Stock Note

Dodla Dairy Ltd.

November 08, 2023

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Dodla Dairy Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Dairy	Rs. 738	Buy in Rs. 731-745 band and add more on dips in Rs. 642-656 band	Rs. 813	Rs. 880	2 -3 quarters

HDFC Scrip Code	DODAIEQNR
BSE Code	543306
NSE Code	DODLA
Bloomberg	DODLA IN
CMP (Nov 07, 2023)	738
Equity Capital (RsCr)	59.5
Face Value (Rs)	10
Equity Share O/S (Cr)	5.9
Market Cap (RsCr)	4390
Book Value (Rs)	178
Avg. 52 Wk Volumes (in '000s)	94
52 Week High	908
52 Week Low	417

Share holding Pattern % (Sept, 2023)	
Promoters	62.21
Institutions	27.90
Non Institutions	9.89
Total	100.0

* Refer at the end for explanation on Risk Ratings

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Our Take:

Incorporated in 1995, Dodla Dairy Limited (DDL) is an integrated dairy company in South India that is engaged in the procurement, processing, distribution, and marketing of milk and other dairy products. It processes and sells milk including standardized, toned, and double toned milk, and produces dairy products like curd, butter, ghee, ice cream, flavoured milk, etc. It also manufactures and sells cattle feed to farmers through its procurement network.

DDL's Indian operations are mainly undertaken under the brand name of "Dodla", "Dodla Dairy", and "KC+" whereas it serves overseas market under the brand name of "Dodla Dairy", "Dairy Top", and "Dodla+". Telangana, Andhra Pradesh, Karnataka, Tamil Nadu, and Maharashtra are the key Indian market segments served by the company while in the overseas market; it mainly serves countries like Uganda and Kenya.

The long-term outlook of Indian dairy sector is favourable on account of favourable demographics, increase in expenditure on packaged food, brand awareness, urbanization & increase in nuclear families, and government support. The growth would be primarily driven by increase in the demand for value-added milk products. DDL has proven track record and promising growth trajectory ahead of them owing to their expanding procurement network, growing share of margin heavy value-added products, and improving brand visibility. The company's management enjoys strong reputation within dairy industry.

Valuation & Recommendation:

We believe, the company's integrated business model with strong procurement policy (procures ~93% of total raw milk directly from farmers) coupled with a focus toward increasing its value added product provides scope to further improve operating performance. It has a strong balance sheet with steady working capital management, low debt and improving cash flows. Its return profile of mid-to-high teens is better as compared to some of the closest peers. Company has healthy cash reserves of ~Rs 330 cr as of September 30, 2023 which will be deployed for organic expansion to increase inventory to largely match sales needs (increasing cow milk procurement), and for inorganic growth opportunities. Strong OCF yield and consumer-centric business makes DDL a strong candidate for re-rating.

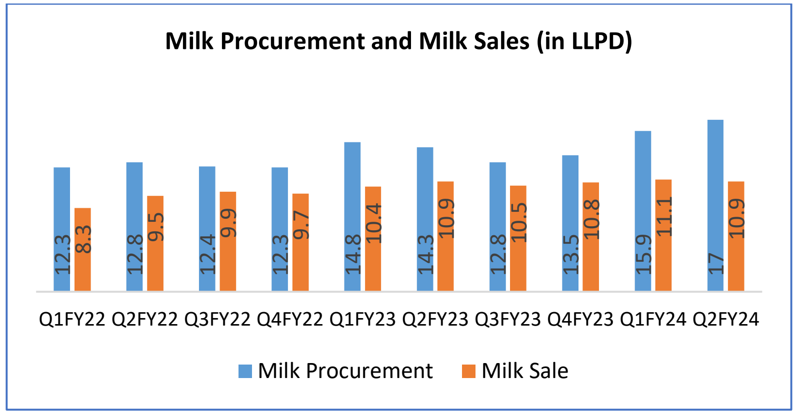
We think the base case fair value of the stock is Rs 813 (25x FY25E EPS) and the bull case fair value of is Rs 880 (27x FY25E EPS). Investors can buy the stock in Rs 731-745 band (22.5x FY25E EPS) and add more on dips in Rs 642-656 (20x FY25E EPS) band.

