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INDIA

Dodla Dairy

BUY

Strong competitive advantages; initiate with BUY Rs600

Dodla Dairy has created multiple competitive advantages in the fast growing dairy industry. Apart from cluster approach in South India, it has developed (1) strong brands, (2) 100% direct milk procurement network and (3) direct distribution model. The company also focusses on products that generate RoCE in excess of cost of capital such as milk and curd, and has negligible/nil presence in cash burning products like ghee, cheese and whey. Milk procurement in South India is growing at ~10% per annum. Dodla has expanded its market share from 0.6% in FY08 to ~1% in FY21. Considering market growth and market share expansion potential, we model Dodla to report mid-teens revenue growth in medium term. We forecast 14.2% and 17.6% CAGR in revenue and PAT, respectively over FY21-23E. We initiate coverage on the stock with a BUY rating and DCF-based target price of Rs700 (24x FY23E). Key risks: Potentially higher competitive intensity in South India and delay in distribution expansion.

- **Cluster approach:** Dodla focusses largely on South India. Its milk procurement, all the plants as well as distribution network are established in South India and has a small business in Africa. It also created strong brands via brand building spends in regional languages. The company is steadily penetrating smaller towns and semi-urban markets. Considering steady growth potential in South India, we believe cluster approach will continue to be a key competitive advantage for the company.
- **Creation of competitive advantages:** Dodla's competitive advantages include: (1) Strong brands like Dodla Dairy, Dodla+ and KC+. The company has steadily increased ad-spend to sales to strengthen its brand equity, (2) it procures ~100% milk directly from farmers which eliminates middle men and helps in providing superior quality milk to consumers, (3) it has also created strong distribution network for selling milk and curd to consumer households. We also note Dodla has created a distribution structure of 1,510+ milk and milk product distributors and 455 Dodla parlors.
- **Focus on products that generate RoCE > cost of capital:** The company plans to focus on key products that generate healthy return ratios such as packaged milk and curd. These products require negligible investments in working capital and also limited capex and hence, they continue to generate return ratios in excess of cost of capital. It also plans to steadily expand its ice cream portfolio but does not plan to expand aggressively in low RoCE products like ghee, whey and cheese.
- **Initiate coverage with BUY:** We model revenue and PAT CAGRs of 14.2% and 17.6%, respectively, over FY21-FY23E. We forecast RoE to be upwards of 17% in FY23E. We initiate coverage on the stock with a BUY rating and DCF-based target price of Rs700 (24x FY23E). Key risks: Delay in distribution and procurement expansion, and failure of some of the new products and potentially higher competitive intensity in South India.

Market Cap	Rs36.4bn/US\$493mn	Year ending Mar	FY20	FY21	FY22E	FY23E
Bloomberg	DODLA IN	Revenue (Rs mn)	21,394	19,440	22,413	25,349
Shares Outstanding (mn)	59.5	Adj Net Profit (Rs mn)	571	1,260	1,389	1,742
52-week Range (Rs)	636/428	Dil. Rec. EPS (Rs)	10.3	21.6	23.4	29.3
Free Float (%)	37.5	% Chg YoY	(9.0)	110.4	8.1	25.4
FII (%)	9.4	P/E (x)	58.5	27.8	25.7	20.5
Daily Volume (US\$'000)	NA	CEPS (Rs)	19.1	30.3	32.8	39.2
Absolute Return 3m (%)	40.0	EV/EBITDA (x)	21.1	13.6	14.7	12.8
Absolute Return 12m (%)	NA	Dividend Yield (%)	0.0	0.0	-	-
Sensex Return 3m (%)	13.8	RoCE (%)	16.0	27.1	19.6	19.3
Sensex Return 12m (%)	62.3	RoE (%)	12.2	21.5	17.4	17.8

Initiating coverage

Dairy

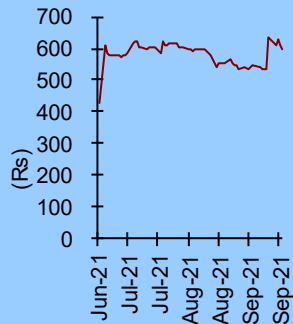
Target price: Rs700

Shareholding pattern

	Mar '21	Jun '21
Promoters	62.5	62.5
Institutional investors		
MFs and others	14.5	18.7
FIs/Bank/Ins	5.5	9.2
Insurance Cos.	1.4	0.1
FIs	4.9	4.9
FIs	2.7	9.4
Others	23.0	18.8

Source: BSE

Price chart



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Investment summary

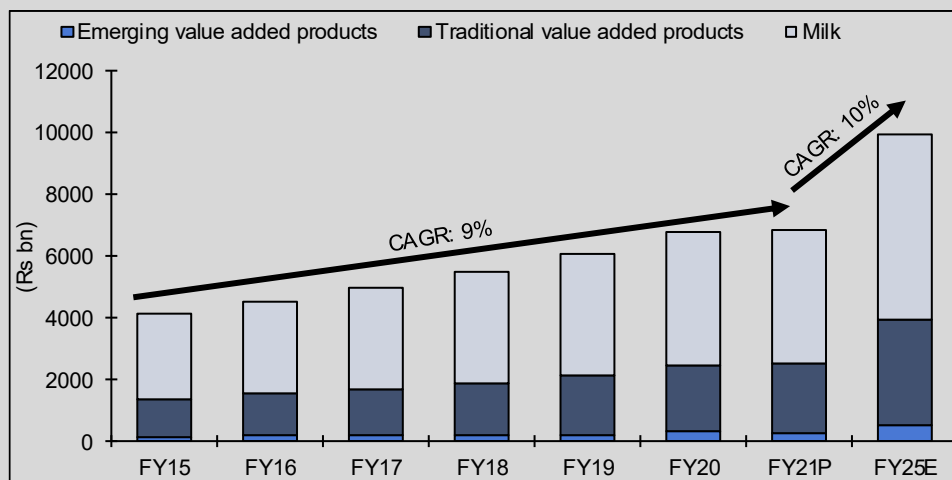
Business

In 1995, Dodla Dairy Limited was promoted by Mr. Dodla Sessa Reddy, Mr. Dodla Sunil Reddy and Dodla Family Trust. The company was initially established in Andhra Pradesh, but it also expanded to rest of South India. It recently acquired Batlagundu and Vedasandur processing plants in Tamil Nadu via a business transfer agreement with KC Dairy Products Private Limited. In order to expand its business, the company also started its business operations in Uganda in FY15. It collects milk from 7,100+ village level collection centres. It has also installed 97 chilling centres. The company distributes its products through 1,510+ distributors and has 455 Dodla retail parlors.

Dairy: One of the fastest growing industries in India

The India dairy industry has grown at a CAGR of 9% in value terms over FY15-FY21. While it slowed down in FY21 due to covid-induced lockdowns, it is likely to grow steadily (~10% CAGR) over FY21-25E. Steady growth in nominal GDP, market share gains from the unorganised sector and rising demand of value-added products are the key growth drivers. We believe rising population, growth of HoReCa and rising demand of milk as a source of protein will help dairy sector maintain healthy growth rates in medium- long term.

Chart 1: Dairy industry growing at ~10% CAGR



Source: Company, Crisil, I-Sec research

Competitive advantages

The company has developed strong brands like *Dodla*, *Dodla Dairy* and *KC+* in the past 26 years via cluster approach, which is crucial in dairy industry. Considering limited surplus for brand building activities, Dodla is investing all the surplus in its core region of South India. It has also established distribution network. Its integrated business model allows it to directly procure milk from farmers every day, process the milk in its 14 plants to distribute through its established network.

Table 1: Competitive advantages

Competitive advantage	Particulars
Brands	Dodla Dairy, Dodla and KC+
Integrated business model	Direct Procurement of milk, 14 processing plants
Distribution network	3,100+ distribution agents, 1,510+ distributors & 455 Dodla retail parlours
Relationship with dairy farmers	Welfare programs & diversification to provide cattle feed under Orga feed brand

Source: Company, I-Sec research

Valuation – reverse DCF indicates EBITDA CAGR of 12%, potentially achievable, in our view

We value Dodla on DCF-basis arriving at a target price of Rs700. As per reverse DCF (assuming cost of equity at 11.3% and terminal growth at 4%), the company needs to achieve an EBITDA CAGR of 12% over FY21-FY32E. The EBITDA CAGR over FY11-21 was 29.4%.

Table 2: Expect EBITDA CAGR of 12% over FY21-FY30E in reverse DCF

Particulars	Amt (Rs)
Cost of Equity (%)	11.3%
Terminal growth rate (%)	4.0%
Discounted interim cash flows (Rs mn)	14,233
Discounted terminal value (Rs mn)	19,170
Total equity value (Rs mn)	33,403
Current price per share (Rs)	600
EBITDA CAGR to achieve over FY21-FY32E (%)	12%

Source: Company, I-Sec research

Competitive advantages of Dodla

Dodla has developed competitive advantages in milk procurement, distribution and branding. We note its competitive advantages are as follows.

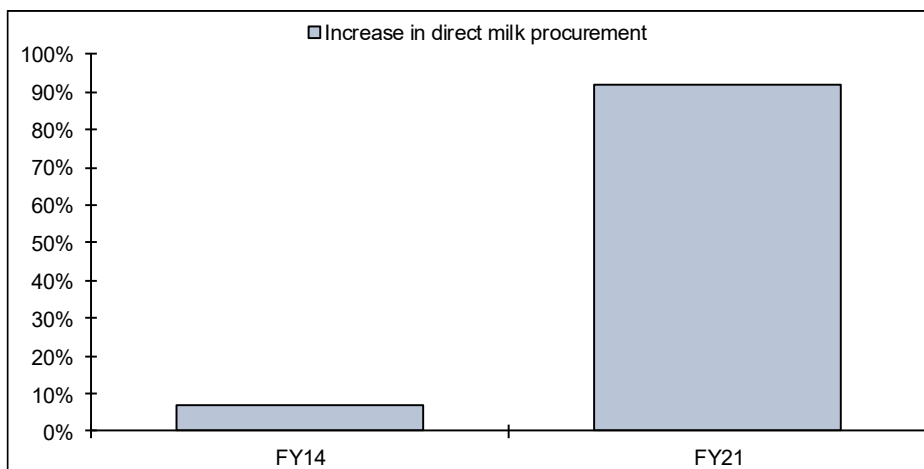
- ~100% direct procurement of milk
- Cluster approach- focus on South India
- Established brand – Dodla Dairy, Dodla+ and KC+
- Direct distribution of milk and other value added products
- Focus on right products which generate RoCE > Cost of Capital.

~100% direct procurement of milk

Dodla procures almost ~100% of milk from farmers. We note procurement of milk from farmers results in two advantages as (1) it helps to reduce procurement price as most middlemen are eliminated and (2) it also results in negative working capital.

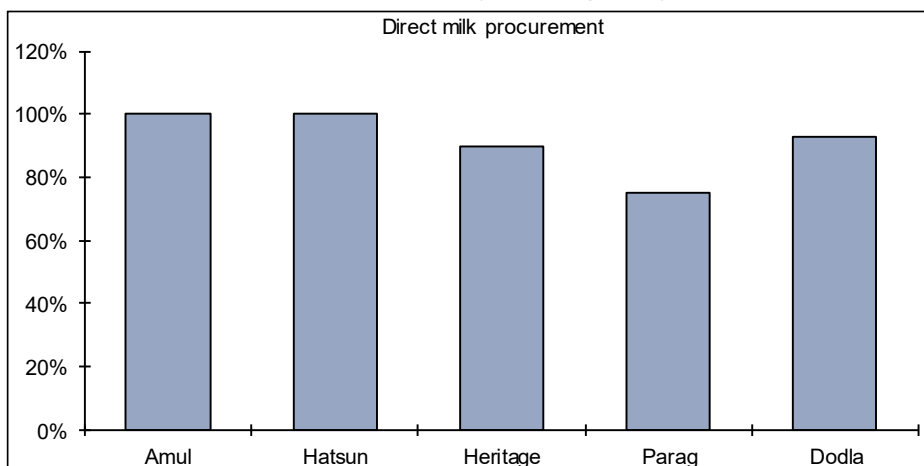
There is limited scope to raise selling prices of packaged liquid milk considering large market share of co-operatives. We believe organised dairy companies like Dodla need to control costs, and direct milk procurement helps reduce costs.

