

## Q3FY19 Result Update Heritage Foods Ltd.

Value added drives growth ; Reiterate Buy

Heritage posted strong 21% growth in its earnings driven by margin improvement across all its segments. Milk volume for the quarter grew by 6%; while the value added segment posted a 24% growth. Share of value added products is increasing in the portfolio and for the quarter stood at 25% vs 22% in Q3FY18. We continue to like Heritage's increasing pan India presence, aggression towards improving the share of value added product and thereby metamorphosing from a plain vanilla regional play to a value added branded PAN India player. We continue with our Buy rating on the stock with a revised price target of INR650.

### Low milk prices and value add growth drives margins

Heritage's consolidated revenue grew by 7% yoy ; driven by milk volume growth of 6% 24% yoy growth in the value added segment. Soft Procurement prices, coupled with improving product mix, resulted in strong gross margin expansion of 116 bps on a yoy basis. The core Operating profit grew 20% yoy at INR 45 crore; while the margin expanded by 110 bps yoy largely led by gross margin expansion. Led by strong operating performance, the net earnings grew 21.3% yoy at INR 20.2 crore.

### FY20- Volumes to be back in double digits; with some impact on margins

The management in its commentary stated that the low milk pricing scenario has been arrested and it is seeing some upward movement in the milk procurement price ahead, which is likely to result in double digit growth for the company. While the realization or the selling prices would witness an increase with a time lag owing to increased competition along with the sentiments towards general election, which can have some marginal impact on the short term margins ahead.

### Key changes in our FY20 estimates

Taking cues from the management comments in terms of pressure on margins for FY20; we have downgraded our overall margin estimates by 40 bps from the earlier estimate of 8% to current level of 7.6%, resulting in around 9% downgrade in our FY20 earnings from the earlier estimate of INR 120 crore to INR 107 crore.

### Profitable growth + solid balance sheet + Attractive valuation –re-iterate Buy

Heritage focused strategy of balancing aggression in growth with profitability and efficiency continues to keep us positive on the company. We expect its revenue to grow at a CAGR of 11% while earnings to grow at a CAGR of 40% over FY18-20. We maintain Buy with a revised price target of INR 650 (valued at 25x FY20 + 40% discount of investment value of FRL)

Sangeeta Tripathi  
Research Analyst  
Sangeeta.tripathi@edelweissfin.com

CMP INR: 490

Rating: Maintain BUY

Target Price INR: 650

Upside: 33%

Bloomberg:	HTFL:IN
52-week range (INR):	790 /421
Share in issue (cr):	6.34
M cap (INR cr):	2,283
Avg. Daily Vol. BSE/NSE :(‘000):	100
Promoter Holding (%)	39.90

	Q3FY19	Q3FY18	% YoY	Q2FY19	% QoQ	FY18	FY19E	FY20E
Net Sales	619	579	7	619	-0	2,373	2,504	2,908
Growth						-10	6	16
EBITDA	45	38	20	49	-7	130	181	221
Adj. PAT	20	17	21	23	-12	55	84	107
% growth						-18	54	27
EPS	4.4	3.6	-	4.9	-	11.8	18.2	23.1
P/E (x)						41	27	21
EV/EBITDA (x)						19	13	11
RoCE (ex Investment)						21	27	28

Date: 04<sup>th</sup> February, 2019

### Key management commentary

**Q3FY19 result takeaway-** Heritage's topline growth of 7% was aided by milk volume growth of 5% and a robust 24% growth in the value added portfolio. The soft milk pricing scenario, along with aggression from the unorganized and certain state led co-operatives resulted in weak offtake in the state of Maharashtra and Tamil Nadu, while other states like Andhra Pradesh, Telanaga, and Karnataka grew posted double digit volume growth. For 9MFY19 revenue grew by mere 4.1%, on the back of weak pricing.

