

HERITAGE FOODS

Volume perks up; margin to be range bound

India Equity Research | Dairy

Heritage Foods' (HFL) Q4FY19 sales jumped 13% (4% ahead of estimate). This was led by volume spurt riding lower competition from unorganised and cooperative players. Value-added dairy products (VADP) grew a healthy ~22% YoY (18% for FY19). EBITDA margin dipped ~72bps leading to 3% EBITDA growth (in line with estimate). With ebbing competition from cooperatives, management expects double digit volume from FY20 (~5% in FY19). However, it has moved the INR60bn sales guidance from 2022 to 2024 (implying 19% sales CAGR) due to prevalent over supply situation. Further, with rising milk prices and 50-75bps incremental cost of growth, management estimates EBITDA margin to be range bound at ~6.5-7.5% over the ensuing three years. Hence, we revise down target multiple to 20x (25x earlier) Q2FY21E EPS. HFL's focus remains on doubling procurement and scaling up VADP from 26% to 40% over FY19–23. We estimate EBITDA CAGR of 29% over FY19–21 and core ROCE at ~29%. Maintain 'BUY' with revised TP of INR558 (INR691 earlier) implying 24% upside.

Sales growth across milk and value-added category

Q4FY19 revenue grew ~13% driven by 10% YoY volume spurt. VADP portfolio jumped ~22% YoY. Gross margin dipped ~54bps YoY and EBITDA margin fell 72bps YoY. FY19 sales grew mere ~4% due to HFL's strategy of slowing procurement on account of rising competition from co-operatives mainly in Tamil Nadu and Maharashtra while value-added sales grew 18% YoY to INR6.2bn. FY19 EBITDA grew ~43% led by 19% spurt in gross profit and declining losses of Reliance Dairy. Adjusted for impairment of Reliance Dairy, margin stood at 7.7%. Expect margin to be in range of 6.5-7.5%

Way ahead: Volume to perk up, but margin to be range bound

HFL perceives green shoots in volume and reduced competitive intensity from co-operatives and unorganised players. However, it has moved the sales guidance of INR60bn from 2022 to 2024. It expects EBITDA margin to remain range bound at ~6.5-7.5% over the next three years led by 50-75bps incremental cost of growth.

Outlook and valuation: Positive; maintain 'BUY'

We believe, HFL's efforts to transition to a VADP player will yield positive results. However, based on range bound margin guidance, we maintain 'BUY' with revised TP of INR558 (20x rolling Q2FY21E EPS plus market value of investment in Future Retail).

Financials

INRmn

Year to March	Q4FY19	Q4FY18	% change	Q3FY19	% change	FY19	FY20E	FY21E
Net rev. (INR mn)	6,350	5,616	13.1	6,188	2.6	25,148	28,716	33,177
EBITDA (INR mn)	456	443	2.8	450	1.4	1,850	2,082	2,419
Adj. PAT (INR mn)	215	206	4.4	189	13.8	828	991	1,177
Adj. Dil. EPS (INR)	4.6	4.4	4.4	4.1	13.8	17.9	21.4	25.4
Diluted P/E (x)						20.2	16.9	14.2
EV/EBITDA (x)						5.5	4.5	3.7
ROAE (%)						10.3	11.5	12.5

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: HEFL.BO, B: HTFL IN)

CMP	: INR 455
Target Price	: INR 558
52-week range (INR)	: 733 / 411
Share in issue (mn)	: 46.4
M cap (INR bn/USD mn)	: 21 / 389
Avg. Daily Vol. BSE/NSE ('000)	: 39.8

SHARE HOLDING PATTERN (%)

	Current	Q3FY19	Q2FY19
Promoters *	39.9	39.9	39.9
MF's, FI's & BKs	10.6	10.6	9.8
FII's	5.9	5.9	5.8
Others	43.5	43.5	44.5
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(6.3)	(13.8)	(7.4)
3 months	0.4	(9.2)	(9.7)
12 months	(11.6)	(36.8)	(25.2)

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Q4FY19 conference call: Key highlights

