

Investment Call : Heritage Foods Ltd



Heritage Foods: Bottom line to improve

Heritage Foods is one of the largest Dairy companies in India, based in Hyderabad. The company operates in five divisions: Dairy, Retail, Agri, Bakery and Renewable energy. Dairy is the flagship business of the company contributing 74% to the topline in FY15. Heritage Foods has strong distribution network with over 5200 agents and distributors. The company has 134 cooling/chilling units, 14 processing and packaging plants, 1274 dairy parlours and 92 retail stores.

Value added products to aid margin: Value added products like curd, butter, flavored milk, etc. have operating margin of around 15-16% double of milk selling business. The contribution of Value added products have increased to 20% in the total Dairy revenue for FY15 from 17% in FY14. We expect the percentage of Value added products to increase going forward with higher demand for packaged curd, butter milk, butter and flavored milk.

Retail business reported positive EBITDA: Retail division operates 92 stores which offer fresh fruits, vegetables, dry fruits, groceries and other daily use products. The division has been into losses since inception and achieved breakeven on EBITDA level in Q4 FY15. The company expects retail division to turn profitable in next 2 years. Retail will still drag the overall profitability of the company but the level of loss will be reduced going forward.

Dairy industry has tremendous potential: Dairy industry is expected to grow at around 13-15% in coming 4-5 years. According to National Development Dairy Board, total milk production is expected to increase over 200 million tones by 2022 from 150 million tones currently on implementation of National dairy Plan. The potential for organized dairy players is huge who have access to farmers for their milk requirement. We expect Heritage Foods to be a beneficial player as it has strong presence in South India with recognized brands.

Value added services to farmers: The company procures milk from over 3 lakhs farmers and also provides various facilities like assistance in loan procurement, cattle insurance, supply of subsidized quality cattle feed and fodder, health camps for animals etc. These help in garnering the trust of farmers and avoid any supply side problems.

BUY					
Target price Rs.	640				
CMP Rs.	525				
Mkt Cap Rs. Cr.	1216				
52wk H/L (Rs.)	545/282.9				
Avg Vol (30 days)	100,000				
FV Rs.	10				
Shareholding		Latest (%)			
Promoters	40.03				
FII	3.53				
DII	4.77				
Bodies Corporate	18.75				
Others	32.92				
Returns		3M	6M		
Sensex (%)	(2.2) (5) (9.3)				
Company (%)	50.5 39.8 31.9				
12M					

Relative stock price performance



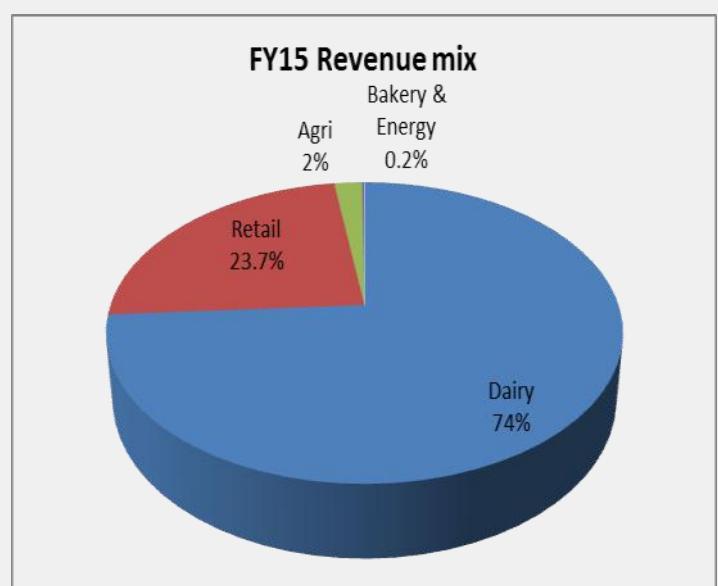
Consolidated data (Rs. In crores)	FY13 A	FY14 A	FY15 A	FY16 E	FY17 E
Total revenue	1,601.8	1,722.0	2,073.0	2,364	2,790
PAT	50.0	45.3	28.4	58.7	74.6
EPS (Rs)	21.6	19.5	12.2	25.3	32.1

Revenue and growth %



Outlook and valuation:

Net sales and PAT surged at CAGR of 18.1% and 38.9% respectively in last 5 years. Management aims to achieve sales of Rs. 6,000 crores by 2020 from Rs. 2,072 crores in FY15. We expect Heritage Foods to grow around 15-20% in next 3-4 years with enormous scope for dairy industry due to rising income level and population, health awareness, better quality of animal food leading to higher productivity, etc. The company has strong presence in Southern states and has also entered Delhi and Maharashtra to cater to these growing markets. Retail division will benefit from higher disposable income, economic growth and availability of many products under one roof. Bakery, Agri and Energy divisions contribute to less than 4% of the total revenue but are expected to grow at over 20-25% due to low base effect and thus will benefit the topline.



