

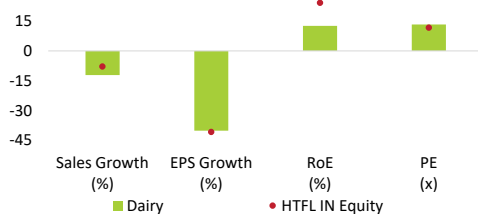
HERITAGE FOODS

COMPANY UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	308
12 month price target (INR)	458
Market cap (INR bn/USD bn)	14/0.2
Free float/Foreign ownership (%)	60.1/5.1
What's Changed	
Target Price	—
Rating/Risk Rating	—

INVESTMENT METRICS

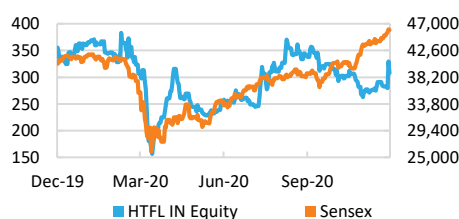


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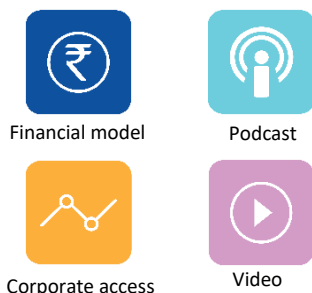
(INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Revenue	27,259	25,122	28,096	30,562
EBITDA	1,293	2,237	2,445	2,708
Adjusted profit	2,096	1,240	1,423	1,565
Diluted EPS (INR)	45.2	26.7	30.7	33.7
EPS growth (%)	156.2	(40.9)	14.8	10.0
RoAE (%)	(1.2)	24.1	22.8	21.2
P/E (x)	6.8	11.5	10.0	9.1
EV/EBITDA (x)	12.6	6.1	5.4	4.6
Dividend yield (%)	0.8	2.2	2.5	2.7

PRICE PERFORMANCE



Explore:



Future stake sale: Overhang eliminated

Heritage Foods (HTFL) has reported the sale of its entire stake in Future Retail (FRL) via open market for a net consideration of INR1,319mn. The sale has been executed at an average price of INR74/share and the funds will be utilised to repay debt.

The stake sale eliminates the unrelated investment overhang on the stock. With debt repayment, HTFL should turn net cash by FY21 end, saving ~INR100mn interest cost in FY22E and offsetting the potential hit of incremental procurement cost. We remain positive on the company owing to its B2C nature and improvement in out-of-home consumption. Maintain 'BUY' with TP of INR458 (15x FY22E EPS).

Stake sale to aid debt repayment

HTFL had sold its retail, agri and bakery businesses in FY18 for a 3.65% stake in FRL, to focus on its core dairy business. There was a lock-in period of three years on the sale of shares, subsequent to which the company could sell the shares under a profit-share agreement with FRL. This lock-in period ended in Q1FY21 and HTFL has since then been selling shares in various tranches via open market. The entire stake (17.8mn shares) has been sold for a net consideration of INR1.32bn at an average price of INR74/share. According to management, these funds will be utilised for debt repayment and should turn HTFL net cash in FY21. With conclusion of the stake sale, we believe management will now sharpen focus on the profitable dairy business.

Demand to improve; competition to intensify

In Q3FY21, onset of the flush season was delayed as lockdown affected artificial insemination programme and calving. Supply is likely to increase over coming months as the season sets in. Further, the festive season, spurt in marriages and hotel industry have revived out-of-home consumption, which will boost HTFL's value-added sales. However, launch of AP-Amul Paala Velluva in Andhra Pradesh providing additional INR4-7/ltr to dairy farmers could increase procurement prices. But, we expect saving on interest cost to offset increased procurement cost.

Outlook and valuation: Focus on core; maintain 'BUY'

The stake sale eliminates one of the major overhangs on the stock--unrelated investment--and should result in sharpened focus on the profitable dairy business. With debt repayment, HTFL should turn net cash in FY21 end, saving interest cost of ~INR100mn in FY22E and negating hit of incremental procurement cost.

Led by a strong earnings cycle and management's debt repayment efforts, we estimate HTFL to post 38% EBITDA CAGR and 71% PAT CAGR with ROCE jumping from 9.7% in FY20 to 27.2%/29.8% in FY21/22. We maintain 'BUY' with TP of INR458/share, valuing the business at 15x FY22E EPS.