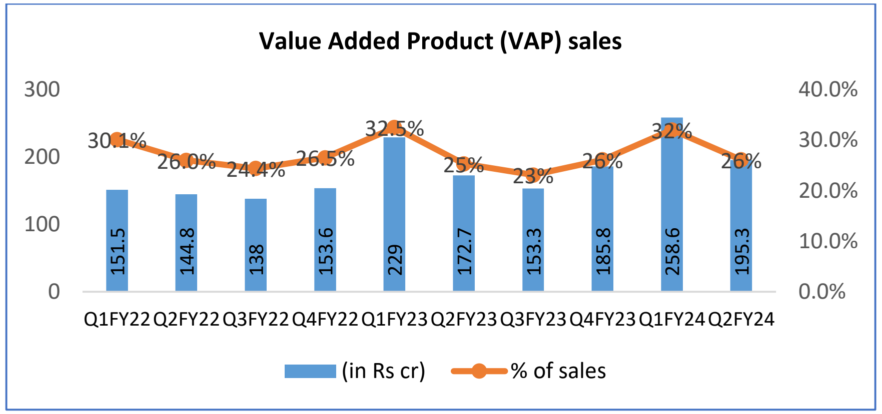
Dodla Dairy Ltd.

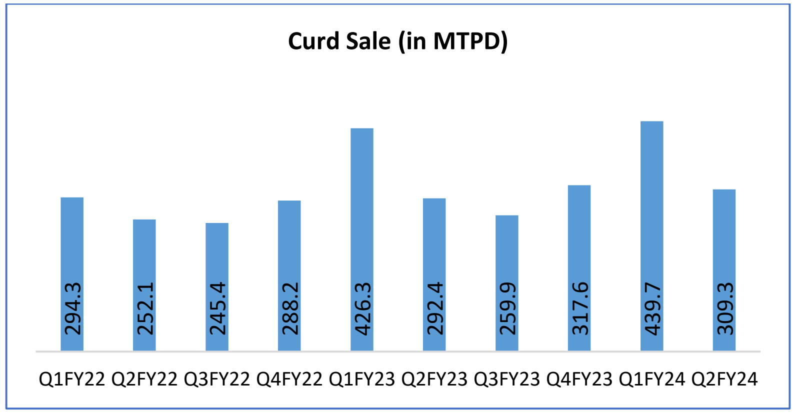
Financial Summary

Particulars (in Rs Cr)	Q2FY24	Q2FY23	YoY-%	Q1FY24	QoQ-%	FY21	FY22	FY23	FY24E	FY25E
Operating Income	768	695	10%	823	-7%	1,944	2,243	2,812	3,228	3,667
EBITDA	70	59	19%	60	16%	242	211	191	268	308
APAT	44	39	11%	35	25%	126	133	122	167	194
Diluted EPS (Rs)	7.3	6.6	10%	5.8	25%	21.6	22.3	20.6	28.1	32.6
RoE-%						23.1	17.7	13.5	15.9	15.7
P/E (x)						34	33	36	26	23
EV/EBITDA						17	20	21	15	12

(Source: Company, HDFC sec)







(Source: Company, HDFC sec)

Q2FY24 results: Key Highlights

Revenue stood at Rs 768 cr in Q2FY24 – registering growth of 10.4% YoY. Domestic business grew by 11.2% YoY to Rs 716 cr whereas, the International business revenues stood at Rs 52 cr in Q2FY24. Volume growth on a YoY basis was minimal due to higher competition from state cooperatives, unseasonal rains and lower pack sizes. However realization and margins rose.

Gross margin improved 120 bps YoY, driven by lower milk procurement prices. EBITDA grew by 19.2% YoY to Rs 70 cr in Q2FY24. EBITDA margin expanded by 67 bps YoY/ 182 bps QoQ to 9.1% owing to improvement in gross margin. However, employee expenses and other expenses grew by 19 bps YoY and 32 bps YoY, respectively in Q2FY24. PAT grew by 10.3% YoY at Rs 44 cr in Q2FY24.

Average milk procurement during Q2FY24 was at 17.0 LLPD as compared to 14.3 LLPD in Q2FY23, registering 18.9% YoY growth. Average milk sales during Q2FY24 was at 10.9 LLPD. The rest is built up in inventory. Curd sales during Q2FY24 was at 309.3 MTPD as compared to 292.4 MTPD in Q2 FY23, increasing by 5.8% YoY.

Revenue from Value Added Products (VAP) including fat & fat-based products grew by 13.1% YoY to Rs. 195 cr in Q2FY24 vis-à-vis Rs 173 cr in Q2FY23. VAP including fat & fat-based products contribution stood at 26.1% of the overall dairy revenue during Q2FY24 as compared to 25.3% contribution of the overall dairy revenue during Q2FY23.

