

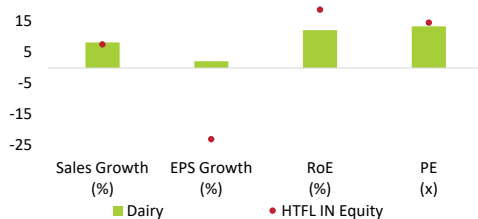
HERITAGE FOODS

POST-CONFERENCE NOTES

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	335
12 month price target (INR)	565
Market cap (INR bn/USD bn)	16/0.2
Free float/Foreign ownership (%)	60.1/4.6
What's Changed	
Target Price	—
Rating/Risk Rating	—

INVESTMENT METRICS

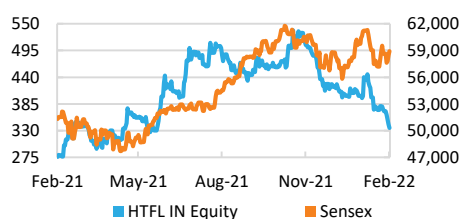


FINANCIALS

(INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	24,731	26,645	29,452	32,408
EBITDA	2,711	2,137	2,466	2,799
Adjusted profit	1,569	1,208	1,455	1,691
Diluted EPS (INR)	33.8	26.0	31.4	36.5
EPS growth (%)	171.9	(23.0)	20.5	16.3
RoAE (%)	28.8	18.8	19.5	19.5
P/E (x)	11.2	14.6	12.1	10.4
EV/EBITDA (x)	6.5	7.7	6.1	4.9
Dividend yield (%)	1.3	1.7	2.1	2.9

PRICE PERFORMANCE



Explore:



Elevated costs price hikes likely

We hosted top management of c(HTFL) at the *Edelweiss India e-Conference 2022: The New Edge*. Highlights: i) The company faced a severe margin pressure (down 360bp QoQ to 6.1%) in the wake of a cyclone in Andhra Pradesh. To combat it, HTFL took price hikes of 3–5%. Management is targeting EBITDA margins of 8%-plus. ii) The company is aiming to achieve a double-digit sales growth target and a rise in the share of VADP sales. iii) Management plans to widen the regional footprint, by expanding procurement and sales network.

HTFL looks set to achieve its sales growth targets as markets opens up. With a normalising base, we estimate an 18% PAT CAGR over FY22–24E. Maintain 'BUY' at 18x FY23E EPS, yielding a TP of INR565.

Key takeaways

- During the quarter, management saw growth all-across, despite cyclones in key end-user markets. Sales should remain on a strong footing as demand picks up and markets open up.
- Revenue rose 10% YoY, with healthy sales of 12% YoY and a gain in the dairy business, while VADP sales grew higher at ~21% YoY owing to higher curd sales led by healthy curd volume growth of 17%. VADP contribution stands at 25.1% in Q3FY22 (Q3FY21: 23.1% of sales).
- While milk prices were expected to be volatile with the onset of the flush season, a severe cyclone in its key regions of Andhra Pradesh led to EBITDA margin contraction of 360bp QoQ/675bp YoY and EBITDA fell 48% YoY. Management has taken price hikes of 3–5% to alleviate the pressure.
- HTFL is targeting an EBITDA margin of 7.5–8% on a normalised level and endeavours to revert to normalised levels.
- Management aims to grow revenue at a 20% CAGR, with contribution from the value-added portfolio at 45–50%. Hence they are targeting INR1.1bn per year after two years (and have capacity for that).

Outlook and valuation: Healthy sales uptick; maintain 'BUY'

HTFL is poised to achieve its sales growth targets as markets normalise. However with lower spreads due to the cyclone and a high base, there are some margin pressures. However with a normalising base, we expect an 18% PAT CAGR over FY22–24E. Maintain 'BUY' at 18x FY23E EPS, leading to a TP of INR565. The stock is trading at a deep discount to peers.

