

Dairy

Target price: Rs450

Earnings revision

(%)	FY23E	FY24E
Sales	↓ 0.0	↓ 0.0
EBITDA	↓ 4.0	↓ 4.6
EPS	↓ 6.2	↓ 4.8

Target price revision

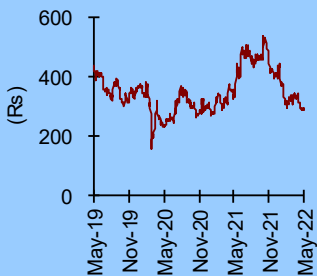
Rs450 from Rs500

Shareholding pattern

	Sep '21	Dec '21	Mar '22
Promoters	39.5	39.4	39.4
Institutional investors			
MFs and other	17.7	19.5	17.5
Banks / FI's	14.1	15.4	15.8
FII's	0.0	0.0	0.0
FII's	3.6	4.1	1.7
Others	42.8	41.1	43.1

Source: BSE

Price chart



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INDIA

Heritage Foods

BUY
Maintained

EBITDA margin impacted by rising milk procurement prices

Rs295

Takeaways from Q4FY22: (1) Revenue grew 12.4% YoY driven by strong volume growth in dairy segment, (2) gross margin declined 304bps YoY due to higher milk procurement prices but limited price hikes, and (3) steady launch of new products continued during the quarter. Steady value migration from co-operatives and unorganised players to private players is likely to benefit Heritage. We model Heritage to report PAT CAGR of 33.4% over FY22-FY24 with (1) high single-digit growth in milk procurement and (2) steady increase in the share of value-added product portfolio. We cut earnings estimates due to delay in price hikes. We stay positive and maintain BUY rating on the stock with a revised DCF-based target price of Rs450 (implied P/E 11x of FY24E EPS; earlier TP: Rs500).

- ▶ **Q4FY22 result:** Heritage reported revenue growth of 12.4% YoY, but reported EBITDA and adj. PAT decline of 33.1% and 46.8% YoY, respectively. Gross and EBITDA margins declined 304bps and 313bps YoY, respectively, due to higher input prices. Reduction in interest cost (due to repayment of debt) arrested the decline in PAT margin to just 211bps YoY.
- ▶ **Segment-wise performance:** While dairy segment reported revenue growth of 13.5%, its feed business revenue declined 15.7% YoY. Share of value-added products increased to 27.2% from 26.6% Q4FY21. We believe the contribution of VAP would have increased due to favourable base and higher revenue of curd and ice-cream.
- ▶ **Steady launch of new products:** The company has launched *Badam Charger* in Q4FY22. We note there is a good customer acceptance for Novandie products and thus, the company has launched Novandie products in new markets and is also expanding the product portfolio.
- ▶ **Limited price hikes despite higher procurement costs:** The company took price hikes in a staggered manner. Net realisation was up 3.9% in milk and 3.6% in curd in Q4FY22. The average milk procurement price increased to Rs38.5 per litre (up 3.2% YoY).
- ▶ **Maintain BUY:** We model Heritage to report revenue and PAT CAGRs of 14.3% and 33.4%, respectively, over FY22-FY24E with RoE > cost of capital. We are positive on its business model led by its competitive advantages and strong growth opportunity. We maintain BUY rating on the stock and value it as per DCF methodology at Rs450 (implied P/E 11x FY24E).

