Hatsun Agro Products

Dairy

Ice cream – likely to emerge as major value driver

Hatsun Agro's ice cream business has strong potential to create value, in our view, as (1) it has built multiple competitive advantages such as established brands (Arun and Ibaco), HAP Daily, three manufacturing units which help to cater to a large geography – this results in higher TAM at lower freight costs and storage units which help in reducing capex, (2) most players in ice cream segment are going through a rough patch (in our view) like Kwality Walls, which may be sold by its parent. Co-operatives face issues of relatively weaker balance sheets and some players operate in niches like Naturals (premium tubs largely in West India), Baskin Robbins (premium/luxury segment). Hatsun is well poised to gain market share amidst evolving market conditions, in our view and (3) initiatives like instant quick freeze (IQF) help to make ice cream variants with extruded technology. It also helps to maintain freshness and superior quality. It may result in higher consumer loyalty in medium-long term due to superior product quality. (4) There is potential to improve margins of ice cream (as well as overall margins) with rising scale of operations and trade initiatives. We remain constructive on medium-long growth prospects Hatsun Agro. Maintain **BUY**.

Strong competitive advantages in ice cream

Hatsun has developed multiple competitive advantages in ice cream such as (1) established brands like Arun (low, mid and premium positioning) and Ibaco (premium/luxury), (2) three large manufacturing units to cover geographies in South, West, East and Central India, (3) storage units for reducing capex and applying better go-to-market strategy, (4) it also has a large product portfolio across price points, (5) investments in trade in freezers and HAP daily (long life).

Focused play across segments amidst evolving market conditions

We note players such as (1) Kwality Walls may be sold by its parent and could be separately listed in India, (2) Heritage (Alpenvie and Heritage) as well as Dodla are still in investment mode, (3) Naturals focuses on niche premium market of tubs, (4) Baskin Robbins focuses on premium/ luxury segment and (5) most co-operatives focus on value-for-money products. We believe Hatsun has created a large product portfolio across sub-segments catering to different types (needs) of consumers.

Financial Summary

Y/E March (INR mn)	FY24A	FY25E	FY26E	FY27E
Net Revenue	79,904	90,739	1,03,568	1,18,229
EBITDA	8,990	10,744	12,307	14,453
EBITDA Margin (%)	11.3	11.8	11.9	12.2
Net Profit	2,673	3,895	5,227	6,900
EPS (INR)	12.0	17.5	23.5	31.0
EPS % Chg YoY	61.2	45.7	34.2	32.0
P/E (x)	91.1	62.5	46.6	35.3
EV/EBITDA (x)	29.2	23.3	19.9	16.5
RoCE (%)	10.2	13.1	18.7	24.1
RoE (%)	17.7	23.3	27.0	29.6

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Market Data

Market Cap (INR)	243bn
Market Cap (USD)	2,873mn
Bloomberg Code	HTSMF IN
Reuters Code	HAPL.BO
52-week Range (INR)	1,400 /956
Free Float (%)	23.0
ADTV-3M (mn) (USD)	0.8

Price Performance (%)	3m	6m	12m
Absolute	(17.0)	8.0	0.3
Relative to Sensex	(14.2)	(0.5)	(18.6)

ESG Score	2022	2023	Change
ESG score	**48.2**	**59.8**	**11.6**
Environment	23.0	32.7	9.7
Social	36.3	60.9	24.6
Governance	76.0	78.8	2.8

Note - Score ranges from 0 - 100 with a higher number indicating a higher ESG score.

Source: SES ESG, I-sec research

Previous Reports

05-11-2024: Q2FY25 results review

31-07-2024: Company Update

Potential for margins to expand

We expect margins of ice cream business to expand from current levels, driving up overall margins. Our expectation is premised on (1) higher capacity utilisation at Govindapur plant and operating leverage, (2) lower trade margins vs peers as Hatsun provides access to refrigeration and also leverages HAP Daily for distribution and (3) launch of premium variants/SKUs.

Maintain BUY

We model Hatsun to report FY24–27E revenue/PAT CAGR of 14.0%/37.2%. Our DCF-based TP stands at INR 1,250, implying a P/E of 53/40x FY26/27E. Retain **BUY**.

