

Done with rising

Milk procurement prices set to stabilise

February 2020



Flowing towards stability

CRISIL expects milk prices to have started peaking out after the back-to-back hikes that have made the commodity dearer by Rs 4-5 per litre on-year over the past 9 months or so.

The upmove started in May 2019, with Gujarat Cooperative Milk Marketing Federation (GCMMF, better known as Amul) and Mother Dairy hiking the maximum retail price of their full-cream milk pouches by Rs 2 per litre. The two giants followed this up with a further hike of Rs 2 and Rs 3 per litre, respectively, in December, taking it to ~Rs 55.

Other large dairy processors have started following suit, spurred by the shortfall in milk production around the country, and thereby supply.

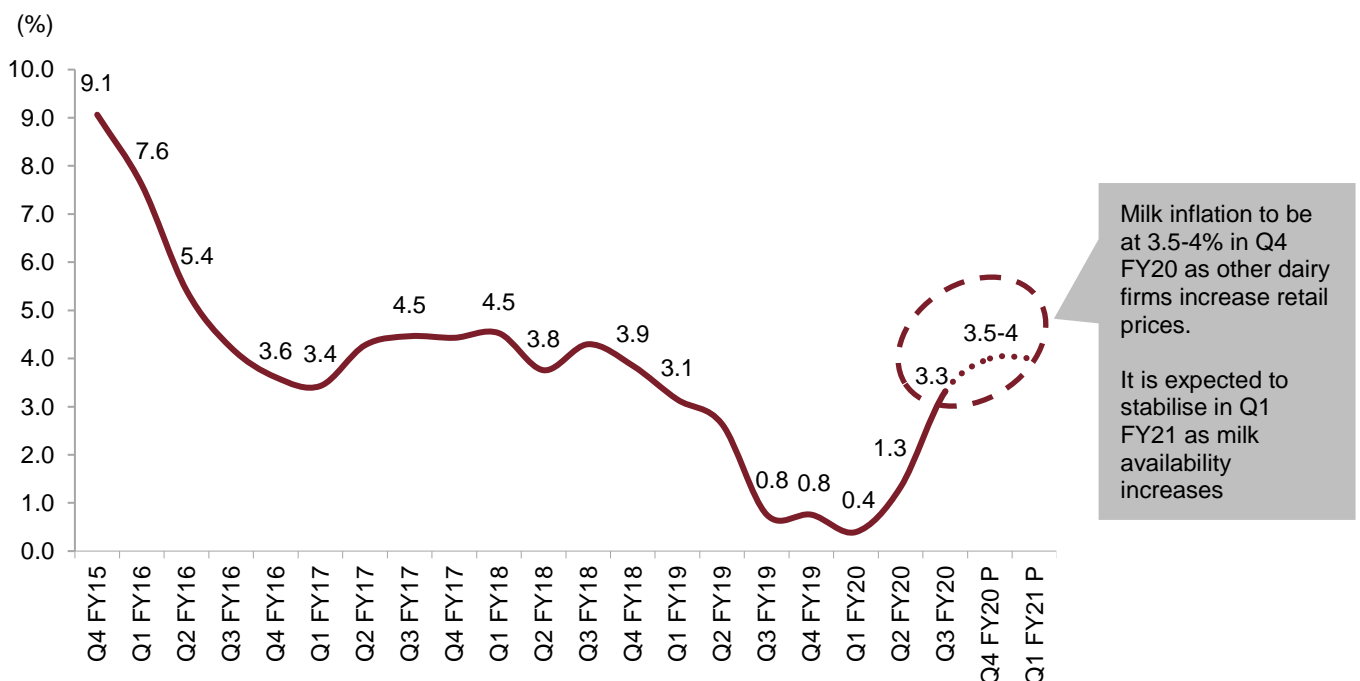
To be sure, production has been shrinking since April last year.

Initially, the fall in production was due to high summer temperatures and lower availability of water, made worse by delay in rainfall. Then, there were floods in various parts of the country, which led to poor animal health. Also, water logging in green pastures kept animals from grazing and damage to crops such as maize and sugarcane, which are used for fodder, cramped fodder availability. All this led to a decrease in milk yield of cattle, and thereby lower milk production in the country.