**Gross margin expanded driven by improved spread and better product mix** - The gross margin improved 116 bps from 20.1% in Q3FY18 to 21.3% in Q3FY19, led by improvement in spread in liquid milk (low milk procurement prices and stable realization) and faster growth in the high margin value added product portfolio (The value added portfolio grew at 24% yoy. The gross margin expansion would have been higher but

**Revenue to inch towards double digit growth** On the growth front, the company remained positive and expects normal double digit growth in FY20, driven by its deepening strategy in the existing states of Tamil Nadu, Andhra Pradesh, Telangana, Karnataka and Maharashtra along with wider focus on the newly acquired northern state.

**Short term pressure on margins likely on lag milk prices; though long term trend towards margin expansion continues** - The management in its commentary stated that the low milk pricing scenario has been arrested and it is seeing some upward movement in the milk procurement price, but the milk realization would not witness a similar increase in the next season or so aided by competitive dynamics along with the general election, thus there can be some impact on the margins for the next 2 quarters.

**Marked reduction in fat inventory resulted in higher losses-** For 9MFY19, the company posted an inventory loss of INR 33.67 crore Vs INR 14.2 crore in 9MFY18. It has led to reduction in strain on the inventory levels for the company even on comprising some margin element. We believe this speaks of prudence and inventory management efforts of the company on the cost of short term margin gain

**Incurred INR 66 crore capex for 9MFY19; and re-iterated guidance of INR 100 crore annual capex for next 3 years time frame**

**Southern market still constitutes 80% of the overall sales-** For Q3FY19, AP/Telanga / Kanataka and Tamil Nadu together constituted around 80% of the revenue; while North states contributed around 8-10% revenue, and balance 10% comes from Maharashtra.

**Re-iteration of growth led by volumes and value added share** – The management's vision towards doubling of milk procurement from current level of 14 lakh litres to 28-30 lac litres remains intact and its strategy for growth via increasing share of value added products from current 25% level to 40% in next 3-4 years.

## Heritage Foods Ltd.

## Q3FY19 Result Highlights

Year to March	Q3FY19	Q3FY18	% Change	Q2FY19	% Change	9MFY19	9MFY18	% change
Income from operations	619	579	7	619	-0	1,886	1,812	4.1
Direct costs	487	462	5	483	1	1,477	1,475	0
Gross Profit	132	117	13.0	136	-3	403	337	20
<b>Gross profit margin (%)</b>	<b>21.3</b>	<b>20.1</b>	<b>116</b>	<b>22.0</b>	<b>-66.8</b>	<b>21.4</b>	<b>18.6</b>	<b>278</b>
Employee costs	37	31	18	37	-2	109	94	16
Other expenses	50	48	5	50	0	154	150	3
Total operating expenses	574	541	6	571	1	1,740	1,719	1
EBITDA	45.0	37.6	20	49	-7	145	93	56
<b>EBITDA margin (%)</b>	<b>7.3</b>	<b>6.5</b>	<b>77</b>	<b>7.8</b>	<b>-57</b>	<b>7.7</b>	<b>5.1</b>	<b>257</b>
Depreciation and amortisation	11	10	19	11	2	33	28	21
EBIT	34	28	20	37	-10	112	66	71
Interest expenses	5	5	4	5	9	15	13	19
Profit before tax	30	23	30	35	-12	101	56	79
Provision for tax	10	8	35	13	-23	34	15	122
Profit after tax	20.2	16.7	21.3	23	-12	67	36	85
No. Of Shares (Cr)	4.6	4.6		4.6		4.6	4.6	-
Diluted EPS (INR)	4.4	3.6		4.9		14.4	7.8	85

As a % of Revenue	Q3FY19	Q3FY18	% Change	Q2FY19	% Change	9MFY19	9MFY18	% change
Raw Material Cost	78.7	79.9	-1.2	78.0	0.7	78.3	81.4	-3.1
EBITDA	7.3	6.5	0.8	7.8	-0.6	7.7	5.1	2.6
EBIT	5.4	4.8	0.6	6.0	-0.6	5.9	3.6	2.3
Net Profit	3.3	2.9	0.4	3.7	-0.4	3.5	2.0	1.6