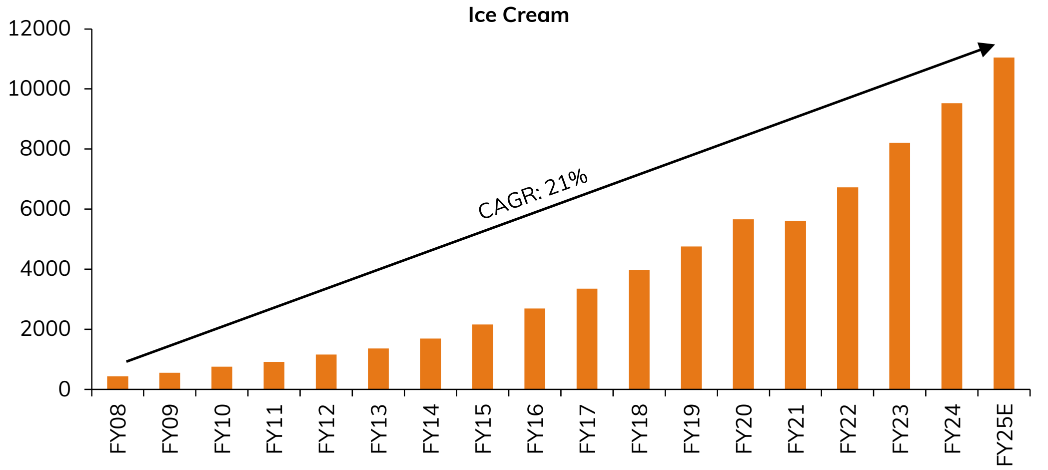
Key risks: Higher competitive pressures and material inflation in RM prices.

Ice cream: Likely to be a major value driver

We model ice cream business to be a key growth driver for Hatsun over FY26-27E. While summer season (~60% of ice cream sales) was impacted in FY24 and FY25 due to unseasonal weather conditions, we model revenue growth to be strong (>15%) over FY25-27E.

We also believe ice cream revenue may reach INR 13bn+ in FY25E. The strong growth is led by the commencement of Govindapur plant, rollout of differentiated launches, distribution expansion in South Indian states and aggressive expansion in West, Central and East India.

Exhibit 1: Ice cream business revenue (indicative)



Source: Company data, I-Sec research

Aggressive investments in ice cream business: Hatsun commenced its ice cream plant at Govindapur (AP) near Hyderabad in FY23. We note the company has incurred a capex of INR 6bn and there is potential to generate revenue of up to INR 17bn at current market prices. We also expect revenue to rise with steady premiumisation and expansion in realisation.

Exhibit 2: Investments in ice cream business

Particulars	Comments
Number of plants	Three
Installed Capacity	Among the largest in India
Storage units	To store ice cream and reduce capex
Portfolio	One of the largest
Established brands	Arun (Low, Mid and premium range), Ibaco (Premium/ Luxury)
Retail outlets	Investments in freezers as well as technology to reduce electricity bill
Investment in HAP Daily (Long Life)	To strengthen the moat in the trade

Source: Company data, I-Sec research

Favourable market conditions: We believe market conditions are favourable for Hatsun considering (1) multiple brands are still in investment mode and are yet to show successful track record. E.g. Alpenvie by Heritage. (2) As some co-operatives have weak balance sheets due to losses/ higher debt, we do not model material investments from them in ice cream category. (3) Established brands such as Kwality Walls may be demerged/ sold by the parent.

Now consumers are also aware that there are only limited number of brands selling milk-based ice creams such as Hatsun, Havmor and Amul. Many leading brands have started using vegetable oil-based contents in their ice cream products.

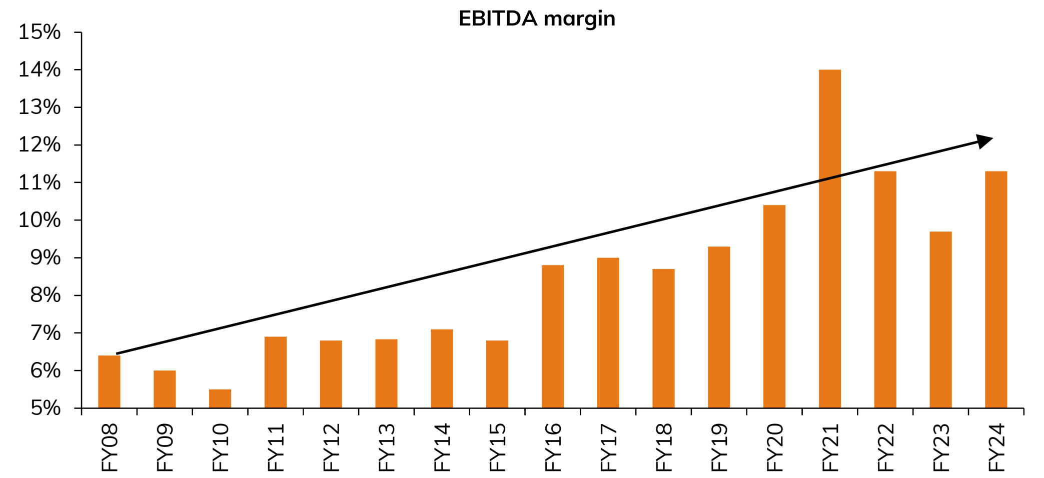
Exhibit 3: Favourable conditions for Hatsun to expand market share

