

Dairy

Target price: Rs380

Earnings revision

(%)	FY23E	FY24E
Sales	↑ 1.6	↑ 1.6
EBITDA	↓ 14.7	↓ 5.2
EPS	↓ 20.2	↓ 7.3

Target price revision

Rs380 from Rs400

Shareholding pattern

	Mar '22	Jun '22	Sep '22
Promoters	39.4	39.4	39.4
Institutional investors	17.5	16.7	17.8
MFs and other	15.8	14.5	15.4
Banks / FI's	0.0	0.0	0.0
FII's	1.7	2.2	2.4
Others	43.1	43.9	43.8

Source: BSE

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INDIA

Heritage Foods

BUY
Maintained

Revenue growth remains strong; margin recovers sequentially

Rs326

While 19% increase in milk procurement prices impacted EBITDA margin (in-line with expectations), we note the positives as (1) the revenue growth was strong and share of VAPs has increased to 27% now, (2) EBITDA margin has improved sequentially. We believe the EBITDA margin has probably bottomed out now and should move upwards in H2FY23. We model the company to report PAT CAGR of 25.4% over FY22-FY24E with: (1) high single-digit growth in milk procurement, and (2) steady increase in the share of VAP portfolio. We believe Heritage will benefit from steady value migration from cooperatives and unorganised players to private organised players. We cut our earnings estimates due to delay in price hikes and likely impact on milk prices due to lumpy skin disease. Maintain BUY with a revised DCF-based TP of Rs380, (0.5x FY24E EPS; prior TP: Rs400).

- Q2FY23 results:** Heritage reported revenue growth of 21.8% YoY, but EBITDA and adjusted PAT declined 38.8% and 50.8% YoY respectively. Gross and EBITDA margins contracted by 511bps and 483bps YoY due to 19% higher milk procurement prices. Due to price hikes, EBITDA margin improved sequentially.
- Segment-wise performance:** While dairy and feed segments reported revenue growth of 22.5% and 7.9% respectively, renewable energy revenues declined 9% YoY. Share of VAPs increased to 27% in Q2FY23 from 25.7% in Q2FY22. Curd volume sales were up 16.7% YoY during the quarter. We believe the company is on track to achieve 40% of its sales from VAPs in the next three years.
- Steady launch of new products:** Q2FY23 saw launch of Heritage's *Gluko Shakti (200ml pouch)* – instant whey energy drink. We note the company is consistently introducing new innovative products every quarter. Rising share of VAPs indicates customer acceptance of these products.
- Strong volume growth:** Company procured 1.12mn-litres of milk per day, up 8.4% YoY, in Q2FY23 (3-year CAGR: -2.4%). Average milk sales during the quarter were also up 15.4% YoY (3-year CAGR: -1.8%).
- Maintain BUY:** We model Heritage to report revenue and PAT CAGRs of 18.4% and 25.4% respectively over FY22-FY24E 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 Rs380 (implied P/E 10.5x FY24E).