Indeed, this fiscal, milk production is expected to be lower by 5-6% on-year at ~176 million tonne. As of December, milk production is estimated to have been lower by ~6%. The flush season that usually begins in November-December is estimated to have shifted by 1-2 months because of the delayed monsoon. So milk production is expected to pick up from this month, which would limit any further fall this fiscal.

In fiscal 2021, milk production is expected to pick up, given abundant water in reservoirs and expectations of a normal monsoon. That should arrest any further rise in milk procurement and retail prices.

Milk inflation seen nosing up this quarter before plateauing



Source: Ministry of Statistics, Industry, CRISIL Research

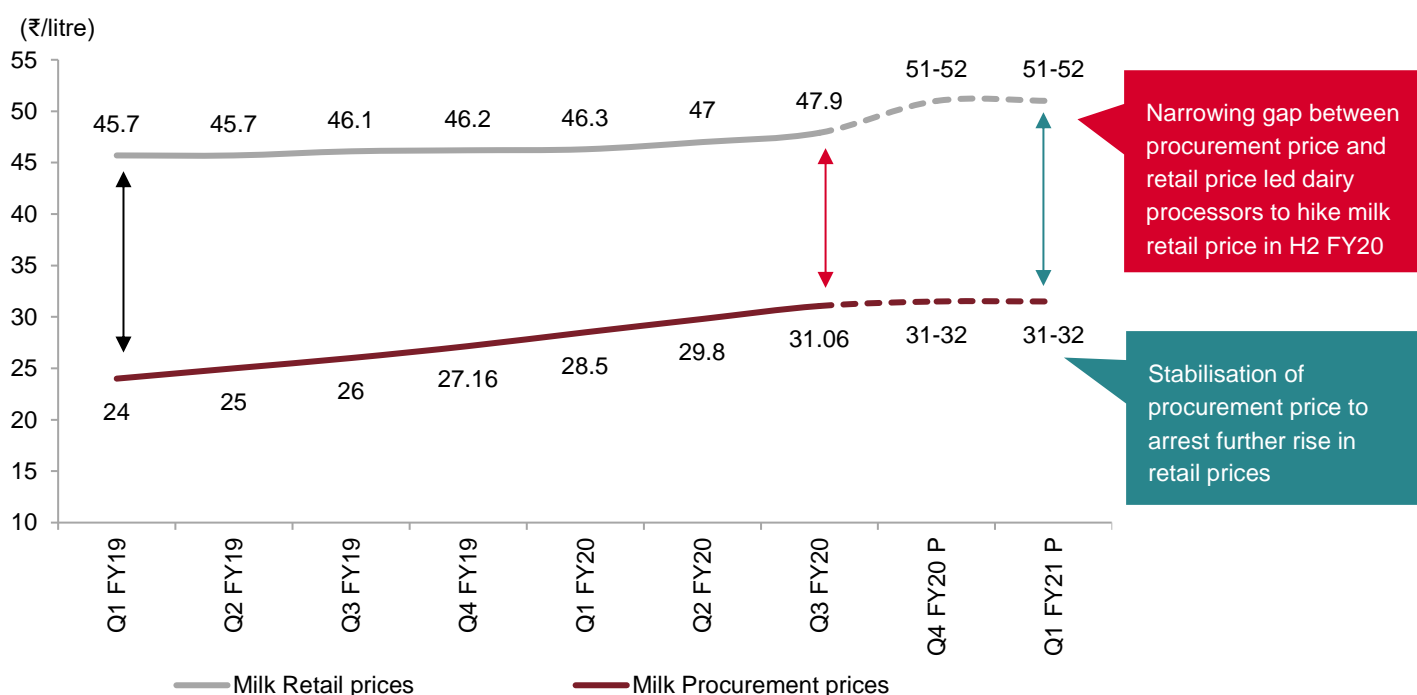
Profitability of dairies to improve

Milk procurement prices are estimated to have risen 19% on-year between April and December, 2019, and for the full fiscal, the inflation is expected to be similar, at 18-20% on year.