Particulars	Comments
Kwality Walls	Parent wants to sell the business; to be listed separately in India
Alpenvie by Heritage	Moderate consumer response
Heritage and Dodla ice cream	In investment stage
Dessert brands	Likely to lose market share to ice cream players
Brands by Co-operatives	Limited investments due to weak Balance Sheets

Source: Company data, I-Sec research

Ice cream: Likely to be margin attractive: We note Hatsun's EBITDA margin has steadily expanded over FY10-24. While operating leverage, improving brand maturity and backward integration have also helped in expanding margins, we believe increase in revenue share of ice cream segment has also partly led to margin improvement.

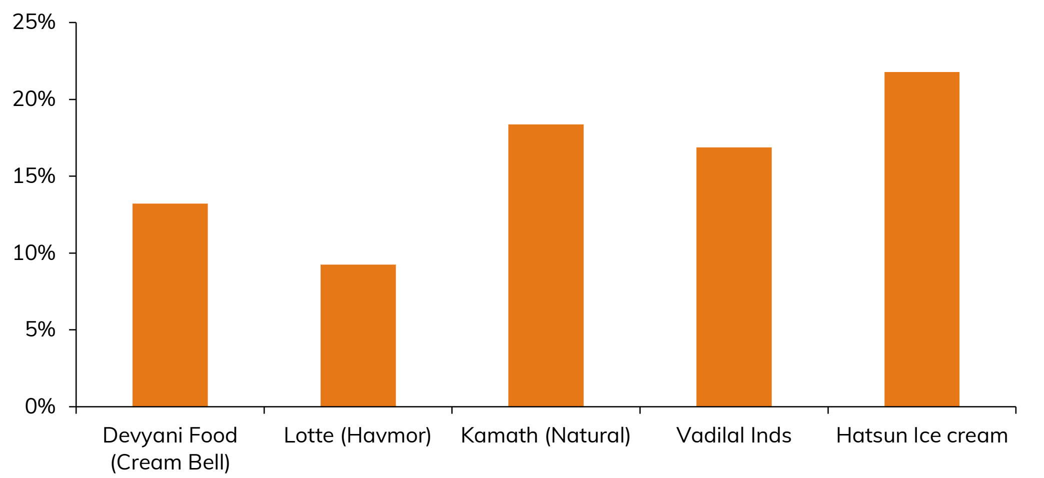
Exhibit 4: Hatsun's EBITDA margin is inching upwards, partly due to the success of ice cream



Source: Company data, I-Sec research

Hatsun has likely gained market share in ice cream: Hatsun has gained market share in our view over FY19-23 in ice cream category. Its market share expansion is largely led by growth in differentiated product portfolio and rising acceptance of Arun brand in Maharashtra, Odisha and maturity of Ibaco brand. As Hatsun sells ice cream vs desserts sold by many leading brands, it helps in attracting and retaining consumer attention.

Exhibit 5: Revenue CAGR (%)* over FY19-23 for select ice cream companies



Source: Company data, I-Sec research *Company revenue CAGR

What are the competitive advantages in ice cream for Hatsun?

Three plants to cater to markets: We note the company has three plants across South India now. We note it is able to cater to different geographies from these three plants. Commencement of Govindapur plant has helped the company to reach new geographies and expand its total addressable market.

Exhibit 6: Three ice cream plants spread across South India

Source: Company data, I-Sec research

Large product portfolio: Hatsun has established a large product portfolio across price points. It has products ranging as low as INR 5/ SKU. It has also introduced premium/ luxury range under the brand Ibaco, paving a path for premiumisation. We believe the large product portfolio of Hatsun helps in differentiating itself vs peers.

