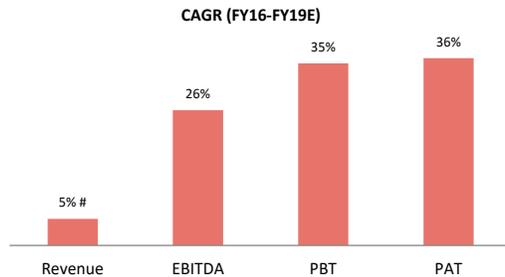


February 14, 2017

Result Update

Dairy Sector Outlook - Positive



Due to sale of retail & other business

Stock Recommendation	Buy
CMP (₹)	1127
Price Target (₹)	1350
Upside	20%
52 Week H / L (₹)	1174/467
BSE 30	28339

Key Data

No. of Shares, Mn.	23.2
Mcap, ₹ Mn	26135
Mcap USD Mn @₹68	384
2 W Avg Qty, (BSE+NSE)	69674

Shareholding, Dec'16

Promoters	39.9
FII	6.4
DII	6.3
Public & Others	47.4

Performance	1 M	3 M	6 M	12 M
Stock Return %	33.2	34.8	82.0	150.5
Relative Return %	28.4	31.5	80.5	124.4



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Topline Growth has been marginally above expectation: Heritage Foods has reported topline of ₹6.67bn (+14.5% YoY, +4% QoQ) during Q3FY17 which is slightly above our expectation of ₹6.60bn. Muted growth in Dairy segment (₹4.6bn, +6.8% YoY, -0.5% QoQ) was more than offset by better than expected growth in retail segment (₹2.05bn, +41.7% YoY, +17.2% QoQ). 12.2% Y/Y degrowth in Milk procurement (1.06mn Litres/ day) has been key reason behind muted Dairy growth while ban on high denomination currency notes has prompted higher than expected retail division sales growth. 9MFY17 sales was up 11% to ₹19.42bn with Retail growing 31% (₹5.48bn) while Dairy grew at muted 5.6% (₹13.82 bn).

EBITDA margin expanded due to positive impact of operating leverage: Due to better than expected sales growth in Retail division, its quarterly EBITDA turned positive at ₹11mn (0.5%) vs -₹21.0mn during Q3FY16. Dairy segment EBITDA margin came at 8% during Q3FY17 vs 7.2% in Q3FY16 due to reduced Fat losses. As a combined impact of the same, consolidated EBITDA margin during the quarter expanded by 70bps YoY (QoQ as well) to 5.8%. EBITDA for the quarter came at ₹387mn (+29.2% YoY, +17.4% QoQ). On 9 m basis EBITDA was up 15% to ₹1.05bn while EBITDA margin was up 20bps YoY to 5.52%.

Lower Finance Cost and Tax further boosted Net profit: Finance cost during the quarter was down 25% YoY to ₹24.45mn while Tax rate was down 352bps YoY to 28.2%. As a result PAT for the quarter was up 40% YoY, +26% QoQ to ₹198mn. Net Margin for the quarter was up 60bps YoY to 3.0%. On 9M basis, PAT was up 29.7% YoY to ₹521mn while NPM expanded by 40bps YoY to 2.7%.

Buy with price target of ₹1350:

Looking at the upwards revision in Earnings and superior return ratios post disposal of Retail and associated businesses, we have revised valuation multiple for Dairy business and valued it at 11x FY19 EBITDA while locked-in investment in Future Retail has been valued at ₹2360mn, @ 20% discount to deal valuation of ₹2950mn. This way we get fair value of company's equity at ₹1350/ share. At the targeted fair price of ₹1350, stock is valued at 26.9x FY18 projected EPS and 22.2x FY19 projected EPS and offers upside potential of 20%.