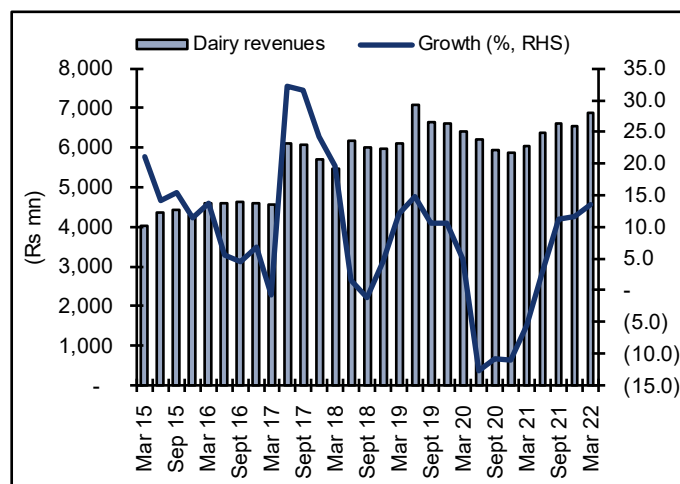
Market Cap	Rs13.7bn/US\$177mn	Year to March	FY21	FY22P	FY23E	FY24E
Reuters/Bloomberg	HEFI.BO / HTFL IN	Revenue (Rs mn)	24,731	26,813	30,753	35,059
Shares Outstanding (mn)	46.4	Adj. Net Profit (Rs mn)	1,598	1,066	1,554	1,898
52-week Range (Rs)	536/288	Dil. Rec. EPS (Rs)	34.4	23.0	33.5	40.9
Free Float (%)	60.6	% Chg YoY	174.4	(33.3)	45.9	22.1
FII (%)	1.7	P/E (x)	8.6	12.9	8.8	7.2
Daily Volume (US\$'000)	702	CEPS (Rs)	44.4	34.2	46.1	55.0
Absolute Return 3m (%)	(4.5)	EV/EBITDA (x)	5.1	7.2	5.4	4.7
Absolute Return 12m (%)	(9.4)	Dividend Yield (%)	1.7	2.0	2.4	2.7
Sensex Return 3m (%)	(0.2)	RoCE (%)	31.5	19.9	25.1	24.4
Sensex Return 12m (%)	10.2	RoE (%)	29.0	16.4	20.9	21.5

Table 1: Q4FY22 financial performance*(Rs mn, year ending March 31)*

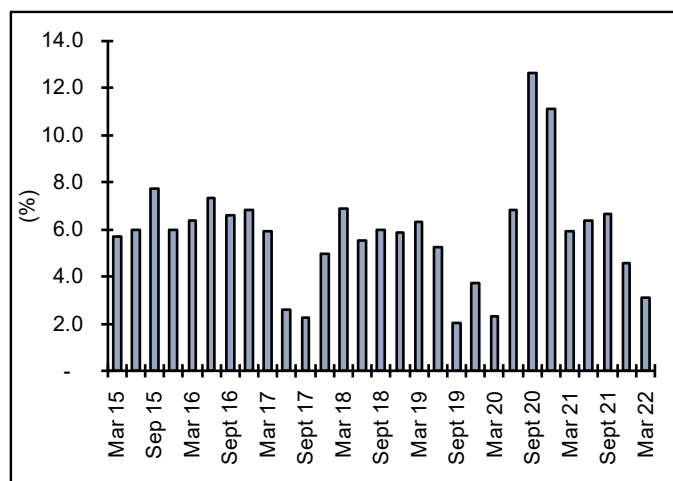
Y/e March	Q4FY22	Q4FY21	YoY gr.	Q3FY22	QoQ gr.
Revenue	6,959	6,194	12.4	6,670	4.3
Expenditure					
Raw materials	5,555	4,756	16.8	5,225	6.3
% of revenue	79.8	76.8		78.3	
Employee cost	418	445	(5.9)	484	(13.5)
% of revenue	6.0	7.2		7.3	
Other expenditure	666	515	29.3	554	20.2
% of revenue	9.6	8.3		8.3	
Total expenditure	6,639	5,715	16.2	6,263	6.0
EBITDA	320	478	(33.1)	408	(21.6)
EBITDA margin	4.6	7.7		6.1	
Other income	25	35	(30.4)	31	(19.7)
PBDIT	345	514	(32.9)	438	(21.4)
Depreciation	135	120	12.4	129	4.1
PBIT	210	394	(46.7)	309	(32.1)
Interest	11	30	(65.3)	6	74.4
PBT	199	364	(45.2)	303	(34.2)
Prov for tax	51	86	(39.9)	79	(35.1)
% of PBT	25.8	23.5		26.1	
Adjusted PAT	148	278	(46.8)	224	(33.9)
Extra ordinary items	(21)	(31)	(30.1)	(18)	18.7
Reported PAT	127	248	(48.8)	206	(38.5)