Chart 2: Rising direct milk procurement from farmers



Source: Company, I-Sec research

Chart 3: Direct milk procurement* by leading dairy companies



Source: Company, Industry, I-Sec research *Direct procurement as % of total milk procurement

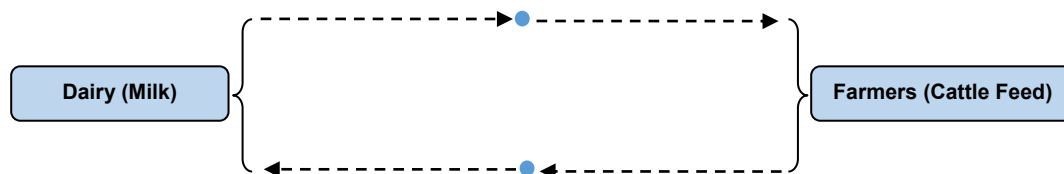
Investments in cattle feed: The company purchased OrgaFeed, cattle feed business in FY20. We note cattle feed business helps in improving relationships with farmers. Once a farmer starts purchasing cattle feed from the company, his dependence on the dairy company increases. As revenues of OrgaFeed increase, we expect Dodla to be a net beneficiary of investment in cattle feed business.

Table 1: Investments in cattle feed reduces effective milk procurement price

Particulars	Cash	Cash & Animal feed
Milk purchased from farmer (Ltrs)	10	10
Milk price (Rs/Ltr)	30	30
Total payment due (Rs)	300	300
Animal Feed Given to farmer (Kg)	-	10
Price (Rs/Kg)		23
Total Animal feed given to farmers (Rs)		230
Cash/Bank payment to farmers (Rs)	300	70
Profit on Animal Feed (~6%)		13.8
Total value given to farmers (Rs)	300	286.2
Effective cost of milk purchase (Rs/Ltr)	30.00	28.62

Source: Company, I-Sec research

Chart 4: Stronger relations with farmers

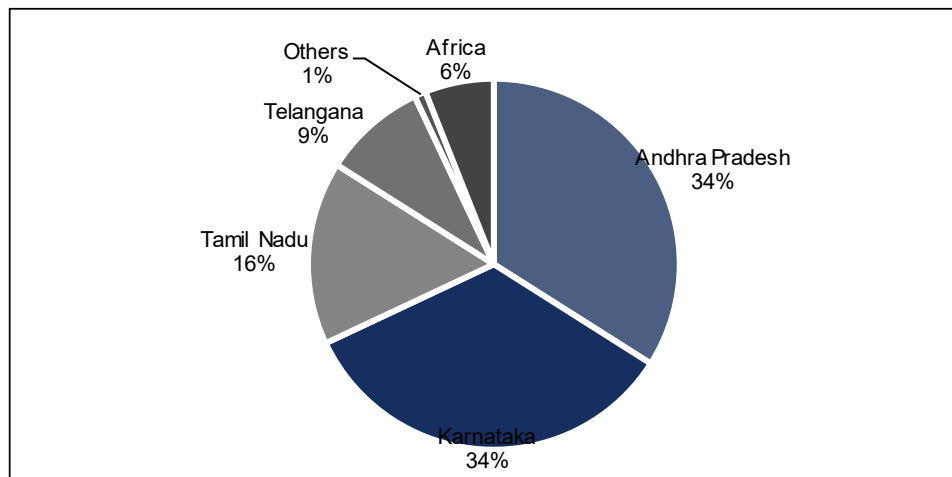


Source: Company, I-Sec research

Cluster approach- focus on South India

Cluster approach is extremely important in dairy industry. Considering limited surplus for brand building activities, Dodla is investing all the surplus in its core region of South India. Milk is a local product as it is not economical to transport it beyond 250kms. Also, many consumers have preferences for regional milk (taste, smell, cow/buffalo milk etc). Hence, we believe, Dodla’s focus on South India is working well.

Chart 5: Geographical revenue breakup of the company (FY21)



Source: Company, I-Sec research

All milk processing units are located in South India: Dodla has set up all its manufacturing units in South India (except one unit in Africa). We believe steady investments in new units in core region of South India have allowed the company to leverage milk procurement as well as establish brand equity in South India.

Chart 6: All processing units are located in South India



Source: Company, I-Sec research

Established brand

The company has done most of its brand building investments in just one brand i.e. Dodla. Considering limited surplus to invest in brand building, we believe, it is necessary to invest in limited number of brands. Dodla has also introduced some products under the brand equity of Dodla+ and has recently acquired KC+ Dairy brand in Tamil Nadu.

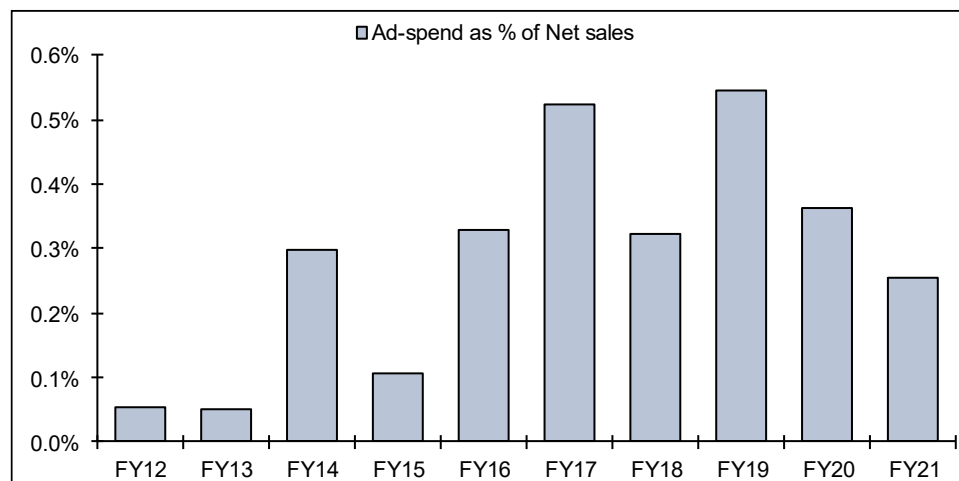
Chart 7: Key brands of Dodla Dairy



Source: Company, I-Sec research

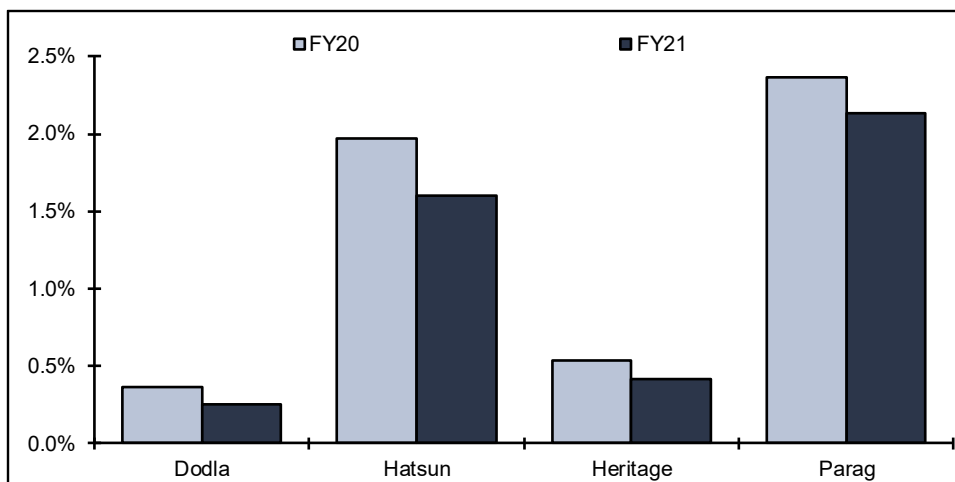
Steady increase in ad-spend to sales: The company has steadily increased the ad-spend to sales ratio from 0.1% in FY15 to 0.4% in FY20. Ad-spend has increased at CAGR of 48% over FY15-20. While the company cut ad-spend to sales (ratio) in FY21, as part of covid cost cutting measures, we model it to report increased levels of ad-spends over FY22-23. We also note the ad-spend as % of gross profit has increased from 0.6% in FY15 to 1.6% in FY20.

Chart 8: Steady increase in ad-spend to sales



Source: Company, I-Sec research

Chart 9: Ad-spend as % of net sales for dairy companies



Source: Company, I-Sec research

Direct distribution of milk and VAPs

Most consumers prefer receiving the milk at their homes early in the morning and do not like going to the market to purchase it. Dodla delivers the milk at the doorsteps of its consumers. We believe it is significantly difficult to establish such distribution network. As Dodla has established such distribution, we believe, it will be in a stronger position than most entrants in the dairy segment.

Table 3: Distribution network (As on 30th June'21)

Particulars	Nos.
Sales offices	42
Distribution agents	3,100
Milk distributors*	1,510
Dodla retail parlours	455

Source: Company, I-Sec research, *Includes both milk and milk product distributors

Focus on right products

While most products show strong growth, they do not report healthy return ratios (i.e. > cost of capital) in dairy industry. We note milk, curd, buttermilk and cottage cheese (paneer) generate healthy return ratios whereas products like cheese, ghee, they generate lower return ratios. Dodla focusses on right products like milk and curd.

Table 4: Profitability of cheese and whey

Particulars	Cheese and Whey
MRP of cheese (Rs/Kg)	450
Less: trade margin @15%	59
Company selling price	391
Less: GST 12%	42
Company net realisation (Rs/Kg) [A]	349
Value of by-products	
Whey powder generated (Kg)	0.2
Whey powder Price/Kg	300
Revenues of Whey Powder [B]	45
Total revenues [A+B]	394
Milk required (litres)	10
Price of milk (Rs/litre)	28
Raw material cost	280
Other raw materials @5% of sales	20
Packaging material @4% of sales	16
Total raw material cost (Rs)	315
Total Gross profit	79
Gross margin (%)	20.0
Other costs @5% of sales	20
Product EBITDA	59
Product EBITDA margin (%)	15.0
Working capital days	
Inventory	60
Debtors	30
Creditors	15
Net working capital days	75
Investment in working capital (Rs) [D]	82

Source: Company, I-Sec research

Table 5: Ghee and skimmed milk powder are also RoE dilutive products

Particulars	Ghee and SMP
MRP (Rs/Kg)	550
Less: trade margin @15%	72
Company selling price	478
Less: GST 12%	51.24
Company net realisation (Rs/Kg) [A]	427
Value of by-products	
SMP generated (Kg)	2.2
SMP Price/Kg	200
Revenues of SMP [B]	440
Total revenues [A+B]	867
Milk required (litres)	24
Price of milk (Rs/litre)	28
Raw material cost	672
Other raw materials @5% of sales	43
Packaging material @4% of sales	35
Total raw material cost (Rs)	750
Total Gross profit	117
Gross margin (%)	13.5
Other costs @5% of sales	43
Product EBITDA	74
Product EBITDA margin (%)	8.5
Working capital days	
Inventory	30
Debtors	30
Creditors	15
Net working capital days	45
Investment in working capital (Rs) [D]	108

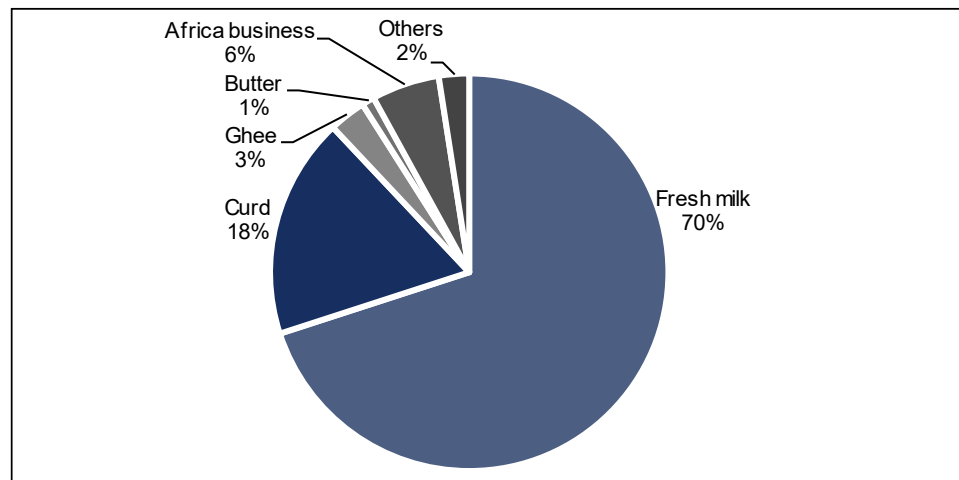
Source: Company data, I-Sec research

Focus area of Dodla

Table 6: Fresh milk products like curd enjoy strong return ratios

Particulars	Curd
MRP (Rs/Kg)	60
Less: trade margin @25%	12
Company selling price (Rs/Kg)	48
Milk required (litres)	1
Price of milk (Rs/litre)	28
Raw material cost	28
Other raw materials @5% of sales	2
Packaging material @4% of sales	2
Total raw material cost (Rs)	32
Total Gross profit	16
Gross margin (%)	32.7
Other costs @5% of sales	2
Product EBIT	13
Product EBIT margin (%)	27.7
Working capital days	
Inventory	2
Debtors	15
Creditors	15
Net working capital days	2
Investment in working capital (Rs)	0