- Revenue grew ~13% driven by 10% YoY volume growth and 22% spurt in VADP. This is compared to average 4% sales growth in 9mFY19. SMP inventory in the system is dipping.
- The company has revised overall sales guidance to INR60bn by 2024 versus 2022 earlier implying 19% sales CAGR over the next five years.
- Rationalization of milk procurement is mostly done in the quarter as it grew 5.9% YoY in Q4FY19 to an average of 14.02LLPD.
- Competition in liquid milk from unorganised players has reduced with the start of the lean season.
- **Volume green shoots:** According to the management, production has normalised and the carry forward inventory has been liquidated. Therefore, it does not expect dumping from co-operatives and anticipates volume green shoots across states.
- **VADP sales remain healthy:** The VADP portfolio sustained healthy growth—grew ~22% YoY in Q4FY19. FY19 VADP sales grew 18% to INR6,2bn primarily driven by curd sales. VADP contributed ~25% to FY19 dairy revenue. Going forward, management expects this segment to continue to grow 25% YoY.
- HFL introduced two new lassi variants—Ragi and Sabja. The company expects the yogurt processing facility in Mumbai to be commissioned within 1.5 months and sales to begin from end of current financial year.
- **Fat products:** HFL incurred EBITDA loss margin of 10.3% for the quarter. For FY19 it posted 16% EBITDA margin loss. Further, FAT product sales declined 12.78% for full year.
- Gross profit margin dipped ~54bps YoY to 21.9% on delay in pass-through of higher procurement prices (up 1% QoQ) with realisation being flat QoQ. Consequently, EBITDA margin dipped ~72bps leading to EBITDA growth of 3% YoY (in line with our estimate). For FY19, EBITDA grew ~43% (EBIDTA margin up 188bps YoY) led by 19% increase in gross profit (gross margin up 243bps YoY) and declining losses of Reliance Dairy. HFL has recognised impairment loss worth INR35mn for Reliance Dairy business. Adjusted for this impairment, margin stood at 7.7% and 7.5% in Q4FY19 and FY19, respectively. Management has guided for impairment worth INR10mn in FY20.
- **Margin guidance:** Management expects EBITDA margin at ~6.5-7.5% over the next three years led by 50-75bps incremental cost of growth. Further, according to management, capacity utilisation will take around two years to scale up.
- **Capex:** In FY19, HFL incurred capex of INR1,030mn for the dairy division and INR254mn for the Nutrivet division. Management has guided for capex of INR1.1-1.2bn annually over the ensuing four years.
- Current capacity stands at 19.5lac liters. HFL expects to cross 30-35lac liters in the next five years.

Financial snapshot

(INR mn)

Year to March	Q4FY19	Q4FY18	% change	Q3FY19	% change	FY19	FY20E	FY21E
Net revenues	6,350	5,616	13.1	6,188	2.6	25,148	28,716	33,177
Raw material	4,960	4,356	13.9	4,871	1.8	19,730	22,450	26,036
Staff costs	330	303	8.8	366	(9.9)	1,418	1,608	1,848
Other expenses	605	514	17.7	501	20.6	2,149	2,575	2,874
Total expenditure	5,894	5,173	13.9	5,738	2.7	23,297	26,633	30,758
EBITDA	456	443	2.8	450	1.4	1,850	2,082	2,419
Depreciation	113	103	9.8	114	(0.7)	447	524	602
EBIT	343	340	0.7	335	2.1	1,404	1,559	1,816
Interest	63	56	13.7	50	26.3	215	169	155
Other income	32	33	(5.2)	21	47.4	90	89	94
Profit before tax	311	318	(2.2)	307	1.3	1,279	1,479	1,756
Provision for taxes	108	118	(8.7)	103	4.6	447	488	579
Minority interest	(14)	(8)	NA	13	NA	-	-	-
Associate profit share	(2)	(1)	NA	(1)	NA	-	-	-
Reported net profit	215	206	4.4	189	13.8	832	991	1,177
Adjusted Profit	215	206	4.4	189	13.8	828	991	1,177
Diluted shares (mn)	46	46		46		46	46	46
Adjusted Diluted EPS	4.6	4.4	4.4	4.1	13.8	17.9	21.4	25.4
Diluted P/E (x)	-	-		-		20.2	16.9	14.2
EV/EBITDA (x)	-	-		-		5.5	4.5	3.7
ROAE (%)	-	-		-		10.3	11.5	12.5

As % of net revenues

Raw material	78.1	77.6		78.7		78.5	78.2	78.5
Employee cost	5.2	5.4		5.9		5.6	5.6	5.6
Other expenses	9.5	9.1		8.1		8.5	9.0	8.7
EBITDA	7.2	7.9		7.3		7.4	7.3	7.3
Reported net profit	3.4	3.7		3.1		3.3	3.5	3.5