Milk retail prices, on the other hand, have risen 3-4% over April-December 2019, and are expected to be higher at ~5% for fiscal 2020.

Our interactions with stakeholders indicate that prices of key value-added products such as butter, ghee and skimmed milk powder (SMP) are expected to rise ~5% by the end of this fiscal.

Procurement prices seen stabilising with the onset of flush season



Note: 1) Milk procurement prices and retail prices are a weighted average of top 15 states of mixed milk (cow and buffalows)

2) Milk procurement prices pertain to co-operative procurement; Private procurement prices could be higher

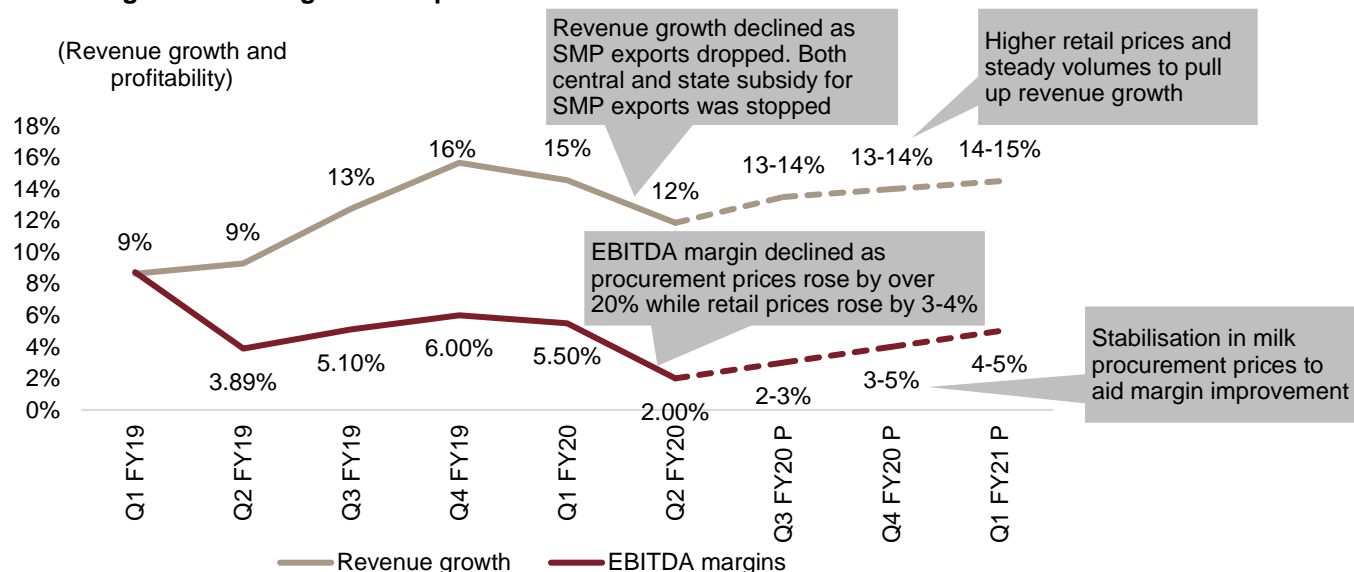
Source: Ministry of Agriculture, Industry, CRISIL Research

A sharper rise in milk procurement costs compared with retail prices led to a decline of ~200 bps in the earnings before interest, tax, depreciation and amortisation (EBITDA) margins of large dairy players in the second and third quarters of this fiscal.

The trend is expected to continue in the closing quarter as well as milk procurement prices are expected to rise by 16-20% on-year, while retail prices of key products such as milk, milk powder, butter and ghee are expected to rise only marginally, by ~5%, on-year. This would result in an EBITDA margin contraction of 150-200 bps on-year in Q4 fiscal 2020.

However, in the first quarter of fiscal 2021, the margin contraction should ease to 50-100 bps as milk procurement prices moderate. With the flush season shifting, milk production should increase between this month and April. That, in turn, would improve availability and thwart further rise in procurement prices.