Key Triggers:

Integrated Business Model - DDL has built a strong procurement network of farmers. 93% of the milk is directly procured from approximately 1.2 lakh farmers. The operation team ensures that the milk hits the market in about 24-36 hours of being procured. With more than 8000+ village level collection centres and 580 retail parlours, Dodla Dairy operates on a sustainable business model, avoiding leakages, creating a conducive environment, positively impacting both the company as well as the livelihood of the farmers.

VLCCs: Dodla Dairy operates ~8,000 Village Level Collection Centres (VLCC) equipped with GPRS-enabled electronic milk analysers. These analysers test the fat and solid-notfat (SNF) content of the raw milk. By analysing the milk at the village level, the company ensures that the quality of milk meets its standards for further processing.

Chilling Center: DDL operates ~135 chilling centres where the raw milk undergoes adulteration tests and neutralizer tests and later to store milk at appropriate temperature. These tests are conducted to detect and prevent contaminants from entering the milk supply chain. Ensuring the purity and safety of raw milk is crucial for producing high-quality dairy products.

Processing Centers: DDL operates 15 processing plants with an aggregated capacity of 22+ LLPD (Liters per day). These processing plants are fully automated, leading to improved operational efficiencies and reduced operating costs. In India, the company operates 14 milk processing plants located in the states of Andhra Pradesh, Telangana, Karnataka, and Tamil Nadu. DDL has strategically positioned these processing plants near its markets and procurement clusters.

Additionally, the company has a processing plant in Uganda to cater to the dairy markets in Uganda and Kenya. This plant has a capacity of 1.5 LLPD. Another plant is coming up in Kenya with a capacity of 1.0 LLPD by early 2024.

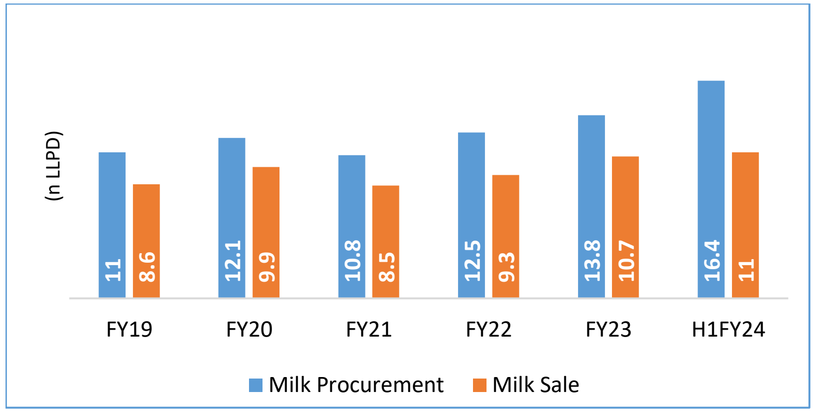
DDL's processing plants

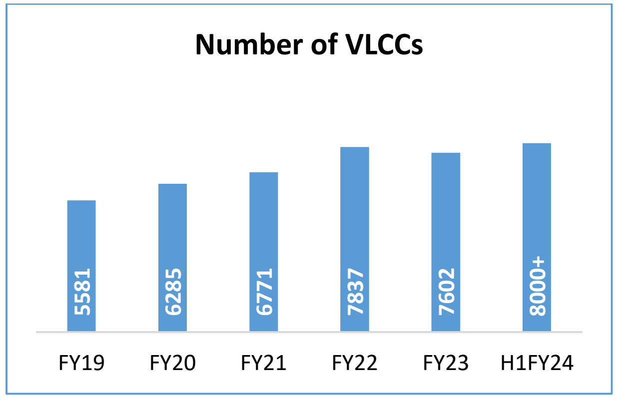
Focused engagement and long term relationship with dairy farmers:
DDL's farmer-friendly policies and continuous engagement with them with welfare programs have strengthened its relationships with farmers which in turn has strengthened its raw milk procurement process. It offers a variety of initiatives for the farmers from whom it procures raw milk. As part of its diversified procurement network, the company relies on third-party suppliers and farmers. In order to ensure transparency, it tests the quality and quantity of the raw milk collected from the farmers with electronic milk analysers.