Financial Statements

Income Statement (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Total operating income	24,731	26,645	29,452	32,408
Gross profit	6,357	6,194	6,887	7,627
Employee costs	1,779	1,910	2,032	2,171
Other expenses	1,867	2,146	2,389	2,657
EBITDA	2,711	2,137	2,466	2,799
Depreciation	505	545	581	630
Less: Interest expense	192	31	30	30
Add: Other income	80	53	90	122
Profit before tax	2,047	1,615	1,945	2,261
Prov for tax	535	407	490	570
Less: Other adjustment	0	0	0	0
Reported profit	1,521	1,208	1,455	1,691
Less: Excp.item (net)	48	0	0	0
Adjusted profit	1,569	1,208	1,455	1,691
Diluted shares o/s	46	46	46	46
Adjusted diluted EPS	34	26	31	36
DPS (INR)	5.0	6.5	7.8	10.9
Tax rate (%)	26.1	25.2	25.2	25.2

Important Ratios (%)

Year to March	FY21A	FY22E	FY23E	FY24E
Milk (% of revenue)	70.6	69.6	68.7	67.9
VAP (% of revenue)	25.6	26.7	27.7	28.5
Gross margin (%)	25.7	23.2	23.4	23.5
EBITDA margin (%)	11.0	8.0	8.4	8.6
Net profit margin (%)	6.3	4.5	4.9	5.2
Rev. Growth (% YoY)	(9.3)	7.6	10.7	10.0
EBITDA growth (% YoY)	109.7	(21.2)	15.4	13.5
Adj. profit growth (%)	171.9	(23.0)	20.5	16.3

Assumptions (%)

Year to March	FY21A	FY22E	FY23E	FY24E
GDP (YoY %)	(8.0)	9.0	7.0	7.0
Repo rate (%)	4.0	4.0	4.3	5.3
USD/INR (average)	75.0	73.0	72.0	71.0
Procurement (INR/l)	34.0	35.7	36.3	36.7
Procurement (mn l/day)	1.2	1.3	2.8	0.4
Milk Vols (mn l/day)	1.0	1.0	1.1	1.2
Milk Realisation (INR/l)	46.3	46.8	47.2	47.3
VAP Sales (% YoY)	(19.4)	14.0	14.5	13.1
Ad Spends (% of sales)	0.4	0.6	0.7	0.8

Valuation Metrics

Year to March	FY21A	FY22E	FY23E	FY24E
Diluted P/E (x)	11.2	14.6	12.1	10.4
Price/BV (x)	3.0	2.5	2.2	1.9
EV/EBITDA (x)	6.5	7.7	6.1	4.9
Dividend yield (%)	1.3	1.7	2.1	2.9

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	6,678	7,800	9,091
Shareholders funds	5,958	6,910	8,032	9,323
Minority interest	5	5	5	5
Borrowings	360	360	360	360
Trade payables	355	504	556	611
Other liabs & prov	1,946	2,078	2,271	2,475
Total liabilities	8,785	10,027	11,403	12,961
Net block	5,759	5,715	5,633	5,703
Intangible assets	65	65	65	65
Capital WIP	157	157	157	157
Total fixed assets	5,981	5,937	5,855	5,925
Non current inv	132	132	132	132
Cash/cash equivalent	236	1,460	2,975	4,230
Sundry debtors	152	219	242	266
Loans & advances	91	94	98	103
Other assets	2,170	2,163	2,078	2,282
Total assets	8,785	10,027	11,403	12,961

Free Cash Flow (INR mn)

Year to March	FY21A	FY22E	FY23E	FY24E
Reported profit	1,521	1,208	1,455	1,691
Add: Depreciation	505	545	581	630
Interest (net of tax)	142	23	22	22
Others	47	8	8	8
Less: Changes in WC	(475)	227	312	34
Operating cash flow	1,739	2,010	2,378	2,386
Less: Capex	(926)	(500)	(500)	(700)
Free cash flow	813	1,510	1,878	1,686

Key Ratios

Year to March	FY21A	FY22E	FY23E	FY24E
RoE (%)	28.8	18.8	19.5	19.5
RoCE (%)	33.8	24.2	25.2	25.3
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	5.2	4.5	3.9
Net debt/equity (x)	2.1	(15.9)	(32.5)	(41.5)
Interest coverage (x)	11.5	52.1	63.1	72.6

Valuation Drivers

Year to March	FY21A	FY22E	FY23E	FY24E
EPS growth (%)	171.9	(23.0)	20.5	16.3
RoE (%)	28.8	18.8	19.5	19.5
EBITDA growth (%)	109.7	(21.2)	15.4	13.5
Payout ratio (%)	15.3	25.0	25.0	30.0

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. It is focussing on deepening penetration in current markets and expanding reach in new geographies by inorganic acquisition. It is targeting 20% sales growth and share of value-added sales rising to 45-50% from 27% of the mix over next 4-5 years, driven by spate of top management additions and value added product introductions.