Financials	Revenues	EBIDTA	PAT	EPS	P/E	EV/EBIDTA	ROAE
	₹ Mn	Mn Mn	₹ Mn	₹	x	x	%
FY15	20730	821	284	12.3	92.0	17.2	15.3
FY16	23793	1295	556	24.0	47.0	20.7	25.8
FY17	26739	1687	760	32.8	34.4	15.9	28.0
FY18E	24074	2182	1163	50.1	22.5	12.3	40.1*
FY19E	27677	2607	1411	60.8	18.5	10.2	29.0*

Source: Company, Sunidhi Research

*Ex investment value of Rs2950mn in FRL

**Conference Call Highlight:**

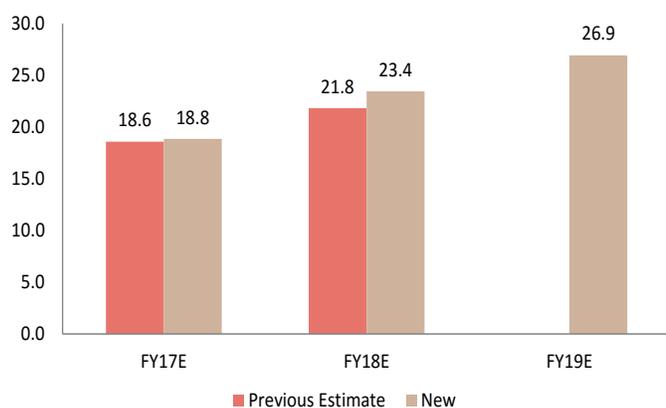
Dairy segment performed well in spite of muted volume growth: Liquid Milk sourcing during the quarter was down 12.2% YoY to 1.06mn Litres per day as a result of conscious decision taken by management. This has resulted into muted YoY topline growth of 6.8% for Dairy segment during the quarter (₹4.60bn) while growth is 5.6% for 9mFY17 (₹ 13.8bn). In spite of muted topline growth in dairy segment, EBITDA during the quarter was up 20% YoY to ₹ 369mn and EBITDA margin expanded by 80bps to 8.00%. On 9 M basis, Dairy segment EBITDA margin expanded by 40bps YoY to 8.15% while EBITDA was up 11.1% to ₹ 1.13bn. Reduced losses in Fats division has been key reason behind margin boost. EBITDA margin for Fats segment during the quarter came at -3.44% against -15% for Q3FY16.

Price hike should help expand margin: Milk procurement price has gone up ₹ 1.60/ litre on YoY basis (₹ 32.6/Litre) while milk sales price has gone up by ₹ 0.90/ litre only (₹ 37.3/ Litre). On sequential basis Milk procurement price went up by ₹ 0.90/ Litre against sales price increase of just ₹ 0.10/ Litre. This has led to spread contracting to ₹ 4.6/Litre during the quarter against ₹ 5.5/litre in Q2FY17 and ₹ 5.4/ Litre during Q3FY16. Management has decided to increase milk prices by ₹ 2/ Litre and curd prices by ₹ 4/kg from February 1, 2017. This price increase will provide much needed boost for Dairy division and full year FY17 liquid milk spread would go to ₹ 5.3/ litre while for FY18, it should move to ₹ 5.6/ Litre. Improvement in Liquid Milk spread along with increasing proportion of VADP should lead to Dairy segment margin enhancement in FY18E and FY19E to 9.0% and 9.4% respectively against 8.6% in FY17E.

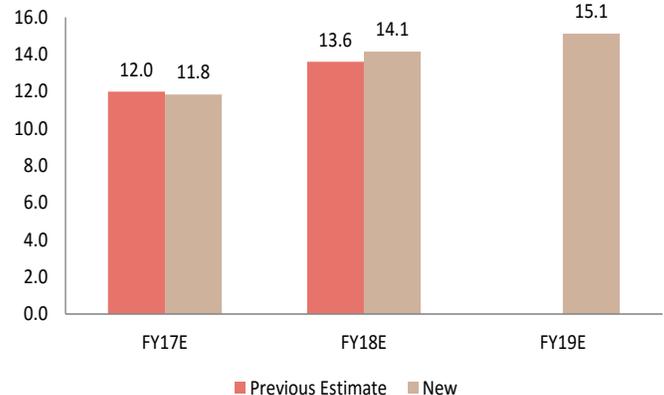
Business reorganization to be completed by April 2017: Company is in the process of integration of Reliance Dairy business with itself. Matter is pending for CCI approval which the company expects to get by March –April 2017. Similarly, Merger of Company's Retail, Agri and Bakery divisions with Future Retail Ltd is pending for NCLT (National Company Law Tribunal) approval. Company expects to get the necessary approval by end of March 2017. Successful reorganization of business will have dual benefit for the company. Due to hiving-off of loss making Retail, Agri and Bakery division, Its consolidated EBITDA margin should expand from FY18 onwards while integration of Reliance Dairy should add another 2.5LLPD (Lac Litres per day) milk procurement capacity to the existing 10.6LLPD of the company. " Dairy Pure " and "Dairy Life", erstwhile brands of Reliance Dairy will also come in company's fold and it will get shelf space at Reliance Retail Outlets for its existing brands as well. Thus, company will get synergy benefits in 4 states (Telangana, Karnataka, Tamilnadu and Maharashtra) while getting access to procurement networks in newer states like UP, Punjab, Rajasthan, Haryana , Delhi & M.P. Company intends to rationalize procurement in M.P where cost benefit is not in its favour.