Exhibit 7: Hatsun's ice cream brands have strong positioning vs peers

Brand	Comments
Hatsun	Arun (Low, Mid and premium range), Ibaco (Premium/ Luxury)
Naturals	Focus on large packs (tubs) and niche/ premium positioning
Baskin Robbins	Present at top end of market
Vadilal, Sheetal	Strong focus on mid and value-for-money products
Kwality Walls	Mostly Desserts, pan-India presence
Amul	Strong presence pan-India but largely value-for-money products

Source: Company data, I-Sec research

Focus on single-serve packets and premium pricing: The company focuses on single-serve packets. As these products can offer a better consumer experience due to usage of multiple ice cream variants, usage of cone/biscuit, nuts, fruits, chocolates etc, there is scope for differentiation. However, there is limited scope for differentiation in family packs. With strong product offering as well as superior brand perception, Hatsun is able to command 30%+ premium over ice cream variants offered by co-operatives.

Exhibit 8: Arun generates higher pricing than Amul; focus is also on single-serve packs

Amul	ML	Price (INR)	Paise/Gram	Arun	ML	Price (INR)	Paise/Gram
Single Serve packs							
Amul Frostik	40	12	30	Arun iBAR mini	40	35	88
Amul Chocobar	40	10	25	Arun Chocobar	40	25	63
Amul Tricone	50	15	30	Arun iCONE	100	55	55

Source: Company data, I-Sec research

Trade investments and commencement of Govindapur plant: Commencement of Govindpur plant (largest ice cream plant in India) augurs well for pan-India presence. The capex of INR 6bn indicates a revenue potential of INR 15-17bn as utilisation level may ramp up to 100% in next three years from current level of ~60%, in our view. We model overall ice cream revenue to reach INR 21-23bn in next three years. We expect revenue contribution of ice cream segment to expand to ~14% in FY26E from ~12% in FY24.

Hatsun's distribution model is also different from peers as it leverages HAP Daily outlets to distribute its products. As the company offers access to refrigerators, store interiors and other furnishings as well as reimburses electricity bills and rent, it is able to offer trade margin of only ~12% compared to ~20% for peers. We believe capex in trade investments strengthens the moat in distribution.

Exhibit 9: Chief growth drivers for ice cream business

Growth drivers	Particulars
Investments in capex	
Commencement of Govindpur plant	Potential to distribute pan India
	Potential to introduce multiple differentiated products
Investment in large storage units	To manufacture and store ice cream for summer usage
Investments in trade	
Investments in refrigerators	Reducing the bottleneck of cold chain
Offering electricity bill and rent	Potential to gain market share from smaller players
Investments in HAP Daily	It strengthens bargaining power of Hatsun

Source: Company data, I-Sec research

Storage units to effectively improve utilisation levels and boost RoCE: In spite of putting up mega capacity, the company plans to use the plant more effectively during non-season. Normally, peak summer season (Apr-May) accounts for ~28% of yearly sales. Most companies consider 7 to 7.2 months of peak summer months as sales for the year.

We note Hatsun is trying to keep its installed capacity at 10% for Apr-May, with shortage of 8% for these months. The company avoids excess capex, but it has built cold storages to produce in Jan-Feb to meet peak demand of Apr-May. Hence, storage facility provides a cushion for capex saved. Further, it enables long-batch production without any interruption, reducing the wastage in plant. It also helps to keep all variants of products without shortage in summer months. Hence, the company can leverage the plant for 10 months instead of seven months. In the long run, 40% more production is possible from the same plant and it may reduce fixed overheads, thus, improving profitability.

These storage units can also be leveraged to keep butter stock in winter as ice cream inventory will be exhausted in summer.

