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Q3FY23 result review and
earnings/TP revision

Dairy

Target price: Rs220

Earnings revision

(%)	FY23E	FY24E
Sales	↓ 1.1	↓ 1.1
EBITDA	↓ 15.3	↓ 1.1
EPS	↓ 21.5	↓ 2.3

Target price revision*

Rs220 from Rs380

*Adjusted for rights issue

Shareholding pattern

	Sep '22	Sep '22	Dec '22
Promoters	39.4	39.2	39.2
Institutional investors			
MFs and other	17.8	17.7	17.8
Banks / FI's	15.4	15.5	15.6
FII's	0.0	0.1	0.0
FII's	2.4	2.1	2.2
Others	43.8	43.1	43.0

Source: BSE

ESG disclosure score

Year	2020	2021	Chg
ESG score	NA	NA	NA
Environment	NA	NA	NA
Social	NA	NA	NA
Governance	NA	NA	NA

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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INDIA

Heritage Foods

BUY
Maintained

Weak flush season impacts margins; Model recovery in FY24

Rs187

Milk procurement prices continue to remain high due to (1) steep increase in RM prices, (2) higher SMP prices and (3) muted flush season. We note delayed price hikes had impacted margins in H1FY23 and similar story continues in H2FY23. Heritage is likely to report lowest EBITDA margin of 4.5% in FY23 in past eight years in our view. We model the margins to recover only in FY24. However, due to price hikes and higher HoReCa and out-of-home sales, revenue growth of the company is likely to remain in mid-high teens in Q4FY23 as well as FY24.

We model the company to report PAT CAGR of 23.8% over FY22-FY25E with: (1) mid-single-digit growth in milk procurement, and (2) steady increase in the share of VAP portfolio. We cut our earnings estimates due to delay in price hikes and impact on milk procurement prices due to muted flush season. Maintain BUY with a revised DCF-based TP of Rs220, (10x FY25E EPS; prior TP: Rs380).

- **Q3FY23 results:** Heritage reported revenue growth of 17.8% YoY, but EBITDA and adjusted PAT declined 20.1% and 39% YoY respectively. Gross and EBITDA margins contracted by 160bps and 197bps YoY due to steep increase in milk procurement prices. Higher ad-spend (in our view) also impacted the margins.
- **Segment-wise performance:** Dairy and feed segments reported revenue growth of 18.4% and 16.3% respectively YoY. Milk procurement was up 20% YoY. Revenues of VAP were up 20.5% YoY. Curd volume sales were up 8.5% YoY. We believe Heritage is on track to achieve 40% of its sales from VAPs in the next 3 years.
- **Steady launch of new products:** The company has continued to introduce multiple new products. It introduced Gluco Shakti, instant whey energy drink in Q2FY23. It has launched *Creamilicious Curd*, a differentiated offering in Q3FY23. We believe steady launches of differentiated products will lead to higher revenues as well as better margins in medium-long term.
- **Margin recovery in FY24:** With steep increase in milk procurement prices, Heritage is likely to post lowest EBITDA margin of 4.5% in FY23E, in our view. However, we model recovery in EBITDA margin to 7% in FY24 due to price hikes, operating leverage and moderation in inflationary pressures.
- **Maintain BUY:** We model Heritage to report revenue and PAT CAGRs of 16.2% and 23.8% respectively over FY22-FY25E with RoE > cost of capital. We remain positive on the business led by competitive advantages and strong growth opportunity. We maintain **BUY** and value it as per DCF at Rs220 (implied P/E 10x FY25E). Key risks are failure of new product launches and higher competitive pressure.

Market Cap	Rs8.7bn/US\$107mn	Year to March	FY22	FY23E	FY24E	FY25E
Reuters/Bloomberg	HEFI.BO / HTFL IN	Revenue (Rs mn)	26,813	32,582	37,144	42,110
Shares Outstanding (mn)	46.4	Adj. Net Profit (Rs mn)	1,066	736	1,639	2,023
52-week Range (Rs)	214/129	Dil. Rec. EPS (Rs)	23.0	7.9	17.7	21.8
Free Float (%)	60.8	% Chg YoY	(33.3)	(65.5)	122.8	23.4
FII (%)	2.2	P/E (x)	8.1	23.6	10.6	8.6
Daily Volume (US\$'000)	713	CEPS (Rs)	34.2	14.1	24.5	29.4
Absolute Return 3m (%)	15.5	EV/EBITDA (x)	4.6	11.9	6.7	5.7
Absolute Return 12m (%)	(11.1)	Dividend Yield (%)	3.2	1.6	1.9	2.1
Sensex Return 3m (%)	2.6	RoCE (%)	19.9	11.7	22.9	23.3
Sensex Return 12m (%)	3.2	RoE (%)	16.4	10.3	20.1	21.0