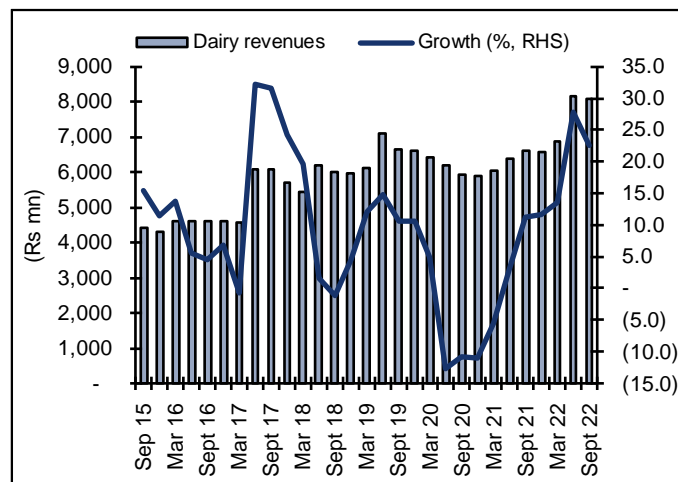
Market Cap	Rs15.1bn/US\$184mn	Year to March	FY21	FY22	FY23E	FY24E
Reuters/Bloomberg	HEFI.BO / HTFL IN	Revenue (Rs mn)	24,731	26,813	32,956	37,570
Shares Outstanding (mn)	46.4	Adj. Net Profit (Rs mn)	1,598	1,066	937	1,675
52-week Range (Rs)	536/254	Dil. Rec. EPS (Rs)	34.4	23.0	20.2	36.1
Free Float (%)	60.6	% Chg YoY	174.4	(33.3)	(12.1)	78.7
FII (%)	2.4	P/E (x)	9.5	14.2	16.2	9.1
Daily Volume (US\$'000)	606	CEPS (Rs)	44.4	34.2	32.6	49.8
Absolute Return 3m (%)	18.7	EV/EBITDA (x)	5.6	8.0	8.8	5.8
Absolute Return 12m (%)	(30.6)	Dividend Yield (%)	1.5	1.8	1.8	1.8
Sensex Return 3m (%)	8.4	RoCE (%)	31.5	19.9	15.2	23.2
Sensex Return 12m (%)	(3.3)	RoE (%)	29.0	16.4	13.1	20.5

Table 1: Q2FY23 financial performance*(Rs mn, year ending March 31)*

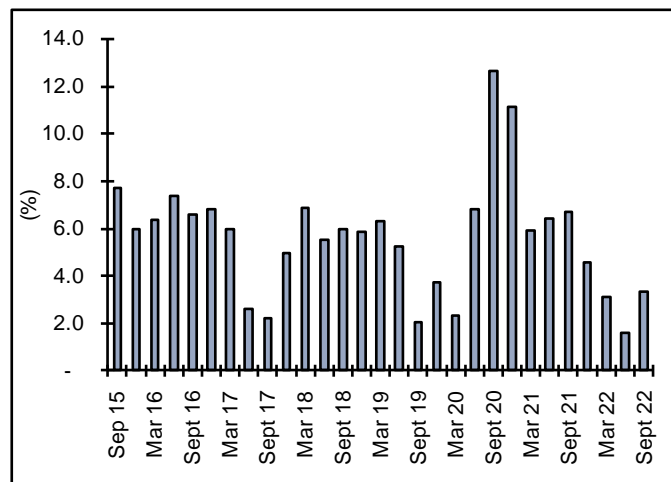
Y/e March	Q2FY23	Q2FY22	YoY gr.	Q1FY23	QoQ gr.
Revenue	8,162	6,703	21.8	8,209	(0.6)
Expenditure					
Raw materials	6,574	5,057	30.0	6,773	(2.9)
% of revenue	80.5	75.4		82.5	
Employee cost	528	479	10.3	512	3.2
% of revenue	6.5	7.1		6.2	
Other expenditure	661	516	28.0	685	(3.6)
% of revenue	8.1	7.7		8.3	
Total expenditure	7,763	6,052	28.3	7,970	(2.6)
EBITDA	399	651	(38.8)	239	66.7
EBITDA margin	4.9	9.7		2.9	
Other income	29	29	0.0	26	9.6
PBDIT	428	680	(37.1)	266	61.0
Depreciation	138	130	6.1	134	2.9
PBIT	289	550	(47.4)	131	120.6
Interest	3	9	(63.9)	7	(51.5)
PBT	286	541	(47.1)	124	130.1
Prov for tax	73	108	(32.4)	33	121.6
% of PBT	25.5	19.9		26.5	
Adjusted PAT	213	433	(50.8)	91	133.2
Extra ordinary items	-	(93)	(100.0)	(0)	(100.0)
Reported PAT	213	340	(37.3)	91	133.4

