

Heritage Foods

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Operating efficiencies to improve margins

- Heritage Dairy's (Heritage) consolidated revenue grew by 14%, 7% below of our estimate. EBITDA grew by 50%, 10% ahead of our expectation and PAT grew by 80%, in line with our estimate.
 - Dairy business' 14% growth was driven by 17% growth in VADP (value added dairy products). Liquid milk business grew by 13%. We believe that Heritage's organic dairy business (excluding Reliance dairy) grew by ~5%.
 - Gross margin improved by 290bps due to improvement in operating efficiency of Reliance dairy. However, EBITDA margin improved by only 190bps due to higher overheads.
 - We expect sales/earnings CAGR of 16%/54% and margin improvement of 210bps over FY18-20E with growing contribution from VADP and improvement in efficiency. We maintain our ACCUMULATE stance with a Target Price (TP) of Rs770, now valuing it at 15x FY20E EV/EBITDA.
- VADP drives revenue growth:** Heritage's consolidated revenue grew by 14%, 7% below our estimate. The Dairy business grew by 14% on the back of 17% growth in VADP (22% of the Dairy business). In VADP, the Curd business (82% of the VADP business) grew by 21% to Rs1bn. The Liquid Milk business (78% of the Dairy business) grew by 14%, largely driven by the Reliance Dairy acquisition. We believe that Heritage's organic growth (ex-Reliance Dairy) grew by ~5%. Milk procurement increased by 24% to 13.2 lpd due to inorganic growth. The management continues to focus on VADP and aspires to increase its contribution to 40% (from 22% in FY18) by 2022E.
 - Improving operational efficiency of Reliance Dairy drives margins:** Gross margin expanded by 290bps due to improving efficiency at Reliance Dairy. The company has rationalized Reliance Dairy operations by reducing third-party processing, sharpening focus on direct milk procurement and consolidating milk processing & chilling centers. EBITDA growth of 51% was 10% ahead of our estimate, with margin expansion of 190bps. Lower-than-expected other income and higher-than-expected depreciation charges led to APAT growth of 80% - in line with our expectations.
 - Valuations:** We appreciate the management's effort to improve efficiency of Reliance Dairy by rationalizing operations and increasing contribution from VADP. On the back of this effort, we expect Heritage's VADP contribution to increase from 22% to 25% and margin to improve by 210bps over FY18-20E. We maintain our ACCUMULATE stance with a TP of Rs770, now valuing the company at 15x FY20E EV/ EBITDA.

Financial Snapshot (Consolidated)

(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenue	23,806	26,429	23,731	28,111	32,153
EBITDA	1,308	1,413	1,304	2,056	2,449
EBITDA Margin (%)	5.5	5.3	5.5	7.3	7.6
APAT	568	668	548	1,020	1,298
EPS (Rs)	12.2	14.4	11.8	22.0	28.0
EPS (% chg)	101.5	17.6	(17.9)	86.0	27.2
ROE (%)	26.3	24.7	10.2	12.5	14.4
P/E (x)	59.2	50.3	61.3	33.0	25.9
EV/EBITDA (x)	26.2	24.5	27.2	17.1	14.1
P/BV (x)	14.0	11.2	4.3	3.9	3.5

Source: Company, Emkay Research

CMP	Target Price
Rs725	Rs770(Δ)
as of (May 28, 2018)	12 months
Rating	Upside
ACCUMULATE (■)	5.7 %

Change in Estimates

EPS ChgFY19E/FY20E (%)	(9)/(5)
Target Price change (%)	4.6
Target Period (Months)	12
Previous Reco	ACCUMULATE

Emkay vs Consensus

	EPS Estimates	
	FY19E	FY20E
Emkay	22.0	28.0
Consensus	20.0	25.9
Mean Consensus TP (12M)	Rs884	

Stock Details

Bloomberg Code	HTFL IN
Face Value (Rs)	5
Shares outstanding (mn)	46
52 Week H/L	889 /520
M Cap (Rsbn/USD bn)	34 / 0.50
Daily Avg Volume (nos.)	48,778
Daily Avg Turnover (US\$ mn)	0.5

Shareholding Pattern Mar '18

Promoters	39.9%
FII's	8.7%
DII's	8.9%
Public and Others	42.5%

Price Performance

(%)	1M	3M	6M	12M
Absolute	3	8	(1)	28
Rel. to Nifty	3	6	(4)	15

Relative price chart



Source: Bloomberg

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Exhibit 1: Actual vs estimates

Rsmn	Actual	Estimate		% variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenues	5616.3	6058.8	6516.5	-7.3%	-13.8%	
EBITDA	447.5	408.2	449.3	9.6%	-0.4%	Operating efficiencies drive margin
EBITDA Margin (%)	8.0%	6.7%	6.9%	123	107	
APAT	203.6	201.1	225.5	1.2%	-9.7%	