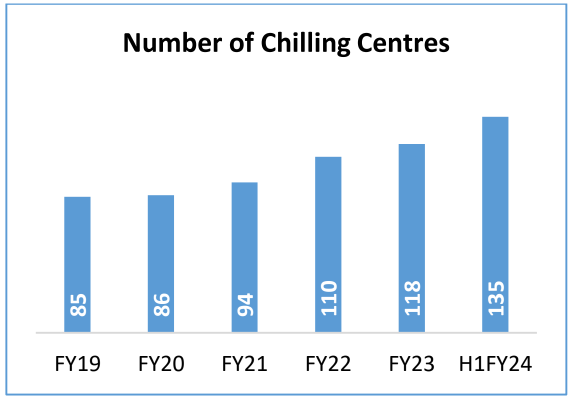
DDL pays the farmers once every 10 to 15 days with the money being sent directly to the bank accounts of ~77% of its farmers and pay the remaining ~23% of its farmers by way of direct cash payments, which motivates them to engage with company more frequently. It also works with regional banks and facilitates sanctioning of loans to farmers which they utilize to invest in their cattle. We believe its continuous engagement with farmers and its knowledge in the dairy industry combined with its welfare programs for the farmers have enabled them to have a strong procurement network in the regions in which it operates and thus helped them to contain the cost of raw milk to some extent and ensure supply of quality raw milk.

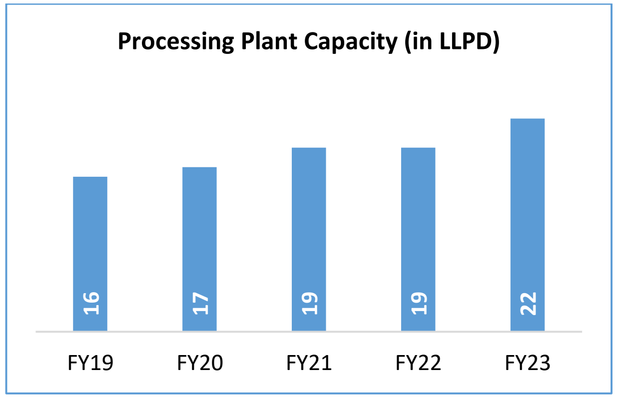
In FY14, only 7% of the milk was directly procured from farmers. However, by FY23, this percentage increased substantially to 93%. This progressive shift towards direct procurement can be observed through the increasing number of Dodla Dairy Collection Centers (DDCs) and the corresponding rise in average Litres Per Day (LPD) procured through these centers.

Year	Number of DDCs	Avg. LPD	%
FY14	322	44,980	7%
FY15	907	1,12,121	15%
FY16	1,769	2,65,870	34%
FY17	2,452	4,03,459	43%
FY18	3,544	5,04,804	49%
FY19	5,581	7,39,284	70%
FY20	6,285	9,20,881	82%
FY21	6,771	9,51,791	93%
FY22	7,837	10,97,732	94%
FY23	7,602	11,99,068	93%









(Source: Company, HDFC sec)

Expansion into overseas market

With a business model similar to the Indian one, DDL contributes significant percentage to Kenya and Uganda milk industry which is characterized by limited competition as well as limited supply of processed milk, easier milk farming due to availability of vast grasslands and a growing population with growing demand for dairy. The business in Uganda and Kenya operates through the subsidiaries Lakeside Dairy Limited & Dodla Dairy Kenya Limited. The African product portfolio is marketed under the brands Dairy Top and Dodla + and includes milk as well as VAP like yogurt with different flavours, ghee, cheese and UHT milk. DDL aims to tap into the growing demand for dairy products in these markets.

The margins in African market are normally double of what company makes domestically owing to lesser competitive intensity to procure milk.

Acquisitions as a way to grow - Small dairy processing units often face challenges such as rising input costs, competition, and limitations in branding and merchandising capabilities. By merging with a larger entity, these units can sustain and overcome these concerns. Since 2001, DDL has expanded through both greenfield and brownfield projects, acquiring a total of 7 plants in Andhra Pradesh, Telangana, Karnataka, Tamil Nadu, and Uganda.

In March 2022, DDL acquired Karnataka based Sri Krishna Milk for Rs 50 cr to expand its presence in North Karnataka & the Goa markets. It was the first private sector dairy company in Karnataka and had a turnover of Rs 50 cr in FY22 and net loss of Rs 15 cr.

In Q2FY24, DDL received the approval from board for acquisition of land in Maharashtra for ~ Rs 15 cr. The company estimates capex of around Rs 150 for setting-up a plant with a capacity of 5 LLPD expandable to 10 LLPD.