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

Chart 3: Milk prices pan India

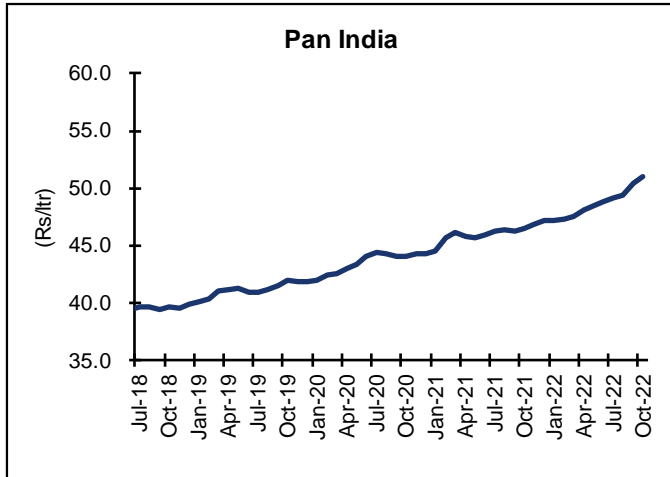
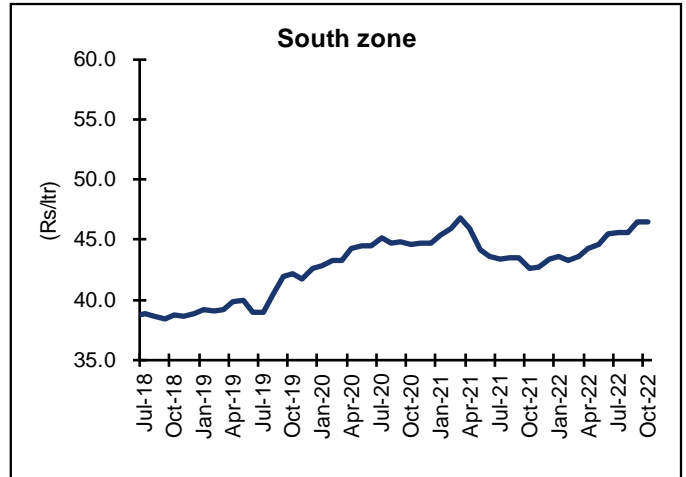
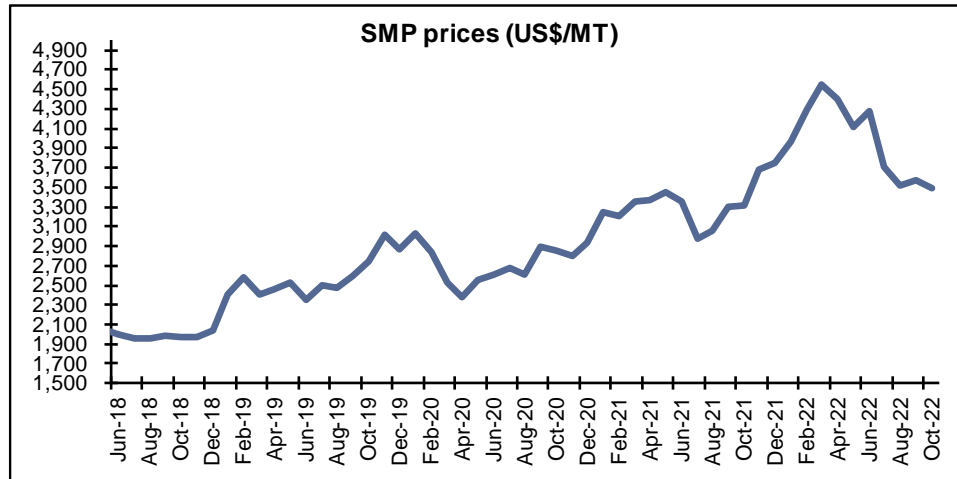


Chart 4: Milk prices – South India



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 18.4% and 25.5% respectively over FY22-FY24E, and RoE to change from 16.4% in FY22 to 20.5% in FY24E. We value the stock at a revised target price of Rs380 (earlier TP: Rs400) as per the DCF methodology. At the target price, implied P/E works out to 10.5x on FY24E EPS. Maintain **BUY**.

