



**SECTOR
RESEARCH**

DAIRY AND DAIRY PRODUCTS

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Value-added dairy products to drive the industry in the near future

Contact

Rajee R
Chief Ratings Officer

Chintan Lakhani
Director – Ratings

Saakshi Kanwar
Sr Manager - Ratings

Vineetha Ann Varughese
Sr Rating Analyst

Praveen Pardeshi
Sr Research Analyst

Diya Roy
Jr Research Analyst

Investor & Media Contact
91 95133 99706
1-860-425-2742
investordesk@brickworkratings.com
media@brickworkratings.com

Executive Summary

India is one of the largest dairy producers globally, with a high domestic consumption of ~85-88% of the total produce. The dairy industry may be broadly classified into various segments such as fluid milk, milk powder and Value-Added Products (VAPs), with fluid milk having the biggest share in the industry. The Covid-19 related disruptions resulted in demand fluctuations within various dairy product segments in FY21. The decline in demand in the Hotels, restaurants and eateries (commercial segment) was offset by increased demand from households and retail segment, leading to a moderate growth at an aggregate level. The dairy industry experienced uncertainties both on the demand and supply sides at the onset of the pandemic on account of restrictive measures imposed for controlling the virus spread which subsequently, resulted in change in Customer preferences and demands. The industry has adapted to such changes during FY22.

During FY21, the industry witnessed 5% decline in the production of fluid milk due to supply-chain constraints brought about by the pandemic and the resultant drop in demand. However, the longer shelf life and convenience value of Milk powder and VAPs augmented the dairy industry's sales at an aggregate level during FY21. On the back of the revival of economic activities in FY22, the demand for fluid milk increased by 5%. The demand for milk powder remained static, while that for VAPs grew by ~5%. The demand patterns were primarily driven by a recovery in demand not only from retail but also the commercial segment. Brickwork Ratings (BWR) expects demand for both milk and milk powder to further increase by 5-7% and 4-6%, respectively, in FY23, with the revival of demand from the commercial segment. Furthermore, BWR expects key products under VAPs namely ghee, butter and ice-cream to grow by 8-10%, 6-8% and 14-15% respectively, in FY23.

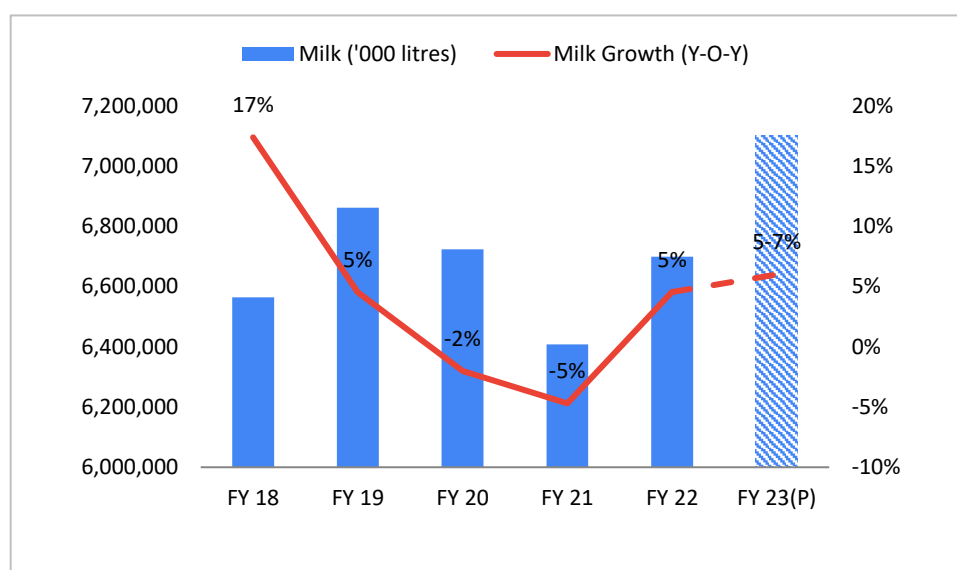
Keeping in view that the bulk of the production is consumed domestically, the Indian dairy industry's exports continue to remain limited. Milk powder accounts for the majority of exports. BWR expects exports to continue to improve in FY23 with the launch of the 'Kamdhenu Cow' logo under Conformity Assessment Scheme, in December 2021. BWR expects that this initiative shall increase milk and milk powder export by ~8-10% and ~20-22%, respectively. Although the industry is expected to witness growth at the top-line level, the increased milk procurement cost including cattle feeds, energy and packaging, along with increased milk prices, is expected to impact the operating margins of milk cooperatives and private companies in FY23.

