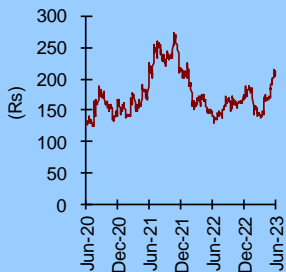
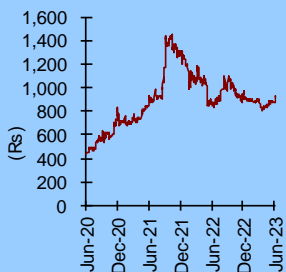


Sector update

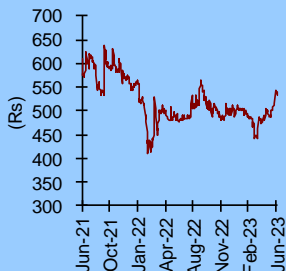
Heritage (BUY)



Hatsun (HOLD)



Dodla (BUY)



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Dairy

Likely correction in milk procurement prices; model EBITDA margin to expand in H2FY24, YoY

Important observations for milk prices: (1) cattle feed prices have stabilized, (2) global SMP prices have corrected 37.6% YoY, (3) there is steady deceleration in milk inflation in South India. It has declined from 12.8% inflation in Dec'22 to 8.4% in May'23 and (4) our channel checks and discussions with dairy companies indicate that milk procurement prices have corrected in May-June'23. While the delayed monsoon may not result in immediate correction in milk procurement prices, we model monsoon in Q2FY24 and flush season in Q3FY24 to result in lower milk procurement prices. We model most dairy companies to report EBITDA margin expansion in H2FY24, YoY.

We remain positive on Dairy sector due to strong return ratios across cycles and likely recovery in H2FY24. 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 10.7% YoY and 0.8% MoM in May'23. Milk prices in south India are up 8.4% YoY. We believe the rise in wholesale prices is attributable to: (1) inflation in animal feed prices, and (2) increase in Out-of-home consumption.
- ▶ **Deceleration in inflationary pressures:** We note milk wholesale prices in South India were up 12.8% YoY in Dec'22. However, milk wholesale prices are up just 8.4% YoY in May'23. There is steady deceleration in inflation in milk prices in South India. However, the inflation in North India continues to remain at elevated level.
- ▶ **Correction in global SMP prices and cattle feed prices:** We note global SMP prices have corrected 37.6% YoY in May'23. Cattle feed prices have also stabilized with stable food-grain prices. We model correction in cattle feed prices and global SMP prices to result in lower milk procurement prices.
- ▶ **Initial trends indicate correction in milk prices:** We note milk procurement prices have corrected in South India in May-June'23. While the delay in monsoon may not allow further correction in milk procurement prices in June'23, we model milk procurement prices to slide again in Q2FY24 post commencement of monsoon and also in Q3FY24 due to commencement of flush season.
- ▶ **Cyclical revival in Dairy sector:** We note the margins of Dairy companies tend to be cyclical due to volatile milk procurement prices. We model the margins of Dairy companies to be in upcycle in H2FY24E-FY25E post weakness in FY23-H1FY24E.
- ▶ **Expect profitability to improve in H2FY24E:** We model dairy companies under our coverage to report EBITDA margin expansion in H2FY24 due to (1) improvement in gross margin due to lower RM prices, (2) benefit of carry-over of price hikes, (3) operating leverage and (4) favourable base.
- ▶ **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. We rate Hatsun as HOLD. **Key risks:** Higher-than-expected rise in milk prices, delay in price hikes, failure of new products and irrational competition.

