

RESULT UPDATE

KEY DATA

Rating	BUY
Sector relative	Outperformer
Price (INR)	379
12 month price target (INR)	565
Market cap (INR bn/USD bn)	18/0.2
Free float/Foreign ownership (%)	60.1/4.6
What's Changed	
Target Price	↓
Rating/Risk Rating	—

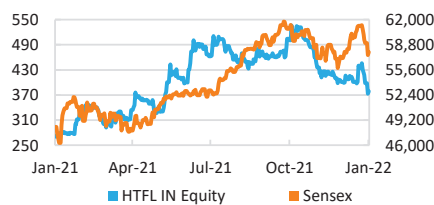
QUICK TAKE

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

FINANCIALS

	(INR mn)			
Year to March	FY21A	FY22E	FY23E	FY24E
Revenue	24,731	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:



Financial model



Podcast



Corporate access



Video

Elevated procurement causes miss

Heritage Foods (HTFL) reported sales growth of 10% YoY, despite cyclones in key end-user markets. This was led by dairy sales, which grew 12% YoY and value-added dairy products (VADP) which grew 21% YoY. However, rising procurement prices caused EBITDA to dip 48% YoY missing estimate by 35%.

HTFL is aiming to achieve its 20% sales growth target and rise in share of VADP sales as part of its changing approach to a consumer-centric FMCG company. To alleviate the near-term procurement price pressure, HTFL has taken price hikes of INR2/l on average. However, the miss has prompted a cut of 16/14% in FY22/23E EPS. Maintain 'BUY' with revised TP of INR565 on 18x rolling over to Mar-23 EPS.

Rising procurement prices impact spreads

Q3FY22 sales was up 10% YoY (3% below estimates) with 7% YoY volume growth and marginal increase in realisations (~1%). Dairy business grew 12% YoY, led by 21% growth of in VADP. Curd sales formed a bulk of the VADP growth, with volume growth of 17% YoY in average volumes. However, procurement prices rose sharply (12% QoQ) impacting gross margin, which fell 290bps QoQ to 21.7%. Thus, EBITDA margin contracted 360bps QoQ and 675bps YoY and EBITDA fell 48% YoY (35% below estimates). Management has taken price hikes in the current quarter to alleviate the pressure on spreads, with average hike of INR2/l across the portfolio.

Well-articulated growth strategy

Management has a focused strategy to achieve 20% revenue growth involving: i) better contribution from VADP; ii) expanding regional footprint by deepening focus; and iii) expanding procurement and sales network. Management plans on introducing innovative products with significant headroom for growth, addressing customer needs, and focusing on omni-channel strategy to improve accessibility. HTFL targets strong growth in curd, ghee and paneer. HTFL is also planning to foray into non-dairy products. However this is at a nascent stage at present, but part of the overall strategy to transform to a consumer-centric company.

Outlook and valuations: Well-placed; maintain 'BUY'

HTFL looks poised to achieve its sales growth targets as markets normalise. With spreads lower than expected, we cut EPS by 16/14% in FY22/23E. We expect 18% PAT CAGR over FY22-24. Maintain **BUY**, valuing at 18x rolling over to FY23 EPS leading to revised TP of INR565 (INR653 earlier). Stock is at a deep discount to peers.

Financials

Year to March	Q3FY22	Q3FY21	% Change	Q2FY22	% Change
Net Revenue	6,670	6,049	10.3	6,703	(0.5)
EBITDA	408	778	(47.6)	651	(37.4)
Adjusted Profit	208	260	(20.0)	419	(50.3)
Diluted EPS (INR)	4.5	5.6	(20.0)	9.0	(50.3)

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
Revenue 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

Q3FY22 conference call: Key highlights

Operating and Financial:

- Revenue rose 10% YoY, with healthy sales growth of 12% YoY gain in the dairy business, offset by cattle feed business which saw a decline of 17% YoY.
- Milk procurement rose 3%YoY in Q2FY22 to 1.2 million litre per day (MLPD), however, procurement prices rose 10% YoY, 12% QoQ.
- Average milk sales were up 7% YoY during Q3FY22 was 1.04MLPD as compared to 0.973MLPD in Q3FY21.
- VADP sales higher: VADP grew ~21% YoY owing to higher curd sales. Curd volumes were up 17% during Q3FY22 at 271 metric tonnes per day (MTPD) as compared to 231MTPD in Q3FY21. VADP contribution stands at ~25.1% in Q3FY22 (Q3FY21: 23.1% of sales).
- Procurement prices rose 10% YoY, 12% QoQ to INR38.3/litre, gross margin dipped 658bps YoY, 290bps QoQ to 21.7%. Thus, EBITDA margin dipped 675bps YoY, 360bps QoQ to 6.1%. Spreads narrowed to INR8.4/litre, down 27% YoY, lowest in past 8 quarters.
- Management has raised selling prices as a result of higher procurement prices by INR2/l on average.
- While milk prices were expected to temper with the onset of flush season, normalised demand levels and no curbs in movement ensured prices remained elevated.
- HTFL targets EBITDA margin of 7.5-8% on a normalised level and endeavours to revert to normalised levels.
- Heritage Nutrivet reported a 17% dip in revenues, while EBIT de-grew 75% YoY, and margin declined 554bps to 2% owing to high soya prices and healthy monsoon resulting in improved availability of green fodder. Management has started raising prices to improve margins.
- Management is focused on product portfolio & geographic expansion. It is enriching VADP portfolio. Company highlighted its key focus areas in value added products like Curd, paneer, ghee, beverages and ice creams – where they are targeting leadership position, drinkable yogurt and deserts.
- During Q3FY22, HTFL launched frozen desserts and A2 milk across several products.
- In VADP, HTFL has made several launches in recent past in its JV with French major Novandie. Under the brand Mamie Yova, the company has launched a range of stirred and drinkable yogurt products. The JV with the French player Novandie seems to be progressing well, as management launched the 8SKUs in Hyderabad, post the launch of the yogurt and YoPop in Bangalore. The opportunity remains attractive and is a natural extension of its curd portfolio. Management anticipates 2.5-3x growth in sales with seasonal change, diversifying channel mix (60% modern retail at present), along with scale and throughput benefits.

- Management maintains growth strategy involving: 1) better contribution from VADP; 2) deepening penetration in regional markets; and 3) expanding procurement and sales systematically.
- Management is focused on products with strong headroom for growth and consumer-centric marketing and positioning along with omni-channel strategy to improve accessibility of products.
- Management aims to grow the revenues at 20% CAGR, with contribution from value-added products at 45-50% of the mix with a consumer-centric focus.
- Management continues to explore adjacent products in the dairy portfolio which should aid in improving growth across VADP.
- Management is also exploring products in the non-dairy segments, falling within scope of the vision laid out by the company. Management is not looking to create new customer segments but complementarities to the current portfolio. These would leverage existing distribution channels, and HTFL plans to foray into the category expansion via third-party manufacturers. Margins of the business are likely to be accretive.
- Debt-Equity at 0.01:1 & Cash and Cash Equivalents at INR662mn as on Q3FY22 end.
- 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.

Exhibit 1: Quarterly financial snapshot

Year to March	Q3FY22	Q3FY21	% change	Q2FY22	% change	YTD FY22	FY22E	FY23E
Revenues	6,670	6,049	10.3	6,703	(0.5)	19,854	26,645	29,452
Raw material	5,225	4,340	20.4	5,057	3.3	15,280	20,451	22,565
Staff costs	484	468	3.3	479	1.0	1,425	1,910	2,032
Others	554	463	19.6	516	7.3	1,557	2,146	2,389
Total expenditure	6,263	5,271	18.8	6,052	3.5	18,261	24,508	26,986
EBITDA	408	778	-47.6	651	(37.4)	1,593	2,137	2,466
Depreciation	129	113	14.2	130	(0.8)	387	545	581
EBIT	278	665	-58.1	521	(46.5)	1,205	1,593	1,884
Interest	6	51	-88.1	9		30	31	30
Other income	31	11	177.2	29	5.9	76	53	90
Add: Prior period items								
Add: Exceptional items	0	-204		0		0	0	0
Profit Before Tax	303	421	-28.0	541	(43.9)	1,252	1,615	1,945
Less: Provision for Tax	79	155	-49.0	108	(26.5)	291	407	490
Less: Minority Interest	0	-4		0		-1	0	0
Add: Share of profit from associates	-16	-5		-14		-43	0	0
Less: Profit from Discontinued Operations								
Reported Profit	209	264	-20.9	419	(50.3)	919	1,208	1,455
Adjusted Profit	209	468	-55.4	419	(50.3)	919	1,208	1,455
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	4.5	10.1	-55.4	9.0	(50.3)	19.8	26.0	31.4
P/E (x)							14.6	12.1
EV/EBITDA (x)							7.7	6.1
ROAE(%)							18.8	19.5
As % of net revenues								
Raw material	78.3	71.7		75.4		77.0	76.8	76.6
Staff expenses	7.3	7.7		7.1		7.2	7.2	6.9
Other expenses	8.3	7.7		7.7		7.8	8.1	8.1
EBITDA	6.11	12.9	-6.75	9.7	-3.60	8.0	8.0	8.4
Net profit	3.1	7.7		6.3		4.6	4.5	4.9

