

Heritage Foods

Refer to important disclosures at the end of this report

Near term pricing pressures, expect FY20 to be better

- Heritage Foods reported strong EBITDA and PAT growth of 20%, in line with our expectations. Margins expanded by 80bps on higher VADP contribution and lower milk prices.
 - Revenue growth was marginally ahead of our expectations due to 24% growth in VADP. Revenue was partially impacted by higher competition in liquid milk. However, management is foreseeing early signs of recovery with the SMP inventory reduction.
 - Management indicated milk prices are expected to rise with the start of a lean season. While milk price inflation in VADP would be passed on, delay in increase in liquid milk prices in the run up to election would lead to a temporary moderation of margin.
 - While operational performance is in line, we lower our earnings estimates due to higher depreciation and tax rates. We maintain our positive stance, given the growing contribution of VADP and moderation of competition in liquid milk. Valuations of 10x FY20E EBITDA look attractive, given 27% RoE (excl. FRL stake value). We maintain Buy, with a target price of Rs660, based on 15x FY20E EV/EBITDA.
- Strong growth in VADP continues; early signs of recovery in liquid milk:** Heritage's revenues grew 7%, driven by strong growth of 24% in VADP. VADP growth was driven by 24% growth in curd. VADP contribution has increased to 25% in 9MFY19 vs. last year, in line with management guidance. Liquid milk volumes rose 5%, partially impacted by higher competition from unorganized players and co-operatives in Tamil Nadu and the northern states. However, management is foreseeing early signs of recovery in liquid milk with the reduction in SMP inventories in the country. Management is optimistic of achieving double-digit growth in liquid milk and 20%+ growth in VADP.
 - Lower milk prices aid margin expansion:** Gross margins expanded by 120bps due to lower milk prices. Milk procurement was up 6%, while prices were down 4% on account of flush season. Overheads were up 10%, arresting the EBITDA margin expansion to 80bps. EBITDA and PAT grew 20%, in line with our estimates. Management highlighted there would be an uptick in milk procurement prices with the start of a lean season and SMP inventory reduction. Management indicated moderation of margins as price hikes of liquid milk would be delayed in the run up to elections; however, higher contribution and price hikes of VADP would support margins.
 - Valuation remains attractive; maintain Buy:** We appreciate management's focus on driving growth by entering into new geographies, expanding distribution and increasing VADP contribution. We have reduced our earnings estimates on revision of depreciation and tax rates. We maintain our positive stance, with a revised TP of Rs660 (from 710), valuing at 15x FY20E EV/EBITDA.

Financial Snapshot (Consolidated)

(Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenue	23,806	26,429	23,731	25,088	28,640
EBITDA	1,308	1,413	1,304	1,879	2,210
EBITDA Margin (%)	5.5	5.3	5.5	7.5	7.7
APAT	568	668	548	859	1,059
EPS (Rs)	12.2	14.4	11.8	18.5	22.8
EPS (% chg)	101.5	17.6	(17.9)	56.6	23.4
ROE (%)	26.3	24.7	10.2	10.6	11.8
P/E (x)	40.5	34.4	41.9	26.8	21.7
EV/EBITDA (x)	18.2	17.1	19.3	13.0	10.8
P/BV (x)	9.6	7.7	3.0	2.7	2.4

Source: Company, Emkay Research

CMP	Target Price
Rs 496	Rs 660 (▼)
as of (February 1, 2019)	12 months
Rating	Upside
BUY (■)	33.1 %

Change in Estimates

EPS Chg FY19E/FY20E (%)	-/-
Target Price change (%)	(7.0)
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

EPS Estimates		
	FY19E	FY20E
Emkay	18.5	22.8
Consensus	18.8	24.2
Mean Consensus TP (12M)	Rs 714	

Stock Details

Bloomberg Code	HTFL IN
Face Value (Rs)	5
Shares outstanding (mn)	46
52 Week H/L	802 / 419
M Cap (Rs bn/USD bn)	23 / 0.32
Daily Avg Volume (nos.)	43,766
Daily Avg Turnover (US\$ mn)	0.3

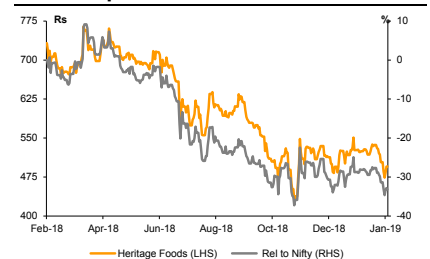
Shareholding Pattern Dec '18

Promoters	39.9%
FIIIs	5.9%
DIIIs	10.7%
Public and Others	43.5%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(6)	(5)	(19)	(34)
Rel. to Nifty	(6)	(10)	(15)	(33)

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

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Exhibit 1: Actual vs. estimates