HTFL is well placed led by B2C nature of its business (90% plus), and strong return ratios (30% pre-tax ROCE). We see improvement in revenue traction post covid normalisation. HTFL is well-poised to achieve its sales growth targets as markets normalise. We expect healthy 18% PAT CAGR over FY22-24.

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 & MD	Bhuvaneswari Nara
Executive Director	Brahmani Nara
President	Sambasiva Rao
Auditor	Walker Chandio & Co

Holdings – Top 10*

% Holding		% Holding	
UTI AMC	3.87	Dorlic Asia Pac	1.50
Sundaram AMC	3.00	IDFC MF	0.71
L&T MF	2.54	Tata MF	0.64
Kotak Mahindra	1.69	Dimensional Fun	0.36
ABSL AMC	1.52	WisdomTree Inve	0.11

*Latest public data

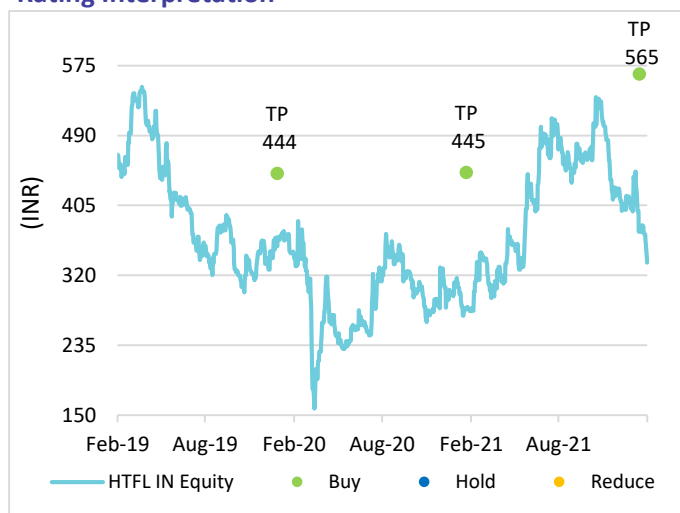
Recent Company Research

Date	Title	Price	Reco
25-Jan-22	Elevated procurement causes miss; <i>Result Update</i>	379	Buy
22-Oct-21	Procurement picks up ; <i>Result Update</i>	505	Buy
30-Jul-21	Strong strategic moves ; <i>Result Update</i>	490	Buy

Recent Sector Research

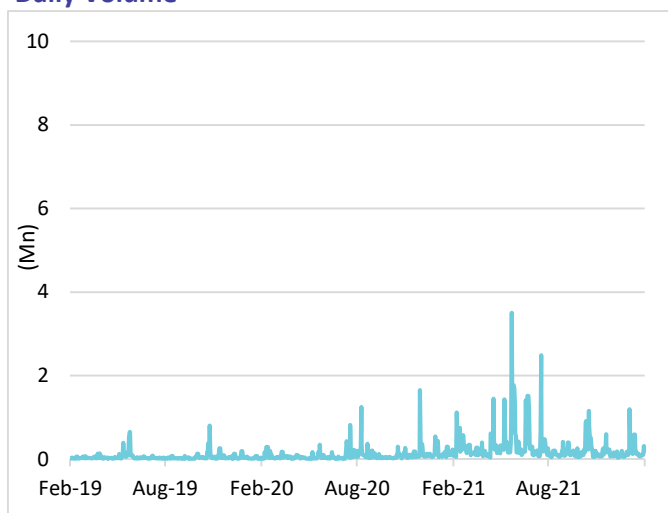
Date	Name of Co./Sector	Title
07-Feb-22	Parag Milk Foods	Sales uptick; margins inline; <i>Result Update</i>
08-Nov-21	Parag Milk Foods	Sales uptick; margins better; <i>Result Update</i>
04-Aug-21	Parag Milk Foods	Sustainable uptick awaited; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	193	54	16	264
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	237	40	5	282

*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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