JV with European Players still work in progress: Company has been in negotiation with Couple of European players for new Products under Value Added Category. Management has indicated that it might take another couple of quarters before something concrete can be divulged.

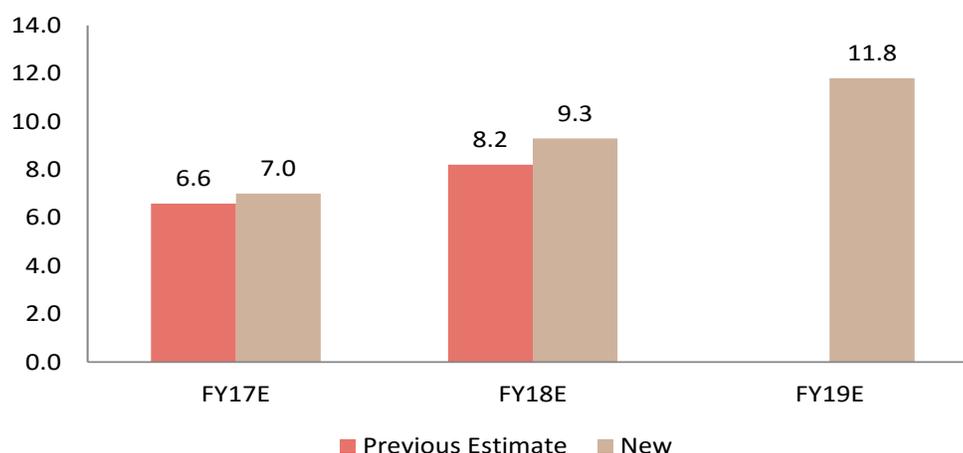
Change in Estimate: Based on 9MFy17 performance of the company and announcements made by the management, our projection for FY18 has two inherent assumptions-1) Retail, Agri and Bakery division merger with Future Retail is effected from March 31, 2017 and hence not part of Heritage Foods consolidated revenue and 2) Reliance Dairy with close to 1.75 LLPD (adjusting for procurement rationalization) milk sourcing is part of Heritage Foods Ltd from April 1, 2017.

**Change in Estimates Dairy (₹ Bn)**

Source: Company, Sunidhi Research

Change in Estimates-Liquid Milk (₹ Bn)

Source: Company, Sunidhi Research

Change in Estimates – VADP & Others (₹ Bn)

Source: Company, Sunidhi Research

Change in Estimates:

₹ mn	FY17			FY18			FY19
	Previous	Revised	Change	Previous	Revised*	Change	New
Revenue	25,921	26,739	3.2%	31,327	24,074	-23.2%	27,676.64
EBITDA	1,620	1,687	4.1%	2,077	2,182	5.1%	2,607.50
PAT	723	760	5.2%	979	1,163	18.8%	1,410.51

Source: Company, Sunidhi Research *Adjusting for sale of retail & other business and integration of Reliance Dairy

Buy with Price Target of ₹1350:

Looking at the upwards revision in Earnings and superior return ratios post disposal of Retail and associated businesses, we have revised valuation multiple for Dairy business and valued it at 11x FY19 EBITDA while locked-in investment in Future Retail has been valued at ₹2360mn, @ 20% discount to deal valuation of ₹2950mn. This way we get fair value of company's equity at ₹1350/ share. At the targeted fair price of ₹1350, stock is valued at 26.9x FY18 projected EPS and 22.2x FY19 projected EPS and offers upside potential of 20%.

