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Q3FY21 result review and
earnings revision

Dairy

Target price: Rs400

Earnings revision

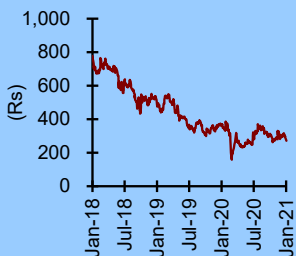
(%)	FY21E	FY22E
Sales	↓ 2.8	↓ 2.8
EBITDA	↑ 4.1	↓ 0.1
EPS	↑ 6.8	↑ 10.0

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	39.9	39.9	39.9
Institutional investors	19.0	19.1	20.0
MFs and other	13.9	14.9	15.4
Banks / FI's	0.0	0.0	0.0
FII's	5.1	4.2	4.6
Others	41.1	41.0	40.1

Source: BSE

Price chart



INDIA

Heritage Foods

BUY

Maintained

Lower procurement prices drive earnings growth **Rs279**

Three highlights from Q3FY21 earnings: (1) EBITDA margin expanded 790bps due to reduction in milk procurement prices. However, we expect milk procurement prices to rise in FY22 due to reopening of economy and higher global SMP prices, (2) revenue decline of 10% was largely attributable to consumers not returning to urban centres, extreme weather conditions and lower out-of-home consumption. Heritage lost revenues of ~7 days due to excess rainfall. Reopening of economy, lower covid cases and initiation of vaccination drive will steadily lead to higher revenues, and (3) the company has sold its stake in Future Retail, which will reduce its debt and interest cost in FY22. We model Heritage to report PAT CAGR of 49% over FY20-FY23 with improvement in core return ratios. Maintain BUY with a target price of Rs400 (10x FY23E).

- **Revenue impacted due to reverse migration and extreme weather conditions:** Heritage reported revenue decline of 10%, YoY. Liquid milk volume declined 13.7%. Decline in off-take is attributable to (1) consumers not yet returning to urban centres from their hometowns/ villages and (2) excess rainfall which impacted supply chain for ~7 days during the quarter. We believe Heritage generates ~15% revenues from HoReCa and institutions whose demand was also impacted during the quarter. Revenue of value-added products declined 12.6% due to (1) lower HoReCa sales and (2) reduction in out-of-home consumption.
- **Lower input prices and better revenue drove margins upwards:** EBITDA margin expanded 790bps, YoY, due to (1) carry-over of price hikes, (2) higher share of B2C sales and (3) lower procurement prices. Operating expenses and employee costs have largely reverted to pre-covid levels. PAT was up 220.1% YoY.
- **Demand is expected to improve with opening up of educational institutes:** We expect demand for milk and milk products to come back with families returning to urban centres with the opening up of educational institutes, lower number of covid cases and initiation of vaccination drive.
- **Possibility of higher milk prices in Q1FY22:** Milk procurement prices started declining post lockdown due to lower demand of milk. However, with reopening up of the economy as well as higher global SMP prices, we believe milk procurement prices will move upwards. Our channel checks also suggest that milk procurement prices have slightly increased in Dec'20-Jan'21. We have incorporated 200bps EBITDA margin decline in FY22 to factor in the likely impact of higher input prices.
- **Retain BUY:** We model Heritage to report revenue and PAT CAGRs of 7% and 49%, respectively, over FY20-FY23E. Core return ratios are expected to improve over the same timeframe. We have valued the stock as per DCF methodology at Rs400 (Implied P/E 10x FY23E).

