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INDIAN DAIRY INDUSTRY

Industry reels under input cost pressures; retail price hikes may continue

OCTOBER 2022

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Highlights

Global milk production to witness modest impact of ongoing Russia-Ukraine conflict; international dairy prices have declined in last two quarters after firming up post pandemic.

Domestic milk production expected to grow by 4-5% in FY2023, given impact of Lumpy Skin Disease on productivity in northern states in H1 FY2023.

As per FAO dairy market review 2021 estimates, global milk production grew marginally by ~1.5% in CY2021, mainly led by growth in Asia and North America. However, in CY2022, there has been modest impact on global milk production led by disruptions due to the ongoing Russia-Ukraine war and declining cattle population in Europe.

The global dairy trade grew by 4.2% on a YoY basis during CY2021 driven by recovery in demand from Asia, especially China, which is the largest dairy importer, forming ~25% of the total global imports Global dairy demand revival especially in China resulted in firming up of international dairy prices in CY2021; however, since April 2022, prices have moderated on account of fresh lockdowns in China and subsequently depreciating currency and recessionary trends in Europe.

India continues to maintain its leadership position in milk production with ~23% of the total global milk production in CY2021. However, it forms only 0.5% of the global dairy trade, given the high internal consumption and tariff/non-tariff barriers. India's milk production also continued to rise steadily and is estimated to have grown by 5-6% in FY2022.

In H1 FY2023, in addition to a harsher summer, production yields were impacted owing to the incidence of the Lumpy Skin Disease (LSD) particularly in the cow population in the northern states. While successful vaccination coverage has now contained the disease, ICRA expects some moderation of the production growth to 4-5% for FY2023.

Highlights

Average raw milk procurement prices have been significantly increasing in FY2023 led by high livestock rearing costs for dairy farmers, in the form of higher feed and fodder prices and impact of LSD on milk production yields in H1 FY2023.

Dairy players have also been witnessing high operating costs in the form of fuel and packaging costs. To combat cost pressures, there have been multiple price hikes across product segments by dairy players, over the last few quarters.

VADPs, which form around 34-36% of the organised Indian dairy industry revenues, witnessed a YoY growth of 18-20% in FY2022 for ICRA sample set. This was driven by demand recovery across both the retail and the institutional segments. Due to the early onset of the summer season and the limited impact of the third wave of the pandemic, growth in the VADP segment was higher than ICRA's earlier estimate of 13-15%.

After being subdued in FY2021 due to weak demand, raw milk procurement prices increased in FY2022 owing to healthy demand and constrained milk availability due to disruption in cattle insemination programmes earlier during the pandemic. They continue to increase in the current fiscal, given the substantially growing cattle feed and fodder costs for dairy farmers. This apart, incidence of LSD temporarily constrained milk availability. ICRA expects raw milk prices to remain firm in H2 FY2023 given the healthy demand expectations during the festive and wedding seasons.

In addition to high raw milk prices, dairy players have also been facing increasing transportation, processing and packaging costs. Consequently, unlike historical trends, in the current fiscal, there has been a slew of retail price hikes by dairy players to combat these cost pressures.

For its sample set, ICRA expects revenues in the liquid milk segment to grow at a higher rate of 7-9% in FY2023 supported by growing per capita consumption and rising realisations. With a strong demand recovery post the pandemic, healthy demand in summers as well as ongoing festive season and also growing realisations, ICRA expects the VADPs segment to grow at 18-20% for FY2023.

Highlights

In line with expectations, industry has been able to liquidate SMP inventory supported by healthy demand recovery in institutional and HoReCa segments. Domestic SMP prices have been on the rise over the last one year

Margins to moderate by 120-160 bps in FY2023 as the price hikes are not expected to be commensurate to the cost increase

ICRA's sample set is expected to witness revenue growth of ~12-14% in FY2023 on the back of healthy demand and firm prices. However, operating margins are expected to moderate by 120-160 bps as the retail price hikes are expected to provide a partial support to address input cost pressures. Further price hikes could also continue in the current scenario, more so in the VADP segment.

ICRA expects moderate capex to continue with focus on VADP capacity expansion by most private companies. Thus, industry will witness some increase in debt levels, towards funding for aforesaid capex.

ICRA maintains a Stable outlook on the sector. While credit metrics for dairy players are expected to moderate in FY2023 led by margin pressures, going forward, regular raw milk supply in absence of disease and stabilisation in feed costs for farmers should curtail incremental rise in input costs for dairy players, along with a buoyant demand outlook should support dairy players' credit profile.

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Thank You!