

31 March 2024

India | Equity research | Sector Update

Dairy

Strong potential for margin expansion to continue in H1FY25E

Trends in milk prices: (1) Wholesale milk prices have remained elevated YoY in Mar'24. (2) Milk prices in south India have inflated 5.9% YoY in Mar'24, after remaining in a deflationary trend in CY23 and (3) SMP prices have increased 4.2% YoY in Mar'24 but corrected MoM. We note milk supply has remained strong even in Mar'24, indicating lower/ stable milk procurement prices. We also note dairy companies are accumulating SMP inventory at lower levels. It can help in maintaining profitability even if there is a rise in milk procurement prices. Hence, we believe there is strong potential to expand margins YoY even in H1FY25E. We remain constructive on the sector led by its strong return ratios (>cost of capital) across cycles and likely higher margins in H1FY25E. We have **BUY** rating on Heritage Foods, **ADD** on Dodla Dairy and **HOLD** on Hatsun Agro.

Wholesale milk prices are rising YoY

Pan-India wholesale milk prices have increased 4.2% YoY in Mar'24-TD. However, they have remained flat in CY24-TD with a marginal decline in Mar'24 MoM. Milk prices in south India are up 5.9% YoY. Milk prices in north and east India are up 2.3% and 4.9% YoY, respectively.

Global SMP and cattle feed prices lower MoM in Mar'24

Global skimmed milk powder (SMP) prices are up 4.2% YoY in Mar'24-TD. Global SMP prices had spiked in Feb'24 (+8.7% YoY) after remaining in deflationary zone for the entire CY23. However, they corrected MoM in Mar'24. Higher global SMP prices may induce exports, ultimately resulting in lower milk availability in India.

Cattle feed prices have stabilised with stable food grain prices. We model stable cattle feed prices to result in lower costs for cattle farmers.

Milk procurement prices to remain stable

We note milk procurement prices have declined post Mar'23 due to (1) stability in global supply and lower global SMP prices, (2) reduction in the impact of lumpy skin disease and (3) strong flush season. Considering milk supply has remained strong even in Mar'24, we believe milk procurement prices may remain stable/ lower over H1FY25E.

Higher SMP inventory with dairy companies

We note dairy companies are accumulating SMP inventory at lower prices. We believe higher investments in SMP inventory can help in maintaining profitability even if milk procurement prices start inching upwards. However, we model steep increase in working capital days and increase in short-term debt at the end of Mar'24.

Scope for price hikes

We note (1) dairy companies have not changed MRPs for more than 12 months. If they maintain same MRPs for next 3-4 months, they will be in a position to pass on price hikes without much resistance and (2) reduction in grammage from 500ml to 450ml has met negligible resistance in FY24. Hence, we model dairy companies to effectively utilise the route of grammage reduction in FY25-26E.

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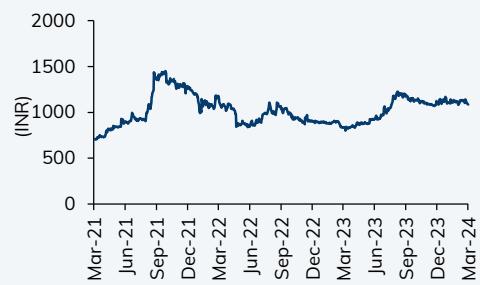
Heritage Foods (BUY)



Dodla Dairy (ADD)



Hatsun Agro (HOLD)



Source: Bloomberg

Profitability to remain elevated in H1FY25E

We model dairy companies under our coverage to report EBITDA margin expansion in H1FY25E. While there seems to be marginal scope for further deflation in raw material prices, factors such as operating leverage, better product mix and favourable base shall help maintain higher margins. We model higher profitability due to strong volume growth and better margins.