Market Cap	Rs12.9bn/US\$177mn	Year to March	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	HEFI.BO / HTFL IN	Revenue (Rs mn)	27,259	25,394	29,108	33,366
Shares Outstanding (mn)	46.4	Adj. Net Profit (Rs mn)	582	1,670	1,700	1,934
52-week Range (Rs)	386/158	Dil. Rec. EPS (Rs)	12.5	36.0	36.6	41.7
Free Float (%)	60.0	% Chg YoY	(31.8)	186.8	1.8	13.8
FII (%)	4.6	P/E (x)	22.2	7.7	7.6	6.7
Daily Volume (US\$'000)	550	CEPS (Rs)	23.4	48.2	51.5	58.3
Absolute Return 3m (%)	(9.1)	EV/EBITDA (x)	11.6	5.2	5.5	4.8
Absolute Return 12m (%)	(24.2)	Dividend Yield (%)	0.9	0.9	1.0	1.0
Sensex Return 3m (%)	16.9	RoCE (%)	8.5	31.3	26.7	26.5
Sensex Return 12m (%)	15.0	RoE (%)	8.9	29.9	23.9	22.0

Please refer to important disclosures at the end of this report

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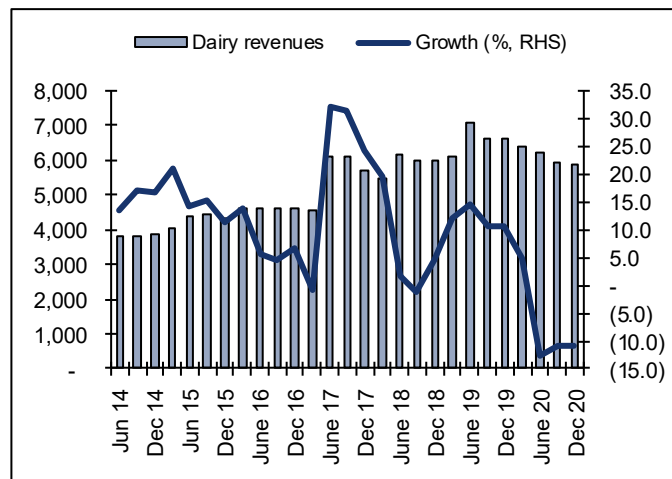
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Table 1: Q3FY21 financial performance*(Rs mn, year ending March 31)*

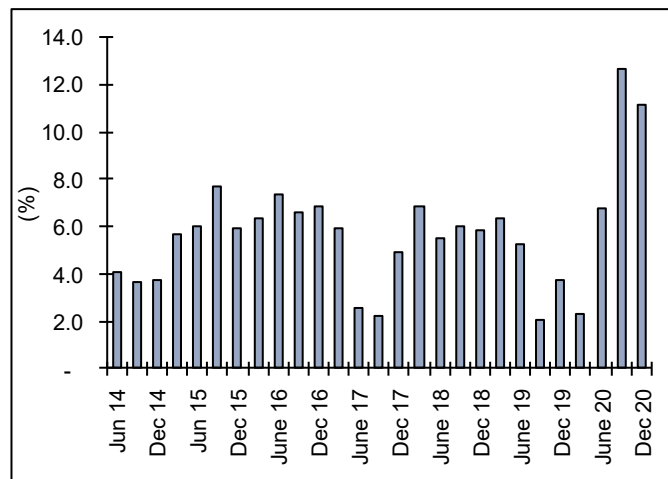
Ye March	Q3FY21	Q3FY20	YoY gr.	Q2FY21	QoQ gr.
Revenue	6,049	6,724	(10.0)	6,100	(0.8)
Expenditure					
Raw materials	4,340	5,465	(20.6)	4,328	0.3
% of revenue	71.7	81.3		70.9	
Employee cost	468	399	17.2	450	4.0
% of revenue	7.7	5.9		7.4	
Other expenditure	463	526	(12.0)	447	3.6
% of revenue	7.7	7.8		7.3	
Total expenditure	5,271	6,391	(17.5)	5,224	0.9
EBITDA	778	334	133.2	876	(11.2)
EBITDA margin	12.9	5.0		14.4	
Other income	11	13	(15.3)	18	(37.6)
PBDIT	789	347	127.6	894	(11.7)
Depreciation	113	128	(11.9)	111	2.4
PBIT	676	218	209.6	783	(13.7)
Interest	51	54	(5.6)	48	6.6
PBT	625	164	280.2	735	(15.0)
Prov for tax	155	45	246.1	193	(19.5)
% of PBT	24.9	27.3		26.3	
Adjusted PAT	470	119	293.1	542	(13.4)
Extra ordinary items	(274)	(184)	49.3	(687)	(60.0)
Reported PAT	195	(64)	(402.8)	(145)	(234.9)