Growth in milk and milk powder production to be driven by demand revival from the commercial segment

India's domestic milk production increased by 5% in FY22 after a consecutive dip in the production level in FY20 (-3%) and FY21 (-5%) driven by the steady recovery in consumption across all end segments. There was an adverse impact of Covid-19's subsequent waves up to Q1FY22, however post recovery across the economy along with normal monsoons has resulted in stable growth of ~5% on an annual basis. The industry's milk production is likely to be impacted during Q1FY23 due to the extended heatwave across the top ten milk producing states (Uttar Pradesh, Rajasthan, Madhya Pradesh, Gujarat etc.) with an exception of Karnataka. However, with a normal monsoon, onset of the flush season (December to March) and steady demand from traditional products and VAPs, BWR expects a growth of ~5-7% in the production in the milk.

Demand for dairy and dairy products in FY23 to be driven by the reopening of commercial segments such as hotels, restaurants and eateries

Trend in Production of Fluid Milk

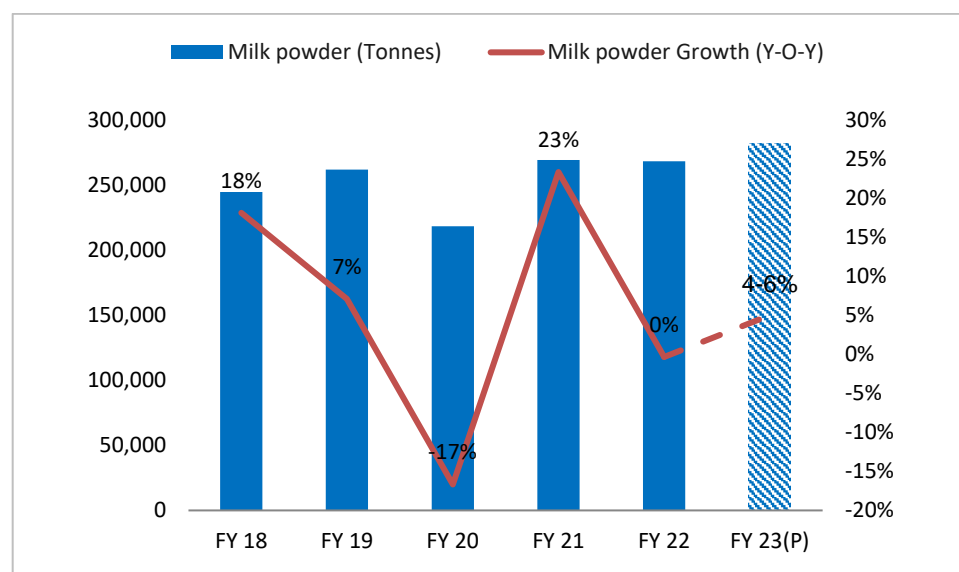


P-Projected

Source: CMIE, BWR Research

The prolonged presence of the pandemic has resulted in change in consumer preferences. The consumers are moving towards healthier options to improve their immunity. Hence, the consumption of dairy-based ingredients continues to be the favourable option for many. Additionally, accentuated attention towards food safety is expected to tilt consumer preferences towards packaged and branded products.