Chart 10: Product-wise revenue breakup of Dodla Dairy (FY21)

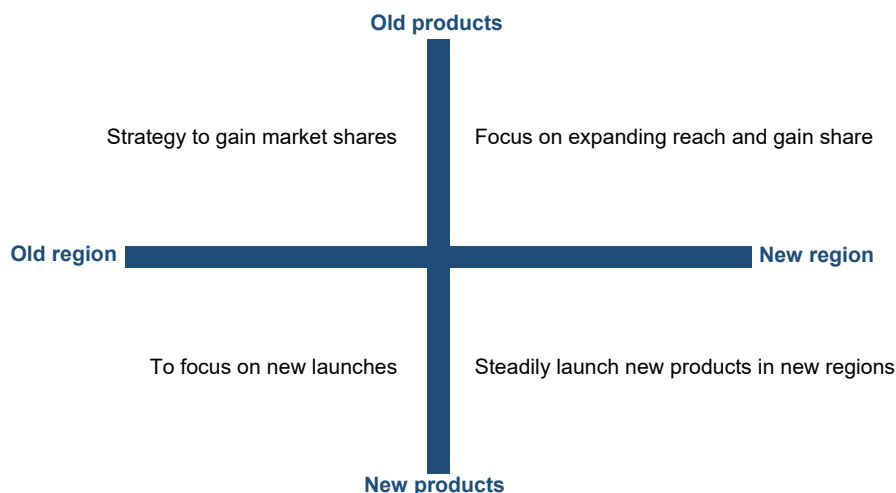


Source: Company, I-Sec research

Growth strategy

Dodla is working on a multi-pronged growth strategy. It plans to expand in new regions of South India as well as steadily introduce new products. It also plans to focus on gaining market share in its key regions and invest in strengthening its distribution network.

Chart 11: Growth strategy of Dodla Dairy



Source: Company, I-Sec research

Steady expansion of market size

The market size (milk procurement) in the key region of South India expanded by 5.8% CAGR over FY08-19. Steady increase in population of cows and buffalos as well as improvement in productivity are leading to higher growth of the market. We believe Dodla will be the net beneficiary of this trend.

Table 7: Steady expansion of milk procurement in South India

MT	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19	CAGR (%)
Tamil Nadu	6,540	6,651	6,787	6,831	6,968	7,005	7,049	7,132	7,244	7,556	7,742	8,362	2.3%
AP + Telangana	8,925	9,570	10,429	11,203	12,088	12,773	13,007	13,863	15,259	16,859	18,690	20,460	7.8%
Karnataka	4,244	4,538	4,822	5,114	5,447	5,718	5,997	6,121	6,344	6,562	7,137	7,901	5.8%
Total	19,709	20,759	22,038	23,148	24,503	25,496	26,053	27,116	28,847	30,977	33,569	36,723	5.8%

Source: NDDB, Company, I-Sec research

Market share expansion of Dodla

Dodla is gaining market share steadily in its core region of South India. We note steady increase in milk procurement as well as expansion of distribution network are leading to market share gains. We model the company to continue to gain market share in coming years, too.

Table 8: Increase in market share of Dodla

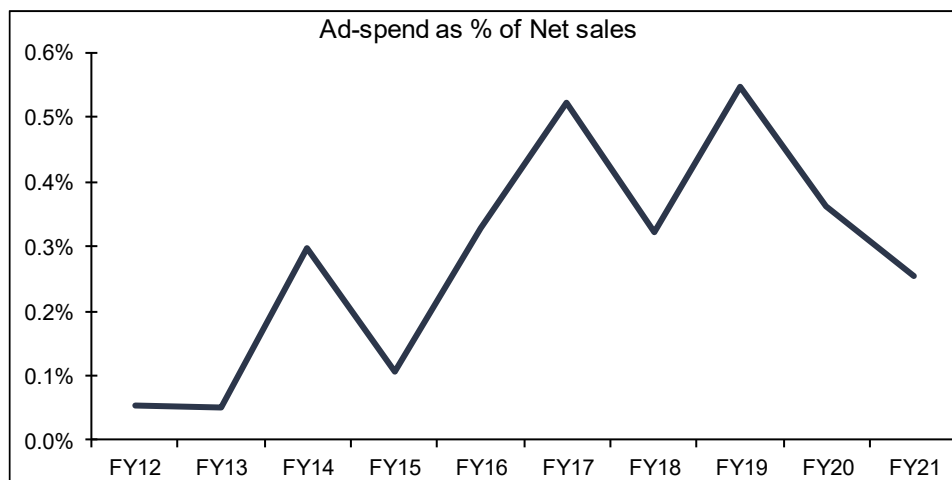
mnpd	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19
Total (mnpd)	54	57	60	63	67	70	71	74	79	85	92	101
Dodla (mnpd)	0.3	0.4	0.4	0.5	0.6	0.6	0.6	0.8	0.8	0.9	1.0	1.1
Market share (%)	0.6%	0.6%	0.7%	0.7%	0.9%	0.9%	0.9%	1.0%	1.0%	1.1%	1.1%	1.0%

Source: NDDB, Company, I-Sec research

Increase in ad-spend leading to stronger brand equity

The company has steadily expanded its ad-spend to sales ratio from 0.1% in FY15 to 0.3% in FY21. We believe stronger brand equity will lead to higher market share as well as better pricing power for the company.

Chart 12: Steady expansion of ad-spend to sales

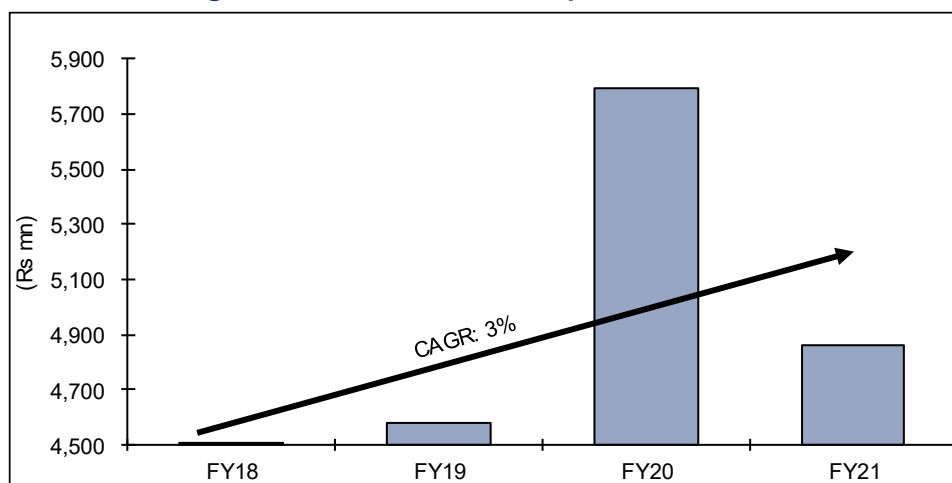


Source: Company, I-Sec research

Rising revenue share of value-added products

Value-added products reported 3% CAGR over FY18-21. We note value-added products account for ~30% of revenues now compared to 28% of revenues in FY17. These value-added products fetch better realisation and margin for the company. Hence, we believe, increase in revenue share of value-added products will likely lead to better revenues/ profitability.

Chart 13: Rising revenues of value-added products

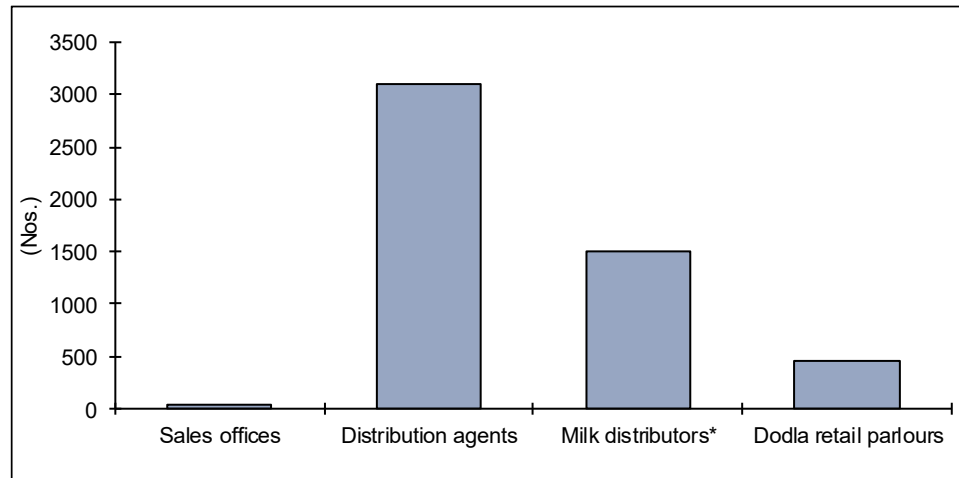


Source: Company, I-Sec research

Expansion of distribution network

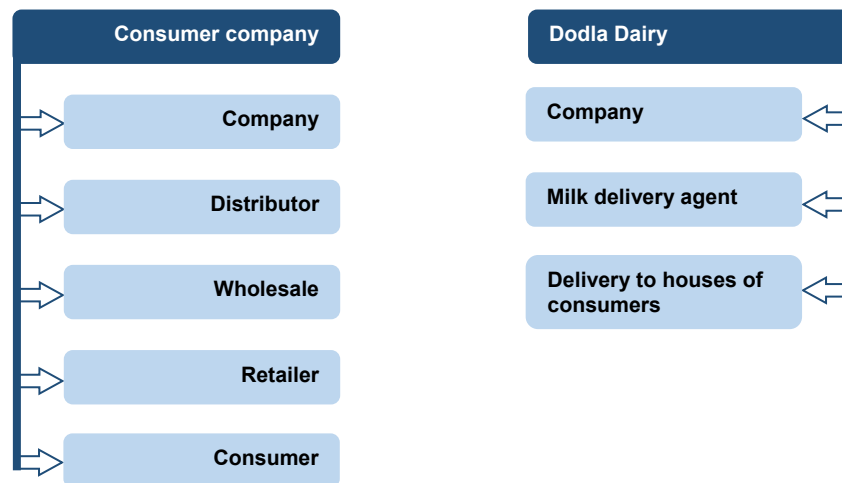
Dodla has reached 3,100 distribution agents at end of Q1FY22. It has 1,510+ milk and milk product distributors and has also rolled out 455 Dodla retail parlours. We also note the company has established strong distribution network to sell its products to the houses of end consumers.