Source: Company data, I-Sec research

Key performance highlights

Chart 1: Revenues and revenue growth

Source: Company data, I-Sec research

Chart 2: EBIT margin of dairy segment

Source: Company data, I-Sec research

Table 2: Key financial details

Particulars	Dec 18	Mar 19	June 19	Sept 19	Dec 19	Mar 20	June 20	Sept 20	Dec 20
Liquid milk sales (llpd)	11.1	11.2	11.6	12.1	11.3	10.9	9.2	9.6	9.7
Mil procurement (llpd)	14.5	14.0	15.0	13.9	13.6	12.7	14.5	12.0	11.7

Source: Company data, I-Sec research

Valuation and risks

We expect Heritage to report revenue and PAT CAGRs of 7% and 49%, respectively, over FY20-FY23E and adjusted RoE to expand from 19% in FY20 to 22% in FY23E. We value the stock at a target price of Rs400 as per DCF methodology. At the DCF price, the implied P/E works out to 10x on FY23E EPS. Maintain **BUY**.

Table 3: DCF valuation

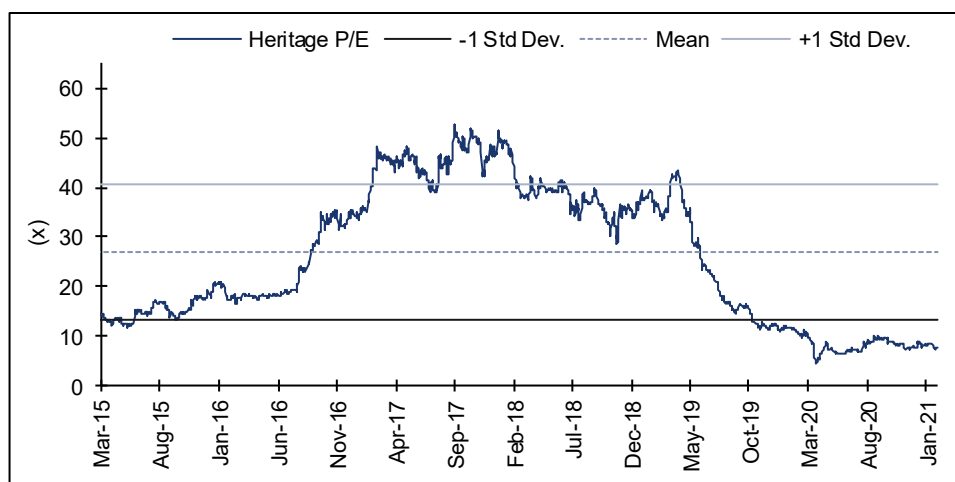
Particulars (Rs mn)	Amt (Rs)
Cost of Equity	13.1%
Terminal growth rate	3.0%
Discounted interim cash flows	10,208
Discounted terminal value	8,351
Total equity value	18,559
Value per share (Rs)	400

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 three years. The stock is trading well below its mean PE- 1 SD now.

Chart 3: Mean P/E and standard deviation



Source: Company data, I-Sec research

Risks

Sharp increase in input prices

Any major increase in commodity prices will result in downside to our estimates.

Financial summary

Table 4: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Net Sales	27,259	25,394	29,108	33,366
Operating Expenses	25,966	22,498	26,371	30,228
EBITDA	1,293	2,896	2,737	3,138
% margins	4.7	11.4	9.4	9.4
Depreciation & Amortisation	501	568	688	770
Gross Interest	226	146	42	10
Other Income	89	81	297	260
Recurring PBT	654	2,263	2,304	2,618
Less: Taxes	153	577	588	668
Less: Minority Interest	(82)	16	16	16
Net Income (Reported)	582	1,670	1,700	1,934
Extraordinaries (Net)	(3,897)	-	-	-
Recurring Net Income	(3,315)	1,670	1,700	1,934