Trend in Production of Milk Powder



P-Projected

Sources: CMIE, BWR Research

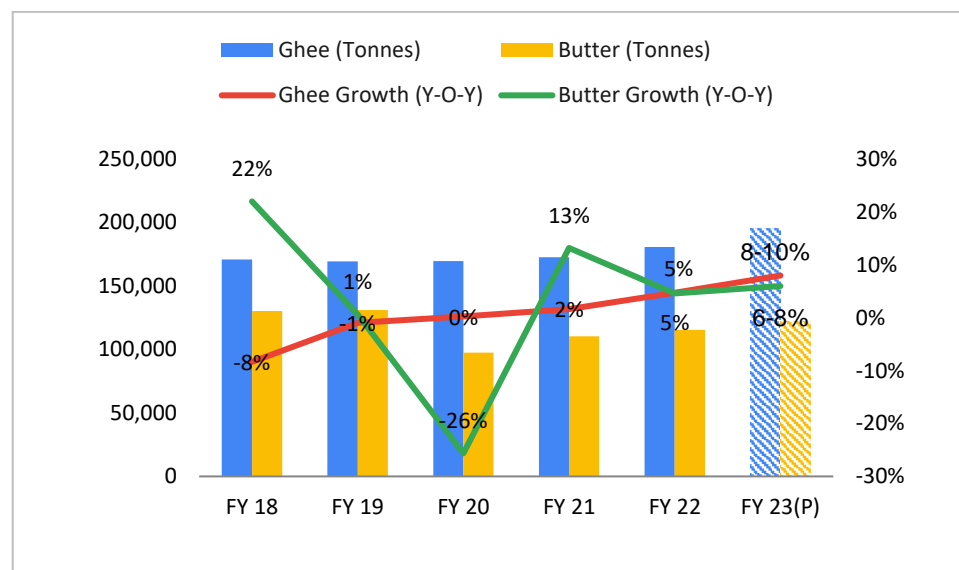
While the milk production decreased in FY21 due to a decrease in demand, the production of milk powder saw a rise of 23%. Dairies convert liquid milk into Skimmed Milk Powder (SMP) to prolong its shelf life to 12-18 months. SMP is used in the lean season, when milk supplies dwindle. SMP can then be reconverted into liquid milk or VAPs.

BWR expects the production of milk powder to increase by ~4-6% in FY23, with the economy recovering from the pandemic impact. Furthermore, consumers have increased the consumption of homemade food, which would be a growth driver for the segment as well.

Demand for VAPs expected to increase, going forward

In FY21, while the overall demand for milk decreased, the production of VAPs namely, ghee, butter, paneer, curd etc. witnessed healthy growth, backed by an increase in demand from Indian households. A change in the consumer preference on account of restrictions on movement due to the pandemic, led to the average consumer staying indoors for longer durations. Also, the longer shelf life added to the convenience value. In FY22, with the easing of the pandemic induced restrictions and reopening of the venues for weddings and other celebrations there has been an increase in demand for milk products such as ghee and butter from the commercial segment as well.

Trend in Production of Ghee and Butter



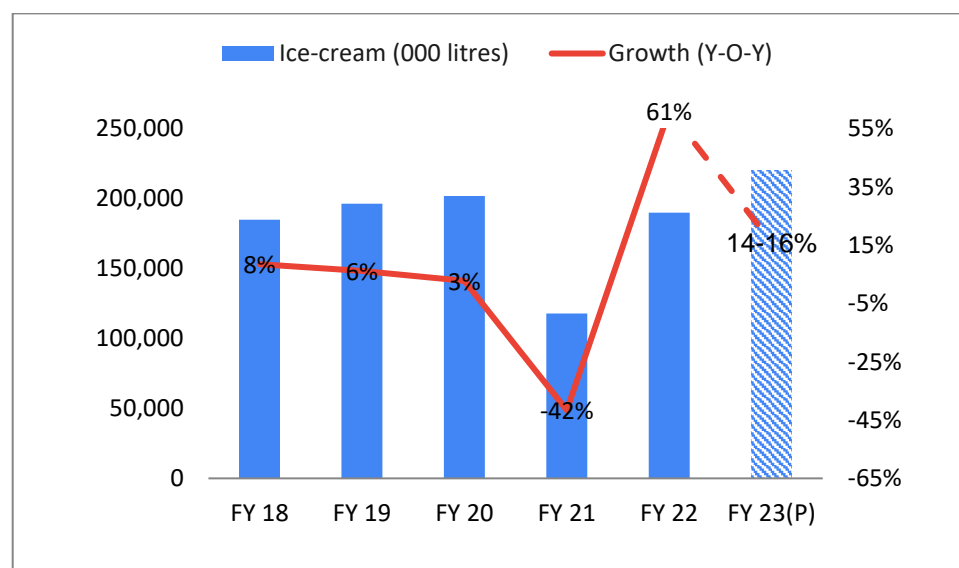
P-Projected

Source: CMIE, BWR Research

With the rise in demand for milk, demand for VAPs such as butter and ghee is expected to rise with the increase in commercial activities and also for ice-cream, backed by heatwaves in certain parts of the country

BWR expects the growth momentum to continue in FY23 for VAPs such as butter and ghee, at ~6-8% and ~8-10%, respectively. The ghee market in India is bigger than the butter market as it derives its demand from Indian households wherein traditionally, ghee is preferred over the latter for various occasions. In addition, increasing consumer awareness about the benefits of ghee over butter is expected to lead to a further increase in demand.