Sector view and top picks

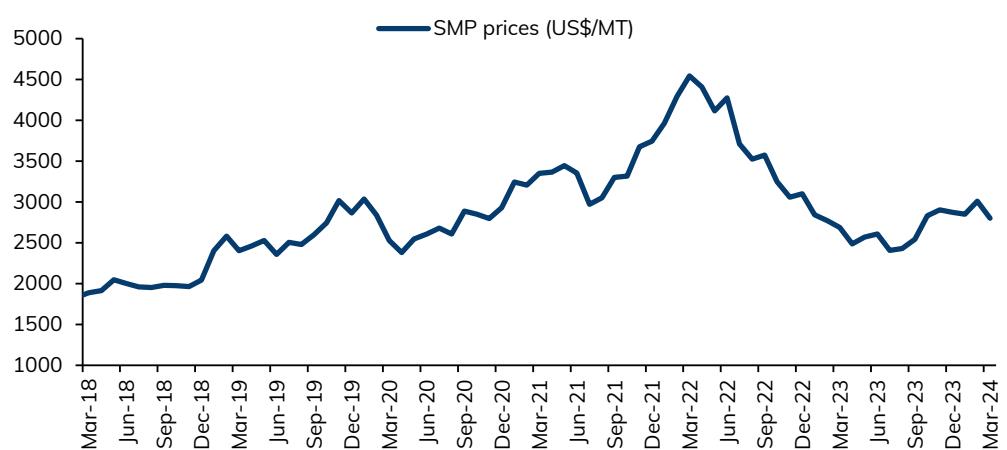
We remain positive on dairy sector on the back of structural growth triggers such as: (1) Migration from unorganised sector to organised sector; (2) growing consumption of margin-accretive value-added products; and (3) strong return ratios and growth potential. We prefer Heritage Foods (**BUY**) and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

Exhibit 1: Wholesale milk prices

| | Oct-23 | Nov-23 | Dec-23 | Jan-24 | Feb-24 | Mar-24 |
|-------------------------------|--------|--------|--------|--------|--------|--------|
| Region (INR/ltr) | | | | | | |
| North zone | 56.0 | 55.9 | 55.9 | 55.8 | 55.8 | 55.7 |
| West zone | 52.1 | 52.1 | 52.0 | 51.9 | 51.7 | 51.8 |
| East zone | 52.2 | 52.2 | 52.2 | 52.2 | 52.2 | 52.2 |
| North-East zone | 66.8 | 66.8 | 66.9 | 67.2 | 67.3 | 67.5 |
| South zone | 50.0 | 50.5 | 50.7 | 50.7 | 50.8 | 50.5 |
| Pan-India | 55.0 | 55.1 | 55.0 | 55.0 | 55.0 | 55.0 |
| Growth rates (YoY) (%) | | | | | | |
| North zone | 7.4 | 6.7 | 6.0 | 5.5 | 3.7 | 2.3 |
| West zone | 4.0 | 4.9 | 5.5 | 4.2 | 3.7 | 3.3 |
| East zone | 8.0 | 6.8 | 6.2 | 5.9 | 5.7 | 4.9 |
| North-East zone | 3.4 | 4.4 | 6.3 | 4.9 | 4.9 | 5.0 |
| South zone | 7.3 | 6.6 | 3.8 | 5.8 | 6.5 | 5.9 |
| Pan-India | 7.3 | 6.6 | 5.7 | 5.4 | 4.9 | 4.2 |

Source: Industry data, I-Sec research

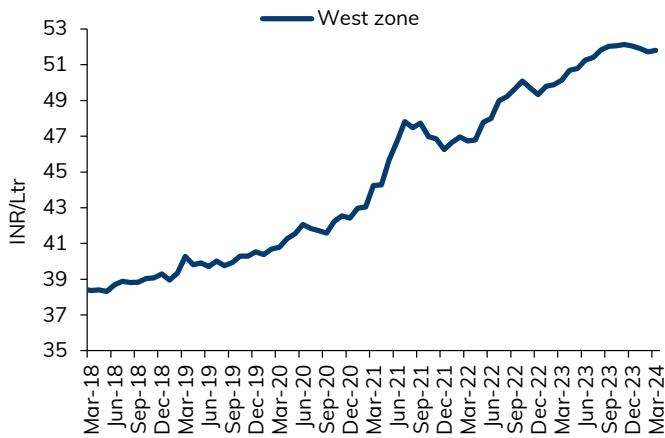
Exhibit 2: SMP prices have corrected YoY