Chart 14: Current distribution network



Source: Company, I-Sec research , *Includes both milk and milk product distributors

Chart 15: Distribution network of consumer companies vs Dodla Dairy

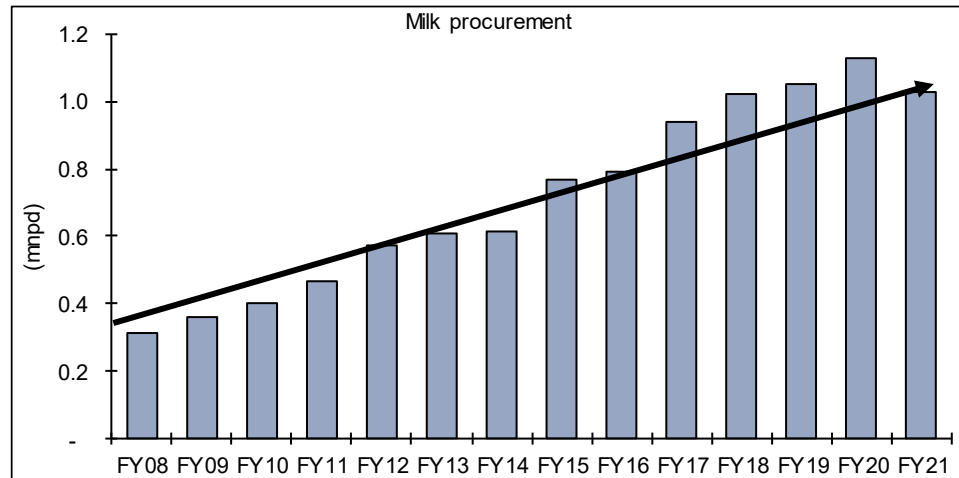


Source: Company, I-Sec research

Milk Procurement network

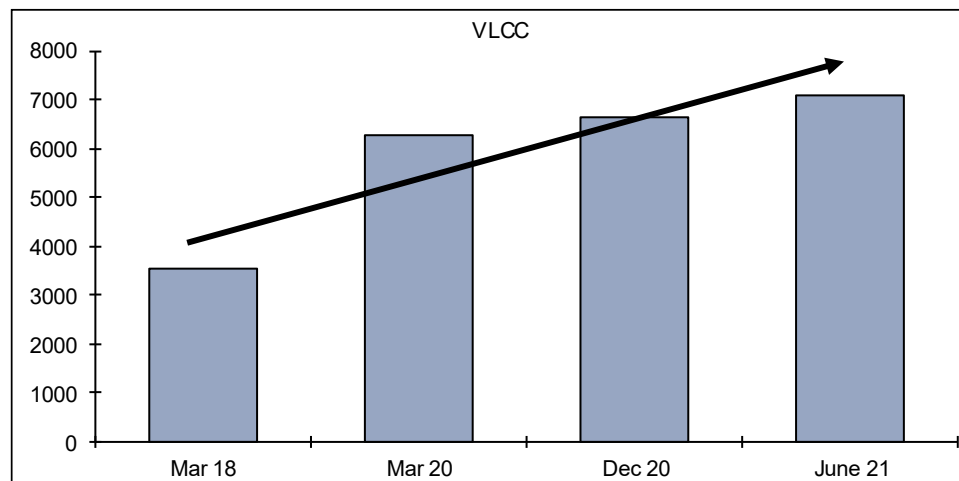
Milk procurement has increased from 0.61 mnpd in FY13 to 1.03 mnpd in FY21 at a CAGR of 6.7%. We note the company has increased the number of village level collection centres (VLCCs) at a CAGR of 24% over FY18-21. Expansion of VLCCs has allowed the company to expand direct milk procurement from farmers from 7% in FY14 to 93% in FY21.

Chart 16: Increase in milk procurement



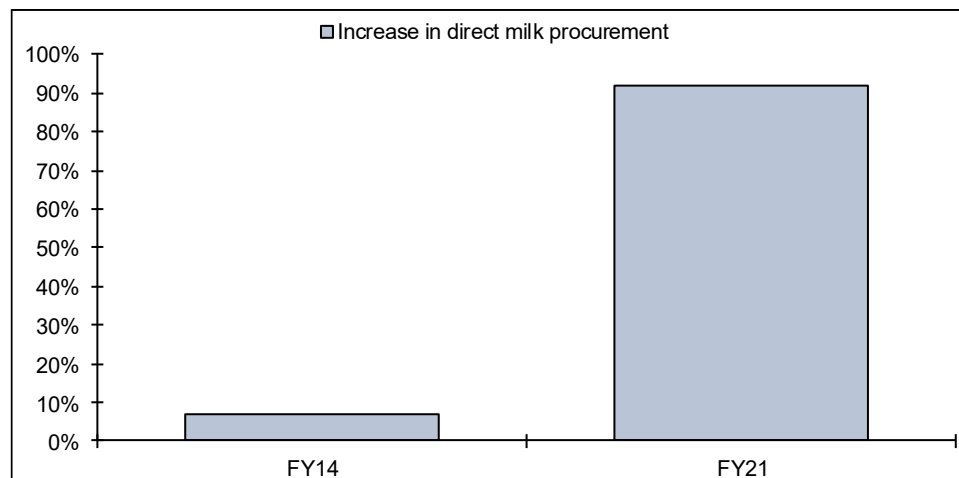
Source: Company, I-Sec research

Chart 17: Steady expansion of village level collection centres



Source: Company, I-Sec research

Chart 18: Increase in direct milk procurement as % of total procurement



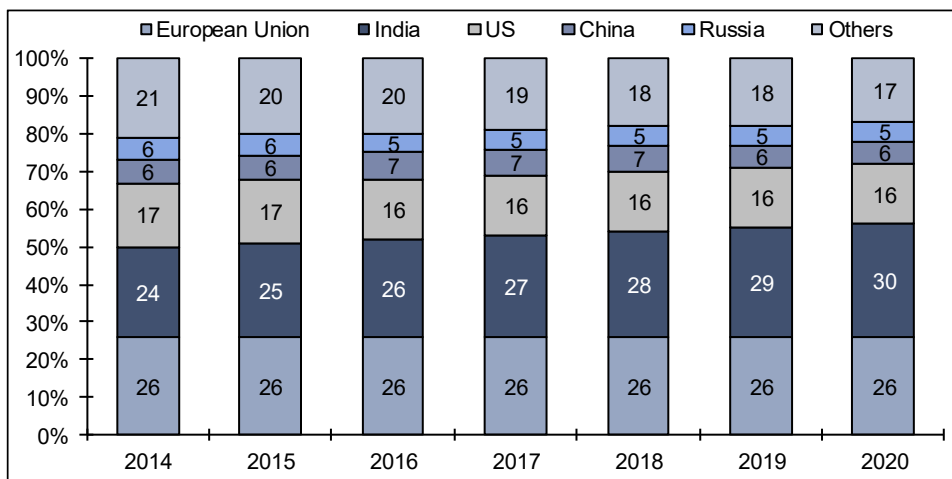
Source: Company, I-Sec research

Dairy sector: A growing industry

India: Largest milk producer in the world

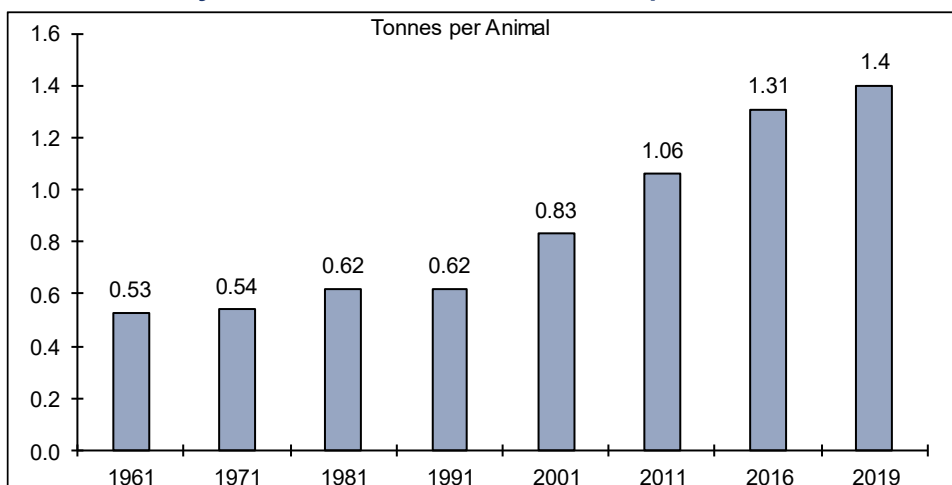
India is the global leader in milk production, contributing ~30% of milk production in 2020. India's share in overall production increased from 25% in 2015 to 30% in 2020.

Chart 19: India is largest milk producer (CY2020)



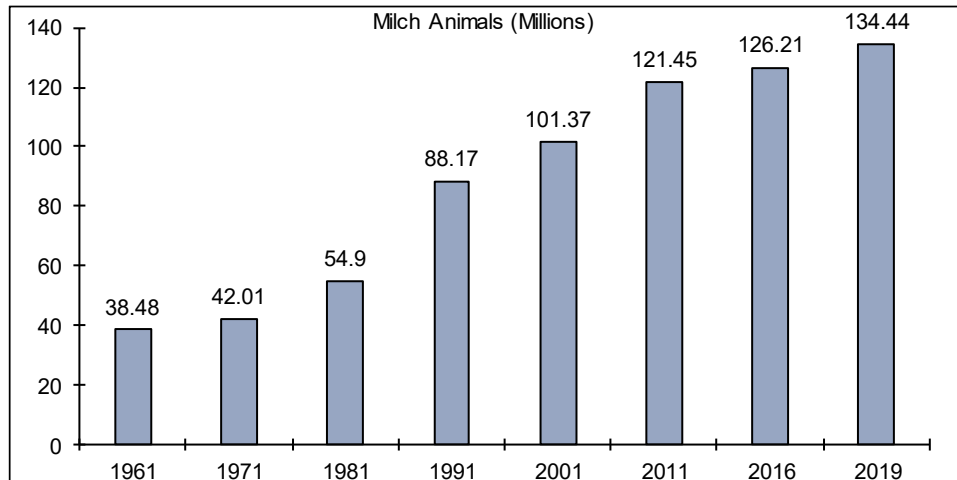
Source: USDA, Industry, CRISIL Research, I-Sec research

Chart 20: Milk yields in India are lower vs developed countries



Source: FAOSTAT, CRISIL Research, I-Sec research

Chart 21: Steady increase in number of milch animals in India

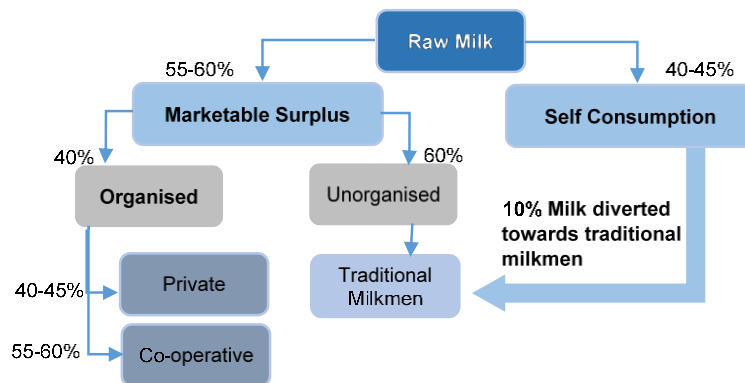


Source: FAOSTAT, CRISIL Research, I-Sec research

The structure of the Indian dairy industry

The Indian dairy industry is broadly divided into organised and unorganised segments. The organised segment comprises cooperative and private companies, while the unorganised segment comprises local vendors / farmers.

Chart 22: Domestic milk market (FY20)

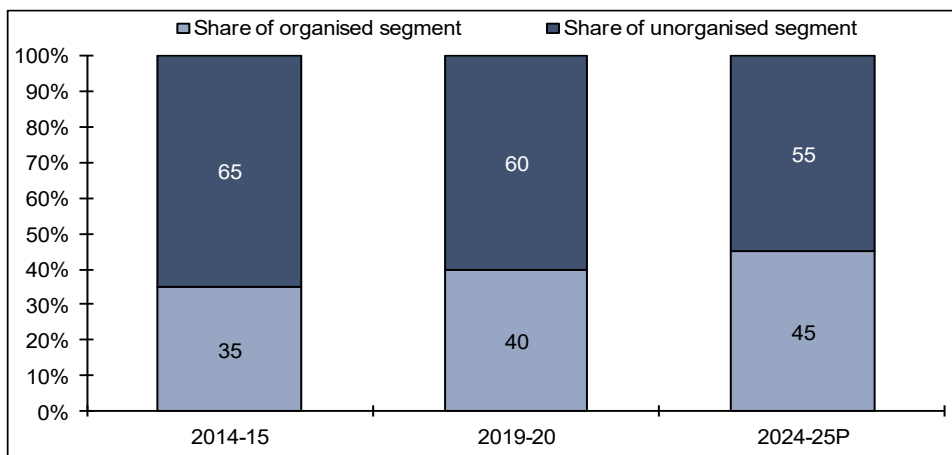


Source: NDDB, Industry, CRISIL Research, I-Sec research

Indian dairy sector is fragmented as well as unorganised

In fiscal 2020, the unorganised segment had ~60% market share. The organised sector had ~40% share. We believe rising consumerism, growing urbanisation and preference for branded packaged foods will drive shift from unorganised to organised sector.

