

HERITAGE FOODS

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	327
12 month price target (INR)	410
Market cap (INR bn/USD bn)	15/0.2
Free float/Foreign ownership (%)	60.1/4.6
What's Changed	
Target Price	↓
Rating/Risk Rating	—

QUICK TAKE

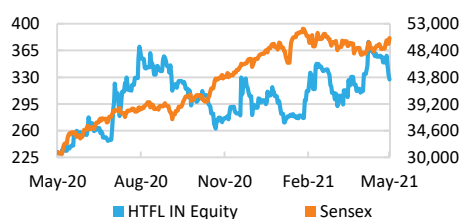
	Above	In line	Below
Profit			•
Margins			•
Revenue Growth		•	
Overall			•

FINANCIALS

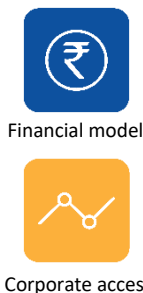
(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	24,731	27,008	30,015	32,988
EBITDA	2,711	2,266	2,639	2,988
Adjusted profit	1,569	1,298	1,574	1,832
Diluted EPS (INR)	33.8	28.0	33.9	39.5
EPS growth (%)	171.9	(17.3)	21.3	16.3
RoAE (%)	28.8	20.0	20.7	20.5
P/E (x)	9.7	11.7	9.6	8.3
EV/EBITDA (x)	5.6	6.2	4.8	3.7
Dividend yield (%)	1.5	2.1	2.6	3.6

PRICE PERFORMANCE



Explore:



Spreads dip sequentially

Heritage Foods (HTFL) reported sales in line, but EBITDA growth of 74% missed estimate by 20%. This was led by gross margin decline of ~504bps QoQ to 23.2% with 7% QoQ increase in procurement cost. Sales fell 5% YoY, but grew 2.4% QoQ. Further, value-added dairy products (VADP) sales grew 18% QoQ and fell mere 3% YoY.

With the Future Retail (FRL) stake sale and strong profit in FY21 (EBITDA up 100%), the company reduced debt by INR2.2bn. rising procurement costs and some realisation cuts, we pare our FY22/23E EPS 15%/10%. However, HTFL is well placed led by B2C nature of its business and reasonable valuations. Maintain 'BUY' with revised TP of INR410 (INR445 earlier), valuing at 13x Q2FY23E EPS.

Sales stabilise; spreads soften

Q4FY21 sales came in line-- down 5% YoY with 9% YoY volume decline and 5% price increase. This came optically lower versus peers as HTFL had preserved fat stocks in March anticipating better summer. Further, VADP fell mere ~3% YoY (versus 23% decline in 9mFY21; up 18% QoQ). With procurement prices up 7% QoQ, gross margin fell 503bps QoQ to 23% versus 29% in the past two quarters. EBITDA margin improved 352bps YoY, leading to 74% YoY jump, but a 20% miss on our estimates.

Sales to pick up; margin under pressure

Procurement dipped 14% YoY in FY21. Sales declined 9% YoY in FY21 to INR24.7bn. The company is enhancing value-added products portfolio and launched Mozzarella and processed cheese, fresh cream, and further expanded its ice cream portfolio. Hence, post Q1FY22, as lockdowns open, we expect sales to pick up. For FY21, EBITDA registered 100% growth to INR 2.7bn, with margin improving 600bps to 11%. Management believes 8.5% margin to be sustainable. While procurement prices have tightened, the company is sitting on SMP inventory, which should help in the summer season. HTFL has taken price cut in Tamil Nadu (~10% of sales); however, management believes it can be rolled back once lockdown opens. It expects capex to halve in FY22 versus INR880mn in FY21 as it has already created infrastructure.

Outlook and valuations: Strong B2C; maintain 'BUY'

HTFL is well placed led by B2C nature of its business (90% plus), strong realisation despite lower procurement price and strong return ratios (30% pre-tax ROCE). However, due to dip in spreads we have revised down our FY22/23E EPS 15%/10%. We maintain 'BUY' with TP of INR410 (13x June 2022E EPS).