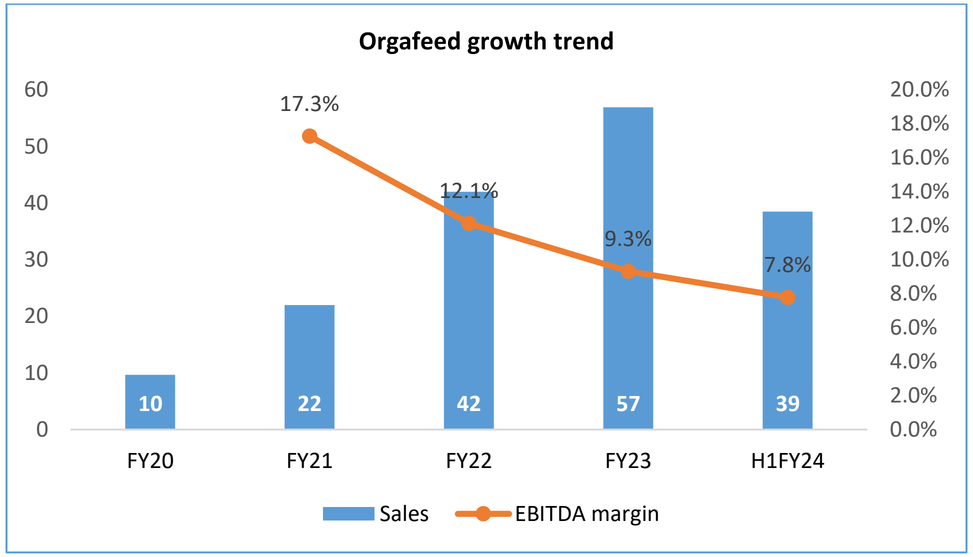
Going forward, as guided by the management, the company will be hunting for acquisitions as it will empower the company to enter new geographical territories.

Feed business complements dairy business:

DDL's feed business, Orgafeed, is involved in a wide range of agricultural activities including farming, breeding, horticulture, and allied activities such as poultry, dairy, and livestock farming. In addition to these operations, Orgafeed is also engaged in seed crushing, manufacturing, and dealing of groundnuts, gingerly, cotton, and the production of cattle feed.

Orgafeed adopts a unique approach by selling its cattle feed directly to farmers through its procurement network. This approach enables the company to have a direct relationship with its customers and ensures that farmers have access to the required feed for their livestock.

Moreover, the cost of the cattle feed is adjusted against the value of raw milk supplied by the farmers, providing them with a convenient and transparent payment mechanism.

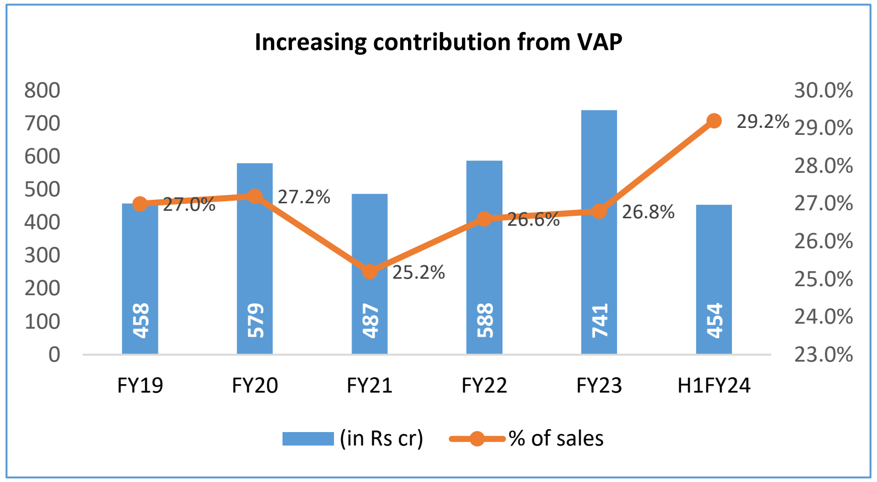


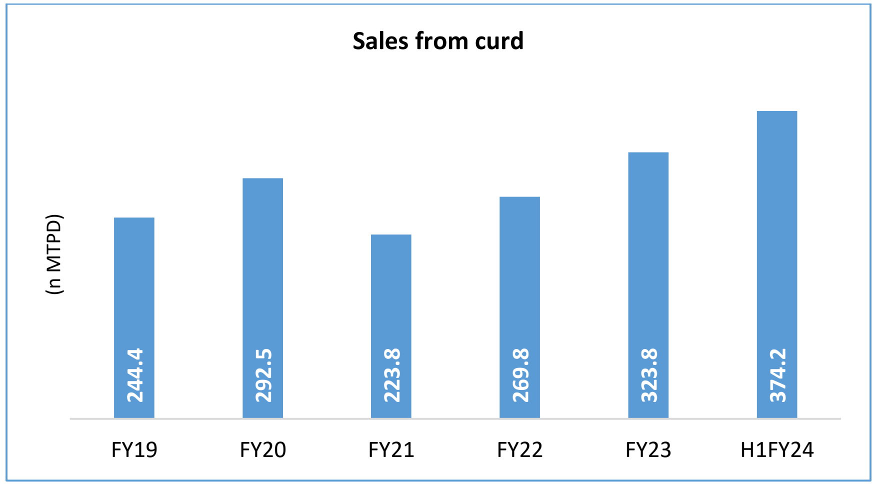
(Source: Company, HDFC sec)