Financial Statements

Income Statement (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Total operating income	27,259	25,122	28,096	30,562
Gross profit	5,013	5,849	6,506	7,085
Employee costs	1,564	1,678	1,854	1,971
Other expenses	2,157	1,934	2,206	2,406
EBITDA	1,293	2,237	2,445	2,708
Depreciation	509	522	611	707
Less: Interest expense	226	129	14	4
Add: Other income	89	71	82	96
Profit before tax	(1,525)	1,657	1,902	2,093
Prov for tax	153	418	479	527
Less: Other adjustment	0	0	0	0
Reported profit	(75)	1,240	1,423	1,565
Less: Excp.item (net)	2,171	0	0	0
Adjusted profit	2,096	1,240	1,423	1,565
Diluted shares o/s	46	46	46	46
Adjusted diluted EPS	45	27	31	34
DPS (INR)	2.5	6.7	7.7	8.4
Tax rate (%)	10.1	25.2	25.2	25.2

Important Ratios (%)

Year to March	FY20A	FY21E	FY22E	FY23E
Milk (% of revenue)	66.9	70.0	69.0	68.6
VAP (% of revenue)	27.6	25.0	25.9	26.3
Gross margin (%)	18.4	23.3	23.2	23.2
EBITDA margin (%)	4.7	8.9	8.7	8.9
Net profit margin (%)	7.7	4.9	5.1	5.1
Revenue growth (% YoY)	8.4	(8.0)	11.8	8.9
EBITDA growth (% YoY)	(31.5)	73.1	9.3	10.7
Adj. profit growth (%)	156.2	(40.9)	14.8	10.0

Assumptions (%)

Year to March	FY20A	FY21E	FY22E	FY23E
GDP (YoY %)	4.8	(6.0)	7.0	6.0
Repo rate (%)	4.4	3.5	3.5	4.0
USD/INR (average)	70.7	75.0	73.0	72.0
Procurement (INR/l)	35.8	33.9	34.3	34.7
Procurement (mn l/day)	1.5	1.3	1.4	2.8
Milk Vols (mn l/day)	1.1	1.0	1.1	1.2
Milk Realisation (INR/l)	41.9	44.5	44.3	44.4
VAP Sales (% YoY)	16.8	(20.7)	15.9	10.6
Ad Spends (% of sales)	0.7	0.4	0.6	0.6

Valuation Metrics

Year to March	FY20A	FY21E	FY22E	FY23E
Diluted P/E (x)	6.8	11.5	10.0	9.1
Price/BV (x)	3.1	2.5	2.1	1.8
EV/EBITDA (x)	12.6	6.1	5.4	4.6
Dividend yield (%)	0.8	2.2	2.5	2.7

Source: Company and Edelweiss estimates

Balance Sheet (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Share capital	232	232	232	232
Reserves	4,364	5,476	6,557	7,731
Shareholders funds	4,596	5,708	6,789	7,963
Minority interest	22	22	22	22
Borrowings	2,607	203	103	3
Trade payables	599	475	532	579
Other liabs & prov	1,937	1,802	1,989	2,144
Total liabilities	9,882	8,338	9,569	10,851
Net block	4,750	4,878	5,467	5,960
Intangible assets	77	77	77	77
Capital WIP	757	757	757	757
Total fixed assets	5,584	5,712	6,301	6,794
Non current inv	1,523	126	126	126
Cash/cash equivalent	582	745	1,188	1,814
Sundry debtors	219	206	231	251
Loans & advances	82	80	83	86
Other assets	1,857	1,434	1,606	1,747
Total assets	9,882	8,338	9,569	10,851

Free Cash Flow (INR mn)

Year to March	FY20A	FY21E	FY22E	FY23E
Reported profit	(75)	1,240	1,423	1,565
Add: Depreciation	509	522	611	707
Interest (net of tax)	249	97	10	3
Others	459	33	3	1
Less: Changes in WC	26	185	51	45
Operating cash flow	1,167	2,076	2,099	2,322
Less: Capex	(1,120)	(650)	(1,200)	(1,200)
Free cash flow	47	1,426	899	1,122

Key Ratios

Year to March	FY20A	FY21E	FY22E	FY23E
RoE (%)	(1.2)	24.1	22.8	21.2
RoCE (%)	9.7	27.2	29.8	28.1
Inventory days	23	24	19	19
Receivable days	4	3	3	3
Payable days	11	10	9	9
Working cap (% sales)	(0.6)	(1.3)	(1.3)	(1.4)
Gross debt/equity (x)	56.5	3.5	1.5	0
Net debt/equity (x)	43.8	(9.5)	(15.9)	(22.7)
Interest coverage (x)	3.5	13.3	133.3	473.2