Financials

Year to March	Q4FY21	Q4FY20	% Change	Q3FY21	% Change
Net Revenue	6,194	6,526	(5.1)	6,049	2.4
EBITDA	478	274	74.3	778	(38.5)
Adjusted Profit	242	(2,092)	NM	260	(6.9)
Diluted EPS (INR)	5.2	(45.2)	NM	5.6	(6.9)

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	24,731	27,008	30,015	32,988
Gross profit	6,357	6,268	7,040	7,785
Employee costs	1,779	1,918	2,047	2,210
Other expenses	1,867	2,084	2,354	2,587
EBITDA	2,711	2,266	2,639	2,988
Depreciation	505	553	595	637
Less: Interest expense	192	30	30	30
Add: Other income	80	52	91	128
Profit before tax	2,047	1,735	2,105	2,449
Prov for tax	535	437	530	617
Less: Other adjustment	0	0	0	0
Reported profit	1,521	1,298	1,574	1,832
Less: Excp.item (net)	48	0	0	0
Adjusted profit	1,569	1,298	1,574	1,832
Diluted shares o/s	46	46	46	46
Adjusted diluted EPS	34	28	34	39
DPS (INR)	5.0	7.0	8.5	11.8
Tax rate (%)	26.1	25.2	25.2	25.2

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Milk (% of revenue)	70.6	70.0	69.5	68.5
VAP (% of revenue)	25.6	26.1	26.7	27.7
Gross margin (%)	25.7	23.2	23.5	23.6
EBITDA margin (%)	11.0	8.4	8.8	9.1
Net profit margin (%)	6.3	4.8	5.2	5.6
Revenue growth (% YoY)	(9.3)	9.0	11.3	9.9
EBITDA growth (% YoY)	109.7	(16.4)	16.5	13.2
Adj. profit growth (%)	171.9	(17.3)	21.3	16.3

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(6.0)	7.0	6.0	6.0
Repo rate (%)	3.5	3.5	4.0	4.0
USD/INR (average)	75.0	73.0	72.0	72.0
Procurement (INR/l)	34.0	34.8	35.2	35.5
Procurement (mn l/day)	1.2	1.3	2.8	0.4
Milk Vols (mn l/day)	1.0	1.0	1.2	1.2
Milk Realisation (INR/l)	46.3	45.4	45.6	45.6
VAP Sales (% YoY)	(19.4)	11.2	13.8	13.8
Ad Spends (% of sales)	0.4	0.6	0.6	0.6

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	9.7	11.7	9.6	8.3
Price/BV (x)	2.5	2.2	1.8	1.6
EV/EBITDA (x)	5.6	6.2	4.8	3.7
Dividend yield (%)	1.5	2.1	2.6	3.6

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Share capital	232	232	232	232
Reserves	5,726	6,769	7,986	9,384
Shareholders funds	5,958	7,001	8,218	9,616
Minority interest	5	5	5	5
Borrowings	360	360	360	360
Trade payables	355	511	566	621
Other liabs & prov	1,946	2,103	2,310	2,515
Total liabilities	8,785	10,149	11,637	13,304
Net block	5,759	5,806	5,811	5,773
Intangible assets	65	65	65	65
Capital WIP	157	157	157	157
Total fixed assets	5,981	6,028	6,033	5,996
Non current inv	132	132	132	132
Cash/cash equivalent	236	1,457	2,988	4,458
Sundry debtors	152	222	247	271
Loans & advances	91	95	99	104
Other assets	2,170	2,193	2,116	2,321
Total assets	8,785	10,149	11,637	13,304

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	1,521	1,298	1,574	1,832
Add: Depreciation	505	553	595	637
Interest (net of tax)	142	22	22	22
Others	47	8	8	8
Less: Changes in WC	(475)	225	319	34
Operating cash flow	1,739	2,107	2,519	2,533
Less: Capex	(926)	(600)	(600)	(600)
Free cash flow	813	1,507	1,919	1,933

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	28.8	20.0	20.7	20.5
RoCE (%)	33.8	25.8	26.8	26.7
Inventory days	34	35	31	29
Receivable days	3	3	3	3
Payable days	9	8	9	9
Working cap (% sales)	1.4	0.5	(0.6)	(0.6)
Gross debt/equity (x)	6.0	5.1	4.4	3.7
Net debt/equity (x)	2.1	(15.7)	(32.0)	(42.6)
Interest coverage (x)	11.5	57.4	68.5	78.7