Chart 23: Share of Organised to Unorganised dairy market



Source: Industry, CRISIL Research, I-Sec research

Co-operatives benefit due to subsidy

Co-operatives have a strong procurement and storage capacity with established network of collection as well as chilling centres. Also, a few state governments such as those in Karnataka and Telangana offer subsidies of Rs3-5/litre to the farmers on supplying their milk to co-operative dairies. Hence, co-operative players have advantage in milk procurement in these states.

Growth drivers for the dairy industry

As per industry estimates, the Indian dairy industry is expected to grow at ~10% CAGR over FY21-25 based on the following:

Rising urban population

Growth in dairy industry is expected to be aided by rising consumerism, growing urbanisation and increasing number of nuclear families, especially in the value-added dairy product segment.

Growth of HoReCa sector to boost consumption of dairy

Changing consumption patterns in India has fuelled the growth of HoReCa industry in India. According to National Restaurant Association of India (NRAI), food services industry in India (which is predominantly unorganised) was estimated around Rs.4.23trn in FY19, which is expected to grow at a pace of 9-10% over FY20-FY25.

Rising acceptance of packaged milk

Rapid urbanisation, number of nuclear families, and rising health awareness have led to higher growth of packaged milk. Easy availability and hygiene are also key drivers of growth.

Importance of milk as a source of protein

Given the high proportion of vegetarians in the overall population mix, it is expected to result in rising demand for milk/ milk products as it is an important source of protein.

Priority sector lending for dairy sector

Priority sector lending status for dairy sector since 1999 has played a pivotal role in shaping the sector. Better access to credit has fuelled the growth of the sector.

Rising share of Value added products

With changing dietary patterns as well as consumer lifestyle, demand for value added products is growing faster than milk. The revenue share of value added products is expected to be higher in short-medium term.

Product innovation

Dairy companies are steadily innovating and manufacturing products across all price points to cater to consumers. Better packaging also leads to higher acceptance among consumers.

Investments in supply chain

With cold storage facilities and transportation infrastructure improving across India, dairies are expected to benefit, over the medium-long term. Penetration of milk and value added products in rural markets is expected to increase.

Product-wise growth outlook

The revenue share of fluid milk (packaged + unprocessed) as a percentage of the dairy industry has remained above 65%, but continues to decrease steadily. Value added products are expected to grow at faster pace than packaged milk.

Chart 24: Product-wise margins, market size and growth

(₹ billion)	EBITDA margin	FY15	FY20	FY21E	FY25P	CAGR FY15-20	CAGR FY21-25P
Fluid milk	4-6%	2,783	4,311	4,359	6,000	~9%	~6-8%
Ghee	20-22%	590	1049	1101	1,773	~12%	~13-14%
Paneer	19-21%	209	443	494	894	~16%	~15-17%
Butter	17-19%	130	228	238	380	~12%	~12-13%
Curd	19-21%	120	187	180	308	~9%	~13-15%
Ice cream	37-39%	43	113	83	170	~21%	~19-21%
SMP	6-8%	60	90	90	136	~9%	~9-10%
Yogurt	24-26%	19	51	55	110	~22%	~20-21%
Khoa	14-16%	47	75	61	93	~9%	~11-12%
Cheese	29-31%	36	72	69	120	~14%	~14-16%
Whey	27-29%	8	17	14	22	~16%	~13-14%
Buttermilk & Lassi	10-12%	5	7	8	12	~8%	~10-11%

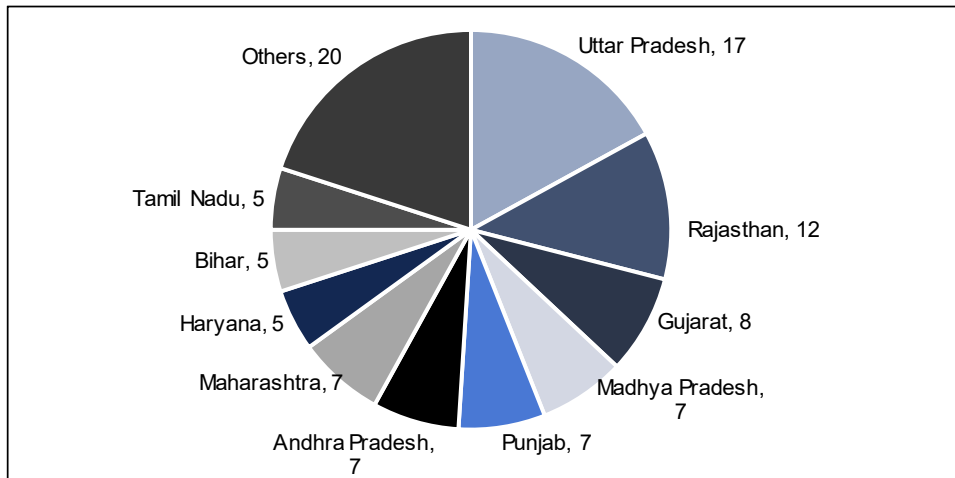
Note: E: Estimated, P Projected

Source: Industry, CRISIL Research, I-Sec research

Geographic breakup of dairy industry

Although dairy farming is the primary profession of many people in rural areas, milk production is concentrated in 10 states that account for over 80% of total milk production in India. Uttar Pradesh, Rajasthan and Gujarat are top milk producing states.

Chart 25: State-wise milk procurement in India

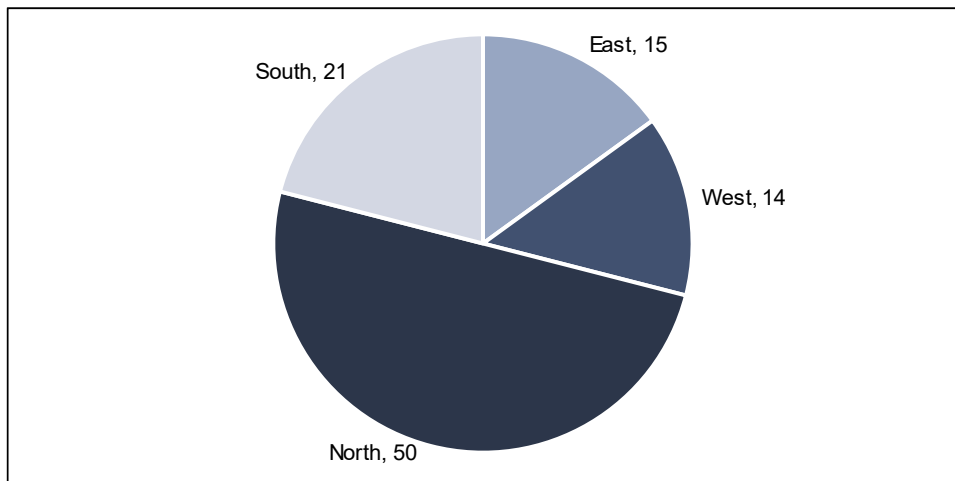


Note: State wise share is estimated based on CRISIL estimates of volume produced
 Source: NDDB, Industry, CRISIL Research, I-Sec research

Region-wise milk procurement

South India maintained a share of 21% in FY20. Over FY15-20, milk production in South India reported CAGR of 7.0%.

Chart 26: Southern region maintained ~21% share in milk production



Source: NDDB, CRISIL Research, I-Sec research

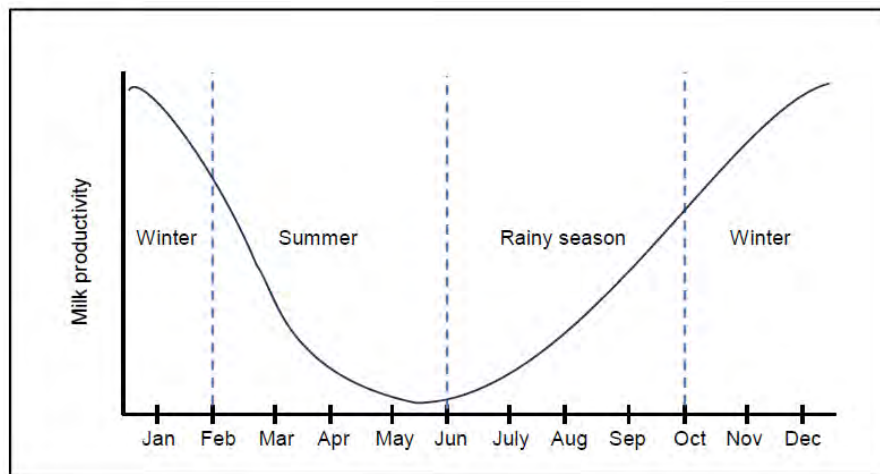
Milk procurement cycle and impact on Dodla

Milk remains a cyclical commodity and there are many factors which affect the price and production of milk. The changes in production as well as prices affect revenues and profitability of dairy companies. We believe milk procurement prices were passing through a downturn in FY21 and benefitted all dairy companies including Dodla. However, we note the reversal in milk procurement cycle may impact the profitability of organised dairies in H2FY22 and FY23.

Annual production cycle of cow/buffalos

In India, milk production varies a lot among seasons and is generally higher in winter and lower in summer. As consumption remains stable during the year, the excess milk in winter is converted into long shelf-life products such as skimmed milk powder and ghee.

Chart 27: Milk production remains cyclical through seasons

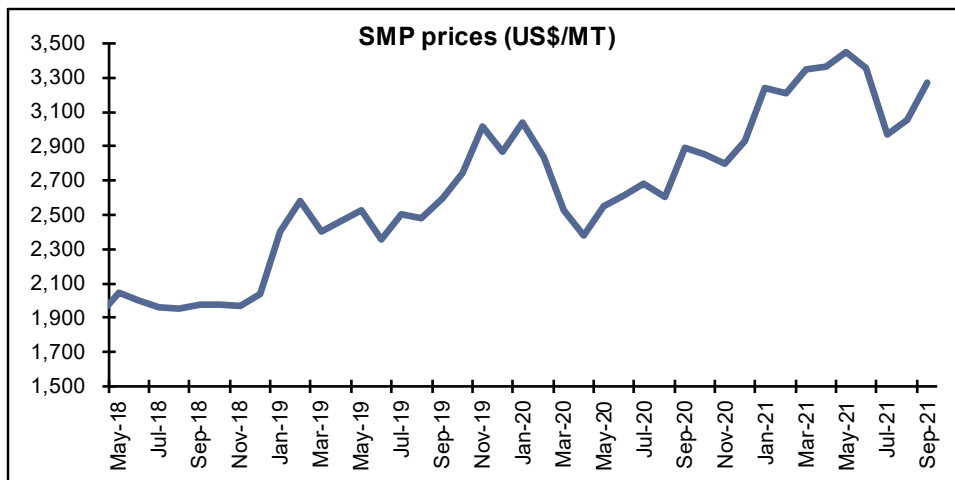


Source: Company, I-Sec research

Change in global SMP prices

Steady changes in global milk production as well as changes in global SMP inventory impact SMP prices globally. It also impacts SMP prices in India. Increase in global SMP prices leads to higher SMP prices in India thus pushing milk procurement prices upwards and vice versa.

Chart 28: Global SMP prices are inching upwards



Source: Company, Industry, I-Sec research

State-wise subsidy

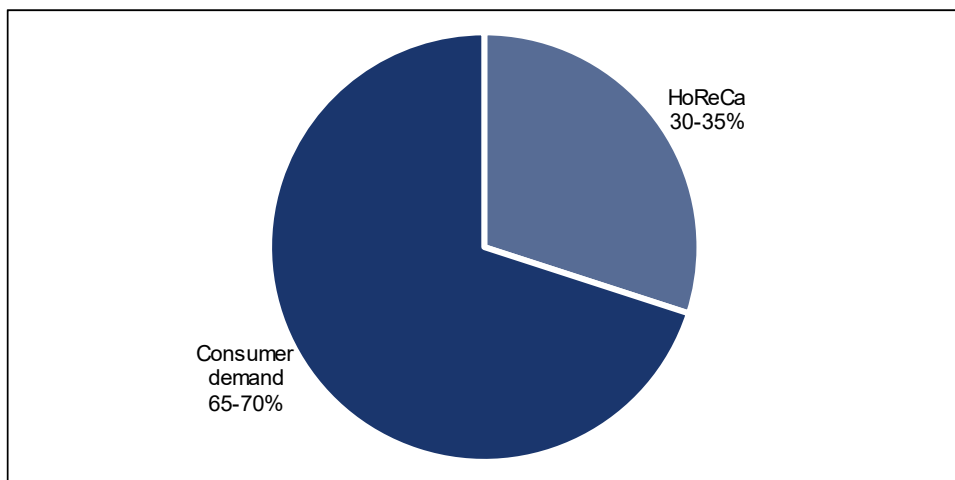
Some states in India offer subsidy on milk. Some states offer subsidy on skimmed milk powder and exports of milk products. We note steady changes in subsidy rates have an impact on milk procurement prices.