Rs mn	Actual	Estimate		% variation		Comment
		Emkay	Consensus	Emkay	Consensus	
Revenues	6187.6	5923.6	5972.6	4%	3.6%	VADP growth of 24% drives outperformance
EBITDA	449.6	446.8	462.4	0.6%	-2.8%	Lower milk prices and higher VADP contribution aid margin expansion
EBITDA Margin (%)	7.3%	7.5%	7.7%	-28	-48	
APAT	203.6	205.2	217.2	-0.8%	-6.3%	

Source: Company, Emkay Research

Exhibit 2: Revision in earnings estimates

Y/E, Mar (Rs. mn)	FY19E			FY20E		
	Earlier	Revised	% Change	Earlier	Revised	% Change
Revenues	25,361	25,088	(1.1)	28,986	28,640	(1.2)
EBITDA	1,926	1,879	(2.4)	2,270	2,210	(2.7)
EBITDA Margin (%)	7.6	7.5	-10 bps	7.8	7.7	-10 bps
APAT	978	859	(12.2)	1,215	1,059	(12.8)
EPS	21.1	18.5	(12.2)	26.2	22.8	(12.8)

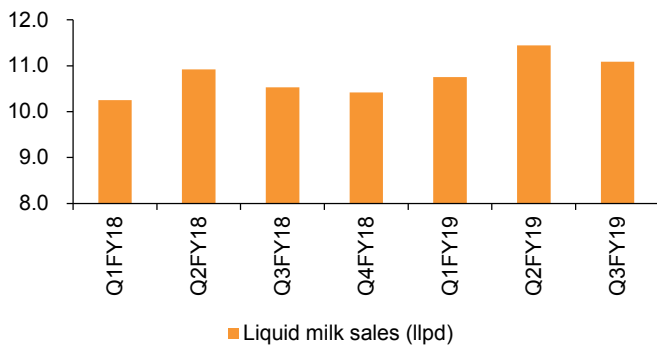
Source: Company, Emkay Research

Exhibit 3:

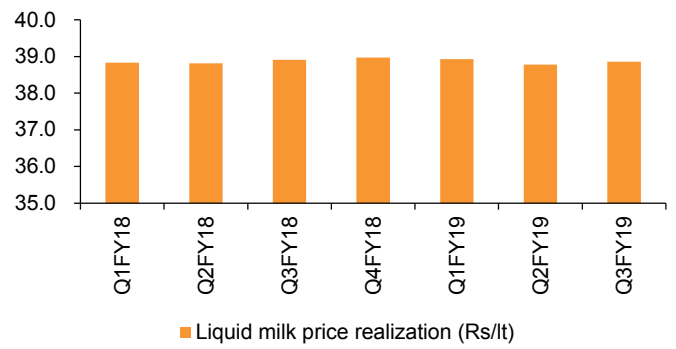
Y/E, Mar (Rs. mn)	Q3FY18	Q2FY19	Q3FY19	YoY (%)	QoQ (%)	9MFY18	9MFY19	Gr (%)
Revenue	5,789	6,194	6,188	6.9	-0.1	18,115	18,797	3.8
Expenditure	5,413	5,707	5,738	6.0	0.5	17,258	17,401	0.8
Consumption of RM	4,624	4,834	4,871	5.3	0.8	14,748	14,770	0.2
as % of sales	79.9	78.0	78.7			81.4	78.6	
Employee Cost	310	375	366	17.9	-2.4	939	1,089	15.9
as % of sales	5.4	6.1	5.9			5.2	5.8	
Other expenditure	479	498	501	4.8	0.7	1,572	1,542	-1.9
as % of sales	8.3	8.0	8.1			8.7	8.2	
EBITDA	376	487	450	19.6	-7.6	856	1,396	63.1
Depreciation	96	114	114	19.5	0.4	275	335	21.7
EBIT	281	373	335	19.6	-10.1	581	1,061	82.6
Other Income	11	18	21	91.5	18.8	43	59	34.9
Interest	48	46	50	4.7	8.9	127	152	19.6
PBT	244	345	307	25.8	-11.1	498	968	94.5
Total Tax	77	134	103	34.7	-22.9	153	339	121.7
Adjusted PAT	167	211	204	21.7	-3.6	345	629	82.5
Extra ordinary items	0	0	0	NA	NA	0	0	NA
Reported PAT	167	211	204	21.7	-3.6	345	629	82.5
Adjusted EPS	3.6	4.5	4.4	21.2	-3.8	7.4	13.5	81.9

Margins (%)				(bps)	(bps)				(bps)
Gross Margin	20.1	22.0	21.3	120	-70	18.6	21.4	280	
EBIDTA	6.5	7.9	7.3	80	-60	4.7	7.4	270	
EBIT	4.8	6.0	5.4	60	-60	3.2	5.6	240	
EBT	4.2	5.6	5.0	70	-60	2.7	5.2	240	
PAT	2.9	3.4	3.3	40	-10	1.9	3.3	140	
Effective Tax rate	31.4	38.8	33.7	220	-520	30.7	35.0	430	