Revenue growth starting to look up



Note: The financials pertain to Hatsun Agro Products Ltd, Heritage Foods (India) Ltd, Parag Milk foods Ltd, Vadilal industries Ltd, Milkfoods Ltd, and Modern Dairies Ltd

Source: Industry, CRISIL Research

In fiscal 2021, water availability is expected to be abundant as reservoir levels have risen significantly after a 10%-surplus monsoon. That would play a key role in sowing and harvest, which would, in turn, improve animal health. Reservoir levels were 41% above 10-year average as of January this year, compared with 5% below the 10-year average level in January 2019.

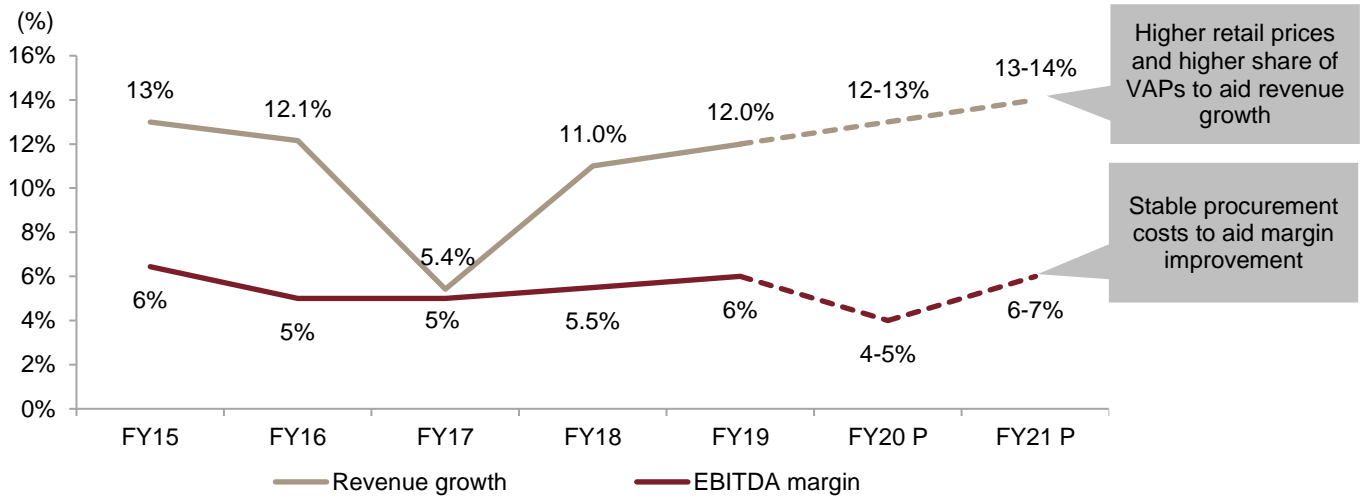
Further, rabi sowing area had increased 10% as on January 31, 2020. This is expected to lead to a 12% increase in crop production for the season. So higher arrivals of key crops such as wheat, bajra, jowar and maize from March would mean copious fodder availability, which should raise milk production next fiscal.

This is expected to stabilise milk procurement costs, bolstering the operating margins of dairy processors. So, milk prices are not expected to rise any further in the coming few quarters, unless monsoons spoil the game for processors.

Further, milk prices are also dependent on availability of skimmed milk powder (SMP) as it can be used to produce value-added products. In fiscal 2020, closing inventory of SMP is expected to be on the lower side, despite exports declining over 95%. That's because, lower milk availability led to utilisation of stored SMP to make value-added products. That also meant domestic prices of SMP doubled from Rs 150 per kg in calendar 2018 to Rs 300 per kg in 2019.

Next fiscal, higher milk production is expected to lead to higher SMP production and a fresh build-up of inventory. That should keep SMP prices from rising afresh. Also, imports would be thwarted by the high 60% duty, which makes imported SMP expensive by ~Rs. 20 per kg

EBITDA margins to improve in fiscal 2021



Note: The financials pertain to Hatsun Agro Products Ltd, Heritage Foods (India) Ltd, Parag Milk foods Ltd, Vadilal industries Ltd, Milkfoods Ltd, and Modern Dairies Ltd

Note: VAPs: Value Added Products

Source: Industry, CRISIL Research

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