Exhibit 10: Lower capex requirement for Hatsun due to storage units

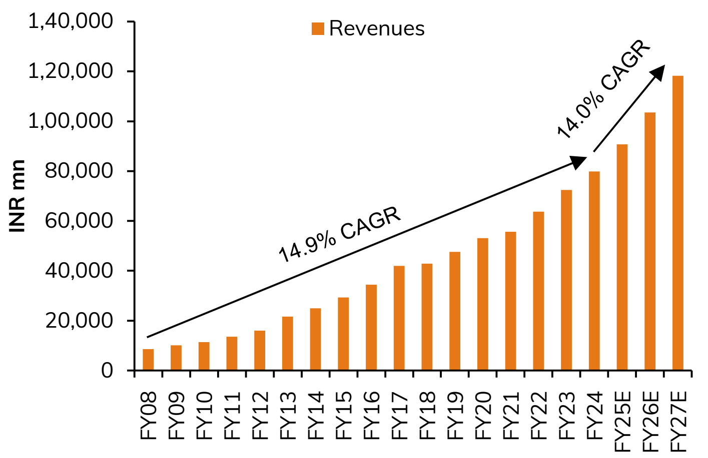
Particulars	Hatsun	Peers	Comments
Sales (Kg)	100.0	100.0	Assumed both have same sales (Kg)
Production (Apr) (Kg)	10.0	14.0	Assuming both will produce at peak capacity
Production (May) (Kg)	10.0	14.0	Assuming both will produce at peak capacity
Production required in rest of the months (Kg)	80.0	72.0	
Average production per month (Kg)	8.0	7.2	Hatsun will have higher production in remaining months
Peak Capacity required to set up (Monthly basis)	10.0	14.0	
Peak Capacity required to set up (Annual basis)	**120.0**	**168.0**	**Hatsun needs to invest less in capex due to storage units**
Underutilised capacity	20%	68%	Hatsun's capacity utilization > peers

Source: Company data, I-Sec research

Usage of IQF technology: Hatsun has invested in instant quick freeze technology at its Govindapur plant. While it has led to higher capex, it may allow Hatsun to (1) launch extruded ice cream variants and (2) retain the freshness and quality of ice cream. We believe superior product quality could fetch higher market share in medium-long term. As consumers can realise the difference in product quality, we believe Hatsun may be able to charge a premium price in medium-long term.