Change in Estimates

	FY20E			FY21E			Comments
	New	Old	% change	New	Old	% change	
Net Revenue	28,716	28,484	0.8	33,177	32,742	1.3	
EBITDA	2,082	2,181	(4.5)	2,419	2,523	(4.1)	
EBITDA Margin	7.3	7.7		7.3	7.7		
Adjusted Profit After Tax	991	1,070	(7.4)	1,176	1,260	(6.6)	Lower margin and other income
Net Profit Margin	3.5	3.8		3.5	3.8		
Capex	1,100	1,000	10.0	1,200	1,200	0.0	

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 FY17 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, is diversifying into VADP. It has set a strong target of INR60bn of sales with procurement of ~2.8 mn litres per day in 5 years. It is focussing on deepening penetration in current markets and expanding reach in new geographies by inorganic acquisition. It is prudently straddling the high RoCE pouch milk segment and high-growth & margin curd, yogurt and ice-cream segments to attain its target. Targeting large categories like curd (INR288bn) with organised penetration at mere 6% and high margin segments like ice-cream are envisaged to spur Heritage's growth and margin.

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 or private players, either in form of procurement (by increasing prices to farmers) or selling price (via lower prices), can impact Heritage's performance.

Financial Statements

Key Assumptions

Year to March	FY18	FY19	FY20E	FY21E
Macro				
GDP(Y-o-Y %)	6.7	7.3	7.6	7.6
Inflation (Avg)	3.6	4.5	4.5	4.5
Repo rate (exit rate)	6.0	6.8	6.8	6.8
USD/INR (Avg)	64.5	70.0	72.0	72.0
Company				
Procurement price (INR/litre)	34.0	32.4	33.9	35.3
Procurement price increase (%)	4.7	(4.9)	4.8	4.0
Procurement (mn litres/day)	1.3	1.4	1.6	1.8
Growth (%)	25.4	9.5	11.7	12.2
Sales growth (%)				
Manufactured				
Milk (%)	27.7	5.5	12.2	14.3
Curd (%)	23.7	18.4	19.8	18.3
Ice Cream (%)	23.2	14.5	16.7	23.4
Paneer (%)	28.0	18.0	18.0	18.0
Flavoured Milk (%)	28.0	15.0	17.0	18.0
Butter milk (%)	25	15	25	25
Sweets (%)	25.0	15.0	15.0	15.0
Others (%)	25.0	15.0	25.0	25.0
Vetca (%)	10.0	10.0	10.0	10.0
Traded (%)	(83.2)	12.3	10.5	14.1
Revenue Share (%)				
Milk (% of Sales)	63.0	62.7	61.6	61.0
Curd (% of sales)	17.0	19.0	19.9	20.4
Other Value Added Products (% of Sales)	3.4	3.7	3.9	4.0
Fat Products (% of Sales)	8.5	6.6	6.6	6.6
SMP (% of Sales)	0.5	-	-	-
Traded (% of Sales)	5.8	6.1	5.9	5.8
Interest (% of total borrowings) (Assumptions)	7.4	8.2	7.0	7.0

Income statement

(INR mn)

Year to March	FY18	FY19	FY20E	FY21E
Net revenue	23,731	25,148	28,716	33,177
Materials costs	19,194	19,730	22,450	26,036
Employee costs	1,241	1,418	1,608	1,848
Other Expenses	1,995	2,149	2,575	2,874
Total operating expenses	22,430	23,297	26,633	30,758
EBITDA	1,301	1,850	2,082	2,419
Depreciation	364	447	524	602
EBIT	937	1,404	1,559	1,816
Less: Interest Expense	182	215	169	155
Add: Other income	76.73	90.17	89.17	94.49
Profit Before Tax	915	1,277	1,479	1,756
Less: Provision for Tax	271	447	488	579
Less: Minority Interest	(1)	-	-	-
Add: Exceptional items	83	(3)	-	-
Associate profit share	(1)	(4)	-	-
Reported Profit	643	826	991	1,177
Exceptional Items	83	(3)	-	-
Adjusted Profit	560	828	991	1,177
Shares o/s (mn)	46	46	46	46
Adjusted Basic EPS	12.1	17.9	21.4	25.4
Diluted shares o/s (mn)	46	46	46	46
Adjusted Diluted EPS	12.1	17.9	21.4	25.4
Adjusted Cash EPS	19.9	27.5	32.6	38.3
Dividend per share (DPS)	4.0	2.0	8.0	8.0
Dividend Payout Ratio(%)	33.1	11.2	37.5	31.5