Wholesale milk prices

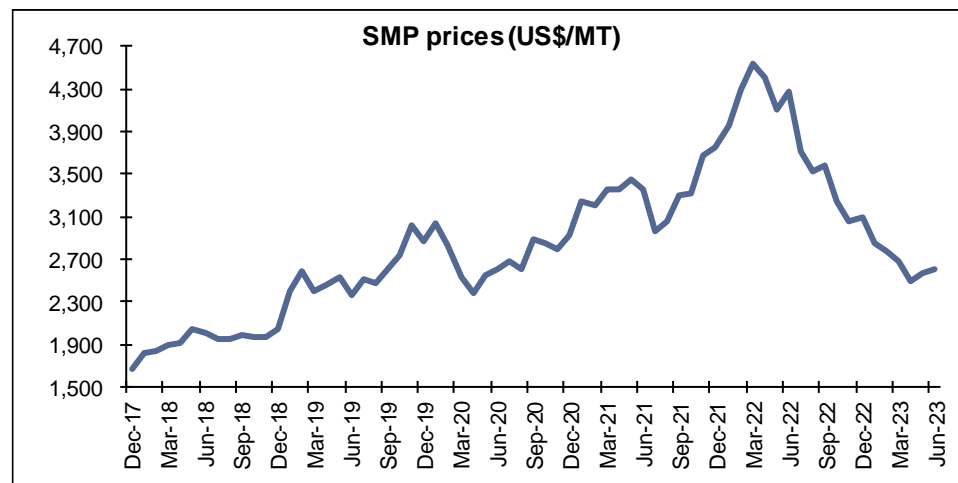
Table 1: Wholesale milk prices

(Rs/ltr)	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
North zone	52.9	53.8	54.4	55.1	55.3	55.6
West zone	49.8	49.9	50.1	50.7	50.8	51.2
East zone	49.3	49.4	49.8	50.8	51.4	51.6
North-East zone	64.0	64.2	64.4	64.2	64.7	64.9
South zone	47.9	47.7	47.7	47.6	48.3	48.8
Pan-India	52.2	52.5	52.8	53.2	53.7	54.1
Growth rates (% YoY)						
North zone	7.4	9.5	10.6	10.4	10.3	9.8
West zone	6.8	6.2	7.3	8.3	6.3	6.8
East zone	8.2	8.1	8.5	9.9	10.7	11.0
North-East zone	2.7	2.7	2.7	0.8	1.6	4.0
South zone	10.0	10.3	9.5	7.6	8.4	7.5
Pan-India	10.7	10.9	11.2	10.7	10.7	10.6

Source: Department of consumer prices, I-Sec research

Correction in global SMP prices YoY

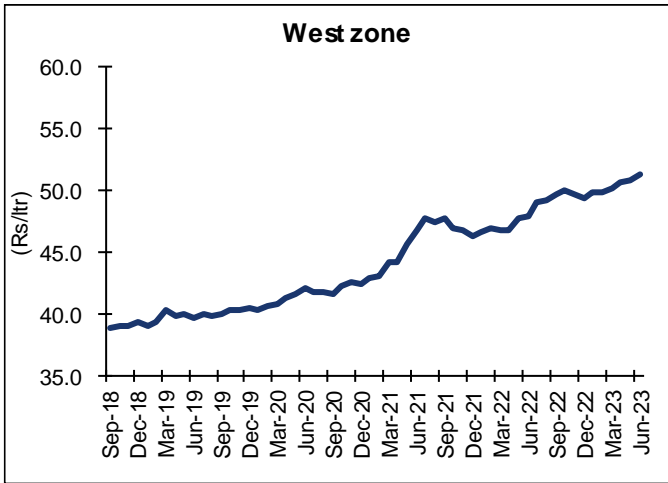
Chart 1: Skimmed milk powder (SMP) prices have corrected



Source: Industry, I-Sec research

Wholesale milk prices across India

Chart 2: Milk prices in west India



Source: Department of consumer prices, I-Sec research

Chart 3: Milk prices in south India

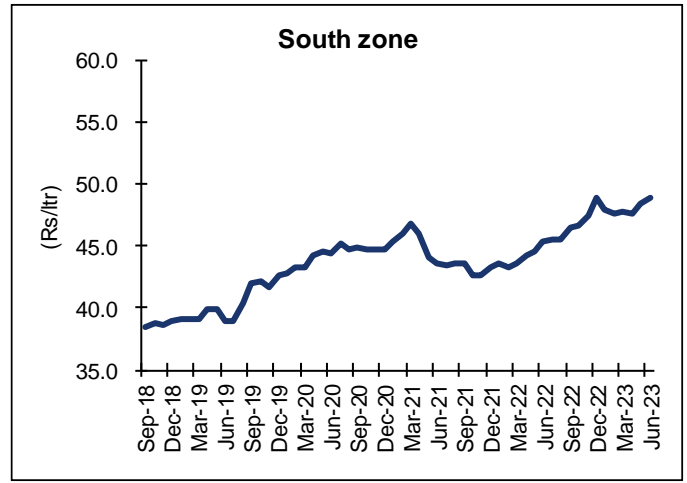
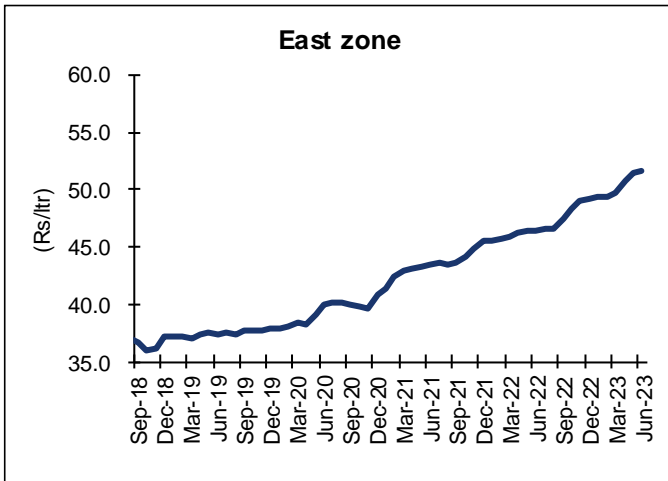