What happened in FY21?

Post covid and lockdown, demand from HoReCa sector declined. We believe HoReCa accounts for 30-35% of total milk consumption in India. At the same time, the consumption of out-of-home consumption products such as flavoured milk, butter milk, lassi, milkshakes and ice-cream also declined as most consumers were working from home.

Hence, it resulted in lower demand but stable supply of milk. Hence, milk procurement prices declined during FY21. However, with normalisation of economy, milk procurement is expected to move upwards.

Chart 29: Demand from HoReCa as % of total demand



Source: Company, I-Sec research

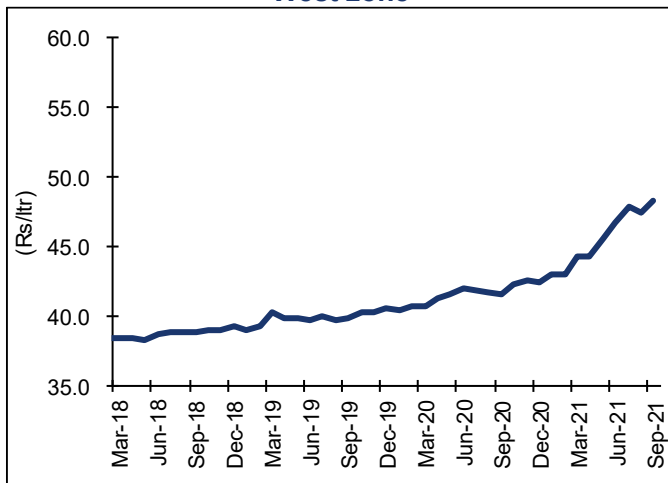
Where do we see milk procurement prices in H2FY22 and FY23?

Milk procurement prices are expected to move upwards in H2FY22 and FY23 considering (1) normalisation of economy, and (2) increase in freight cost post rise in crude oil prices. We also note most cooperatives have started raising milk selling prices. We believe private players like Dodla will also be able to increase milk selling prices even if milk procurement prices increase.

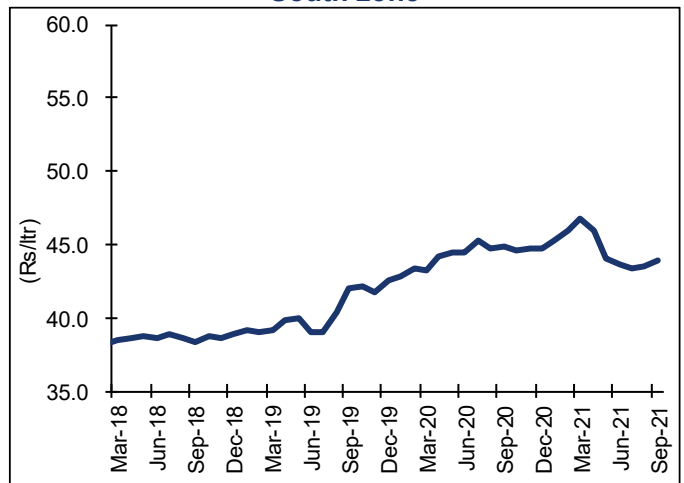
We see some impact on profitability of dairy companies in H2FY22 and FY23 compared to FY21. However, we model dairy companies to still generate better profitability than pre-covid levels i.e. FY20.

Chart 30: Milk procurement prices across regions

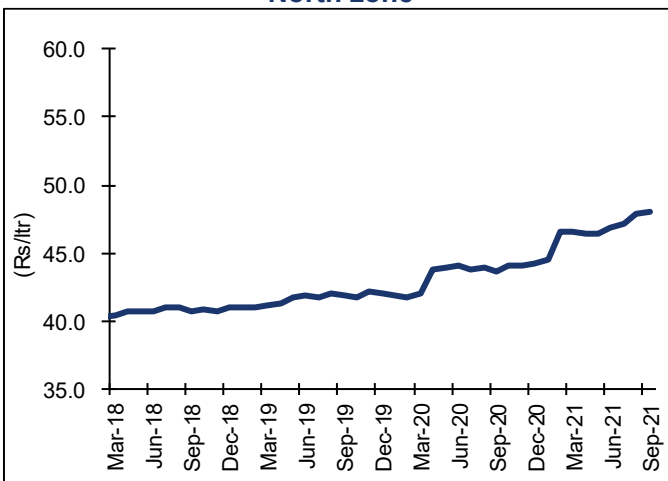
West zone



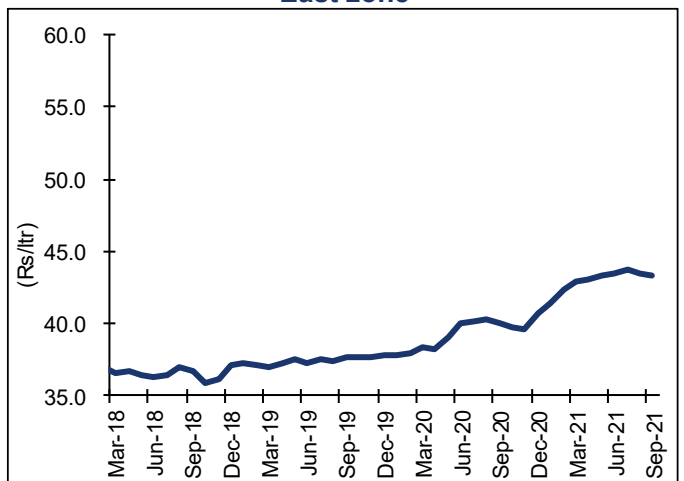
South zone



North zone



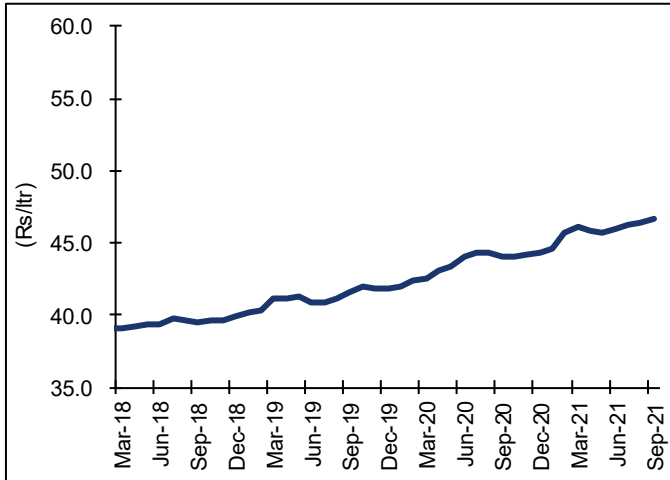
East zone



Source: Company data, I-Sec research.

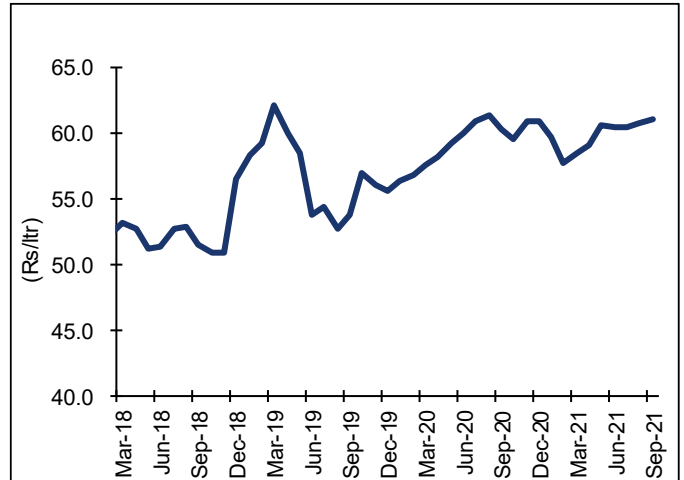
Source: Company data, I-Sec research.

Pan India



Source: Company data, I-Sec research.

North-East zone



Source: Company data, I-Sec research.

Peer group comparison

Revenues

(Rs mn)	FY19	FY20	FY21	CAGR (%)
Hatsun	47,603	53,083	55,697	8.2%
Heritage	25,148	27,259	24,731	-0.8%
Parag	23,957	24,379	18,418	-12.3%
Amul	3,31,943	3,85,757	NA	
Dodla	16,917	21,394	19,440	7.2%

EBIT

(Rs mn)	FY19	FY20	FY21	CAGR (%)
Hatsun	2,409	2,536	4,688	39.5%
Heritage	1,440	791	2,249	25.0%
Parag	1,733	1,575	730	-35.1%
Amul	966	585		
Dodla	976	999	1,917	40.1%

Gross margin

(%)	FY19	FY20	FY21
Hatsun	29.8	29.1	31.7
Heritage	21.5	18.4	25.7
Parag	30.8	25.6	26.1
Amul	4.7	4.3	-
Dodla	25.7	23.3	30.5

EBIT margin

(%)	FY19	FY20	FY21
Hatsun	5.1	4.8	8.4
Heritage	5.7	2.9	9.1
Parag	7.2	6.5	4.0
Amul	0.3	0.2	-
Dodla	5.8	4.7	9.9

RoE

(%)	FY19	FY20	FY21
Hatsun	18.5	12.3	24.0
Heritage	10.5	8.9	29.0
Parag	15.9	11.0	2.3
Amul	11.4	11.3	-
Dodla	16.5	12.2	21.5

Adspend as % of net sales

(%)	FY19	FY20	FY21
Hatsun	2.2	2.0	1.6
Heritage	0.8	0.5	0.4
Parag	4.0	2.4	2.1
Amul	2.5	2.5	-
Dodla	0.5	0.4	0.3

EBITDA

(Rs mn)	FY19	FY20	FY21	CAGR (%)
Hatsun	4,415	5,501	7,787	32.8%
Heritage	1,887	1,293	2,712	19.9%
Parag	2,235	2,111	1,248	-25.3%
Amul	2,214	1,946		
Dodla	1,347	1,491	2,425	34.1%

PAT

(Rs mn)	FY19	FY20	FY21	CAGR (%)
Hatsun	1,148	1,123	2,464	46.5%
Heritage	853	582	1,598	36.8%
Parag	1,207	937	207	-58.6%
Amul	528	562		
Dodla	628	571	1,260	41.7%

EBITDA margin

(%)	FY19	FY20	FY21
Hatsun	9.3	10.4	14.0
Heritage	7.5	4.7	11.0
Parag	9.3	8.7	6.8
Amul	0.7	0.5	-
Dodla	8.0	7.0	12.5

PAT margin

(%)	FY19	FY20	FY21
Hatsun	2.4	2.1	4.4
Heritage	3.4	2.1	6.5
Parag	5.0	3.8	1.1
Amul	0.2	0.1	-
Dodla	3.7	2.7	6.5

RoCE

(%)	FY19	FY20	FY21
Hatsun	13.5	12.9	21.3
Heritage	13.1	8.5	31.5
Parag	16.8	13.4	5.7
Amul	5.6	4.3	-
Dodla	17.6	16.0	27.1

Net working capital days

(%)	FY19	FY20	FY21
Hatsun	10	(14)	(6)
Heritage	(4)	(6)	4
Parag	82	113	154
Amul	0	(5)	-
Dodla	5	(3)	(15)

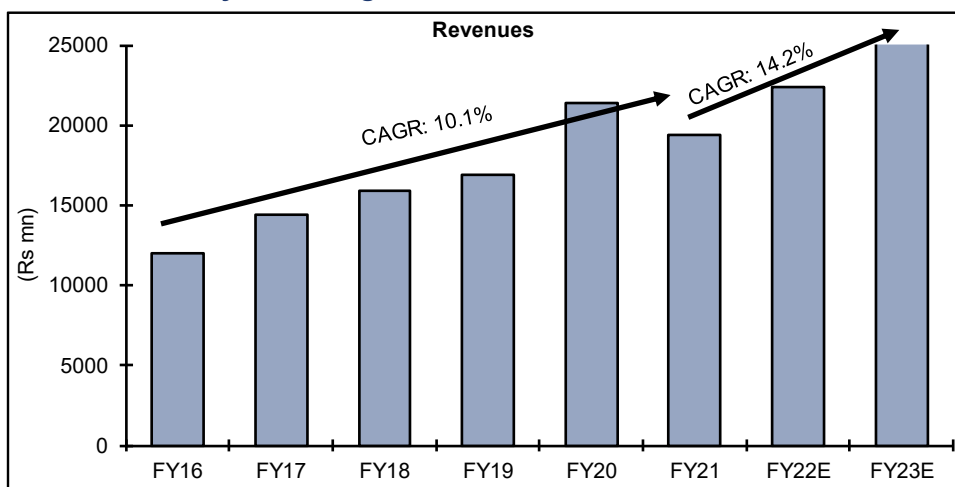
Source: Company data, I-Sec research

Financial performance

Expect steady revenue growth ahead

Dodla reported revenue CAGR of 10.1% over FY16-FY21. Key reasons for such strong growth were: 1) Steady expansion of distribution network, and 2) introduction of new value-added products. We model the company to report revenue CAGR of 14.2% over FY21-FY23E.