Trend in Production of Ice-cream



P-Projected

Source: CMIE, BWR Research

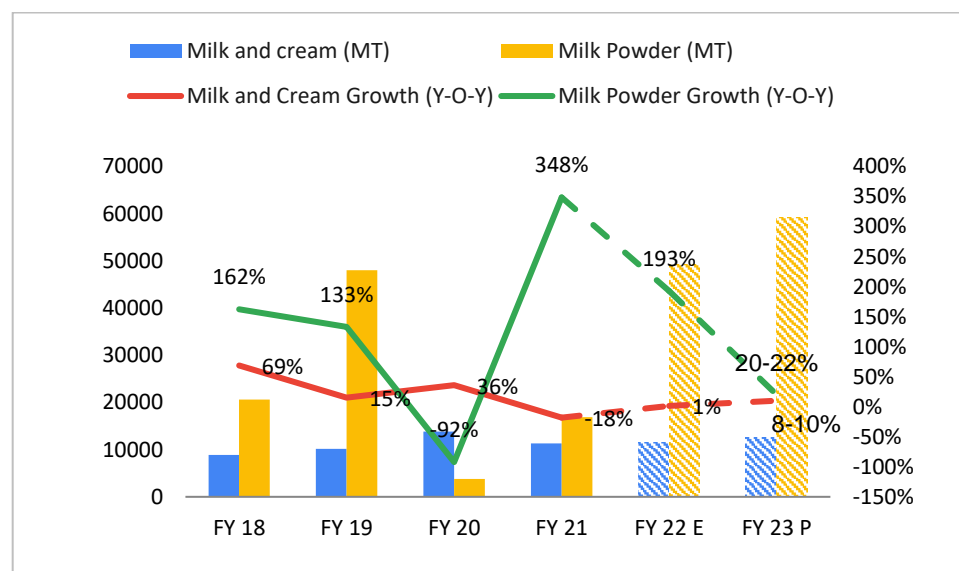
Ice-cream production plummeted in FY21 due to the pandemic as demand from the retail and commercial segment was impacted significantly. However, with removal of mobility restrictions in FY22, demand and sales for ice-cream witnessed an expected increase. BWR expects the demand for ice-cream to further increase by 14-16% in FY23, factoring in the exceptionally hot and extended summers in many parts of the country in Q1FY23, stable demand growth from household consumption and recovery in demand from the commercial segment.

Unified system to check milk products' quality to create new opportunities in the international market in FY23

India accounts for ~22% of the world's milk production, of which it consumes almost 85-87% domestically. Milk powder accounts for the majority of exports. Exports, which witnessed robust growth of 133% in FY19 due to the implementation of the Merchandise Exports from India Scheme, saw a dip of 92% in FY20 due to a decrease in demand from the majority of its export markets such as Bangladesh, Afghanistan, Malaysia, Pakistan, and the UAE. However, in FY21, demand for milk powder witnessed growth aided by competitive pricing vis-a-vis other export oriented nations along with a lower base. As per FY22E, milk powder and milk are expected to have reached the pre-pandemic levels.

Indian dairy exports are also expected to grow, backed by newer opportunities due to the implementation of the unified common logo of Kamdhenu Cow