In October 2023, DDL commissioned manufacturing of cattle feed plant at Kuppam, Chittoor District, Andhra Pradesh with the capacity of the new plant at 12,000 tons per month. This has taken the overall capacity to 14,400 tons per month. Revenue from this segment has increased Rs 9.7 cr in FY20 to ~Rs 57 cr in FY23. Management expects Orgafeed to cross ~Rs 100 cr in revenue by FY25 on the back of higher capacities. EBITDA margins to be in range of ~9-10%.

Increasing contribution from Value Added Products (VAP)

DDL is investing heavily in expanding its range of value-added products. It has invested significantly in value-added products such as Curd, Ice Creams, Flavored Milk, Lassi, Butter Milk, Yoghurt to name a few. The company already has a strong distribution network in southern states for milk as well as value added products through which it can rollout existing and upcoming products. 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. The company has a clear focus on high-RoCE products like ice-creams, flavoured milk, lassi, butter milk, ghee, yoghurt and butter and stayed away from low-ROCE products like cheese, whey, etc. Currently, curd accounts for over 90% of company's VAP.





(Source: Company, HDFC sec)

Financial Summary:

In FY23, DDL reported ~15% YoY growth in volume and ~10% in realisation, however, it reported 364 bps decline in gross margin owing to sharp rise in milk procurement costs. DDL is currently witnessing benefits of ongoing flush season which is expected to peak in October. Milk procurement prices have corrected in anticipation of good production and increased supply which should aid the gross margin recovery.

DDL's 5-year revenue CAGR stands at 12%. While domestic business has grown at 11% CAGR over FY18-23, overseas business has grown at ~34%.

DDL's management targets a growth rate of 15% in revenue with a standard growth rate of 10-12% in volume. Volume growth to be driven by increase in penetration in key markets and expanding into new markets. We expect the company to report 14% CAGR in revenue over FY23-25E.

Apart from the easing raw material prices, increased share of high-margin value-added products as well as operating leverage owing to healthy top-line growth, should support margin improvement. We expect 160 bps improvement in company's EBITDA margins over FY23-25E. PAT likely to grow at 26% CAGR over FY23-25E.

DDL enjoys superior balance sheet strength and has strong cash generation with OCF/EBITDA at ~94% (avg. FY18-FY23). Return ratios are healthy with good profitability and healthy asset turnover. We expect 220 bps/ 412 bps expansion in RoE/RoCE respt. over FY23-25E.

Key Concerns

Susceptibility to regulatory changes: Milk prices are sensitive to any change in government policies which have a direct impact on the operating margins of dairy product manufacturers.

Epidemic-related factors: Dairies are also vulnerable to risks of failure in milk production on account of cattle diseases. In July 2022, there was outbreak of Lumpy skin disease among cattle resulting in significant death count and subsequent shortage in milk supply.

Exposure to volatility in milk prices: Profitability remains susceptible to fluctuations in milk prices while realisations are further impacted by volatility in global skimmed milk powder prices coupled with changes in import/export policy by the Govt. Given the intense competition especially from state cooperatives, ability to pass on the increase in prices to customers is limited.

Lower margin compared to Hatsun: DDL earns lower margins than Hatsun as Hatsun has no distributor and sells 100% through their retail chain. Also it entered high margin ice cream market decades ago and its sales are a good proportion of overall sales. DDL currently sells ~12% through its retail parlours and aims to increase the sale of VAP including icecream to narrow the difference in margins.

Faces competition from co-operatives: Co-operatives are able to sell dairy products including milk at a lower price as they get subsidy from the state, have no profit motive and have social cause to be fulfilled. Despite this, DDL has been able to carve out market share in each state it is present in based on the quality of its products and brand pull even though its sells at a premium.