Source: Heritage Foods

FY15 has been a sluggish year for Heritage Foods as the cost of its key raw material (Skimmed Milk Powder) shot high and losses from retail business dragged its profits. With falling and stable prices of raw material and recovery in retail business, margins will improve going ahead. Milk prices have been rising and are expected to increase further on account of heavy demand which in turn will improve the cash profits of the company.

H1 FY16 results (Consolidated): Total income grew at 14.5% to Rs. 1,165.3 crores while Net profit rose at 157% to Rs. 26 crores. Low raw material cost boosted profitability and the same is expected to prevail ahead. DE ratio reduced to 0.42 in Sep-15 compared to 0.74 in Mar-2015 while cash equivalents stood at Rs. 51.2 crores for Sep-15.

Recent investments and acquisitions in dairy industry have been done on rich valuations. Heritage is trading relatively cheap compared to its peer and thus we advise to buy the stock at CMP of Rs. 525 with a target price of Rs. 640 for long term horizon. At CMP of Rs. 525 the stock is trading at FY16 E P/E of 20.7 and FY17 E P/E of 16.3 times.

Key risks:

1. Competition from online retailers can impact sales of retail stores.
2. Profits will reduce if the retail division fails to turn around.
3. Increase in key raw material prices will impact its margins.

Consolidated Financials (Rs. In crores)	FY11	FY12	FY13	FY14	FY15
Total revenue	1,096.1	1,393.4	1,601.8	1,722	2,073
EBITDA	35.8	51.2	98.7	94.6	82
EBITDA %	3.3	3.7	6.2	5.5	4
PAT	1.1	9.2	50.0	45.3	28.4
PAT %	0.1	0.7	3.1	2.6	1.4
EPS (in Rs)	0.5	4.0	21.6	19.5	12.2
Total shareholder funds	86.3	92.8	141.7	178.8	192.9
Total debt	154.2	140.5	98.2	127.4	142.5
Fixed Assets	231.2	239.5	245.1	282.6	289.7
DE	1.79	1.51	0.69	0.71	0.74
ROC %	8.8	14.6	32.1	25.2	16.4
ROE %	1.5	10.3	42.6	28.3	15.3
Payout %	158.6	26.2	7.0	15.8	25.8

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S. No.	Statement	Answer
		Yes No
	I/we or any of my/our relative has any financial interest in the subject company? [If answer is yes, nature of Interest is given below this table]	No
	I/we or any of my/our relatives, have actual/beneficial ownership of one per cent. or more securities of the subject company, at the end of the month immediately preceding the date of publication of the research report or date of the public appearance?	No
	I/we or any of my/our relative, has any other material conflict of interest at the time of publication of the research report or at the time of public appearance?	No
	I/we have received any compensation from the subject company in the past twelve months?	No
	I/we have managed or co-managed public offering of securities for the subject company in the past twelve months?	No
	I/we have received any compensation for brokerage services from the subject company in the past twelve months?	No
	I/we have received any compensation for products or services other than brokerage services from the subject company in the past twelve months?	No
	I/we have received any compensation or other benefits from the subject company or third party in connection with the research report?	No
	I/we have served as an officer, director or employee of the subject company?	No
	I/we have been engaged in market making activity for the subject company?	No

Nature of Interest (if answer to F (a) above is Yes :

Name(s) with Signature(s) of RA(s).

[Please note that only in case of multiple RAs and if the answers differ inter-se between the RAs, then RA specific answer with respect to questions under F (a) to F(j) above , are given below]

SS..No.	Name(s) of RA.	Signatures of RA	Serial Question of question which the signing RA needs to make a separate declaration / answer	Yes	No.

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