Common size metrics

Year to March	FY18	FY19	FY20E	FY21E
Gross margin	19.1	21.5	21.8	21.5
Depreciation	1.5	1.8	1.8	1.8
Interest Expense	0.8	0.9	0.6	0.5
EBITDA margins	5.5	7.4	7.3	7.3
Net Profit margins	2.4	3.3	3.5	3.5

Growth ratios (%)

Year to March	FY18	FY19	FY20E	FY21E
Revenues	27.8	6.0	14.2	15.5
EBITDA	(1.2)	42.3	12.5	16.1
PBT	(70.4)	39.6	15.8	18.7
Adjusted Profit	(16.3)	47.9	19.6	18.7
EPS	(16.3)	47.9	19.6	18.7

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19	FY20E	FY21E	
Share capital	232	232	232	232	
Reserves & Surplus	7,545	7,794	8,682	9,450	
Shareholders' funds	7,777	8,026	8,914	9,682	
Minority Interest	106	117	117	117	
Long term borrowings	1,423	1,666	1,466	1,266	
Short term borrowings	1,041	946	946	946	
Total Borrowings	2,464	2,612	2,412	2,212	
Long Term Liabilities	186	263	263	263	
Def. Tax Liability (net)	4,316	3,017	3,168	3,327	
Sources of funds	14,849	14,035	14,874	15,600	
Gross Block	6,465	6,897	7,997	9,197	
Net Block	4,146	4,647	5,223	5,821	
Capital work in progress	185	109	109	109	
Intangible Assets	87	418	418	418	
Total net fixed assets	4,418	5,174	5,750	6,347	
Non current investments	10,017	8,350	8,350	8,350	
Cash and Equivalents	688	747	1,423	1,660	
Inventories	1,547	1,384	1,230	1,427	
Sundry Debtors	129	424	236	273	
Loans & Advances	85	70	73	78	
Other Current Assets	181	197	221	251	
Current Assets (ex cash)	1,943	2,074	1,761	2,028	
Trade payable	670	686	554	642	
Other Current Liab	1,548	1,625	1,855	2,143	
Total Current Liab	2,218	2,310	2,409	2,785	
Net Curr Assets-ex cash	(275)	(236)	(648)	(757)	
Uses of funds	14,849	14,035	14,874	15,600	
BVPS (INR)	169.9	175.5	194.6	211.2	

Free cash flow		(INR mn)			
Year to March	FY18	FY19	FY20E	FY21E	
Reported Profit	643	826	991	1,177	
Add: Depreciation	364	447	524	602	
Interest (Net of Tax)	128	140	113	104	
Others	(64)	82	56	51	
Less: Changes in WC	(3,827)	1,337	(563)	(267)	
Operating cash flow	4,898	157	2,246	2,201	
Less: Capex	2,216	686	1,100	1,200	
Free Cash Flow	2,682	(530)	1,146	1,001	

Peer comparison valuation

Name	Market cap (USD mn)	Core EV/EBITDA (X)		Diluted P/E (X)		EV / EBITDA (X)	
		FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Heritage Foods Limited	21,104,100	-	-	21.3	17.9	10.7	9.0
Parag Milk Foods Limited	20,984,583	-	-	16.1	13.5	8.7	7.3
Prabhat Dairy Ltd	6,724,999	-	-	8.4	-	4.2	-
Median	-	-	-	16.1	17.9	8.7	9.0
AVERAGE	-	-	-	15.3	15.7	7.8	8.2

Source: Edelweiss research

Cash flow metrics		FY18	FY19	FY20E	FY21E
Year to March					
Operating cash flow		4,898	157	2,246	2,201
Financing cash flow		(7,441)	981	(1,100)	(1,200)
Investing cash flow		681	(272)	(471)	(764)
Net cash Flow		(1,861)	865	675	237
Capex		(2,216)	(686)	(1,100)	(1,200)
Dividend paid		(204)	(204)	(102)	(409)