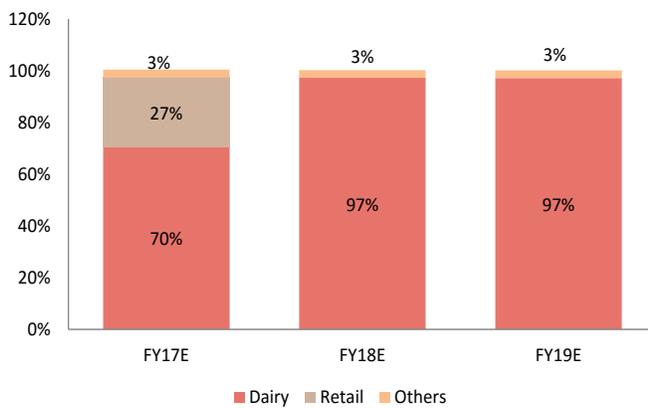


	FY19E EBITDA	Multiplier	Enterprise Value (₹ mn)
Dairy	2607.50	11	28682.5
Retail & Others			2359.5
Gross			31042.0
Gross Debt			828.75
Cash & Short term Investment			555.91
Market Cap			31314.9
No of shares			23.2
Value per share(₹)			1,350.0

Source: Company, Sunidhi Research

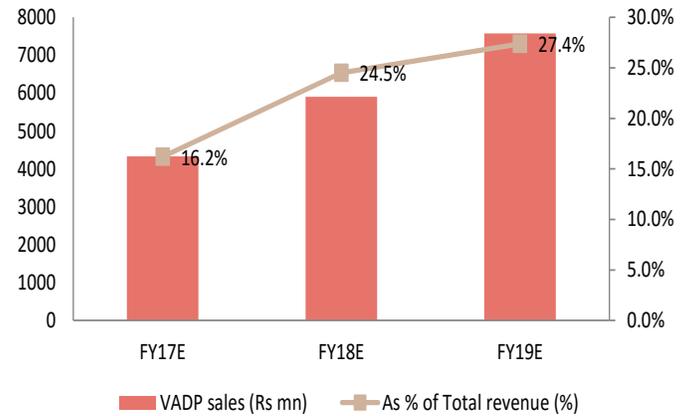
Business Performance Analysis: Annual

Trend of Revenue Mix (%)



Source: Company, Sunidhi Research

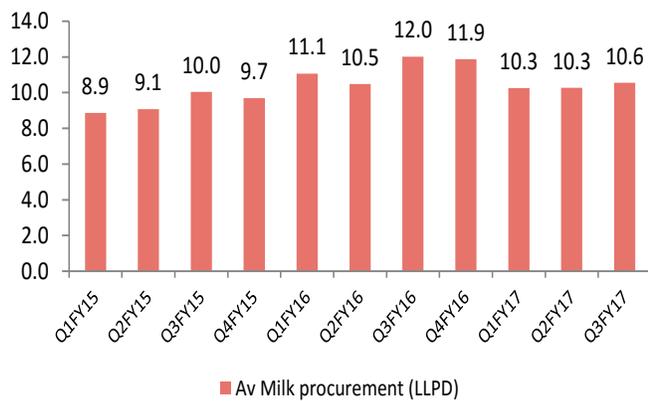
VADP as % Net Sales



Source: Company, Sunidhi Research

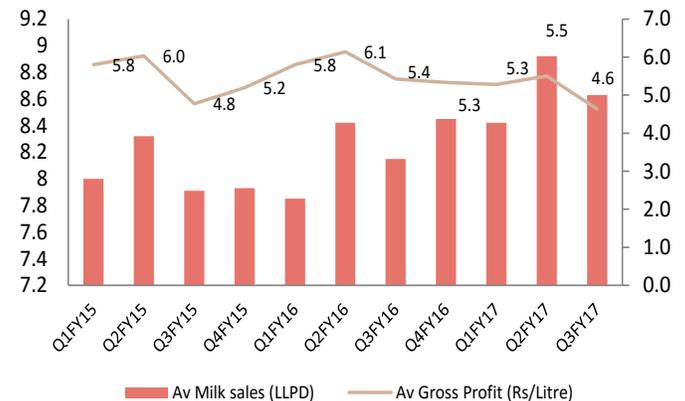
Business Performance Analysis: Quarterly