Source: Company data, I-Sec research

Key performance highlights

Chart 1: Revenue and revenue growth

Source: Company data, I-Sec research

Chart 2: EBIT margin of dairy segment

Source: Company data, I-Sec research

Key highlights from Q4FY22 result and conference call

- The company registered revenue growth of 12.4% YoY in Q4FY22. EBITDA margin declined 313bps YoY.
- EBIT margin declined 280bps YoY in dairy business in Q4FY22.
- Average realisation of per litre milk was Rs48.07 in Q4FY22. Average milk procurement price was Rs38.46 per litre in Q4FY22.
- The company completed 30 years of its operations in the first week of May'22.
- In FY22, there were several headwinds on profitability due to higher milk procurement prices and higher crude oil prices.
- Company has taken several steps to protect the profitability – (1) improving manufacturing efficiency, (2) scaling value-added portfolio and (3) price hikes.
- In FY22, the company procured on an average 1.3mnpd of milk; average sales of milk were 1.06mnpd in FY22.
- The average volume of curd sales was 286mtpd (up ~17% YoY).
- VAP revenue surged ~19% in FY22. It contributed ~26% of revenue in FY22, up from ~24% in FY21.
- With negligible covid impact and high temperatures, out of consumption is rising. This has resulted in higher inventory in market.
- In Q4FY22, revenue contribution of VAP was 27.2% (up from 26.6%).
- The company took price hikes in a staggered manner. Net realisation was up 3.9% in milk and 3.6% in curd in Q4FY22.
- Heritage paid Rs23.2mn to acquire *Shaguna Dairy* in FY22. Milk procurement capacity of *Shaguna* is only 15k litres milk per day.
- Revenue growth guided at 20% (each) YoY for FY23 and FY24. The company maintained its revenue target of Rs50bn by FY26.
- The management guided for EBITDA margin guidance of 7-8%.
- It highlighted EBITDA margin of VAP is double that of milk. So, rising contribution of VAP will improve the profitability of the company.
- Novadie JV update – the company launched new products in the challenging period of second and third covid waves. Management highlighted products are being well accepted in the markets. Thus, it is now focusing on geographical and product portfolio expansion.
- Curd contributed 75% of total VAP revenue. Paneer, ice creams, drinks are other strong contributors to VAP. It highlighted cold coffee is also growing very fast and might be a major revenue contributor in 2-3 years.
- The company is focused on domestic markets only. It aspires to build strong B2C business.
- The company's procurement network is spread across 9 states.

Chart 3: Milk prices – pan-India

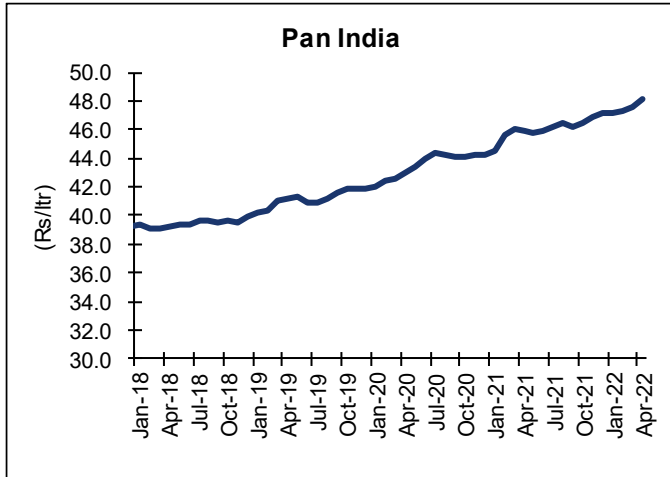
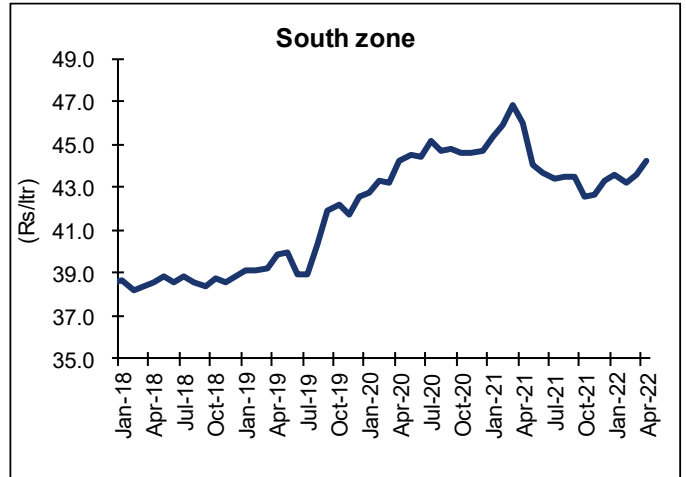
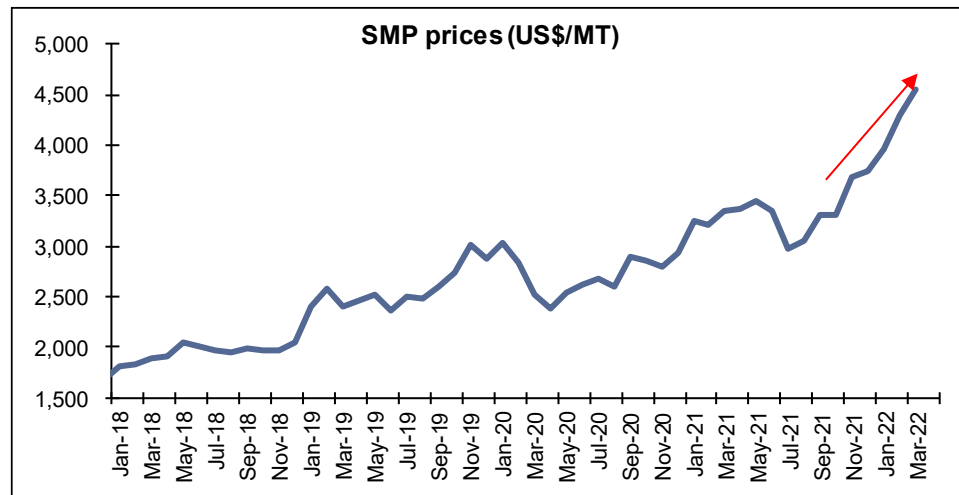