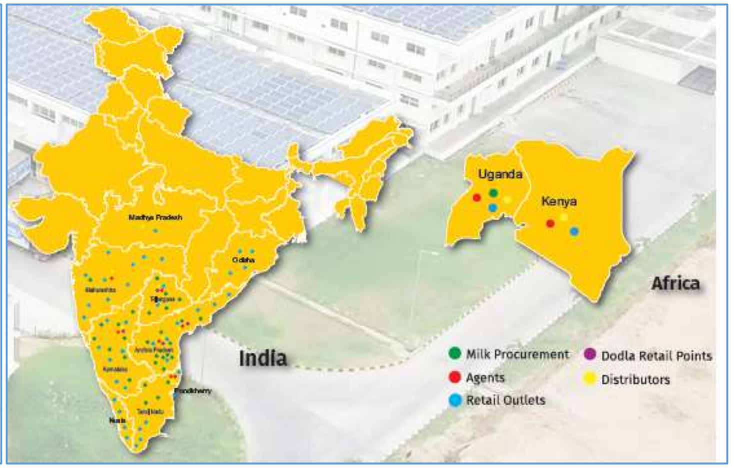
About the company

Dodla Dairy Ltd. (DDL) is one of India's leading integrated dairy companies incorporated in 1995. The company procures, processes, and sells milk and milk products. The Company's product portfolio consists of Milk, Butter Milk, Ghee, Curd, Paneer, Flavoured Milk, Doodh Peda, Lassi, Ice Cream and Milk Based Sweets. Dodla has very minor B2B sales and hence earns good margins.

The company's procurement is centred in 5 states and products are available for purchase in 13 states and has 135 milk chilling centres/plants. The Company's distribution and marketing operations are conducted through its 40+ sales offices, 2,750+ agents, 2,000+ milk and milk product distributors, 65+ modern trade across India. Additionally, the company's milk and dairy based Value-added Products are also available through 625+ 'Dodla Retail Parlours' as on 30th September 2023 and are spread across the states of Andhra Pradesh, Telangana, Tamil Nadu and Karnataka. The Company also has international operations in Uganda and Kenya.

DDL's product portfolio

DDL's Corporate Structure and presence



(Source: Company, HDFC sec)

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Financials

Income Statement

Particulars (in Rs Cr)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Net Revenues	**1692**	**2139**	**1944**	**2243**	**2812**	**3228**	**3667**
Growth (%)	***6.4***	***26.5***	***-9.1***	***15.4***	***25.3***	***14.8***	***13.6***
Operating Expenses	1558	1998	1702	2033	2621	2960	3359
EBITDA	**134**	**141**	**242**	**211**	**191**	**268**	**308**
Growth (%)	***19***	***5.1***	***72***	***-13.1***	***-9.2***	***40***	***15***
EBITDA Margin (%)	***7.9***	***6.6***	***12.5***	***9.4***	***6.8***	***8.3***	***8.4***
Depreciation	37	49	51	52	61	68	76
Other Income	8	6	6	14	23	26	29
EBIT	**105**	**98**	**198**	**172**	**153**	**226**	**261**
Interest expenses	12	16	12	7	1	2	2
PBT	**93**	**82**	**186**	**166**	**152**	**224**	**259**
Tax	31	32	60	33	30	56	65
PAT	**63**	**50**	**126**	**133**	**122**	**167**	**194**
Share of Asso./Minority Int.	0	0	0	0	0	0	0
Adj. PAT	**63**	**50**	**126**	**133**	**122**	**167**	**194**
Growth (%)	***10.4***	***-20.5***	***152.5***	***5.4***	***-7.9***	***36.9***	***15.8***
EPS	11.3	9	21.6	22.3	20.6	28.1	32.6

Balance Sheet

Particulars (in Rs Cr) - As at March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
SOURCE OF FUNDS							
Share Capital	56	56	58	59	59	59	59
Reserves	351	378	600	784	913	1080	1274
Shareholders' Funds	**406**	**433**	**658**	**843**	**972**	**1140**	**1333**
Minority Interest	0	0	0	0	0	0	0
Total Debt	151	136	99	13	32	32	32
Net Deferred Taxes	26	37	45	35	23	23	23
Total Sources of Funds	**583**	**606**	**802**	**891**	**1028**	**1195**	**1389**
APPLICATION OF FUNDS							
Net Block & Goodwill	503	539	549	566	624	666	699
CWIP	11	11	8	4	58	58	58
Investments	26	12	60	184	260	360	510
Other Non-Curr. Assets	24	19	13	61	26	29	33
Total Non-Current Assets	**564**	**581**	**631**	**815**	**968**	**1113**	**1300**
Inventories	125	120	96	121	120	150	166
Debtors	7	7	5	5	9	9	10
Cash & Equivalents	22	69	224	132	125	153	173
Other Current Assets	34	15	16	15	31	27	30
Total Current Assets	**188**	**211**	**341**	**273**	**284**	**339**	**379**
Creditors	76	78	86	103	127	142	161
Other Current Liab & Provisions	93	108	84	95	97	115	130
Total Current Liabilities	**169**	**186**	**170**	**198**	**224**	**257**	**291**
Net Current Assets	19	25	171	75	60	82	88
Total Application of Funds	**583**	**606**	**802**	**891**	**1028**	**1195**	**1389**

