

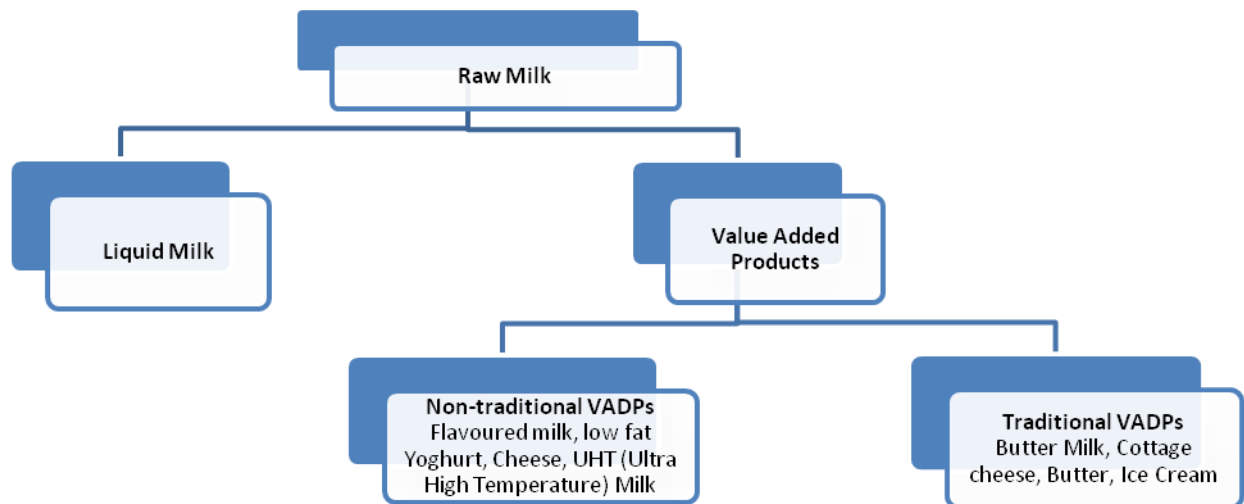
## Beyond Milk: Value Added Dairy Products to boost up profits

The time has arrived for dairy players to skim the cream out of the milk business.

Rising consumption coupled with better margins in the value added dairy products (VADPs) are driving the dairy players to get into the growth and higher profitable trajectory. Change in demographics and rapid urbanization have resulted into manifold surge in the demand for VADPs.

Milk products such as curd which were largely home products are currently available under various brands. Due to convenience, health benefits and increased consumerism, milk derivatives like buttermilk, low fat yogurt and flavored milk are nowadays part of regular consumption.

### ***Categorization of the dairy products:***



### **The traditional way....**

For decades, dairy players in India have been engaged in the liquid milk processing activity only. Backed by operation White Flood in 1970s, the milk industry in India witnessed the first wave of development in the milk production which gave India its status of the largest milk producer in the world. This was spearheaded by the 'Co-operatives model' which was supported by the GoI. Ownership being with the farmers instilled trust among the member milk producers in the cooperative model, which also ensured transparent returns. In addition, cooperatives also provided various services like cattle vaccination, cattle insurance, artificial insemination, installation of coolers at village level etc to improve productivity.

Further, there was minimal involvement of private players in the industry as approximately 80% of the retail price of the liquid milk went back to the farmers leading to low operating margins (4-5%). This was despite the consistent upsurge in the retail prices of the liquid milk. Consequently, the dairy companies were left with insufficient internal funds to plough back into the operations for adoption of modern technologies or development of milk variants.