Chart 4: Milk prices - South India



Source: Department of consumer affairs, I-Sec research

Chart 5: Skimmed milk powder (SMP) prices



Source: Industry, I-Sec research

Valuation and risks

We model Heritage to report revenue and PAT CAGRs of 14.3% and 33.4%, respectively, over FY22-FY24E and adjusted RoE to change from 21.5% in FY22 to 16.2% in FY24E. We value the stock at a target price of Rs450 as per DCF methodology. At the DCF price, implied P/E works out to 11x on FY24E EPS. Maintain BUY.

Table 2: DCF valuation

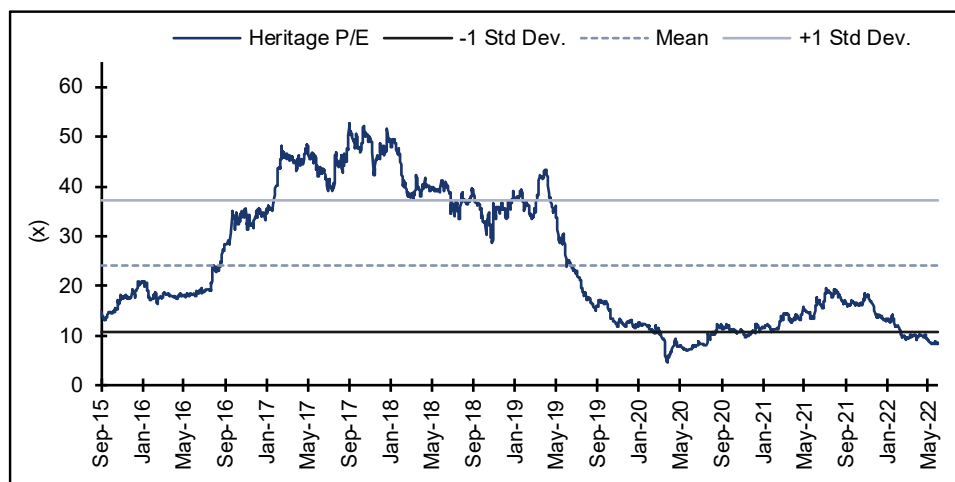
Particulars (Rs mn)	Amt (Rs)
Cost of Equity (%)	12.2
Terminal growth rate (%)	3.0
Discounted interim cash flows (Rsmn)	11,017
Discounted terminal value (Rsmn)	9,862
Total equity value (Rsmn)	20,879
Value per share (Rs)	450

Source: Company data, I-Sec research

Mean P/E and standard valuation

The stock has traded at an average P/E of 24x over the past 10 years. The stock is trading around 1 standard deviation below its mean P/E.

Chart 6: Mean P/E and standard deviation



Source: Company data, I-Sec research

Risks

Sharp increase in input prices

Any major increase in commodity prices will result in downside to our estimates.