Key Indicators	Q3FY19	Q3FY18	% Change	Q2FY19	% Change
Value added products	134.7	108.5	24.2%	186.1	(27.63)
Milk Procurement (lac litres)	14.5	13.7	5.8%	13.5	7.73
Milk Sales volume (lac litres)	11.1	10.5	5.3%	10.8	3.16
Milk Selling price	38.9	38.9	-0.1%	38.9	(0.15)
Cost per litre	32.5	33.9	-4.2%	32.4	0.15

# Heritage Foods Ltd.

## Financials

### Income statement (Consolidated)

(INR cr)

Year to March	FY16	FY17	FY18	FY19E	FY20E
Income from operations	2,381	2,643	2,373	2,504	2,908
EBITDA	131	141	130	181	221
Depreciation and amortisation	35	38	38	38	43
EBIT	96	104	93	142	177
Interest expenses	17	11	18	24	25
Other income	7	6	8	8	8
Profit before tax	86	98	82	126	160
Provision for tax	31	31	27	42	53
Core profit	55	67	55	84	107
Extraordinary items	1	0	0	0	0
Profit after tax	56	67	55	84	107
Minority Interest	0	0	0	0	0
Share from associates	0	0	0	0	0
Adjusted net profit	56	67	55	84	107
Equity shares outstanding (mn)	5	5	5	5	5
EPS (INR) basic	11.9	14.4	11.8	18.2	23.1
Diluted shares (Cr)	4.6	4.6	4.6	4.6	4.6
EPS (INR) fully diluted	11.9	14.4	11.8	18.2	23.1
Dividend per share	0.0	0.0	0.0	0.0	0.0
Dividend payout (%)	0.0	0.0	0.0	0.0	0.0

### Common size metrics- as % of net revenues

Year to March	FY16	FY17	FY18	FY19E	FY20E
Operating expenses	94.5	94.7	94.5	92.8	92.4
Depreciation	1.4	1.4	1.6	1.5	1.5
Interest expenditure	0.7	0.4	0.8	1.0	0.9
EBITDA margins	5.5	5.3	5.5	7.2	7.6
Net profit margins	2.4	2.5	2.3	3.4	3.7

### Growth metrics (%)

Year to March	FY16	FY17	FY18	FY19E	FY20E
Revenues	14.8	11.0	(10.2)	5.5	16.1
EBITDA	56.5	7.9	(7.7)	38.5	22.3
PBT	119.7	14.3	(16.6)	53.7	27.0
Net profit	96.5	20.5	(17.9)	53.9	27.0
EPS	96.5	20.5	(17.9)	53.9	27.0

## Heritage Foods Ltd.

## Financials

### Balance sheet ( Consolidated)

(INR cr)

As on 31st March	FY16	FY17	FY18	FY19E	FY20E
Equity share capital	23	23	23	23	23
Preference Share Capital	0	0	0	0	0
Reserves & surplus	217	280	754	839	946
Shareholders funds	240	303	778	862	969
Secured loans	125	69	109	109	109
Unsecured loans	1	66	142	142	142
Borrowings	126	194	251	251	251
Minority interest	0	0	0	0	0
<b>Sources of funds</b>	<b>366</b>	<b>498</b>	<b>1,028</b>	<b>1,113</b>	<b>1,220</b>
Gross block	518	524	715	815	915
Depreciation	206	244	282	320	364
Net block	312	280	433	495	551
Capital work in progress	10	10	9	9	9
Total fixed assets	322	290	442	503	560
Unrealised profit	0	0	0	0	0
Investments	1	149	576	576	576
Inventories	145	123	155	144	167
Sundry debtors	29	16	13	14	16
Cash and equivalents	45	35	99	109	168
Loans and advances	9	16	4	4	4
Other current assets	0	0	0	0	0
Total current assets	228	189	271	272	355
Sundry creditors and others	158	173	220	206	239
Provisions	16	12	13	13	13
Total CL & provisions	174	185	233	219	252
Net current assets	54	4	38	53	103
Net Deferred tax	-19	-19	-19	-19	-19
Misc expenditure	8	0	0	0	0
<b>Uses of funds</b>	<b>366</b>	<b>424</b>	<b>1,037</b>	<b>1,113</b>	<b>1,220</b>
Book value per share (INR)	52	65	168	186	209