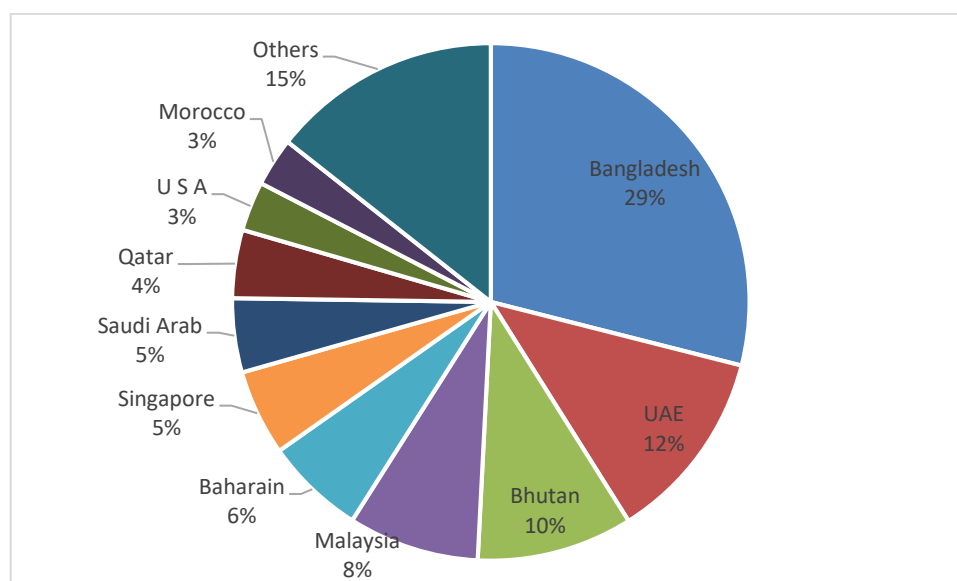
Trend in Export of Milk and Milk Powder



E-Estimated, P-Projected

Source: Department of Animal Husbandry and Dairying, BWR Research

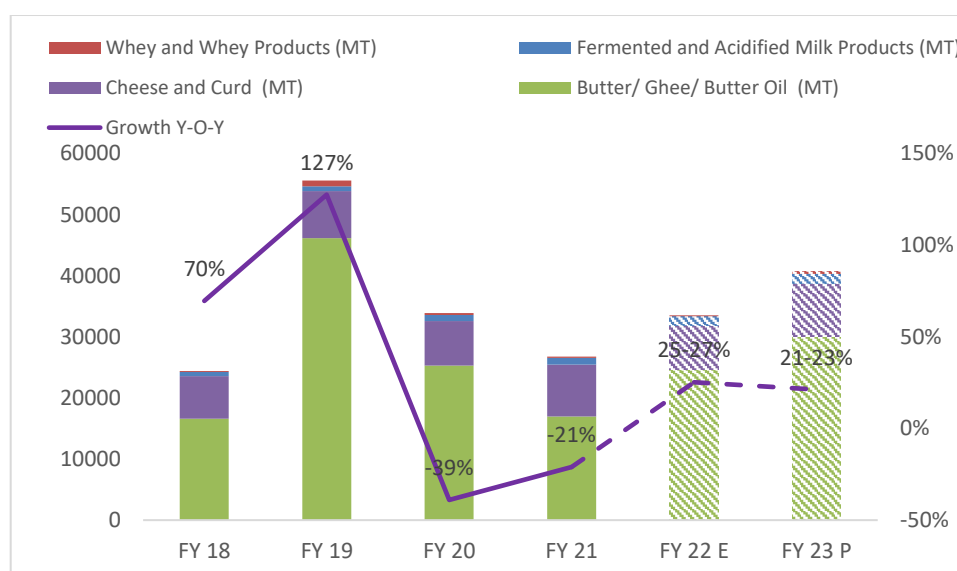
Export destinations for India's Dairy Industry (FY22)



Sources: APEDA, BWR Research

The Bureau of Indian Standards (BIS) and National Dairy Development Board (NDDB) in December 2021 launched a unified system for determining the quality and safety of milk by usage of a common logo of the “Kamdhenu Cow”. This implementation of the unified common logo is expected to assuage any quality and safety concerns and create opportunities for milk producers, especially in the international market. Keeping in view, BWR expects the exports of milk powder to further increase at ~20-22% in FY23.

Trend in Export of Value-Added Products of Milk



E-Estimated, P-Projected

Source: Department of Animal Husbandry and Dairying, BWR Research

While the demand from the international market for milk and milk powder improved during FY22, the demand for fermented and acidified milk products have also been estimated to have witnessed growth of ~45% and ~30%, respectively due to increased consumer awareness about the benefits of fermented dairy products to cure digestive disorders in FY22. BWR expects that in FY23, VAPs such as fermented/acidified milk products and ghee/ butter would grow at a moderate rate of ~15-17% and ~20-22%, respectively.

Profitability to be restricted by higher milk procurement cost

The major players in the Indian dairy sector are unorganised, with around 20% of the total production being collected and distributed by cooperatives and private companies. Due to the high competition, the operating margins of dairy players are predominantly low. In addition, despite the recent price hikes, operating margins of the industry remain subdued on account of increased milk procurement costs such as cattle feed, energy, logistics and packaging costs.

Despite the improved demand expected during FY23, the margins of dairy players are expected to continue to be under pressure on account of higher operating expenses.

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