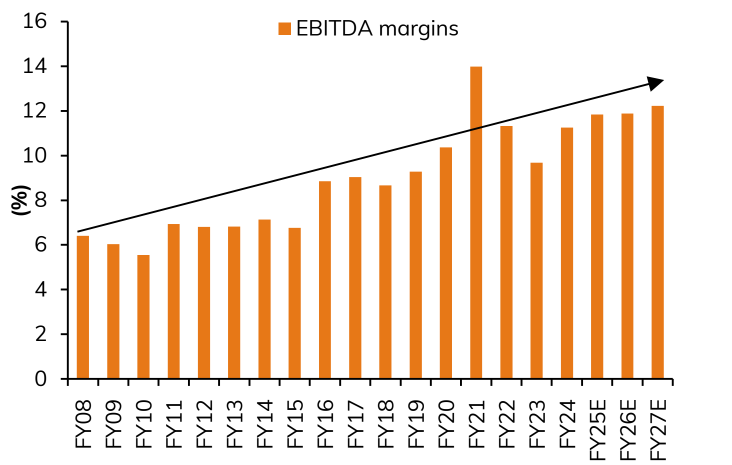
Key highlights – Annual

Exhibit 11: Revenue and growth rates



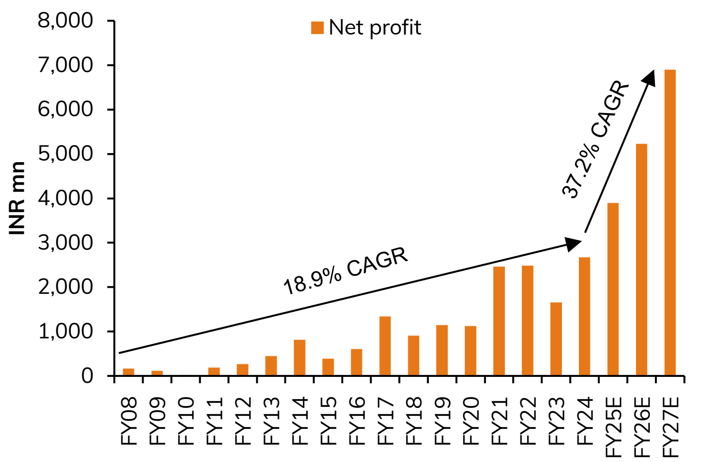
Source: Company data, I-Sec research

Exhibit 12: EBITDA margin



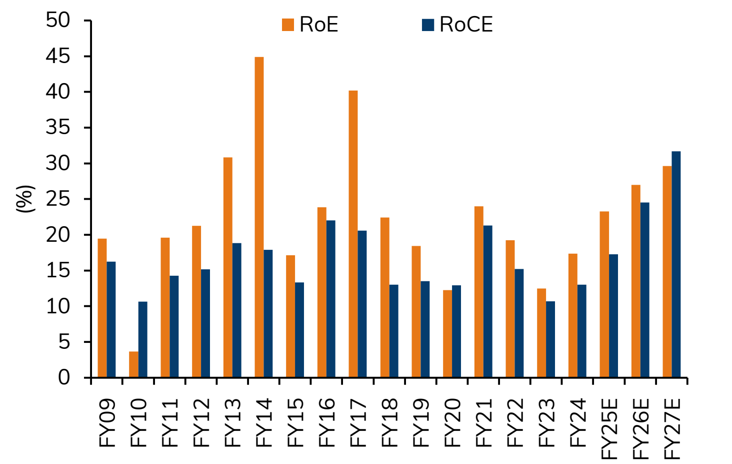
Source: Company data, I-Sec research

Exhibit 13: PAT and growth rates



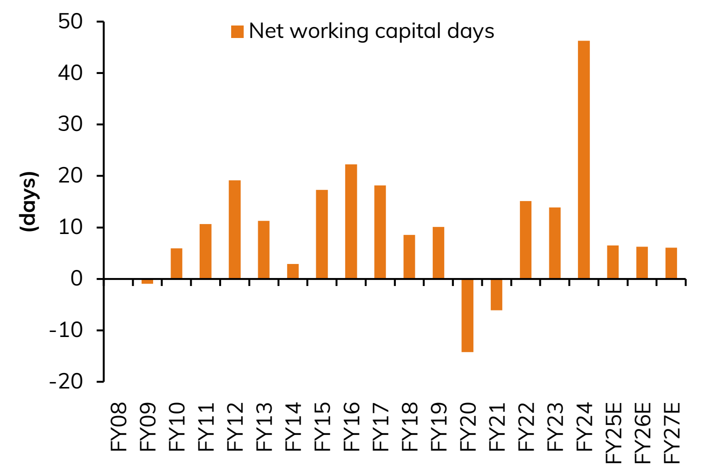
Source: Company data, I-Sec research

Exhibit 14: RoE and RoCE



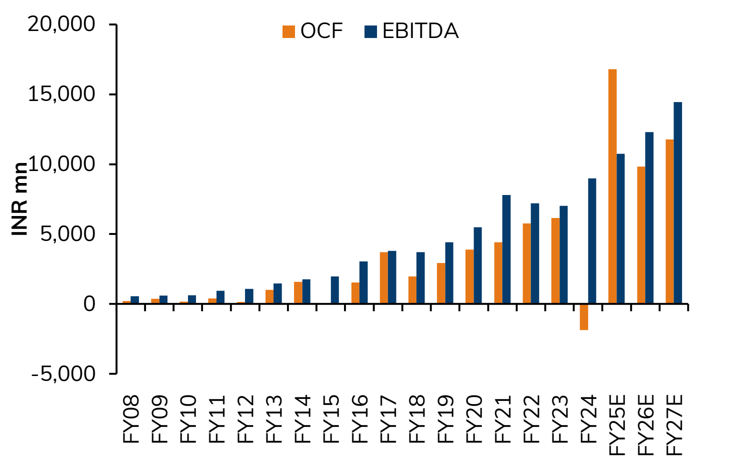
Source: Company data, I-Sec research

Exhibit 15: Net working capital days



Source: Company data, I-Sec research

Exhibit 16: OCF and EBITDA



Source: Company data, I-Sec research

Valuation and risks

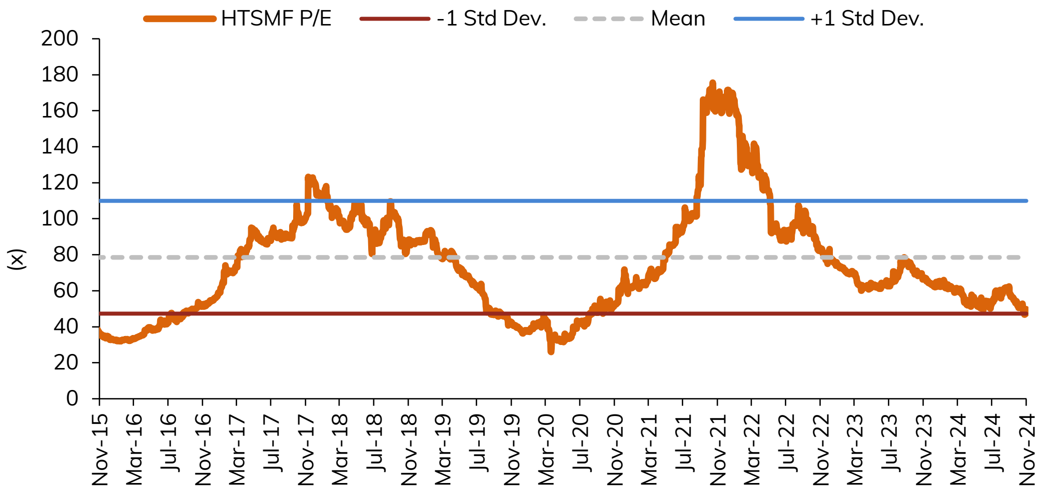
We model Hatsun to report revenue and PAT CAGRs of 14.0% and 37.2% over FY24-FY27E, respectively, and RoE to move to 31.7% in FY27E, from 17.7% in FY24. At our DCF-based target price of INR 1,250, implied P/E works out to 57x FY26E EPS. Maintain **BUY**.