Valuation Drivers

Year to March	FY20A	FY21E	FY22E	FY23E
EPS growth (%)	156.2	(40.9)	14.8	10.0
RoE (%)	(1.2)	24.1	22.8	21.2
EBITDA growth (%)	(31.5)	73.1	9.3	10.7
Payout ratio (%)	nm	25.0	25.0	25.0

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 demerged its loss making retail, agri and bakery businesses, selling them to Future Retail for a consideration of 17.85mn shares (3.6% stake), rendering the company a pure dairy play. The company sold its entire stake by December 2020. 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.

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 38% 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 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
CEO	Sambasiva Rao
Auditor	Walker Chandio & Co

Holdings – Top 10*

% Holding		% Holding	
UTI AMC	5.55	Union MF	1.16
Sundaram AMC	5.04	Invesco AMC	1.05
Dorlic Asia Pacific	2.81	Kedia Securities	1.01
Kotak Mahindra	2.23	Dimensional Fund	0.44
IEPF	1.59	IndiaFirst Life	0.15

*Latest public data

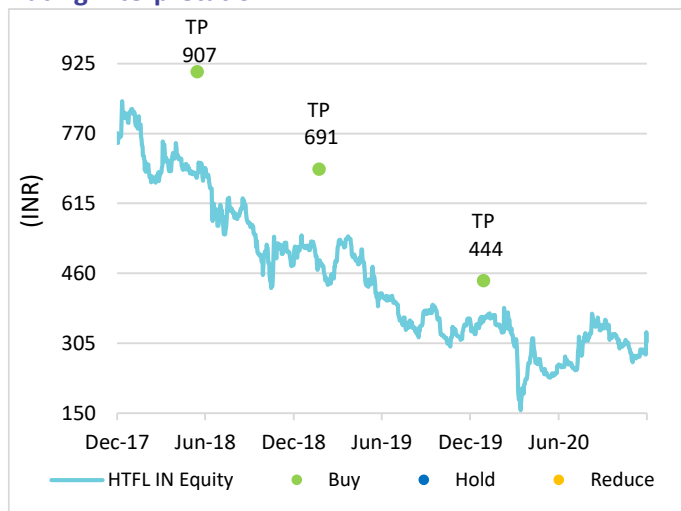
Recent Company Research

Date	Title	Price	Reco
31-Oct-20	Core: Structurally and cyclically strong; <i>Result Update</i>	306	Buy
04-Sep-20	Stable core: Structurally and cyclically strong; <i>Company Update</i>	334	Buy
31-Jul-20	The beginning of dawn; <i>Result Update</i>	311	Buy

Recent Sector Research

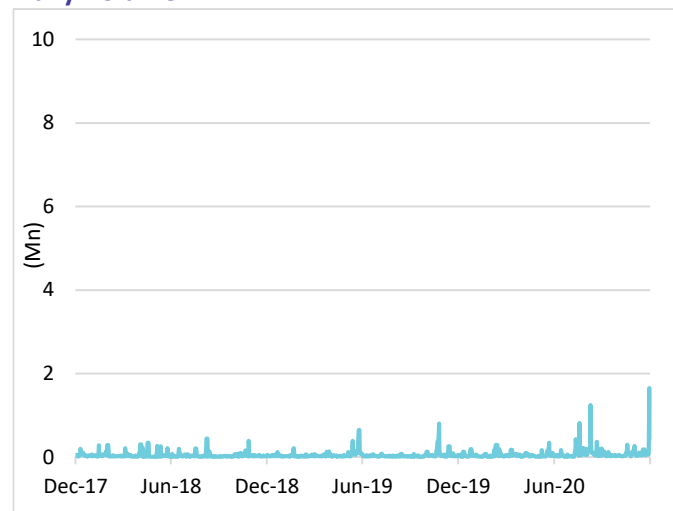
Date	Name of Co./Sector	Title
10-Nov-20	Parag Milk Foods	Modern trade, HORECA sour recovery; <i>Result Update</i>
08-Sep-20	Parag Milk Foods	Parag Milk Foods - Result Update Q1FY21 ; <i>Result Update</i>
30-Jun-20	Parag Milk Foods	Parag Milk Foods - Result Update Q4FY20 ; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	162	63	14	239
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	181	60	5	246

* stocks under review

Rating Rationale

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

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Aditya Narain

Head of Research

Aditya.Narain@edelweissfin.com