Profitability and efficiency ratios

Year to March	FY18	FY19	FY20E	FY21E
ROAE (%)	8.0	10.3	11.5	12.5
ROACE (%)	11.4	14.2	14.8	16.3
Inventory Days	26	27	21	19
Adjusted RoCE (%)	13.6	19.0	19.3	21.0
Debtors Days	2	4	4	3
Payable Days	12	13	10	8
Cash Conversion Cycle	16	19	15	13
Current Ratio	1.2	1.2	1.3	1.3
Debt/EBITDA (x)	1.9	1.4	1.2	0.9
Debt/Equity (x)	0.3	0.3	0.3	0.2
Adjusted Debt/Equity	0.3	0.3	0.3	0.2
Interest Coverage Ratio	5.1	6.5	9.2	11.7

Operating ratios

Year to March	FY18	FY19	FY20E	FY21E
Total Asset Turnover	2.1	1.7	2.0	2.2
Fixed Asset Turnover	6.5	5.5	5.7	5.9
Equity Turnover	3.4	3.1	3.3	3.5

Valuation parameters

Year to March	FY18	FY19	FY20E	FY21E
Adj. Diluted EPS (INR)	12.1	17.9	21.4	25.4
Y-o-Y growth (%)	(16.3)	47.9	19.6	18.7
Adjusted Cash EPS (INR)	19.9	27.5	32.6	38.3
Diluted P/E (x)	37.7	25.5	21.3	17.9
P/B (x)	2.7	2.6	2.3	2.2
EV / Sales (x)	0.4	0.4	0.3	0.3
EV / EBITDA (x)	17.7	12.5	10.7	9.0
Dividend Yield (%)	0.9	0.4	1.8	1.8

Additional Data

Directors Data

Mrs. N Bhuvanewari	Vice Chairperson and Managing Director	Mrs. N Brahmani	Executive Director
Mr. D. Seetharamaiah	Non Executive Independent Chairperson	Mr. N Sri Vishnu Raju	Non Executive Independent Director
Mr. Rajesh Thakur Ahuja	Non Executive Independent Director	Dr. V Nagaraja Naidu	Non Executive Director

Auditors - Walker Chandiok & Co LLP

**as per last available data*

Holding – Top10

	Perc. Holding		Perc. Holding
Nirvana Holdings	11.09	Tata Asset Management	0.88
Megabid Finance	5.28	Invesco Asset Management	0.83
Sundaram Asset Management	3.90	Kotak Mahindra Life Insurance	0.43
Kotak Mahindra Asset Management	1.28	BOI AXA Investment Managers	0.41
Kedia Securities	1.01	Union Mutual Fund	0.37

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Dairy

Heritage Foods Limited, Parag Milk Foods Limited, Prabhat Dairy Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
13-May-19	Parag Milk Foods	Balance sheet strengthens; <i>Result Update</i>	234	Buy
04-Feb-19	Parag Milk Foods	Value-added driven growth sustains; <i>Result Update</i>	205	Buy
01-Feb-19	Heritage Foods	Volume perks up; green shoots visible; <i>Result Update</i>	495	Buy

Distribution of Ratings / Market Cap

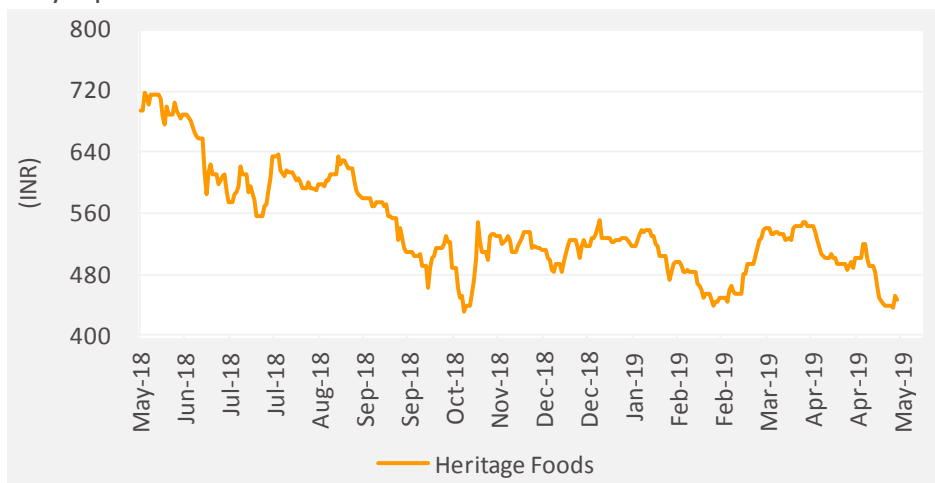
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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