Source: Company data, I-Sec research

Table 5: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Assets				
Total Current Assets	2,461	3,502	2,360	4,281
of which cash & cash eqv.	582	1,740	372	2,033
Total Current Liabilities & Provisions	2,308	2,184	2,503	2,870
Net Current Assets	152	1,318	(143)	1,412
Investments	1,892	229	2,229	2,229
Net Fixed Assets	4,752	5,757	5,969	6,200
Capital Work-in-Progress	773	-	-	-
Total Assets	7,570	7,304	8,055	9,840
Liabilities				
Borrowings	2,729	929	129	129
Deferred Tax Liability	224	224	224	224
Minority Interest	22	22	22	22
Equity Share Capital	232	232	232	232
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	4,364	5,898	7,449	9,234
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	4,596	6,130	7,681	9,466
Total Liabilities	7,570	7,304	8,055	9,840

Source: Company data, I-Sec research

Table 6: Quarterly trend

(Rs mn, year ending March 31)

	Mar 20	June 20	Sept 20	Dec 20
Net sales	6,526	6,388	6,100	6,049
% growth (YoY)	2.8	(11.4)	(10.2)	(10.0)
EBITDA	275	579	876	778
Margin (%)	4.2	9.1	14.4	12.9
Other income	19	16	18	11
Extraordinaries (Net)	(3,351)	865	(687)	(274)
Adjusted Net profit	(3,266)	1,186	(143)	193

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Operating Cashflow	911	2,238	2,388	2,704
Working Capital Changes	25	(8)	93	106
Capital Commitments	(1,084)	(800)	(900)	(1,000)
Free Cashflow	(148)	1,430	1,581	1,811
Cashflow from Investing Activities	91	1,663	(2,000)	-
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	148	(1,800)	(800)	-
Dividend paid	(112)	(136)	(149)	(149)
Change in Deferred Tax Liability	-	-	-	-
Chg. in Cash & Bank balance	(20)	1,157	(1,368)	1,661

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (Rs)				
EPS	12.5	36.0	36.6	41.7
Cash EPS	23.4	48.2	51.5	58.3
Dividend per share (DPS)	2.5	2.5	2.8	2.8
Book Value per share (BV)	103.9	136.9	170.4	208.8
Growth (%)				
Net Sales	8.4	(6.8)	14.6	14.6
EBITDA	(31.5)	124.0	(5.5)	14.6
PAT	(31.8)	186.8	1.8	13.8
Cash EPS	(16.6)	106.5	6.7	13.2
Valuation Ratios (x)				
P/E	22.2	7.7	7.6	6.7
P/CEPS	11.9	5.8	5.4	4.8
P/BV	2.7	2.0	1.6	1.3
EV / EBITDA	11.6	5.2	5.5	4.8
EV / Sales	0.5	0.6	0.5	0.4
Operating Ratios				
Raw Material / Sales (%)	81.6	74.9	76.9	76.9
Employee cost / Sales (%)	5.7	5.7	5.7	5.7
SG&A / Sales (%)	0.5	0.8	0.8	0.8
Other Income / PBT (%)	13.6	3.6	12.9	9.9
Effective Tax Rate (%)	23.5	25.5	25.5	25.5
Working Capital (days)	(1.6)	(1.7)	(1.8)	(1.9)
Inventory Turnover (days)	19.4	19.3	19.3	19.3
Receivables (days)	2.9	2.9	2.9	2.9
Payables (days)	29.4	29.9	29.9	29.9
Net D/E (x)	0.4	(0.1)	(0.3)	(0.4)
Profitability Ratios (%)				
Net Income Margins	1.8	6.6	5.9	5.8
RoACE	8.5	31.3	26.7	26.5
RoAE	8.9	29.9	23.9	22.0
Dividend Payout	19.9	6.9	7.5	6.6
Dividend Yield	0.9	0.9	1.0	1.0
EBITDA Margins	4.7	11.4	9.4	9.4

Source: Company data, I-Sec research

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