Exhibit 17: DCF-based valuation

Particulars	
Cost of equity (%)	11.0%
Terminal growth rate (%)	5.0%
Discounted interim cash flows (INR mn)	1,27,308
Discounted terminal value (INR mn)	1,51,124
Total equity value (INR mn)	2,78,433
Value per share (INR)	**1,250**

Source: Company data, I-Sec research

Exhibit 18: Mean PE (x) and standard deviations



Source: Company Data, I-Sec research, Bloomberg

Risks

Sharp increase in input prices and competitive pressures

Major increase in milk procurement prices and/or increase in competitive pressures may result in a downside to our estimates.

Delays in launch of new plants/products

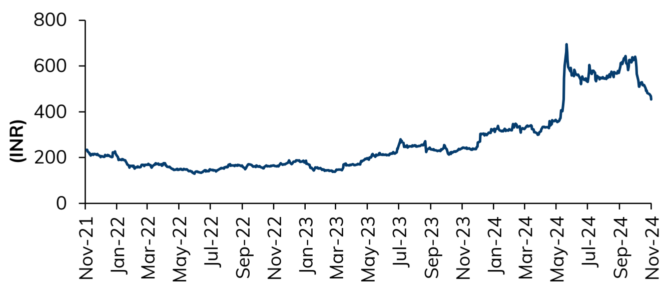
Any delays in launch of new products and/or plants may result in lower earnings than estimated.

Exhibit 19: Shareholding pattern

%	Mar'24	Jun'24	Sep'24
Promoters	73.2	73.2	73.2
Institutional investors	12.7	12.7	13.5
MFs and others	9.6	9.6	9.9
FIs/Banks	0.0	0.0	0.0
Insurance	0.0	0.0	0.0
FIIs	3.1	3.1	3.6
Others	14.1	14.1	13.3

Source: Bloomberg

Exhibit 20: Price chart



Source: Bloomberg

Financial Summary

Exhibit 21: Profit & Loss

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Net Sales	79,904	90,739	1,03,568	1,18,229
Operating Expenses	**70,914**	**79,996**	**91,261**	**1,03,776**
EBITDA	8,990	10,744	12,307	14,453
EBITDA Margin (%)	**11.3**	**11.8**	**11.9**	**12.2**
Depreciation & Amortization	4,095	4,385	4,767	5,047
EBIT	4,895	6,358	7,540	9,406
Interest expenditure	1,542	1,368	773	433
Other Non-operating Income	226	135	110	105
Recurring PBT	3,579	5,126	6,877	9,078
Profit / (Loss) from Associates	**-**	**-**	**-**	**-**
Less: Taxes	**906**	**1,230**	**1,651**	**2,179**
PAT	2,673	3,895	5,227	6,900
Less: Minority Interest	-	-	-	-
Extraordinaries (Net)	(21)	-	-	-
Net Income (Reported)	2,652	3,895	5,227	6,900
Net Income (Adjusted)	**2,673**	**3,895**	**5,227**	**6,900**

