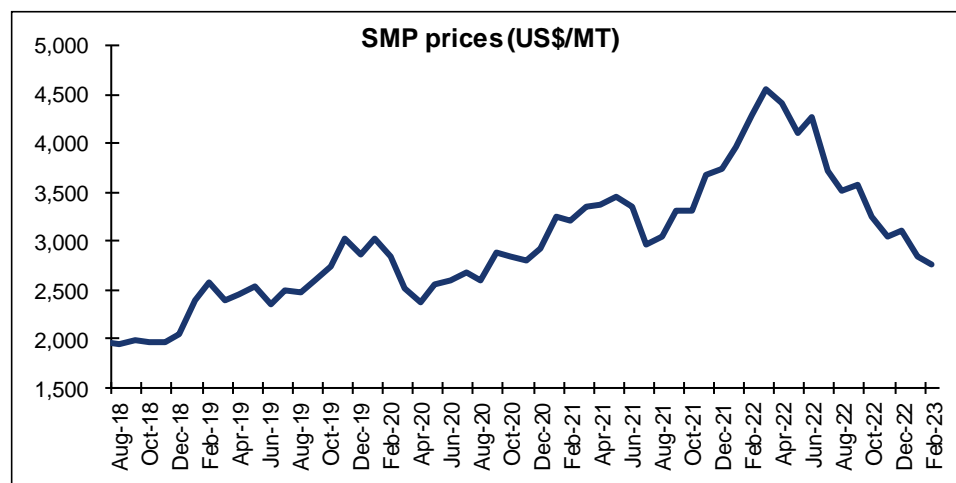
Chart 4: Milk prices in northeast India**Chart 5: Milk prices in north India**

Source: Department of consumer prices, I-Sec research

Chart 6: Milk prices pan-India

Correction in global SMP prices YoY

Chart 7: Skimmed milk powder (SMP) prices have corrected



Source: Industry, 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 will likely result in downside to our estimates.

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