Chart 31: Healthy revenue growth ahead

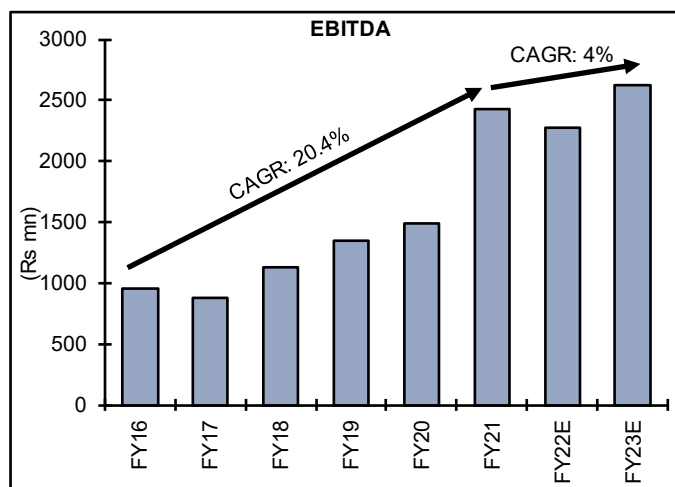


Source: Company data, I-Sec research

EBITDA margin over FY22-FY23E expected to decline from FY21 level

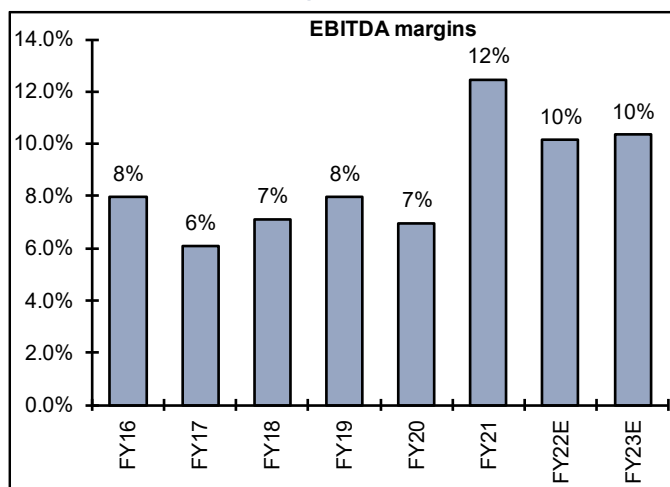
Dodla's EBITDA margin expanded from 8% in FY16 to 12% in FY21. We expect gross margin to fall to ~28% during FY21-FY23E from 30.5% in FY21, and to report EBITDA margin of 10.4% in FY23E.

Chart 32: EBITDA CAGR at 4% over FY21-FY23E



Source: Company data, I-Sec research

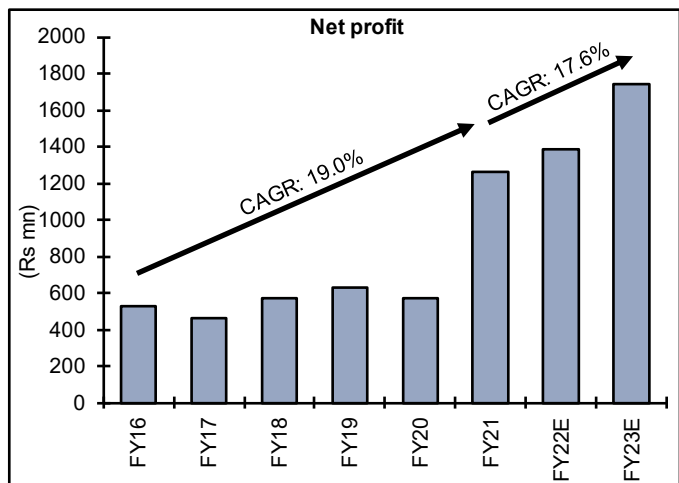
Chart 33: EBITDA margins



Net profit growth to remain strong

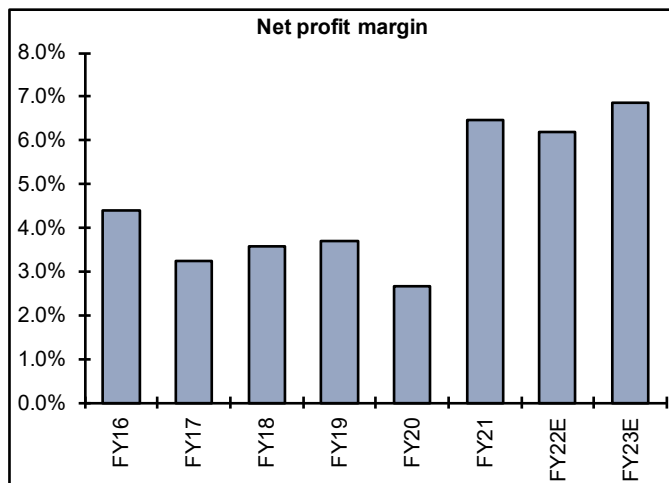
Due to (1) lower interest cost and (2) higher other income, we expect Dodla's PAT margin to be stable over FY21-23E (despite fall in EBITDA margins). We expect the company to report PAT margin of 6.9% in FY23E equal to FY21 levels. We expect net profit CAGR of 17.6% over FY21-FY23E vs revenue CAGR of 14.2% over the same timeframe.

Chart 34: Steady net profit growth ahead



Source: Company data, I-Sec research

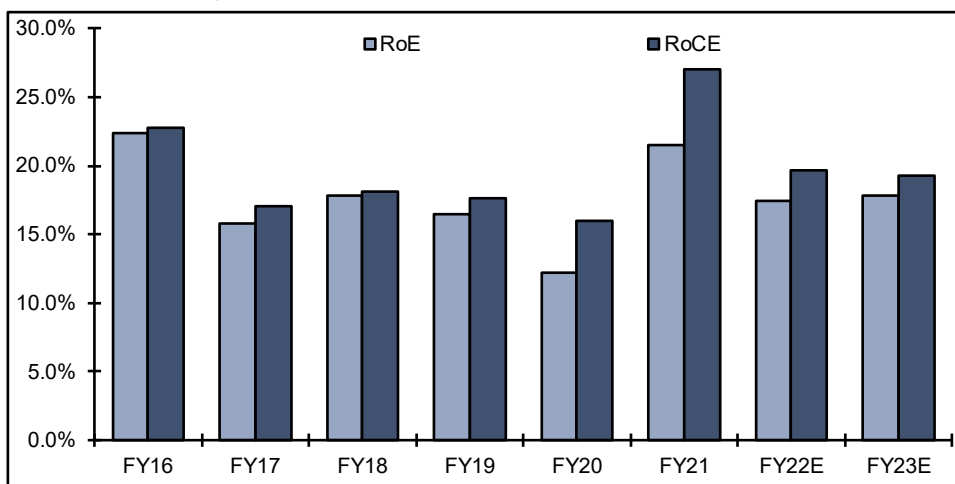
Chart 35: Net profit margins to remain stable



Return ratios > cost of capital

Dodla has maintained strong return ratios over FY16-FY21 due to strong margins as well as high asset turns. Also, improvement in margin has helped improve return ratios. We expect the company to report return ratios in excess of the cost of capital across FY20-FY23E.

Chart 36: Strong return ratios

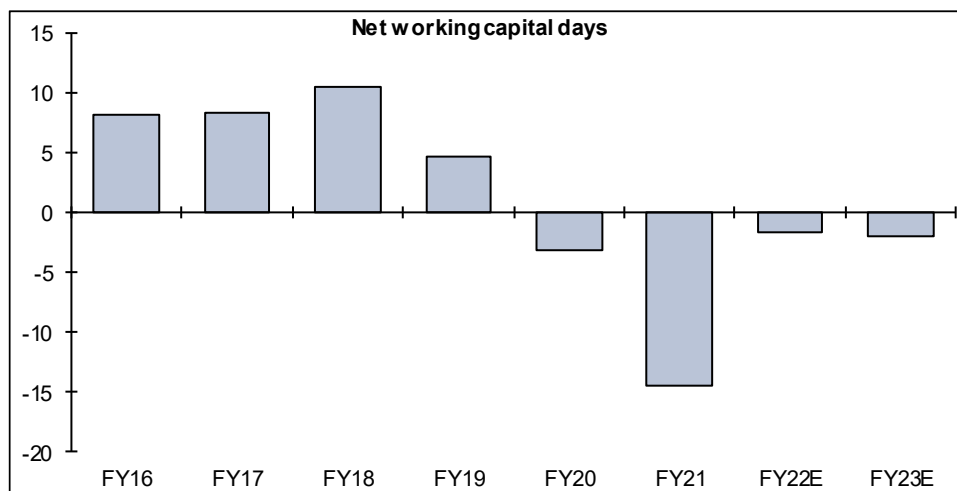


Source: Company data, I-Sec research

Investment in working capital

Due to higher creditor days, we believe Dodla will likely be able to curtail its investment in working capital. Working capital days have reduced from 8 in FY16 to -15 in FY21. We expect net working capital days at -2 by FY23E-end.

Chart 37: Net working capital days



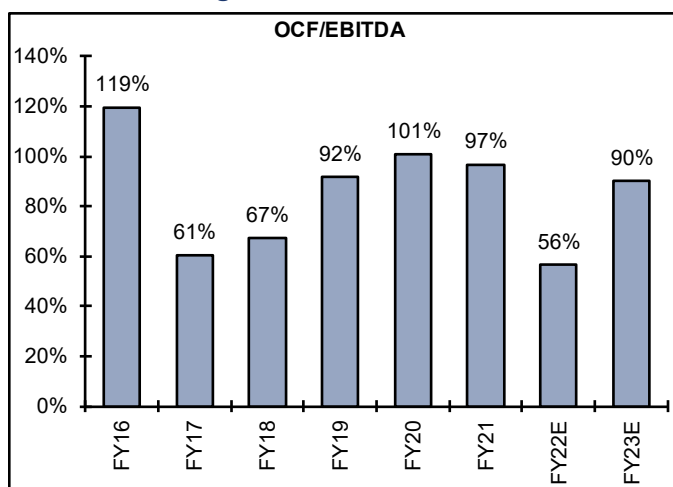
Source: Company data, I-Sec research

Strong OCF generation

Dodla has a healthy cash generation record with an average OCF/EBITDA of 89% over FY16-FY21. It has used the OCF to 1) expand business and distribution, 2) incur capex, 3) launch new products and 4) pay dividends .