Cash Flow Statement

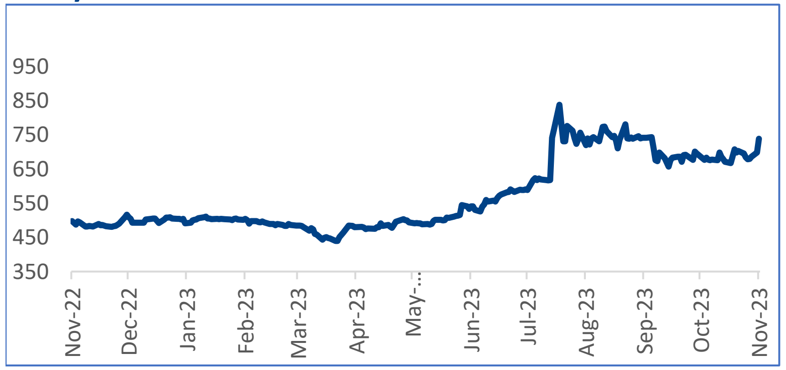
Particulars (in Rs Cr)	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Reported PBT	93	82	186	166	152	224	259
Non-operating & EO items	-2	-2	0	-3	-7	-2	-4
Interest Expenses	11	15	9	0	-10	2	2
Depreciation	37	49	51	52	61	68	76
Working Capital Change	15	33	51	-4	9	5	14
Tax Paid	-19	-12	-51	-40	-45	-56	-65
OPERATING CASH FLOW (a)	**136**	**166**	**245**	**171**	**161**	**240**	**282**
Capex	-97	-95	-56	-70	-105	-110	-110
Free Cash Flow	39	71	189	101	56	130	172
Investments	45	17	-48	-120	-69	-100	-150
Non-operating income	-96	1	-96	54	-37	0	0
INVESTING CASH FLOW (b)	**-148**	**-76**	**-200**	**-137**	**-210**	**-210**	**-260**
Debt Issuance / (Repaid)	72	9	-63	-87	18	0	0
Interest Expenses	-11	-14	-12	-6	0	-2	-2
FCFE	50	84	-30	-58	-31	28	20
Share Capital Issuance	0	0	100	50	0	0	0
Dividend	0	-18	-11	0	0	0	0
Others	-2	-2	-3	-6	-3	0	0
FINANCING CASH FLOW (c)	**60**	**-26**	**11**	**-49**	**15**	**-2**	**-2**
NET CASH FLOW (a+b+c)	**48**	**64**	**56**	**-14**	**-35**	**28**	**20**

Key Ratios

Particulars	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E
Profitability Ratios (%)							
EBITDA Margin	7.9	6.6	12.5	9.4	6.8	8.3	8.4
EBIT Margin	6.2	4.6	10.2	7.7	5.4	7	7.1
APAT Margin	3.7	2.3	6.5	5.9	4.3	5.2	5.3
RoE	16.8	11.9	23.1	17.7	13.5	15.9	15.7
RoCE	20.6	17.4	29.9	21.3	16.5	20.7	20.6
Solvency Ratio (x)							
Net Debt/EBITDA	1	0.5	-0.5	-0.6	-0.5	-0.5	-0.5
Net D/E	0.3	0.2	-0.2	-0.1	-0.1	-0.1	-0.1
PER SHARE DATA (Rs)							
EPS	11.3	9	21.6	22.3	20.6	28.1	32.6
CEPS	17.9	17.8	30.3	31.1	30.8	39.6	45.4
BV	73	77.9	112.8	141.7	163.4	191.6	224.1
Dividend	0	0	0	0	0	0	0
Turnover Ratios (days)							
Debtor days	1	1	1	1	1	1	1
Inventory days	28	21	20	18	16	15	16
Creditors days	15	13	15	15	15	15	15
Valuation (X)							
P/E	65	82	34	33	36	26	23
P/BV	10	9	7	5	5	4	3
EV/EBITDA	34	32	17	20	21	15	12
EV / Revenues	3	2	2	2	1	1	1

(Source: Company, HDFC sec)

One-year Share Price Chart



HARSH RAJENDRA SHETH

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Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

Disclosure:

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