Source Company data, I-Sec research

Exhibit 22: Balance sheet

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Total Current Assets	15,905	8,420	9,445	12,234
of which cash & cash eqv.	533	181	104	1,641
Total Current Liabilities & Provisions	5,246	6,624	7,560	8,631
Net Current Assets	**10,659**	**1,796**	**1,885**	**3,603**
Investments	1,390	1,390	1,390	1,390
Net Fixed Assets	27,590	28,339	26,472	24,425
ROU Assets	-	-	-	-
Capital Work-in-Progress	2,384	-	-	-
Total Intangible Assets	77	77	77	77
Other assets	-	-	-	-
Deferred Tax assets	-	-	-	-
Total Assets	**42,100**	**31,602**	**29,824**	**29,495**
Liabilities				
Borrowings	**26,361**	**13,861**	**8,861**	**3,861**
Deferred Tax Liability	**17**	**17**	**17**	**17**
provisions	-	-	-	-
other Liabilities	-	-	-	-
Equity Share Capital	223	223	223	223
Reserves & Surplus	15,500	17,501	20,723	25,395
Total Net Worth	**15,723**	**17,724**	**20,946**	**25,618**
Minority Interest	-	-	-	-
Total Liabilities	**42,100**	**31,602**	**29,824**	**29,495**

Source Company data, I-Sec research

Exhibit 23: Quarterly trend

(INR mn, year ending March)

	Dec-23	Mar-24	Jun-24	Sep-24
Net Sales	18,875	20,469	23,751	20,721
% growth (YOY)	11.3	14.4	10.4	8.7
EBITDA	2,127	2,296	3,303	2,411
Margin %	11.3	11.2	13.9	11.6
Other Income	41	22	22	66
Extraordinaries	(1)	(24)	9	(9)
Adjusted Net Profit	574	522	1,305	643

Source Company data, I-Sec research

Exhibit 24: Cashflow statement

(INR mn, year ending March)

	FY24A	FY25E	FY26E	FY27E
Operating Cashflow	**(1,862)**	**16,792**	**9,828**	**11,765**
Working Capital Changes	(8,480)	8,511	(165)	(182)
Capital Commitments	(5,353)	(2,750)	(2,900)	(3,000)
Free Cashflow	**(7,215)**	**14,042**	**6,928**	**8,765**
Other investing cashflow	**1,436**	**-**	**-**	**-**
Cashflow from Investing Activities	(3,917)	(2,750)	(2,900)	(3,000)
Issue of Share Capital	-	-	-	-
Interest Cost	-	-	-	-
Inc (Dec) in Borrowings	7,251	(12,500)	(5,000)	(5,000)
Dividend paid	(1,336)	(1,894)	(2,005)	(2,228)
Others	-	-	-	-
Cash flow from Financing Activities	5,915	(14,394)	(7,005)	(7,228)
Chg. in Cash & Bank balance	**136**	**(352)**	**(77)**	**1,537**
Closing cash & balance	507	181	104	1,641

Source Company data, I-Sec research

Exhibit 25: Key ratios

(Year ending March)

	FY24A	FY25E	FY26E	FY27E
Per Share Data (INR)				
Reported EPS	12.0	17.5	23.5	31.0
Adjusted EPS (Diluted)	12.0	17.5	23.5	31.0
Cash EPS	30.4	37.2	44.9	53.6
Dividend per share (DPS)	6.0	8.5	9.0	10.0
Book Value per share (BV)	70.6	79.6	94.0	115.0
Dividend Payout (%)	50.0	48.6	38.4	32.3
Growth (%)				
Net Sales	10.3	13.6	14.1	14.2
EBITDA	28.2	19.5	14.5	17.4
EPS (INR)	61.2	45.7	34.2	32.0
Valuation Ratios (x)				
P/E	91.1	62.5	46.6	35.3
P/CEPS	36.0	29.4	24.4	20.4
P/BV	15.5	13.7	11.6	9.5
EV / EBITDA	29.2	23.3	19.9	16.5
P / Sales	3.0	2.6	2.3	2.0
Dividend Yield (%)	0.5	0.8	0.8	0.9
Operating Ratios				
Gross Profit Margins (%)	29.7	30.4	30.6	30.9
EBITDA Margins (%)	11.3	11.8	11.9	12.2
Effective Tax Rate (%)	25.3	24.0	24.0	24.0
Net Profit Margins (%)	3.3	4.3	5.0	5.8
NWC / Total Assets (%)	24.1	5.1	6.0	6.7
Net Debt / Equity (x)	1.6	0.7	0.4	0.0
Net Debt / EBITDA (x)	2.7	1.1	0.6	0.1
Profitability Ratios				
RoCE (%)	10.2	13.1	18.7	24.1
RoE (%)	17.7	23.3	27.0	29.6
RoIC (%)	10.2	13.1	18.7	24.1
Fixed Asset Turnover (x)	1.9	2.0	2.1	2.2
Inventory Turnover Days	70	31	31	31
Receivables Days	0	1	1	1
Payables Days	24	27	27	27

Source Company data, I-Sec research

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