Source: Company data, I-Sec research

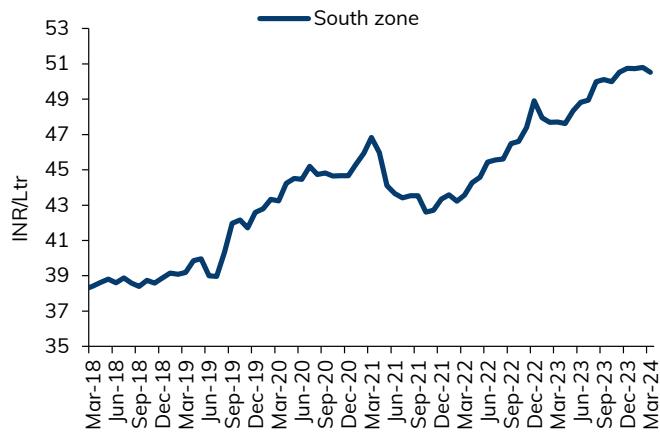
Wholesale milk prices across India

Exhibit 3: Milk prices in west India



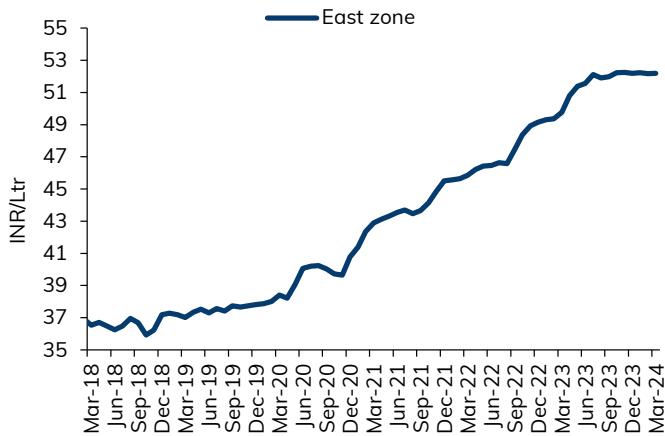
Source: Industry data, I-Sec research

Exhibit 4: Milk prices in south India



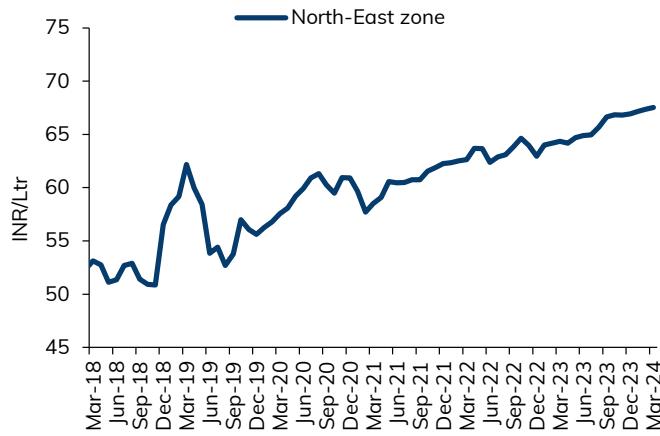
Source: Industry data, I-Sec research

Exhibit 5: Milk prices in east India



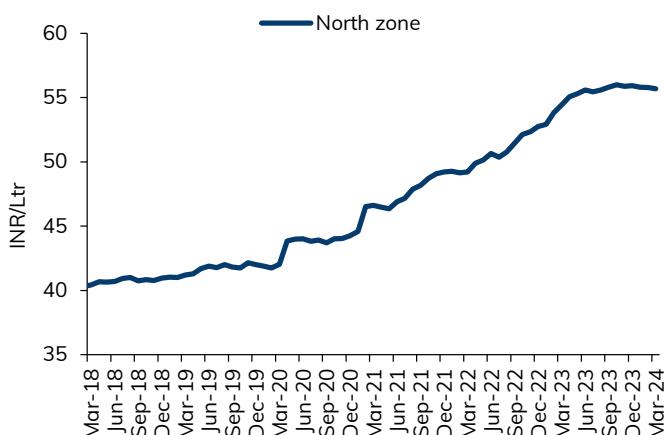
Source: Industry data, I-Sec research

Exhibit 6: Milk prices in northeast India



Source: Industry data, I-Sec research

Exhibit 7: Milk prices in north India



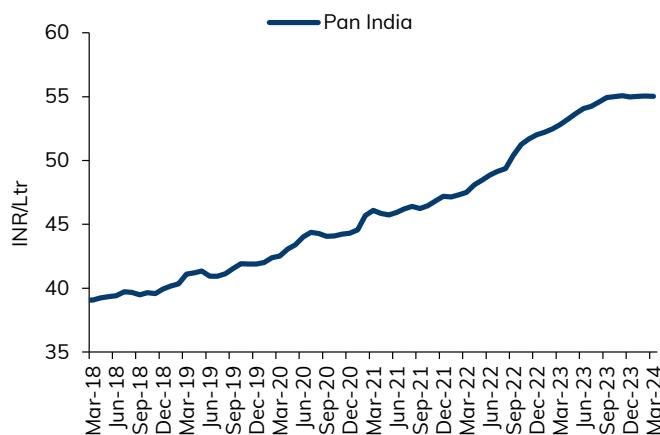
Source: Industry data, I-Sec research

Risks

Sharp increase in input prices: Any major increase in commodity prices may 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.

Exhibit 8: Milk prices pan-India



Source: Industry data, I-Sec research

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