Source: Company, Edelweiss Research

Exhibit 2: We have cut our FY22/23E EPS by 16/14%

(INR mn)	Old		New		% change	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
Revenue	26,642	29,732	26,645	29,452	0.0	-0.9
EBITDA	2,445	2,762	2,137	2,466	-12.6	-10.7
PAT	1,442	1,684	1,208	1,455	-16.2	-13.6

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. 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	Bhuvanewari 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

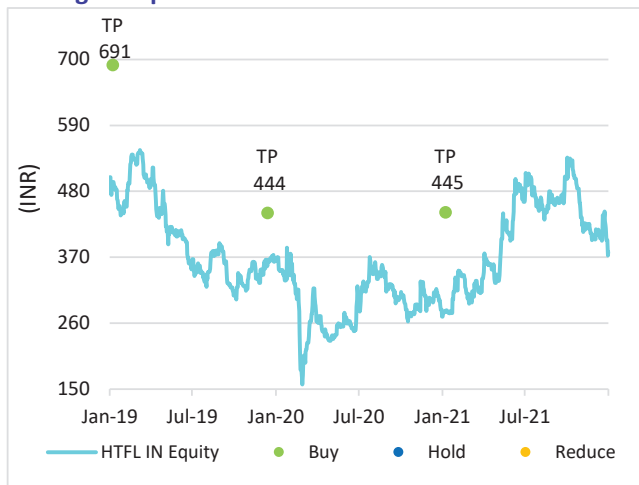
Recent Company Research

Date	Title	Price	Reco
22-Oct-21	Procurement picks up ; <i>Result Update</i>	504.65	Buy
30-Jul-21	Strong strategic moves ; <i>Result Update</i>	490.15	Buy
21-May-21	Spreads dip sequentially; <i>Result Update</i>	327	Buy

Recent Sector Research

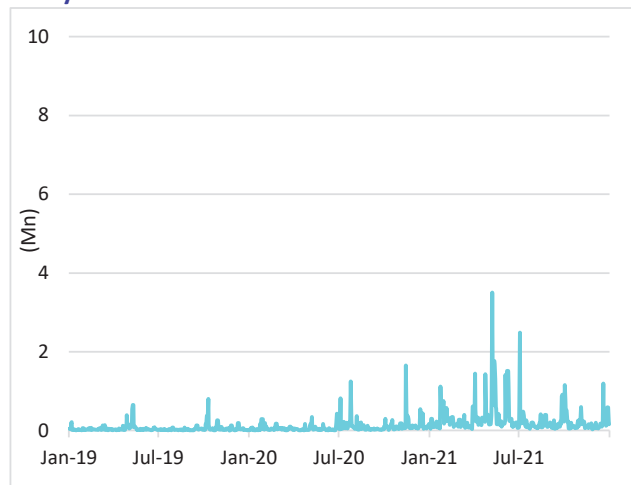
Date	Name of Co./Sector	Title
08-Nov-21	Parag Milk Foods	Sales uptick; margins better; <i>Result Update</i>
04-Aug-21	Parag Milk Foods	Sustainable uptick awaited; <i>Result Update</i>
15-Jun-21	Parag Milk Foods	Recovery lagging peers; <i>Result Update</i>

Rating Interpretation



Source: Bloomberg, Edelweiss research

Daily Volume



Source: Bloomberg

Rating Distribution: Edelweiss Research Coverage

	Buy	Hold	Reduce	Total
Rating Distribution*	190	54	17	262
	>50bn	>10bn and <50bn	<10bn	Total
Market Cap (INR)	235	42	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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