Chart 4: Milk prices in east India



Source: Department of consumer prices, I-Sec research

Chart 5: Milk prices in northeast India

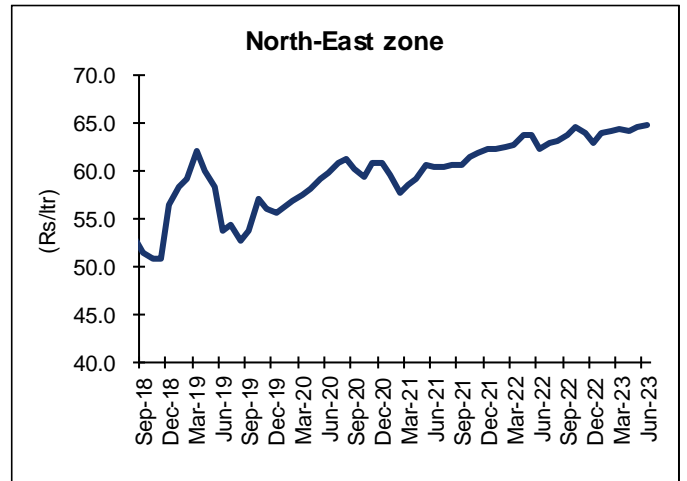
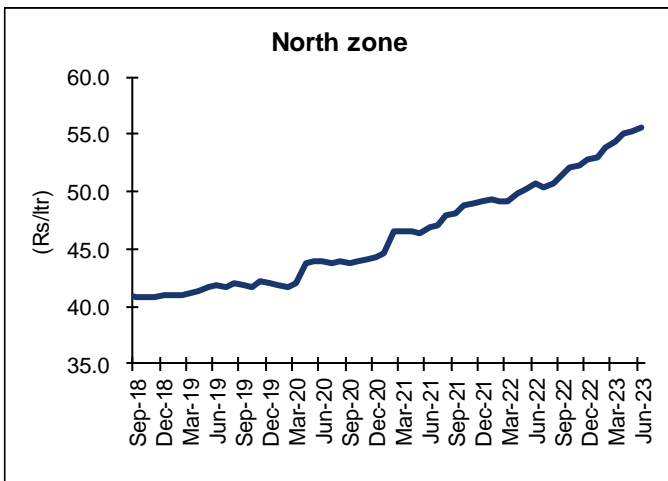
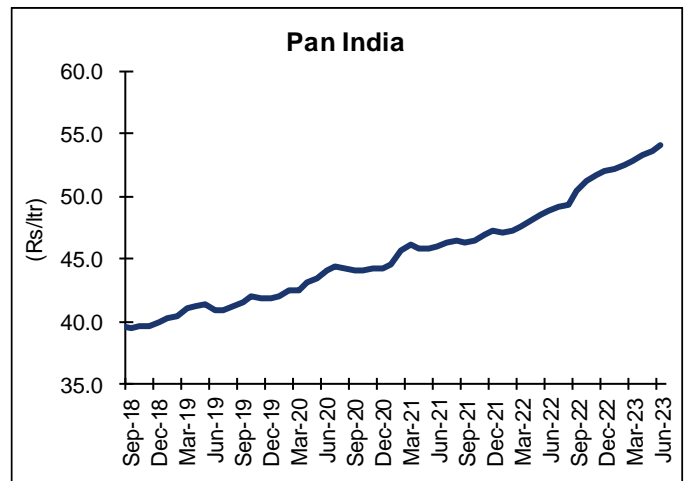


Chart 6: Milk prices in north India



Source: Department of consumer prices, I-Sec research

Chart 7: Milk prices pan-India



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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