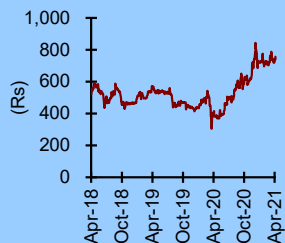
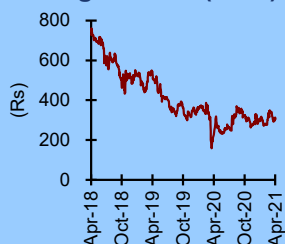


Sector update

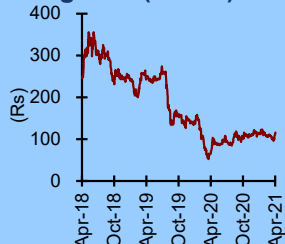
Hatsun Agro (BUY)



Heritage Foods (ADD)



Parag Milk (HOLD)



Dairy

Va tutto bene #7

Exactly a year before, we wrote ‘Andra tutto bene’ (everything is going to be alright!) in which we analysed the likely changes to consumption, industry structures etc. We revisit the thoughts, we looked beyond the noise, and present potential changes in operating environment and likely beneficiaries – Va tutto bene (everything’s fine!). A root-cause-analysis of every trend indicates that it’s a consumer / customer behaviour change. “Andra tutto bene #8” is here - [link](#).

Top long-term trends in dairy sector: The sector was largely unaffected in FY21 as milk & milk products are essential commodities. However, we note the following trends emerged in FY21 and are likely to continue even in FY22: (1) Organised dairies will continue to (structurally) gain market share, (2) reduction in consumption of impulse products such as ice cream, butter milk, flavoured milk, (3) decline in market potential of new categories like whey protein powder, custards and premium cheese variants as consumers focus on essentials, (4) direct distribution to large societies using own logistics / app developed by dairy companies, (5) higher support to trade (e.g. reimbursement of electricity bills by ice cream companies) to grab market share, and (6) milk packaging in tetra packs and dairy whitener will continue to grow at healthy rates.

Beneficiaries: [Hatsun](#), [Heritage](#)

Potentially negatively impacted companies: [Parag](#)

See our previous reports in the series – [Consumer](#), [Agriculture](#), [Pharma](#), [Real Estate](#), [Telecom](#), [Power](#)

- ▶ **Market share gains for organised dairies:** The supply chain network (procurement as well as distribution) of unorganised sector is still impacted due to lockdown and localised lockdowns. The unorganised / smaller dairies are also impacted due to liquidity issues and weaker balance sheet. We note organised dairy companies will continue to gain market share from unorganised sector even in FY22.
- ▶ **Support to trade has increased:** Due to multiple lockdowns and restrictions, dairy dealers are impacted sometimes and also generate higher-than-normal loss in dairy business. We note organised dairies have increased the support to the trade. Some dairies are reimbursing electricity bills of distributors. Dairies are also offering higher schemes and/or credit period to trade. We believe this will strengthen moat as trade may prefer to stock up products of only those dairy companies that are reimbursing costs.
- ▶ **Increase in usage of tetra packs and dairy whitener:** Consumers were seen hoarding tetra packs as well as dairy whiteners in FY21 as they wish to avoid daily visits of milk delivery boys. Some consumers are likely to continue with these habits. We also expect some consumers to buy dairy whitener on a regular basis.
- ▶ **Smaller SKUs remain impacted:** Consumption via small SKUs remains more impacted than larger SKUs. Reduction in frequency to visit retail outlets and lower out-of-home consumption has impacted the off-take of small SKUs. Consumption of products like ghee, which is purchased once a month, has not yet been impacted. We expect this trend to continue even in FY22.
- ▶ **Decline in growth prospects of some dairy segments:** Consumption of new dairy segments such as whey protein powder, custards and premium cheese variants was significantly impacted as consumers were focusing on essentials.

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- ▶ **Own distribution network:** Some dairy companies have started distributing milk and milk products directly to large housing societies offering a bulk discount. This will allow them to bypass distributors as well as retailers. We believe this trend will accelerate going ahead.
- ▶ **Lower investments in new products:** The innovation rate declined in FY22 as consumers are focussing more on just essentials. Most companies were also in cost-containment mode and hence, they have also curtailed investments in new categories.

Under-appreciated short-term challenges:

- Ice cream consumption will likely remain impacted due to (1) fear of coronavirus, (2) reduction in out-of-home consumption and (3) reduction in the number of functions, parties and events.
- Lower demand for milk (due to lower consumption of value-added products) but steady supply of milk by farmers has resulted in lower milk procurement prices. We expect similar trend to continue even in FY22.
- The consumption of milk-based beverages such as buttermilk, lassi and flavoured milk has also been impacted due to reduction in the number of visits to retail outlets.

Risks**Sharp increase in input prices**

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

Supply chain disruption

Any major disruption in supply chain of milk products will result in downside to our estimates.

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