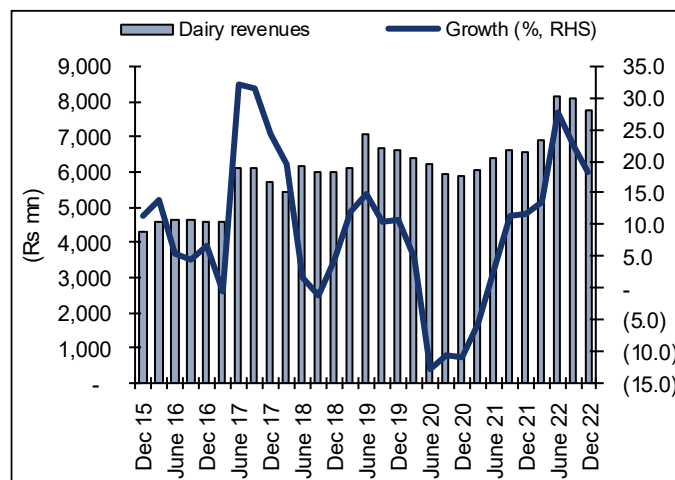
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Table 1: Q3FY23 financial performance*(Rs mn, year ending March 31)*

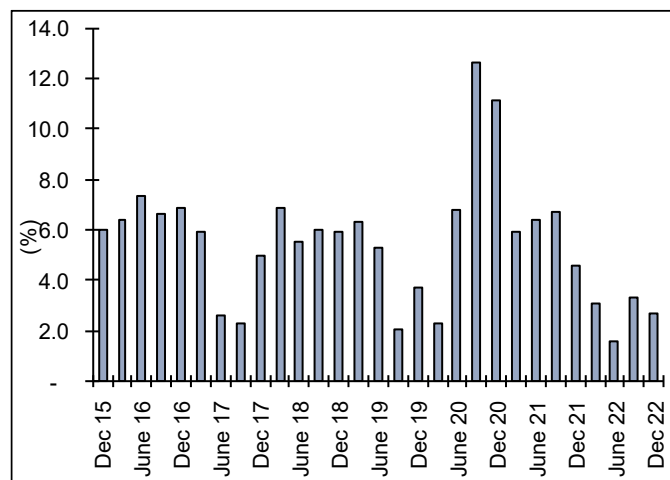
Y/e March	Q3FY23	Q3FY22	YoY gr.	Q2FY23	QoQ gr.
Revenue	7,860	6,670	17.8	8,162	(3.7)
Expenditure					
Raw materials	6,282	5,225	20.2	6,574	(4.4)
% of revenue	79.9	78.3		80.5	
Employee cost	561	484	16.1	528	6.2
% of revenue	7.1	7.3		6.5	
Other expenditure	690	554	24.6	661	4.5
% of revenue	8.8	8.3		8.1	
Total expenditure	7,534	6,263	20.3	7,763	(2.9)
EBITDA	326	408	(20.1)	399	(18.3)
EBITDA margin	4.1	6.1		4.9	
Other income	32	31	2.8	29	8.9
PBDIT	357	438	(18.5)	428	(16.4)
Depreciation	143	129	10.2	138	3.0
PBIT	215	309	(30.5)	289	(25.7)
Interest	5	6	(22.6)	3	40.5
PBT	210	303	(30.7)	286	(26.5)
Prov for tax	53	79	(33.2)	73	(27.4)
% of PBT	25.2	26.1		25.5	
Adjusted PAT	157	224	(29.8)	213	(26.2)
Extra ordinary items	-	(18)	-	-	-
Reported PAT	157	206	(23.6)	213	(26.2)

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

Valuation and risks

We model Heritage to report revenue and PAT CAGRs of 16.2% and 23.8% respectively over FY22-FY25E, and RoE to change from 16.4% in FY22 to 21% in FY25E. We value the stock at a revised target price of Rs220 (earlier TP: Rs380) as per the DCF methodology. We have adjusted the target price for rights issue. At the target price, implied P/E works out to 10x on FY25E EPS. Maintain **BUY**.

Table 2: DCF valuation

Particulars (Rs mn)	Amt (Rs)
Cost of Equity (%)	13.0%
Terminal growth rate (%)	4.0%
Discounted interim cash flows (Rs mn)	10,354
Discounted terminal value (Rs mn)	10,061
Total equity value (Rs mn)	20,415
Value per share (Rs)	220

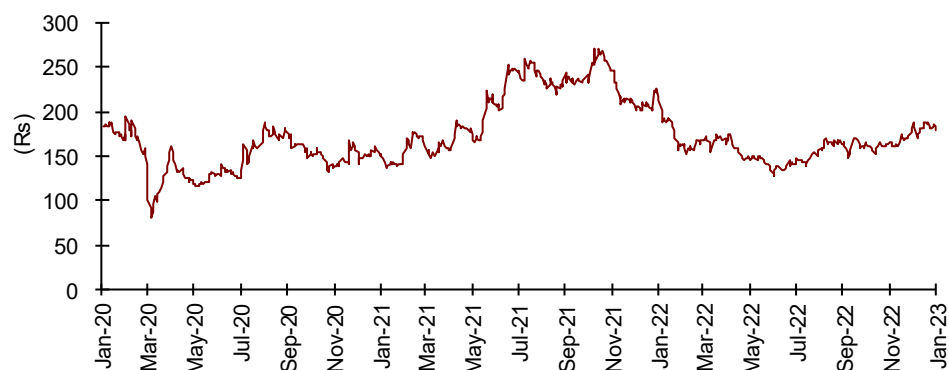
Source: Company data, I-Sec research

Risks

Sharp increase in input prices and/or competition

Any major increase in commodity prices and/or competitive intensity will result in downside to our estimates.