Av Milk procurement (LLPD)



Source: Company, Sunidhi Research

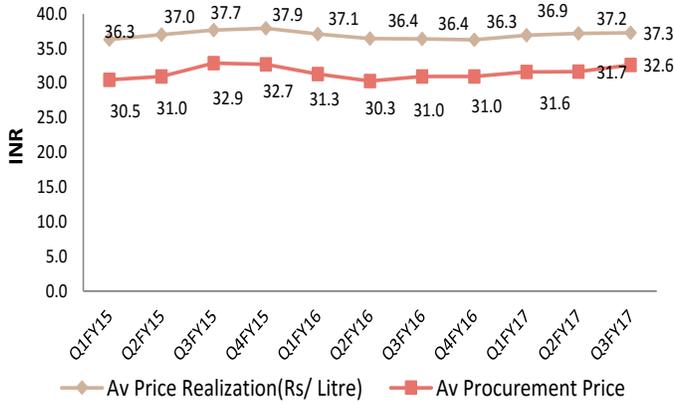
Liquid Milk-Av sales vol vs Av Gross profit



Source: Company, Sunidhi Research

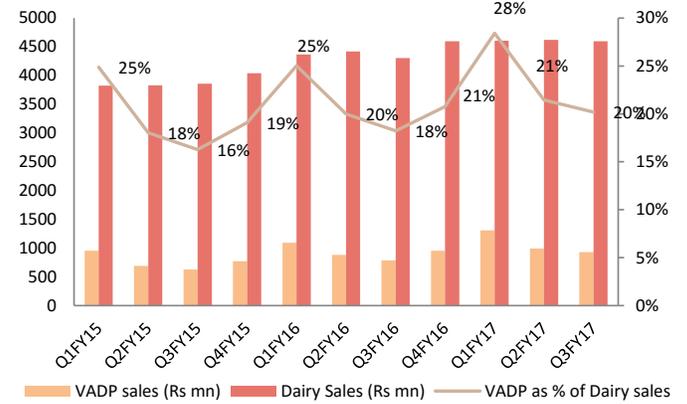


Liquid Milk- Av Realization & Cost trend



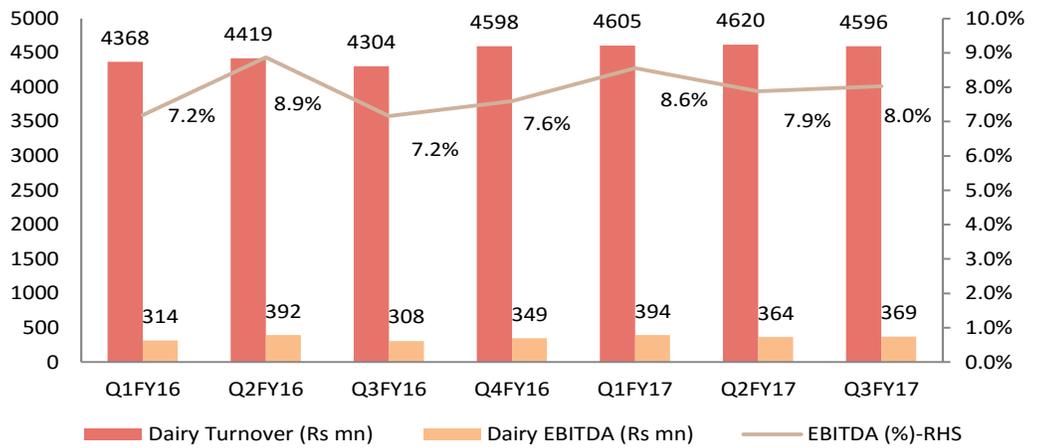
Source: Company, Sunidhi Research

VADP sales -Quarterly Trend



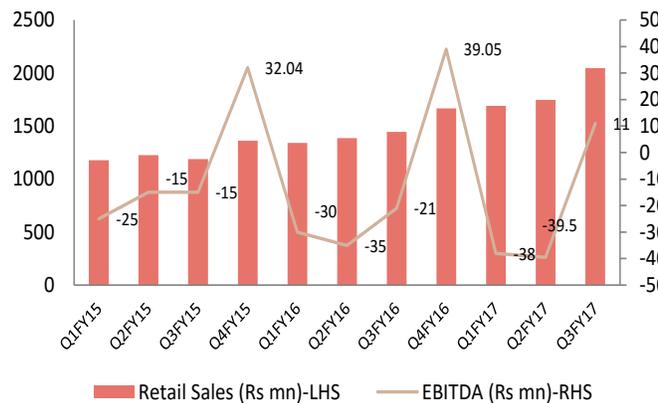
Source: Company, Sunidhi Research

Dairy – Sales & EBITDA trend



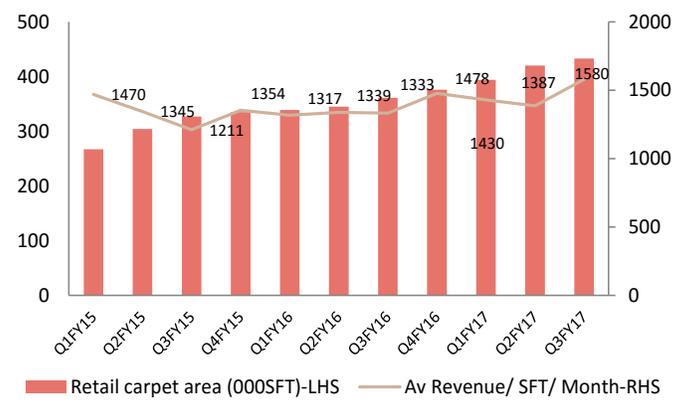
Source: Company, Sunidhi Research

Retail Business- Sales & profitability



Source: Company, Sunidhi Research

Retail Carpet area and Av Revenue



Source: Company, Sunidhi Research



Valuations Summary

Year End-March	FY 15	FY 16	FY 17E	FY 18E	FY19E
Per share (₹)					
Adj. EPS	12.3	24.0	32.8	50.1	60.8
CEPS	26.9	38.8	50.7	63.6	76.5
Adj BVPS	83.2	102.9	131.4	245.6	300.4
DPS(Adj)	3.0	3.0	3.5	4.0	5.0
Payout (%)	24.5%	12.5%	10.7%	8.0%	8.2%
Valuation (x)					
P/E	92.0	47.0	34.4	22.5	18.5
P/BV	13.5	11.0	8.6	4.6	3.8
EV/EBITDA	17.2	20.7	15.9	12.3	10.2
Dividend Yield (%)	0.3%	0.3%	0.3%	0.4%	0.4%
Return ratio (%)					