Source: Company, Emkay Research

Exhibit 2: Revision in earnings estimates

Y/E, Mar (Rs. mn)	FY19E			FY20E		
	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	28,497	28,111	(1.4)	32,125	32,153	0.1
EBITDA	2,090	2,056	(1.6)	2,516	2,449	(2.7)
EBITDA Margin (%)	7.3	7.3	0 bps	7.7	7.6	-10 bps
APAT	1,124	1,020	(9.2)	1,365	1,298	(4.9)
EPS	24.2	22.0	(9.1)	29.4	28.0	(4.9)

Source: Company, Emkay Research

Exhibit 3: Quarterly performance (Consolidated)

Y/E, Mar (Rs. mn)	Q4FY17	Q3FY18	Q4FY18	YoY (%)	QoQ (%)	FY17	FY18	Gr (%)
Revenue	4,940	5,789	5,616	13.7	-3.0	18,941	23,731	25.3
Expenditure	4,643	5,413	5,169	11.3	-4.5	17,479	22,427	28.3
Consumption of RM	3,976	4,624	4,356	9.5	-5.8	14,971	19,194	28.2
as % of sales	80.5	79.9	77.6			79.0	80.9	
Employee Cost	233	310	303	29.8	-2.4	998	1,242	24.4
as % of sales	4.7	5.4	5.4			5.3	5.2	
Other expenditure	433	479	510	17.7	6.5	1,510	1,991	31.9
as % of sales	8.8	8.3	9.1			8.0	8.4	
EBITDA	297	376	447	50.5	19.0	1,463	1,304	-10.9
Depreciation	63	96	103	64.8	8.0	250	378	51.5
EBIT	235	281	344	46.7	22.7	1,213	925	-23.7
Other Income	17	11	33	92.1	197.5	42	77	84.4
Interest	42	48	56	32.1	16.3	97	182	88.0
PBT	210	244	322	53.3	32.0	1,157	820	-29.2
Total Tax	97	77	118	22.5	54.4	324	271	-16.3
Adjusted PAT	113	167	204	79.6	21.7	833	548	-34.2
Extra ordinary items	2076	0	-4	-100.2	NA	2076	79	NA
Reported PAT	2,189	167	200	-90.9	19.3	2,909	628	-78.4
Adjusted EPS	2.4	3.6	4.4	78.8	21.3	18.0	11.8	-34.3

Margins (%)				(bps)	(bps)				(bps)
Gross Margin	19.5	20.1	22.4	290	230	21.0	19.1	-180	
EBIDTA	6.0	6.5	8.0	190	150	7.7	5.5	-220	
EBIT	4.8	4.8	6.1	140	130	6.4	3.9	-250	
EBT	4.3	4.2	5.7	150	150	6.1	3.5	-270	
PAT	2.3	2.9	3.6	130	70	4.4	2.3	-210	
Effective Tax rate	46.0	31.4	36.8	-920	530	28.0	33.1	510	

Source: Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenue	23,806	26,429	23,731	28,111	32,153
Expenditure	22,498	25,016	22,427	26,055	29,704
EBITDA	1,308	1,413	1,304	2,056	2,449
Depreciation	345	378	378	457	515
EBIT	963	1,035	925	1,599	1,934
Other Income	65	60	77	96	120
Interest expenses	155	112	182	195	145
PBT	874	983	820	1,500	1,908
Tax	306	314	271	480	611
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	568	668	548	1,020	1,298
Adjusted PAT	568	668	548	1,020	1,298

Balance Sheet

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity share capital	232	232	232	232	232
Reserves & surplus	2,167	2,775	7,545	8,293	9,293
Net worth	2,399	3,007	7,777	8,525	9,525
Minority Interest	0	0	106	106	106
Loan Funds	1,051	1,403	2,464	1,864	1,364
Net deferred tax liability	187	198	180	180	180
Total Liabilities	3,637	4,607	10,527	10,676	11,175
Net block	3,120	2,971	4,331	5,131	5,931
Investment	8	1,488	5,761	5,761	5,761
Current Assets	2,524	2,032	2,625	2,328	2,494
Cash & bank balance	453	470	688	410	476
Other Current Assets	29	19	175	115	132
Current liabilities & Provision	2,112	1,962	2,277	2,632	3,098
Net current assets	413	70	348	(304)	(604)
Misc. exp	0	0	0	0	0
Total Assets	3,637	4,608	10,527	10,676	11,175