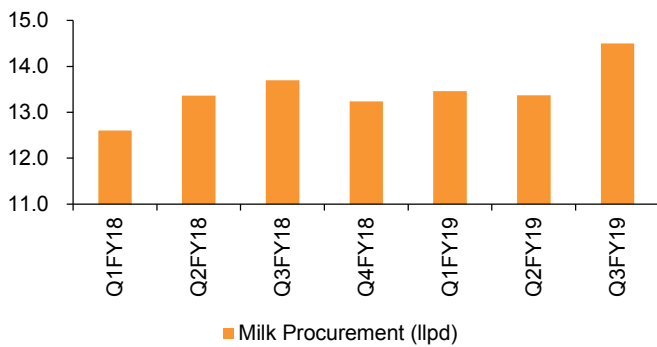
Source: Company, Emkay Research

Exhibit 4: Liquid milk sales have remained stable despite high competition

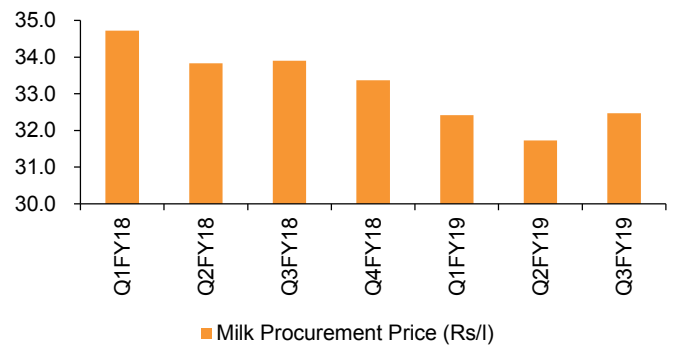
Source: Company, Emkay Research

Exhibit 5: Milk realization prices have remained stable

Source: Company, Emkay Research

Exhibit 6: Milk procurement has increased by ~6%

Source: Company, Emkay Research

Exhibit 7: Milk procurement prices increasing sequentially

Source: Company, Emkay Research

Key Financials (Consolidated)**Income Statement**

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Revenue	23,806	26,429	23,731	25,088	28,640
Expenditure	22,498	25,016	22,427	23,209	26,430
EBITDA	1,308	1,413	1,304	1,879	2,210
Depreciation	345	378	378	442	503
EBIT	963	1,035	925	1,438	1,707
Other Income	65	60	77	75	83
Interest expenses	155	112	182	211	185
PBT	874	983	820	1,301	1,605
Tax	306	314	271	442	546
Extraordinary Items	(14)	0	79	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	555	668	628	859	1,059
Adjusted PAT	568	668	548	859	1,059

Balance Sheet

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Equity share capital	232	232	232	232	232
Reserves & surplus	2,167	2,775	7,545	8,268	9,164
Net worth	2,399	3,007	7,777	8,500	9,396
Minority Interest	0	0	106	106	106
Loan Funds	1,253	1,577	2,779	2,379	2,179
Net deferred tax liability	187	198	180	180	180
Total Liabilities	3,839	4,781	10,842	11,165	11,861
Net block	3,120	2,971	4,331	4,689	5,086
Investment	8	1,488	5,761	5,761	5,761
Current Assets	2,524	2,032	2,625	2,743	3,342
Cash & bank balance	453	470	688	986	1,336
Other Current Assets	29	19	175	103	117
Current liabilities & Provision	1,909	1,789	1,963	2,116	2,415
Net current assets	615	243	662	627	926
Misc. exp	0	0	0	0	0
Total Assets	3,839	4,781	10,842	11,165	11,861

Cash Flow

Y/E Mar (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
PBT (Ex-Other income) (NI+Dep)	874	923	743	1,226	1,522
Other Non-Cash items	45	48	(78)	(75)	(83)
Chg in working cap	216	400	(219)	333	51
Operating Cashflow	1,249	1,119	1,205	1,770	1,715
Capital expenditure	(665)	(211)	(1,747)	(800)	(900)
Free Cash Flow	584	908	(542)	970	815
Investments	0	(1,480)	(4,273)	0	0
Other Investing Cash Flow	(74)	447	3,942	0	0
Investing Cashflow	(673)	(1,184)	(2,001)	(725)	(818)
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	(321)	323	1,203	(400)	(200)
Dividend paid (incl tax)	(85)	(85)	(112)	(136)	(163)
Other Financing Cash Flow	29	18	748	0	0
Financing Cashflow	(531)	143	1,657	(747)	(547)
Net chg in cash	45	79	861	297	350
Opening cash position	408	453	470	688	986
Closing cash position	453	470	688	986	1,336