EBITDA Margin	4.0%	5.4%	6.3%	9.1%	9.4%
PAT Margin	1.4%	2.3%	2.8%	4.8%	5.1%
ROAE	15.3%	25.8%	28.0%	40.1%*	29.0%
ROACE	20.9%	32.9%	35.1%	49.6%*	39.9%
Leverage Ratios (x)					
Gross D/E	0.7	0.4	0.4	0.2	0.1
Net Debt/Equity	0.5	0.3	0.2	0.1	0.1
Interest Coverage	3.5	6.6	8.0	11.7	16.4
Current ratio	0.9	1.0	1.0	1.0	1.1
Growth Ratios (%)					
Income growth	20.4%	14.8%	12.4%	-10.0%	15.0%
EBITDA growth	-13.5%	57.7%	30.3%	29.3%	19.5%
PAT growth	-38%	96%	37%	53%	21%
Turnover Ratios					
Gross F.A Turnover x	4.4	4.4	4.2	3.8	3.8
Inventory Days	24.5	22.2	24.7	27.5	27.5
Debtors Days	4.3	4.4	5.5	6.1	6.4
Payable days	13.7	13.0	12.9	13.7	13.3
Net WC as %of sales	0.6%	-0.5%	0.4%	0.5%	1.5%
Income Statement(₹ mn)					
Year End-March	FY 15	FY 16	FY 17E	FY 18E	FY19E
Revenues	20730	23793	26739	24074	27677
Op. Expenses	19909	22498	25052	21892	25069
EBITDA	821	1295	1687	2182	2607
Other Income	72	65	44	57	32
Depreciation	340	344	415	313	363
EBIT	553	1016	1316	1926	2276
Interest	159	155	164	164	139
PBT	394	861	1151	1762	2137
Tax	109	306	391	599	727
Adj. PAT	284	556	760	1163	1411
Minority	0	0	0	0	0
Sh. of Associates	0	0	0	0	0
Ex. ordinary	0	14	0	0	0
Reported PAT	284	542	760	1163	1411