Cash Flow

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
PBT (Ex-Other income) (NI+Dep)	874	923	743	1,404	1,789
Other Non-Cash items	45	48	0	0	0
Chg in working cap	418	371	(77)	373	367
Operating Cashflow	1,541	1,545	955	1,949	2,205
Capital expenditure	(665)	(211)	(1,747)	(1,257)	(1,315)
Free Cash Flow	876	1,333	(792)	692	890
Investments	0	(1,480)	(4,273)	0	0
Other Investing Cash Flow	(134)	(50)	4,571	0	0
Investing Cashflow	(733)	(1,682)	(1,372)	(1,161)	(1,195)
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(523)	352	1,061	(600)	(500)
Dividend paid (incl tax)	(85)	(85)	(244)	(271)	(299)
Other Financing Cash Flow	0	0	0	0	0
Financing Cashflow	(762)	155	635	(1,066)	(944)
Net chg in cash	45	17	218	(278)	66
Opening cash position	408	453	470	688	410
Closing cash position	453	470	688	410	476

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY16	FY17	FY18	FY19E	FY20E
EBITDA Margin	5.5	5.3	5.5	7.3	7.6
EBIT Margin	4.0	3.9	3.9	5.7	6.0
Effective Tax Rate	35.0	32.0	33.1	32.0	32.0
Net Margin	2.4	2.5	2.3	3.6	4.0
ROCE	28.1	26.6	13.2	16.0	18.8
ROE	26.3	24.7	10.2	12.5	14.4
RoIC	30.7	36.6	28.2	38.0	41.7

Per Share Data (Rs)	FY16	FY17	FY18	FY19E	FY20E
EPS	12.2	14.4	11.8	22.0	28.0
CEPS	19.7	22.6	20.0	31.8	39.1
BVPS	51.7	64.8	167.6	183.7	205.3
DPS	1.8	1.8	5.3	5.9	6.4

Valuations (x)	FY16	FY17	FY18	FY19E	FY20E
PER	59.2	50.3	61.3	33.0	25.9
P/CEPS	35.2	30.7	34.6	21.7	17.7
P/BV	14.0	11.2	4.3	3.9	3.5
EV / Sales	1.4	1.3	1.5	1.2	1.1
EV / EBITDA	26.2	24.5	27.2	17.1	14.1
Dividend Yield (%)	0.3	0.3	0.7	0.8	0.9

Gearing Ratio (x)	FY16	FY17	FY18	FY19E	FY20E
Net Debt/ Equity	0.2	0.3	0.2	0.2	0.1
Net Debt/EBIDTA	0.5	0.7	1.4	0.7	0.4
Working Cap Cycle (days)	(0.6)	(5.5)	(5.2)	(9.3)	(12.3)

Growth (%)	FY16	FY17	FY18	FY19E	FY20E
Revenue	14.8	11.0	(10.2)	18.5	14.4
EBITDA	59.4	8.0	(7.7)	57.7	19.1
EBIT	100.4	7.5	(10.6)	72.8	20.9
PAT	101.5	17.6	(17.9)	86.0	27.2

Quarterly (Rs mn)	Q4FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18
Revenue	4,940	6,164	6,161	5,789	5,616
EBITDA	297	269	211	376	447
EBITDA Margin (%)	6.0	4.4	3.4	6.5	8.0
PAT	2,189	103	74	167	200
EPS (Rs)	47.2	2.2	1.6	3.6	4.3

Source: Company, Emkay Research

Shareholding Pattern (%)	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Promoters	39.9	39.9	39.9	39.9	39.9
FIs	7.2	7.4	8.2	8.5	8.7
DIs	5.8	6.0	6.0	7.5	8.9
Public and Others	47.1	46.7	45.9	44.2	42.5

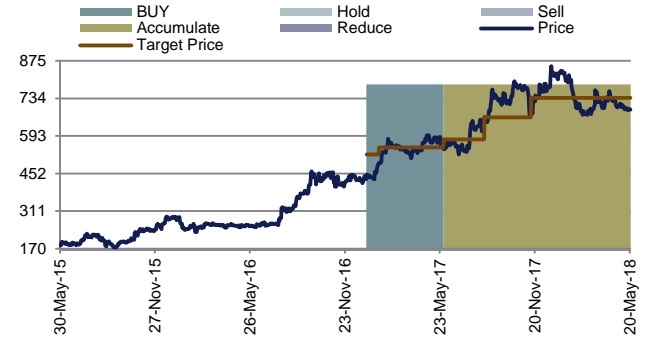
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
13-Nov-17	689	736	12m	Accumulate	Sameep Kasbekar
16-Aug-17	664	663	12m	Accumulate	Dhaval Mehta
30-May-17	544	580	12m	Accumulate	Dhaval Mehta
27-Jan-17	492	550	12m	Buy	Dhaval Mehta
03-Jan-17	440	524	12m	Buy	Dhaval Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

Completed Date: 28 May 2018 22:26:00

Dissemination Date: 28 May 2018 22:27:00

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