Table 2: DCF valuation

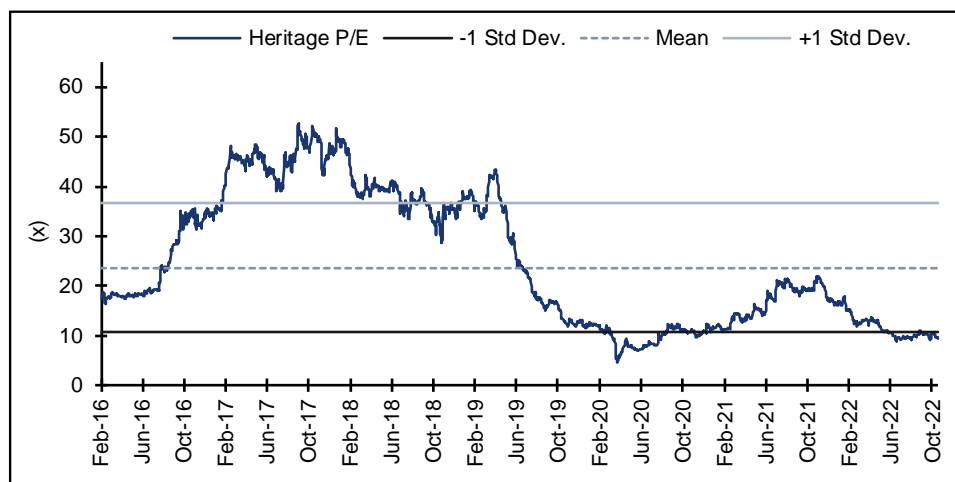
Particulars (Rs mn)	Amt (Rs)
Cost of Equity (%)	12.9
Terminal growth rate (%)	3.0
Discounted interim cash flows (Rs mn)	10,316
Discounted terminal value (Rs mn)	7,316
Total equity value (Rs mn)	17,631
Value per share (Rs)	380

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 and is currently trading around 1 standard deviation below its mean P/E.

Chart 6: Mean P/E and standard deviation



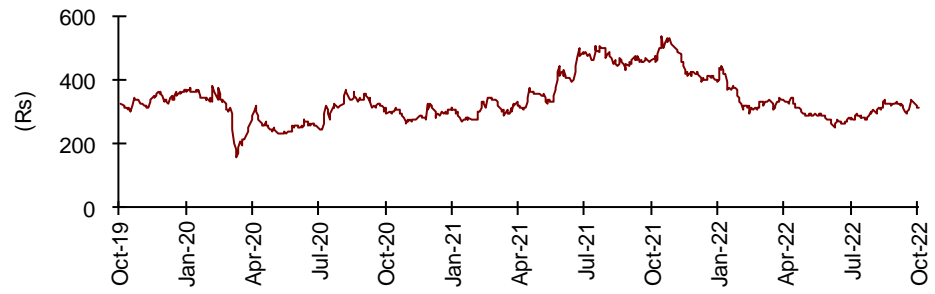
Source: Company data, I-Sec research

Risks

Sharp increase in input prices 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)

	FY21	FY22	FY23E	FY24E
Net Sales	24,731	26,813	32,956	37,570
Operating Expenses	22,020	24,900	31,226	34,940
EBITDA	2,712	1,913	1,730	2,630
% margins	11.0	7.1	5.2	7.0
Depreciation & Amortisation	462	522	576	638
Gross Interest	192	40	42	42
Other Income	80	113	155	308
Recurring PBT	2,138	1,463	1,266	2,257
Less: Taxes	535	342	319	569
Less: Minority Interest	6	56	10	10
Net Income (Reported)	1,598	1,066	937	1,679
Extraordinaries (Net)	(119)	(100)	-	-
Recurring Net Income	1,478	965	937	1,679