### Cash flow statement

(INR cr)

Year to March	FY16	FY17	FY18	FY19E	FY20E
Net profit	55	67	55	84	107
Add: Depreciation	35	38	38	38	43
Add: Misc expenses written off	2	8	0	0	0
Add: Deferred tax	-0	0	-0	0	0
Add: Others	0	0	0	0	0
Gross cash flow	91	113	92	123	151
Less: Changes in W. C.	-19	-39	-31	4	-8
Operating cash flow	110	152	123	119	158
Less: Capex	66	21	166	109	100
<b>Free cash flow</b>	<b>44</b>	<b>131</b>	<b>-43</b>	<b>10</b>	<b>58</b>

**Ratios**

Year to March	FY16	FY17	FY18	FY19E	FY20E
ROAE (%)	25.6	24.6	10.1	10.3	11.7
ROACE (%)	25.6	24.6	12.2	13.0	15.0
Current ratio	1.3	1.0	1.2	1.2	1.4
Debt/Equity	0.5	0.4	0.3	0.3	0.3
Debtors (days)	4	2	2	2	2
Inventory (days)	22	17	24	21	21
Payable (days)	24	24	34	30	30
Cash conversion cycle (days)	2	-5	-8	-7	-7
Debt/EBITDA	1.0	1.0	1.9	1.4	1.1
Adjusted debt/Equity	0.3	0.3	0.2	0.2	0.1

**Valuation parameters**

Year to March	FY16	FY17	FY18	FY19E	FY20E
Diluted EPS (INR)	11.9	14.4	11.8	18.2	23.1
Y-o-Y growth (%)	96.5	20.5	(17.9)	53.9	27.0
CEPS (INR)	19.4	22.5	20.0	26.5	32.4
Diluted P/E (x)	41.0	34.0	41.5	26.9	21.2
Price/BV(x)	9.5	7.5	2.9	2.6	2.3
EV/Sales (x)	1.0	0.9	1.0	1.0	0.8
EV/EBITDA (x)	18.0	16.8	18.6	13.4	10.7
Diluted shares O/S	4.6	4.6	4.6	4.6	4.6
Basic EPS	11.9	14.4	11.8	18.2	23.1
Basic PE (x)	41.0	34.0	41.5	26.9	21.2
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

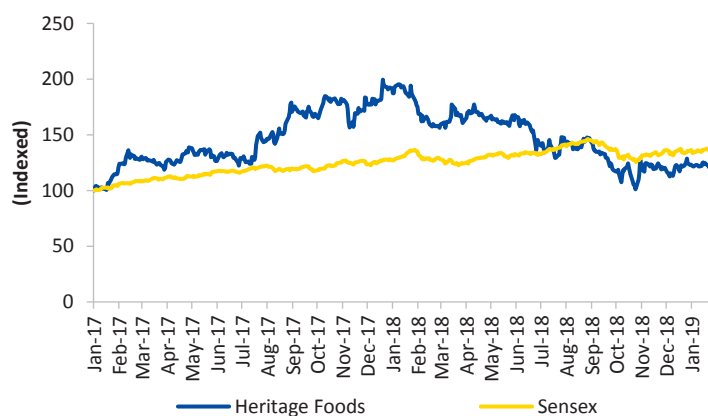
Edelweiss Broking Limited, 1st Floor, Tower 3, Wing B, Kohinoor City Mall, Kohinoor City, Kirool Road, Kurla(W)  
 Board: (91-22) 4272 2200

**Vinay Khattar**

Head Research

vinay.khattar@edelweissfin.com

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate between 5-15% over a 12-month period
Reduce	Return below 5% over a 12-month period



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