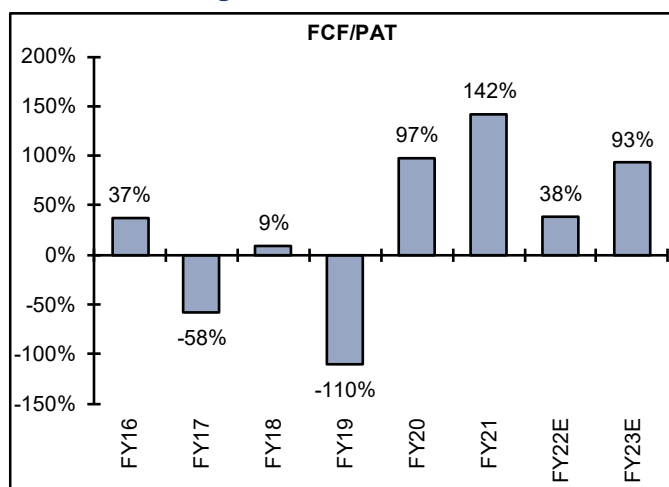
We expect Dodla to use its OCF generation to strengthen balance sheet and competitive advantages in coming years.

Chart 38: Average OCF/EBITDA at 89%*



Source: Company data, I-Sec research *FY16-21

Chart 39: Average FCF/PAT at 20%*



Source: Company data, I-Sec research *FY16-21

Key assumptions

Table 9: Key assumptions

(Rs mn)

	FY20	FY21	FY22E	FY23E
Net revenues	21,394	19,440	22,413	25,349
<i>Growth (%)</i>	26.5%	-9.1%	15.3%	13.1%
Gross profit	4,988	5,931	6,231	7,098
<i>Gross margin (%)</i>	23.3%	30.5%	27.8%	28.0%
EBITDA	1,491	2,425	2,275	2,624
<i>EBITDA margin (%)</i>	7.0%	12.5%	10.2%	10.4%
PBT	891.4	1862.2	1892.6	2233.9
<i>PBT margin (%)</i>	4.2%	9.6%	8.4%	8.8%
<i>Tax rate (%)</i>	35.9%	32.4%	26.6%	22.0%
PAT	571	1,260	1,389	1,742
<i>PAT margin (%)</i>	2.7%	6.5%	6.2%	6.9%
<i>PAT growth (%)</i>	-9.0%	120.4%	10.3%	25.4%
Capex	(953)	(573)	(750)	(750)
Net working capital days	-3	-15	-2	-2
Operating cashflow	1,504	2,346	1,285	2,369
Free cashflow	556	1,784	535	1,619
<i>OCF/EBITDA (%)</i>	100.9%	96.8%	56.5%	90.3%

Source: Company data, I-Sec research

Valuation

We have valued Dodla as per DCF methodology, which leads to a target price of Rs700 per share.

Table 10: DCF valuation

Particulars	Amt (Rs)
Cost of equity (%)	11.3%
Terminal growth rate (%)	4.0%
Discounted interim cash flows (Rs mn)	15,627
Discounted terminal value (Rs mn)	26,018
Total equity value (Rs mn)	41,644
Value per share (Rs)	700

Source: Company, I-Sec research

Relative valuation

Dodla trades at premium to Heritage Foods but at discount to dairy sector valuation in FY23E.

Table 11: Relative valuation

Company	CMP (Rs)	RoE (%) FY22E	RoCE (%) FY22E	CAGR FY21-23 (%)			P/E (x)	
				Revenues	EBITDA	PAT	FY22E	FY23E
Hatsun	1,398	23.1	19.8	16.1	8.0	19.2	112.7	86.1
Heritage	465	22.8	27.9	15.2	2.9	7.8	13.7	11.6
Parag	125	9.3	11.5	21.2	36.6	147.8	11.3	9.5
Dodla	600	17.4	19.6	14.2	29.4	17.6	25.7	20.5

Source: Company data, I-Sec research

Key risks

Steep rise in competitive pressures and input prices: Steep rise in competitive pressures and material increase in production capacities by peers in a short timeframe can hurt Dodla's earnings. Higher cost of production may also impact earnings.

Delays in launch / failure of new products: Any delay in launch of new products and/or failure of new products may impact Dodla's financials.

Weak economic outlook: If there is prolonged weakness in India's economy, it will impact the company's growth prospects.

Competition from cooperatives: The company's inability to compete with dairy cooperatives may adversely affect the results of operations and financial conditions.

Business and management

Dodla Dairy (Dodla) is promoted by Dodla Sunil Reddy, Dodla Sessa Reddy and the Dodla Family Trust in 1995. The company was initially established in Andhra Pradesh, but it acquired a plant in Tamil Nadu. In 2012, Black River invested in the company. In 2019, it acquired Batlagundu and Vedasandur processing plants in Tamil Nadu via a business transfer agreement with KC Dairy Products Private Limited.

The company has the 2nd highest market presence across 12 states in the country. It collects milk from 7,100+ village level collection centres. It has installed 97 chilling centres. It distributes its products through 1,510+ distributors and has 455 Dodla retail parlors.

Table 12: Timeline of Dodla's business operations

FY1995	Incorporation of Dodla Dairy
FY1997	Commenced production in Nellore plant in Andhra Pradesh
FY2001	Commenced production in Penumuru plant in Andhra Pradesh
FY2004	Commenced production in Palamaner plant in Andhra Pradesh
FY2007	Commenced production in Sattenapally and Badvel plants in Andhra Pradesh
FY2009	Implemented Microsoft Dynamic ERP across our Company
FY2011	Commenced production in Tanuku plant in Andhra Pradesh
FY2013	Commenced production in Kurnool plant in Andhra Pradesh
FY2014	Acquired Lakeside Dairy, Uganda and commenced operations
FY2016	Commenced production in Palacode plant in Tamil Nadu
FY2017	Acquired land for our processing plant in Rajahmundry in Andhra Pradesh
FY2019	OPL acquired a cattle feed mix plant business from Bharathi Feed Mixing Plant
FY2021	IPO

Source: Company data, I-Sec research

Table 13: Key managerial personnel

Person	Role
Dodla Sessa Reddy	Chairman and non-executive Director
Dodla Sunil Reddy	Managing Director
Madhusudhana Reddy Ambavaram	Whole-time Director
Akshay Tanna	Non-Executive Nominee Director
Raja Rathinam	Independent Director
Ponnavolu Divya	Independent Director
Rampraveen Swaminathan	Independent Director
Raman Tallam Puranam	Independent Director
Anjaneyulu Ganji	CFO
Venkat Krishna Reddy Busireddy	CEO
Ruchita Malpani	Company Secretary and Compliance Officer
D Prabhakar Reddy	Consultant, production and maintenance
Sebastian Joseph	Quality head
Suresh Subramanian	Deputy manager, procurement department

Source: Company data, I-Sec research

Financials

Table 14: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Gross Sales	21,394	19,440	22,413	25,349
Less: Excise Duty	-	-	-	-
Net Sales	21,394	19,440	22,413	25,349
Growth (%)	26.5	(9.1)	15.3	13.1
Expenditure				
Cost of Goods Sold	16,406	13,509	16,182	18,251
Staff Cost	911	898	1,031	1,166
Power & Fuel	375	361	403	456
Carriage & Freight inwards & outwards	1,467	1,481	1,569	1,774
Advt & Sales Promotion	77	49	112	127
Other Expenses	667	716	840	951
EBITDA	1,491	2,425	2,275	2,624
EBITDA margin	7.0	12.5	10.2	10.4
Depreciation	492	507	562	592
EBIT	999	1,917	1,713	2,032
Interest Expense & Bank Exps	170	119	67	67
Other Income	63	64	246	269
Profit Before Tax	891	1,862	1,893	2,234
Income Taxes	320	602	503	491
Income tax rate	35.9	32.4	26.6	22.0
Profit After Tax	571	1,260	1,389	1,742
Share of Profit From Associates	-	-	-	-
Prof. Dividends/Minority Interest	-	-	-	-
Profit Before X/O	571	1,260	1,389	1,742
Growth (%)	(9.0)	120.4	10.3	25.4
Extraordinary Items	(23)	(0)	-	-
Profit for Shareholders	548	1,259	1,389	1,742

Source: Company data, I-Sec research

Table 15: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
Sources of Funds				
Share Capital	557	583	595	595
Reserves and Surplus	3,778	5,996	7,874	9,616
Deferred Tax Liability	365	454	454	454
Net Worth	4,700	7,034	8,923	10,665
Secured Loans	1,501	530	530	530
Unsecured Loans	194	212	212	212
Total Loans	1,695	742	742	742
Total	6,394	7,776	9,665	11,407
Application of Funds				
Fixed Assets				
Gross Block	6,179	6,768	7,601	8,351
Less: Depreciation	1,258	1,748	2,309	2,901
Net Block	4,921	5,021	5,292	5,450
Capital WIP	112	83	-	-
Gross Block-Brand value	6,179	6,768	7,601	8,351
Other Investments	270	130	130	130
Current Assets	2,114	3,415	1,851	1,915
Inventories	1,202	962	1,345	1,521
Sundry Debtors	72	49	67	76
Cash & Bank Balances	687	2,244	279	158
Loans & Advances	153	160	160	160
Current Liabilities	1,608	1,946	1,681	1,901
Liabilities	1,581	1,834	1,659	1,876
Provisions	28	112	22	25
Net Current Assets	505	1,469	170	14
Total	6,394	7,776	9,665	11,407

Source: Company data, I-Sec research

Table 16: Cashflow statement*(Rs mn, year ending March 31)*

INR Million	FY20	FY21	FY22E	FY23E
OCF before W/C changes	1,179	1,840	1,951	2,334
W/c Changes	325	507	(666)	35
OCF After W/C Changes	1,504	2,346	1,285	2,369
Cash Flow from Investing				
Capital Expenditure	(953)	(573)	(750)	(750)
Disposal	5	11	-	-
Investments	175	(1,472)	(3,000)	(1,740)
Acquisitions	-	-	-	-
Net Cash used in Investing	(773)	(2,035)	(3,750)	(2,490)
Cash Flow from Financing				
Changes in Share Capital	-	982	500	-
Changes in Loans	86	(631)	-	-
Dividends	(182)	(107)	-	-
Net Cash used in Financing	(96)	243	500	-
ExtraOrdinary Items	-	-	-	-
Changes in Cash & Equivalents	636	555	(1,965)	(121)
Opening Cash & Equivalents	51	687	2,244	279
Closing Cash & Equivalents	687	1,241	279	158
Free Cash Flow	556	1,784	535	1,619

Source: Company data, I-Sec research

Table 17: Key ratios*(year ending March 31)*

	FY20	FY21	FY22E	FY23E
Profit margins				
Gross margin	23.3	30.5	27.8	28.0
EBITDA Margin	7.0	12.5	10.2	10.4
EBIT Margin	4.7	9.9	7.6	8.0
PBT Margin	4.2	9.6	8.4	8.8
PAT Margin	2.7	6.5	6.2	6.9
Income Tax Rate	35.9	32.4	26.6	22.0
RoE	12.2	21.5	17.4	17.8
RoCE	16.0	27.1	19.6	19.3
Major Costs as % of Net Sales				
Cost of Goods Sold	76.7	69.5	72.2	72.0
Staff Cost	4.3	4.6	4.6	4.6
Power & Fuel	1.8	1.9	1.8	1.8
Carriage & Freight inwards & outwards	6.9	7.6	7.0	7.0
Advt & Sales Promotion	0.4	0.3	0.5	0.5
Other Expenses	3.1	3.7	3.8	3.8
Per Share Data				
Earnings Per Share	10.3	21.6	23.4	29.3
Increase in %	(9.0)	110.4	8.1	25.4
Book Value per Share	84.4	120.6	150.0	179.3
Increase in %	8.8	42.8	24.4	19.5
Turnover Ratios				
Debtors Turnover ratio	0.3	0.3	0.3	0.3
Current Liabilities Turnover Ratio	7.4	9.4	7.4	7.4
Inventory Turnover Ratio	5.6	4.9	6.0	6.0
Fixed Assets Turnover Ratio	23.5	26.3	23.6	21.5
Valuation Ratios				
Price Earnings	58.5	27.8	25.7	20.5
Price/Book Value	7.1	5.0	4.0	3.3
EV/Sales	1.5	1.7	1.5	1.3
EV/EBITDA	21.1	13.6	14.7	12.8
Other Ratios				
Net debt/Equity	0.2	(0.3)	(0.4)	(0.4)
FCF/EPS	97.4	141.6	38.5	92.9
OCF/Sales	7.0	12.1	5.7	9.3
Div Payout Ratio	31.9	8.5	-	-
Income Tax Rate %	35.9	32.4	26.6	22.0

Source: Company data, I-Sec research

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