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	171.9	(17.3)	21.3	16.3
RoE (%)	28.8	20.0	20.7	20.5
EBITDA growth (%)	109.7	(16.4)	16.5	13.2
Payout ratio (%)	15.3	25.0	25.0	30.0

Q4FY21 conference call: Key highlights

Operating and Financial:

- Revenue declined 5% YoY primarily led by volume decline of 9% YoY to 1.0 MLPD compared to 1.1 MLPD in Q4FY2020, partly mitigated by a 5% YoY increase in realisations. Sales however improved 2.4% QoQ. This came optically lower versus peers as HTFL preserved fat stocks in March anticipating better summer.
- Milk procurement contracted 9%YoY and 3% QoQ in Q4FY21 to 1.2 million litre per day (MLPD) compared to 1.3 MLPD in Q4FY2020.
- VADP sales lower: VADP de-grew mere ~3% YoY and up 18% QoQ (versus 23% decline in 9MFY21) as out-of-home consumption started showing signs of revival in end of Q3FY21. VADP contribution stands at ~26.6% in Q4FY21 (Q3FY21: 22.5% of sales).
- With procurement prices declining 3% YoY but up 7%QoQ to INR37.2/liter, gross margin declined 503bps QoQ to 23% versus 29% in last 2 quarters. EBITDA margin improved 352bps YoY (though down 514bps QoQ) to 7.7%. As a result spreads narrowed to INR9/liter versus average of INR12 in 9MFY21.
- The company continues with its efforts of enhancing value-added product portfolio and launched Mozzarella and processed cheese, fresh cream, cool café drink, and further expanded its ice cream portfolio.
- The company recorded a fair value loss on its FRL stake at INR0.45mn versus INR204mn in Q3FY21.

FY21

- For full year FY21 procurement dipped 14% YoY in FY21. Sales declined 9%YoY in FY21 to INR 24.7bn. Post Q1FY22, as lockdown opens up we expect sales to pick up.
- For FY21, EBIDTA registered 100% growth to INR 2.7bn, with margin improving 600 bps to 11%. Over medium term, company believes 8.5% EBIDTA margin to be sustainable.
- While procurement prices have seen tightening, company is sitting on SMP inventory, which should help in summer season.
- HFTL has taken price cut in market of Tamil Nadu (~10% of sales), however company believes it can be rolled back as lockdown opens up.
- Ecommerce growth been very positive for the company with 55% YoY growth through the segment.
- Modern trade has grown 15% YoY for the company.
- Going forward in FY22, company expects to spend 0.3-1% of sales mainly through new age digital initiatives versus 0.3% in FY21.
- Heritage Nutrivet subsidiary reported 17% YoY growth in sales for FY21. Further EBIT grew 4.1x to INR112mn.
- Further company has appointed Mr. Viney Vatal as Chief Executive Officer (CEO) of Heritage Nutrivet Limited, Wholly Owned Subsidiary Company of the

Company. During the last 15 years (Since Nov 2005) he was associated with M/s. Godrej Agrovet Limited in animal nutrition as 'P&L Head'.

Others

- Capex: The company believes capex in FY22 should halve to INR500mn versus INR0.9bn in FY21 as it has already created infrastructure.
- New Infrastructure created in FY21 includes:
 - 1 Lc liter milk capacity on greenfield basis in Mumbai on Mumbai Surat road which has milk, curd, buttermilk capacity as well.
 - Further it added 50,000 kgs per day curd capacity in Hyderabad and 50,000 kgs per day curd capacity in Vishaka.
 - For the JV with the French player Novandie company has incurred capex of INR340mn. Further company believes they can double capacity from 10MT per day to 20MT per day with minor equipment addition and add more products to the already planned product portfolio of fermented drinks and Yoghurt. Further they will be adding more products like Desserts from JV Partner's portfolio.
 - As a result of improved profitability for FY2021, Heritage Foods has managed to reduce its debt significantly. Further total proceeds from sale of Future Retail (INR 1,360 million) was utilized to repay debt adding to the overall Balance Sheet strength and further strengthening the Company's debt-equity profile.
 - Gross Long-Term Debt stood at INR 469 mn. This has been reduced from INR1.72bn in FY20. Net Long-Term Debt stands at INR 251 mn as on March 31, 2021
 - Debt-Equity at 0.10:1 & Cash and Cash Equivalents at INR 218 mn in FY21.
 - Led by the current covid struggle management believes the INR60bn overall sales target may be attainable in FY26 versus FY25 earlier.
 - Capacity stands currently at 2.1mn litres of milk chilling capacity, 2.37mn litres of processing capacity and 1.7mn litres of packing capacity and 742ktpd curd packaging capacity. HFL expects to cross 3.0–3.5mn litres over the next five years, which will be funded.
 - Company has strong relationships with +0.3 million dairy farmers for milk procurement.
 - HTFL exited its stake in FRL of 17.8mn shares, for a value of INR1.36bn. The same was used to retire debt.