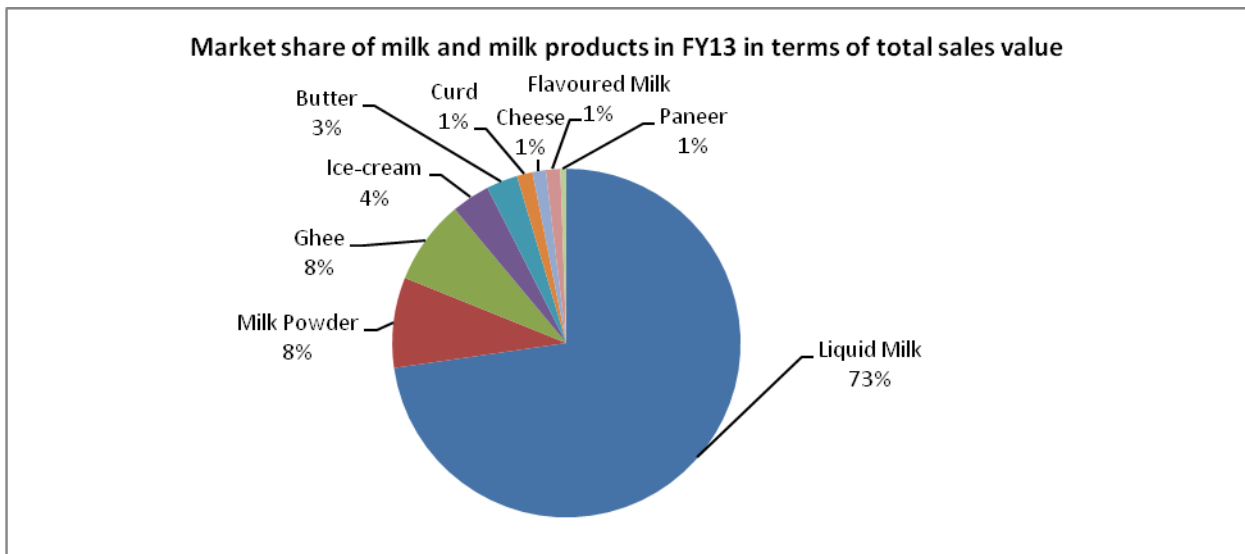
The above reasons coupled with factors such as evolving tastes and preferences, higher affordability, etc, lead to the entities venturing into the VADP segment for better profitability.

### **Going the creamy way....**

Over the past decade, significant transformation took place in the Indian demographic space which led to heightened consumer interest in VADPs. This shift in the dynamics of the industry proved beneficial for the manufacturers since margins in VADPs are more than double the margins in the liquid milk segment. The profitability in liquid milk space ranges from 4-5%, whereas the profitability in VADPs ranges from 12% to 18%, attracting private participation in the industry.

As per the industry estimates, the share of VADP in the milk and milk derivatives segment is growing currently at around 25% every year and is expected to grow at the same rate until 2019-20.

Product innovations are likely to accelerate India's dairy market which is anticipated to improve industry margins by attaining greater scale, higher capacity use and an increasing contribution from new milk variants. Further, the development of processing and packaging technology along with improvement in retail and cold storage infrastructure has increased the shelf life of dairy products.



Source: NDDB and Ministry of Animal Husbandry

### ....the growth trajectory

As per NDDB, the Indian dairy industry is all set to experience high growth rates in the next eight years with demand likely to reach 200 million tonnes by 2022 from 132 million tonnes in 2013. Presently, only 20% of the milk production comes from the organized sector comprising co-operatives and private dairies. The paramount factors driving the growth in the dairy sector include rising disposable incomes, advent of nuclear families and fast/instant food gaining ground in India. Other factors such as structural changes in food habits, expansion of fast food chains and popularity of pizzas and pastas aided the usage of milk variants of mozzarella cheese, processed cheese and flavored milk etc.

### Increasing participation from the private sector....

Consumer preference towards VADPs is taking forward the dairy sector. Besides brown-field/ green-field expansion, global dairy companies too are venturing into milk derivatives business in this part of the world.

The most recent one is the 100% acquisition of Tirumala Milk Products Pvt Ltd by Groupe Lactalis SA, France, one of the largest dairy players in the world. Another French dairy major Danone has also increased its presence in the Indian dairy sector with slew of product launches such as flavored curd, yoghurt etc.