Source: Company data, I-Sec research

Table 4: Balance sheet

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
Assets				
Total Current Assets	2,595	2,908	2,556	2,586
of which cash & cash eqv.	236	356	237	(14)
Total Current Liabilities & Provisions	2,060	1,788	2,801	3,193
Net Current Assets	535	1,119	(246)	(608)
Investments	254	289	2,089	3,589
Net Fixed Assets	5,753	5,749	6,053	6,315
Capital Work-in-Progress	183	80	-	-
Total Assets	6,725	7,238	7,896	9,296
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	7,002	8,402
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	5,958	6,576	7,234	8,634
Total Liabilities	6,725	7,238	7,896	9,296

Source: Company data, I-Sec research

Table 5: Quarterly trend

(Rs mn, year ending March 31)

	Dec 21	Mar 22	June 22	Sept 22
Net sales	6,670	6,959	8,209	8,162
% growth (YoY)	10.3	12.4	26.7	21.8
EBITDA	408	320	239	399
Margin (%)	6.1	4.6	2.9	4.9
Other income	31	25	26	29
Extraordinaries (Net)	(18)	(21)	(0)	-
Net profit	207	129	73	190

Source: Company data, I-Sec research

Table 6: Cashflow statement

(Rs mn, year ending March 31)

	FY21	FY22	FY23E	FY24E
Operating Cashflow	1,999	1,544	1,513	2,316
Working Capital Changes	(475)	(72)	1,246	111
Capital Commitments	(662)	(417)	(800)	(900)
Free Cashflow	862	1,056	1,959	1,527
Cashflow from Investing Activities	1,334	(32)	(1,800)	(1,500)
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	(1,566)	(548)	-	-
Dividend paid	(116)	(348)	(278)	(278)
Change in Deferred Tax Liability	-	-	-	-
Chg. in Cash & Bank balance	514	128	(119)	(251)

Source: Company data, I-Sec research

Table 7: Key ratios

(Year ending March 31)

	FY21	FY22	FY23E	FY24E
Per Share Data (Rs)				
EPS	34.4	23.0	20.2	36.2
Cash EPS	44.4	34.2	32.6	49.9
Dividend per share (DPS)	5.0	6.0	6.0	6.0
Book Value per share (BV)	133.6	146.9	161.1	191.2
Growth (%)				
Net Sales	(9.3)	8.4	22.9	14.0
EBITDA	109.7	(29.5)	(9.5)	52.0
PAT	174.4	(33.3)	(12.1)	79.1
Cash EPS	90.1	(22.9)	(4.7)	53.1
Valuation Ratios (x)				
P/E	9.5	14.2	16.2	9.1
P/CEPS	7.4	9.6	10.0	6.6
P/BV	2.4	2.2	2.0	1.7
EV / EBITDA	5.6	8.0	8.8	5.8
EV / Sales	0.6	0.6	0.5	0.4
Operating Ratios				
Raw Material / Sales (%)	74.3	77.7	80.8	79.0
Employee cost / Sales (%)	7.2	6.9	6.5	6.5
SG&A / Sales (%)	0.4	0.4	0.8	0.8
Other Income / PBT (%)	3.8	7.7	12.2	13.6
Effective Tax Rate (%)	25.0	23.4	25.2	25.2
Working Capital (days)	1.2	2.8	(1.5)	(1.6)
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	2.9	4.5
RoACE	31.5	19.9	15.2	23.2
RoAE	29.0	16.4	13.1	20.5
Dividend Payout	14.5	26.1	29.7	16.6
Dividend Yield	1.8	2.1	2.1	2.1
EBITDA Margins	11.0	7.1	5.2	7.0

Source: Company data, I-Sec research

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