Exhibit 1: Quarterly financial snapshot

Year to March	Q4FY21	Q4FY20	% change	Q3FY21	% change	FY21	FY22E	FY23E
Revenues	6,194	6,526	-5.1	6,049	2.4	24,731	27,008	30,015
Raw material	4,756	5,363	-11.3	4,340	9.6	18,374	20,740	22,975
Staff costs	445	362	22.8	468	(5.0)	1,779	1,918	2,047
Others	515	527	-2.2	463	11.2	1,867	2,084	2,354
Total expenditure	5,715	6,252	-8.6	5,271	8.4	22,020	24,742	27,376
EBITDA	478	274	74.3	778	(38.5)	2,711	2,266	2,639
Depreciation	143	125	14.7	113	26.3	505	553	595
EBIT	335	150	123.9	665	(49.6)	2,206	1,713	2,044
Interest	30	65	-52.9	51		192	30	30
Other income	35	19	82.4	11	219.8	80	52	91
Add: Prior period items								
Add: Exceptional items	0	-2,171		-204		-48	0	0
Profit Before Tax	340	-2,067	NM	421	(19.3)	2,095	1,735	2,105
Less: Provision for Tax	86	30	188.1	155	(45.0)	535	437	530
Less: Minority Interest	1	-7		-4		-9	0	0
Add: Share of profit from associates	-12	-3		-5		-22	0	0
Less: Profit from Discontinued Operations								
Reported Profit	241	-2,092	NM	264	91.4	1,499	1,298	1,574
Adjusted Profit	242	79	205.5	468	(48.3)	1,538	1,298	1,574
Equity capital (FV INR 5)	232	232		232		232	232	232
No. of Diluted shares outstanding (mn)	46	46		46		46	46	46
Adjusted Diluted EPS	5.2	1.7	205.5	10.1	(48.3)	33.1	28.0	33.9
P/E (x)						9.9	11.7	9.6
EV/EBITDA (x)						5.6	6.2	4.7
ROAE(%)						28.9	20.0	20.7
As % of net revenues								
Raw material	76.8	82.2		71.7		74.3	76.8	76.5
Staff expenses	7.2	5.6		7.7		7.2	7.1	6.8
Other expenses	8.3	8.1		7.7		7.5	7.7	7.8
EBITDA	7.72	4.2		12.9		11.0	8.4	8.8
Net profit	3.9	1.2		7.7		6.2	4.8	5.2

Source: Company, Edelweiss Research

Exhibit 2: We have revised our FY22/23E EPS by 15/10% respectively

(INR mn)	Old		New		% change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	27,679	30,284	27,008	30,015	-2.4	-0.9
EBITDA	2,683	2,985	2,266	2,639	-15.5	-11.6
PAT	1,519	1,742	1,298	1,574	-14.6	-9.6

Source: Edelweiss Research

Company Description

Heritage was founded by Mr. Chandrababu Naidu in 1992 as a dairy company. Over the years, Heritage has operated in dairy, retail, agri, bakery and veterinary care. However, it has now demerged its loss making retail, agri and bakery businesses, selling them off to Future Retail for a consideration of 17.85mn shares (3.6% stake), rendering the company a pure dairy play. Heritage sells milk and milk products such as curd (largest share), ice cream, paneer, flavoured milk, ghee, butter and milk powders. Entire dairy sales are B2C and are sold under the Heritage brand. Of FY20 dairy revenues, milk constituted ~66%, VADP 24% and fat products 9% share. Curd's contribution within VADP is 77% and ~18% to Heritage's manufactured dairy sales.