Price chart



Source: Bloomberg

Financial summary

Table 3: Profit & Loss statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Net Sales	26,813	32,582	37,144	42,110
Operating Expenses	24,900	31,116	34,544	39,057
EBITDA	1,913	1,466	2,600	3,053
% margins	7.1	4.5	7.0	7.3
Depreciation & Amortisation	522	576	638	703
Gross Interest	40	42	42	42
Other Income	113	150	285	411
Recurring PBT	1,463	997	2,205	2,718
Less: Taxes	342	251	556	685
Less: Minority Interest	56	10	10	10
Net Income (Reported)	1,066	736	1,639	2,023
Extraordinaries (Net)	(100)	-	-	-
Recurring Net Income	965	736	1,639	2,023

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Assets				
Total Current Assets	2,908	2,655	3,095	3,672
of which cash & cash eqv.	356	359	521	795
Total Current Liabilities & Provisions	1,788	2,769	3,157	3,579
Net Current Assets	1,119	(115)	(63)	93
Investments	289	1,989	2,989	4,189
Net Fixed Assets	5,749	6,053	6,315	6,612
Capital Work-in-Progress	80	-	-	-
Total Assets	7,238	7,927	9,241	10,894
Liabilities				
Borrowings	423	423	423	423
Deferred Tax Liability	239	239	239	239
Minority Interest	0	0	0	0
Equity Share Capital	232	464	464	464
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	6,344	6,801	8,115	9,767
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	6,576	7,265	8,579	10,231
Total Liabilities	7,238	7,927	9,241	10,894

Source: Company data, I-Sec research

Table 5: Quarterly trend

(Rs mn, year ending March 31)

	Mar 22	June 22	Sept 22	Dec 22
Net sales	6,959	8,209	8,162	7,860
% growth (YoY)	12.4	26.7	21.8	17.8
EBITDA	320	239	399	326
Margin (%)	4.6	2.9	4.9	4.1
Other income	25	26	29	32
Extraordinaries (Net)	(21)	(0)	-	-
Net profit	129	73	190	137

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23E	FY24E	FY25E
Operating Cashflow	1,544	1,312	2,277	2,727
Working Capital Changes	(72)	1,237	109	119
Capital Commitments	(417)	(800)	(900)	(1,000)
Free Cashflow	1,056	1,749	1,486	1,846
Cashflow from Investing Activities	(32)	(1,700)	(1,000)	(1,200)
Issue of Share Capital	-	232	-	-
Inc (Dec) in Borrowings	(548)	-	-	-
Dividend paid	(348)	(278)	(325)	(371)
Change in Deferred Tax Liability	-	-	-	-
Chg. in Cash & Bank balance	128	3	162	275

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY22	FY23E	FY24E	FY25E
Per Share Data (Rs)				
EPS	23.0	7.9	17.7	21.8
Cash EPS	34.2	14.1	24.5	29.4
Dividend per share (DPS)	6.0	3.0	3.5	4.0
Book Value per share (BV)	146.9	80.9	95.0	112.8
Growth (%)				
Net Sales	8.4	21.5	14.0	13.4
EBITDA	(29.5)	(23.3)	77.3	17.4
PAT	(33.3)	(31.0)	122.8	23.4
Cash EPS	(22.9)	(17.3)	73.5	19.7
Valuation Ratios (x)				
P/E	8.1	23.6	10.6	8.6
P/CEPS	5.5	13.2	7.6	6.4
P/BV	1.3	2.3	2.0	1.7
EV / EBITDA	4.6	11.9	6.7	5.7
EV / Sales	0.3	0.5	0.5	0.4
Operating Ratios				
Raw Material / Sales (%)	77.7	81.5	79.0	78.8
Employee cost / Sales (%)	6.9	6.5	6.5	6.5
SG&A / Sales (%)	-	0.8	0.8	0.8
Other Income / PBT (%)	7.7	15.0	12.9	15.1
Effective Tax Rate (%)	23.4	25.2	25.2	25.2
Working Capital (days)	2.8	(1.5)	(1.6)	(1.7)
Inventory Turnover (days)	28.0	20.1	20.1	20.1
Receivables (days)	2.5	2.2	2.2	2.2
Payables (days)	23.2	29.2	29.2	29.2
Net D/E (x)	0.0	(0.2)	(0.3)	(0.4)
Profitability Ratios (%)				
Net Income Margins	4.2	2.3	4.4	4.8
RoACE	19.9	11.7	22.9	23.3
RoAE	16.4	10.3	20.1	21.0
Dividend Payout	26.1	37.8	19.8	18.3
Dividend Yield	3.2	1.6	1.9	2.1
EBITDA Margins	7.1	4.5	7.0	7.3

Source: Company data, I-Sec research

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