Sharp increase in competition

Any major increase in competition will result in downside to our estimates

Financial summary

Table 3: Profit & loss statement

(Rs mn, year ending March 31)

	FY21	FY22P	FY23E	FY24E
Net Sales	24,731	26,813	30,753	35,059
Operating Expenses	22,020	24,900	28,201	32,149
EBITDA	2,712	1,913	2,553	2,910
% margins	11.0	7.1	8.3	8.3
Depreciation & Amortisation	462	522	583	655
Gross Interest	192	40	42	42
Other Income	80	113	165	338
Recurring PBT	2,138	1,463	2,091	2,550
Less: Taxes	535	342	527	643
Less: Minority Interest	6	56	10	10
Net Income (Reported)	1,598	1,066	1,554	1,898
Extraordinaries (Net)	(119)	(100)	-	-
Recurring Net Income	1,478	965	1,554	1,898

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22P	FY23E	FY24E
Assets				
Total Current Assets	2,595	2,908	2,546	2,644
of which cash & cash eqv.	236	356	362	197
Total Current Liabilities & Provisions	2,060	1,788	2,614	2,980
Net Current Assets	535	1,119	(68)	(336)
Investments	254	289	2,289	3,739
Net Fixed Assets	5,753	5,749	6,246	6,591
Capital Work-in-Progress	183	80	-	-
Total Assets	6,725	7,238	8,467	9,994
Liabilities				
Borrowings	522	423	423	423
Deferred Tax Liability	241	239	239	239
Minority Interest	5	0	0	0
Equity Share Capital	232	232	232	232
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	5,726	6,344	7,573	9,099
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	5,958	6,576	7,805	9,331
Total Liabilities	6,725	7,238	8,467	9,994

Source: Company data, I-Sec research

Table 5: Quarterly trend

(Rs mn, year ending March 31)

	June 21	Sept 21	Dec 21	Mar 22
Net sales	6,481	6,703	6,670	6,959
% growth (YoY)	1.4	9.9	10.3	12.4
EBITDA	534	651	408	320
Margin (%)	8.2	9.7	6.1	4.6
Other income	28	29	31	25
Extraordinaries (Net)	(1)	(93)	(18)	(21)
Net profit	302	327	207	129

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22P	FY23E	FY24E
Operating Cashflow	1,999	1,544	2,138	2,553
Working Capital Changes	(475)	(72)	1,193	103
Capital Commitments	(662)	(417)	(1,000)	(1,000)
Free Cashflow	862	1,056	2,331	1,656
Cashflow from Investing Activities	1,334	(32)	(2,000)	(1,450)
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	(1,566)	(548)	-	-
Dividend paid	(116)	(348)	(325)	(371)
Change in Deferred Tax Liability	-	-	-	-
Chg. in Cash & Bank balance	514	128	6	(165)

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY21	FY22P	FY23E	FY24E
Per Share Data (Rs)				
EPS	34.4	23.0	33.5	40.9
Cash EPS	44.4	34.2	46.1	55.0
Dividend per share (DPS)	5.0	6.0	7.0	8.0
Book Value per share (BV)	133.6	146.9	173.4	206.3
Growth (%)				
Net Sales	(9.3)	8.4	14.7	14.0
EBITDA	109.7	(29.5)	33.5	14.0
PAT	174.4	(33.3)	45.9	22.1
Cash EPS	90.1	(22.9)	34.7	19.4
Valuation Ratios (x)				
P/E	8.6	12.9	8.8	7.2
P/CEPS	6.7	8.7	6.4	5.4
P/BV	2.2	2.0	1.7	1.4
EV / EBITDA	5.1	7.2	5.4	4.7
EV / Sales	0.6	0.5	0.4	0.4
Operating Ratios				
Raw Material / Sales (%)	74.3	77.7	77.7	77.7
Employee cost / Sales (%)	7.2	6.9	6.5	6.5
SG&A / Sales (%)	0.4	0.6	0.8	0.8
Other Income / PBT (%)	3.8	7.7	7.9	13.2
Effective Tax Rate (%)	25.0	23.4	25.2	25.2
Working Capital (days)	1.2	2.8	(1.4)	(1.5)
Inventory Turnover (days)	29.3	28.0	20.1	20.1
Receivables (days)	2.2	2.5	2.2	2.2
Payables (days)	28.5	23.2	29.2	29.2
Net D/E (x)	0.0	0.0	(0.2)	(0.3)
Profitability Ratios (%)				
Net Income Margins	6.5	4.2	5.1	5.4
RoACE	31.5	19.9	25.1	24.4
RoAE	29.0	16.4	20.9	21.5
Dividend Payout	14.5	26.1	20.9	19.6
Dividend Yield	1.7	2.0	2.4	2.7
EBITDA Margins	11.0	7.1	8.3	8.3

Source: Company data, I-Sec research

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