Investment Theme

Heritage Foods (HFL), a strong private dairy player in south (AP) and a strong franchisee in liquid milk has set a strong target of INR60bn of sales with procurement of ~2.8 mn litres per day in 5 years, from current 1.4 mn liters per day and INR26.8bn of sales. It is focussing on deepening penetration in current markets and expanding reach in new geographies by inorganic acquisition. It is prudently straddling the high RoCE pouch milk segment and high-growth & margin curd, yogurt and ice-cream segments to attain its target. Targeting large categories like curd (INR288bn) with organised penetration at mere 6% and high margin segments like ice-cream are envisaged to spur Heritage's growth and margin.

HTFL is well placed led by B2C nature of its business (90% plus), strong realisation despite lower procurement price and strong return ratios (30% pre-tax ROCE). With improving procurement and milk prices expected to remain subdued, we expect strong margin for dairy players like HFL. Hence post margins bottoming out in FY20 we expect strong 44% EBIDTA CAGR over FY20-22E.

Key Risks

High dependency on low margin milk business

Pouch milk business, wherein margins are low, contributes a sizeable 65% to Heritage's sales. Hence, an increasing milk price scenario impacts the company's margin adversely as the increase in procurement price is passed on with a lag.

Increasing competition

Increase in competition from co-operatives (Amul having entered strongly in Andhra Pradesh with tie up with co-operatives) or private players, either in form of procurement (by increasing prices to farmers) or selling price (via lower prices), can impact Heritage's performance.

Additional Data

Management

Chairperson	D. Seetharamaiah
Vice-Chairperson	Bhuvaneswari Nara
& MD Executive Director	Brahmani Nara
CEO	Sambasiva Rao
Auditor	Walker Chandio & Co

Holdings – Top 10*

% Holding		% Holding	
UTI AMC	5.26	L&T MF	1.51
Sundaram AMC	4.75	Kedia Securities	1.13
Dorlic Asia Pacific	2.22	Union MF	0.74
Kotak Mahindra MF	1.69	SBI Life Insurance	0.71
IEPF	1.69	Dimensional Fund	0.36

*Latest public data

Recent Company Research

Date	Title	Price	Reco
01-Feb-21	Strong spreads sustain; <i>Result Update</i>	280.75	Buy
10-Dec-20	Future stake sale: Overhang eliminated; <i>Company Update</i>	307.7	Buy
30-Oct-20	Core: Structurally and cyclically strong; <i>Result Update</i>	305.7	Buy

Recent Sector Research

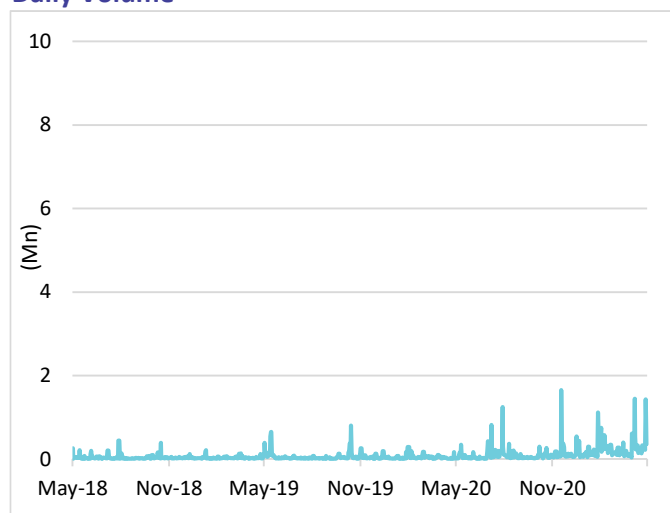
Date	Name of Co./Sector	Title
11-Feb-21	Parag Milk Foods	Recovery still distant; <i>Result Update</i>
10-Nov-20	Parag Milk Foods	Modern trade, HORECA sour recovery; <i>Result Update</i>
08-Sep-20	Parag Milk Foods	Parag Milk Foods - Result Update Q1FY21 ; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	167	56	20	244
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	202	48	3	253

*1 stocks under review

Rating Rationale

Rating	Expected absolute returns over 12 months
Buy:	>15%
Hold:	>15% and <-5%
Reduce:	<-5%

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