Other investments include Nestle India's acquisition of 26% stake in Indocon Agro and Allied Activities Pvt Ltd and Hatsun Agro Products Ltd acquiring 100% stake in Jyothi Dairy Pvt Ltd.

Companies such as Parag Milk Foods Pvt Ltd, Prabhat Dairy Pvt Ltd have augmented their capacities in the recent past to meet the increased demand of milk products.

#### **....drawing investors' attention**

India consumption story and diversification by dairy players into VADPs are drawing interests of investors which have led to surge in the PE deals.

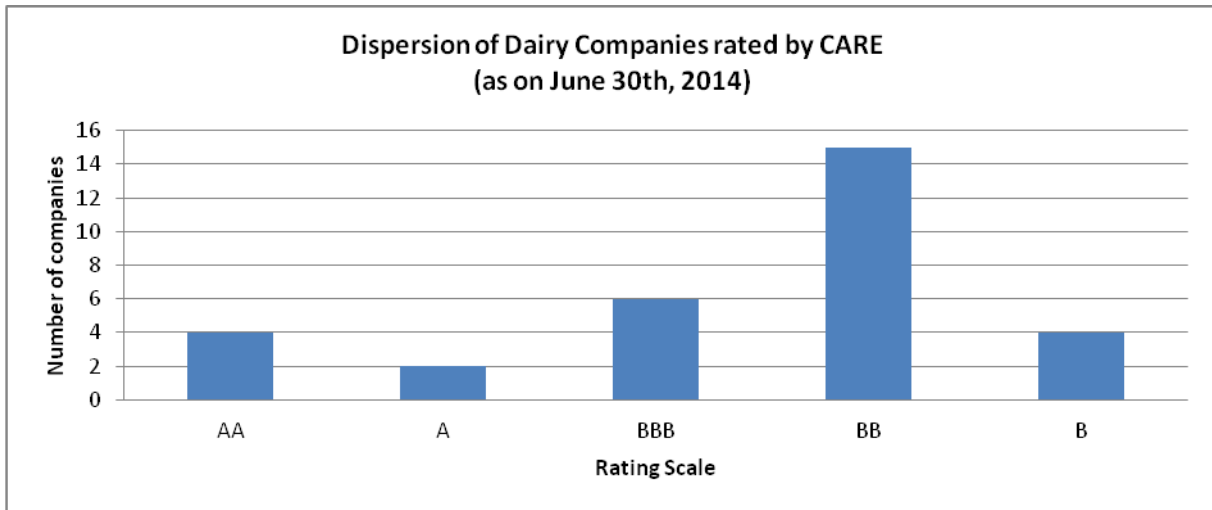
The prominent deals include investment by IDFC and Motilal Oswal in Parag Milk Food Pvt Ltd, Rabobank group and India Agribusiness Fund in Prabhat Dairy Pvt Ltd, IFC into Modern Dairies Ltd and Blackriver Investment in Dolda Dairy Ltd.

In one of the most recent investments, Fidelity Growth Partners, India, along with participation of the existing social venture investor, Aavishkaar, have invested in Odisha-based Milk Mantra Dairy Pvt Ltd.

*Recent deals in the sector are the indication that the investors perceive value in the deals and see growth prospects in the Indian dairy space.*

#### **Right product mix likely to have a positive impact on the credit profile of dairy companies**

Traditionally, the credit risk profile of dairy companies was characterized by low profitability and moderate liquidity. The dairy companies rated by CARE are largely in the BBB or BB category (refer the graph below) primarily on account of moderate solvency profile. However, Mother Dairy Fruit And Vegetable Private Ltd, Co-operatives associated with Gujarat Cooperative Milk Marketing Federation and some private dairies are in the 'AA' and 'A' rating category on account of their superior procurement and marketing channels and high share of VADPs in product portfolio. During FY14, the credit profile of CARE rated dairy companies have broadly remained stable.



The entities with the right product mix of liquid milk and VADPs are expected to have better profitability and solvency parameters. Consequently, there is a high possibility of improvement in the credit profiles of such companies given the robust milk procurement and distribution system.

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