Source: Company, Sunidhi Research

*Ex investment value of Rs 2950mn in FRL

Balance Sheet (₹ mn)

Year End-March	FY 15	FY 16	FY 17E	FY 18E	FY19E
Equity and Liabilities					
Share Capital	232.0	232.0	232.0	232.0	232.0
Reserves and Surplus	1698	2155	2817	5467	6737
Total Shareholders' funds	1930	2387	3049	5699	6969
Minority Interest	0.2	0.2	0.2	0.2	0.2
Non-Current Liability	861	1005	1058	915	774
Long Term Borrowings	557	658	697	538	379
Deferred Tax Liabilities (Net)	188	187	185	184	183
Long Term Liab/ Provisions	116	160	176	193	213
Current Liabilities	2467	2344	2614	2665	2887
Short Term Borrowings	867	393	400	450	450
Trade Payables	775	847	948	901	1009
other CL/Short Term Prov.	824	1105	1265	1314	1428
Grand Total	5258	5737	6721	9279	10630
Assets					
Gross fixed Asset	4623.4	5303.4	6303.4	6363.4	7363.4
Net Fixed Assets	2807	3143	3727	3458	4077
CWIP	90	62	0	0	0
Long term Loan and Adv.	208.5	237.2	263.0	291.7	323.6
non-Current Investments/assets	15.4	14.8	13.8	2964.7	2966.4
Current Assets	2137	2280	2717	2565	3263
Inventories	1394	1449	1811	1811	2083
Trade Receivables	242	288	402	403	483
Cash and Cash Equivalents	407.8	453.3	399.2	227.4	405.9
Short Term Loans & Adv.	78	68	78	90	104
Other Current Assets	15.8	22.2	26.5	33.2	188.0
Grand Total	5258	5737	6721	9279	10630
Cash flow Statement					
Year End-March	FY 15	FY 16	FY 17E	FY 18E	FY19E
PBT	394	861	1151	1762	2137
Depreciation	340	344	415	313	363
Interest (Net)					
Others	-13	-15	23	0	27
CF before W.cap	876	1346	1754	2239	2666
Inc/dec in W.cap	-254	270	-240	-29	-164
Op CF after W.cap	622	1616	1514	2210	2502
Less Taxes	-98	-306	-391	-599	-727
Net CF From Operations	524	1310	1123	1611	1776
(Inc)/dec in F.A + CWIP	-479	-652	-938	-1410	-1000
(Pur)/sale of Investments	0	0	2	-1	-148
others	5	0	7	0	0
CF from Invst Activities	-475	-652	-928	-1411	-1148
Loan Raised/(repaid)	143	-374	0	-110	-198
Interest Paid	-159	-155	-164	-164	-139
Dividend	-80	-84	-84	-98	-112
Equity raised	0	0	0	0	0
CF from Fin Activities	-97	-612	-248	-372	-449
Net inc /(dec) in cash	-48	47	-54	-172	178
Op. bal of cash	438	408	453	399	227
Other bank balance	18	-1	0	0	0
Cl. balance of cash	408	453	399	227	406



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(For Mid & Small cap stocks from 12 months perspective)

BUY	Absolute Return >20%
HOLD	Absolute Return Between 0-20%
SELL	Absolute Return Negative

Apart from Absolute returns our rating for a stock would also include subjective factors like macro environment, outlook of the industry in which the company is operating, growth expectations from the company vis a vis its peers, scope for P/E re-rating/de-rating for the broader market and the company in specific.

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