Source: Company, Emkay Research

Key Ratios

Profitability (%)	FY16	FY17	FY18	FY19E	FY20E
EBITDA Margin	5.5	5.3	5.5	7.5	7.7
EBIT Margin	4.0	3.9	3.9	5.7	6.0
Effective Tax Rate	35.0	32.0	33.1	34.0	34.0
Net Margin	2.4	2.5	2.3	3.4	3.7
ROCE	27.3	25.4	12.8	13.7	15.5
ROE	26.3	24.7	10.2	10.6	11.8
RoIC	29.8	34.4	26.3	33.3	37.9

Per Share Data (Rs)	FY16	FY17	FY18	FY19E	FY20E
EPS	12.2	14.4	11.8	18.5	22.8
CEPS	19.7	22.6	20.0	28.0	33.7
BVPS	51.7	64.8	167.6	183.2	202.5
DPS	1.8	1.8	2.4	2.9	3.5

Valuations (x)	FY16	FY17	FY18	FY19E	FY20E
PER	40.5	34.4	41.9	26.8	21.7
P/CEPS	25.2	22.0	24.8	17.7	14.7
P/BV	9.6	7.7	3.0	2.7	2.4
EV / Sales	1.0	0.9	1.1	1.0	0.8
EV / EBITDA	18.2	17.1	19.3	13.0	10.8
Dividend Yield (%)	0.4	0.4	0.5	0.6	0.7

Gearing Ratio (x)	FY16	FY17	FY18	FY19E	FY20E
Net Debt/ Equity	0.3	0.4	0.3	0.2	0.1
Net Debt/EBIDTA	0.6	0.8	1.6	0.7	0.4
Working Cap Cycle (days)	2.5	(3.1)	(0.4)	(5.2)	(5.2)

Growth (%)	FY16	FY17	FY18	FY19E	FY20E
Revenue	14.8	11.0	(10.2)	5.7	14.2
EBITDA	59.4	8.0	(7.7)	44.2	17.6
EBIT	100.4	7.5	(10.6)	55.3	18.7
PAT	96.6	20.5	(6.1)	36.8	23.4

Quarterly (Rs mn)	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19
Revenue	5,789	5,616	6,416	6,194	6,188
EBITDA	376	447	460	487	450
EBITDA Margin (%)	6.5	8.0	7.2	7.9	7.3
PAT	167	200	215	212	205
EPS (Rs)	3.6	4.3	4.6	4.6	4.4

Source: Company, Emkay Research

Shareholding Pattern (%)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoters	39.9	39.9	39.9	39.9	39.9
FIs	8.5	8.7	6.4	5.8	5.9
DIs	7.5	8.9	9.7	9.0	10.7
Public and Others	44.2	42.5	44.0	45.3	43.5

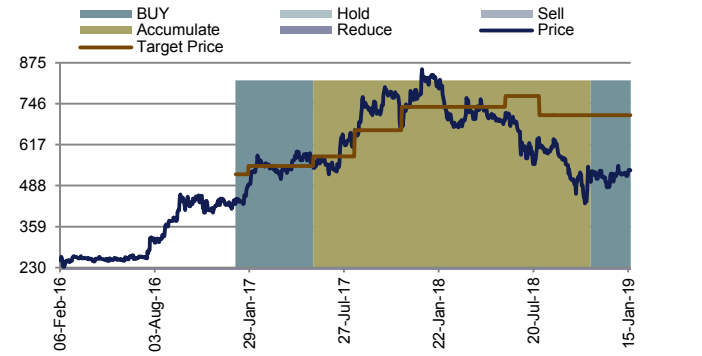
Source: Capitaline

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
20-Dec-18	524	710	12m	Buy	Dhiraj Mistry
05-Nov-18	499	710	12m	Buy	Dhiraj Mistry
31-Jul-18	617	710	12m	Accumulate	Dhiraj Mistry
28-May-18	717	770	12m	Accumulate	Ashit Desai
13-Nov-17	689	736	12m	Accumulate	Sameep Kasbekar
16-Aug-17	664	663	12m	Accumulate	Dhaval Mehta
30-May-17	544	580	12m	Accumulate	Dhaval Mehta
27-Jan-17	492	550	12m	Buy	Dhaval Mehta
03-Jan-17	440	524	12m	Buy	Dhaval Mehta

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price appreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

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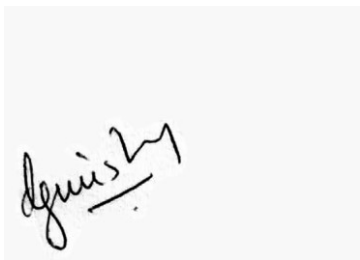
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