

Target Price ₹ 925
CMP ₹ 510
FY18E PE 19.0X

Index Details	
Sensex	25,500
Nifty	7,825
Industry	Packaged Foods

We believe that Heritage offers a compelling opportunity to invest in the fast growing domestic consumption story. At 10.6X FY18 earnings coupled with the strong growth outlook, we believe that the valuations are extremely attractive, considering the heady valuation of its peers and the other consumption stocks.

Scrip Details	
MktCap (₹ cr)	1,182.5
BVPS (₹)	83.2
O/s Shares (Cr)	2.3
AvVol	14,818
52 Week H/L	594/280
Div Yield (%)	0.6
FVPS (₹)	10.0

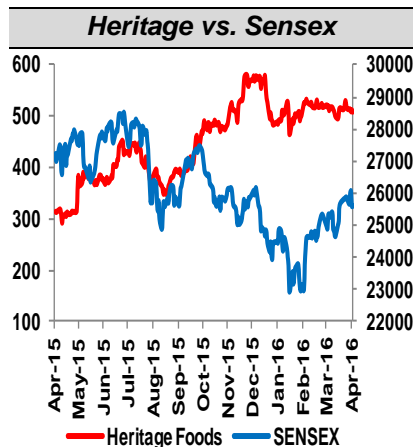
The strong outlook of the dairy sector, expanding geographical footprint, increasing share of the high margin value added dairy business and expected faster turnaround of its retail business operations should sustain the heady growth rates and profitability.

We expect revenues to grow at a CAGR of 17.1% to 3.328 cr by FY18, while earnings are expected to grow at a faster clip (58.5% CAGR) to 113 cr over the same period.

Our optimism stems from the fact that:

Shareholding Pattern	
Shareholders	%
Promoters	39.9
Public	60.1
Total	100.0

- India's dairy industry is expected to maintain growth at a CAGR of approximately 14.9% between 2015 to 2020, to reach a value of Rs 9,397 billion by 2020 from Rs 4,061 billion clocked in FY14. Heritage has historically outpaced the industry growth rate which is expected to continue going forward. We forecast sales to grow at a CAGR of 17.1% from Rs 2,073 cr in FY15 to Rs 3,238 cr by FY18.
- Dairy revenues are expected to grow at a 16.3% CAGR to 2,414 cr by FY18 driven by the expanding geographical footprint and deeper penetration of existing markets.
- The Value added dairy product (VADP) segment revenue share is expected to scale to 28% from 20% on the back of a strong 30% CAGR growth. The imminent JV with a European dairy will not only boost the product portfolio but significantly enhance the brand.

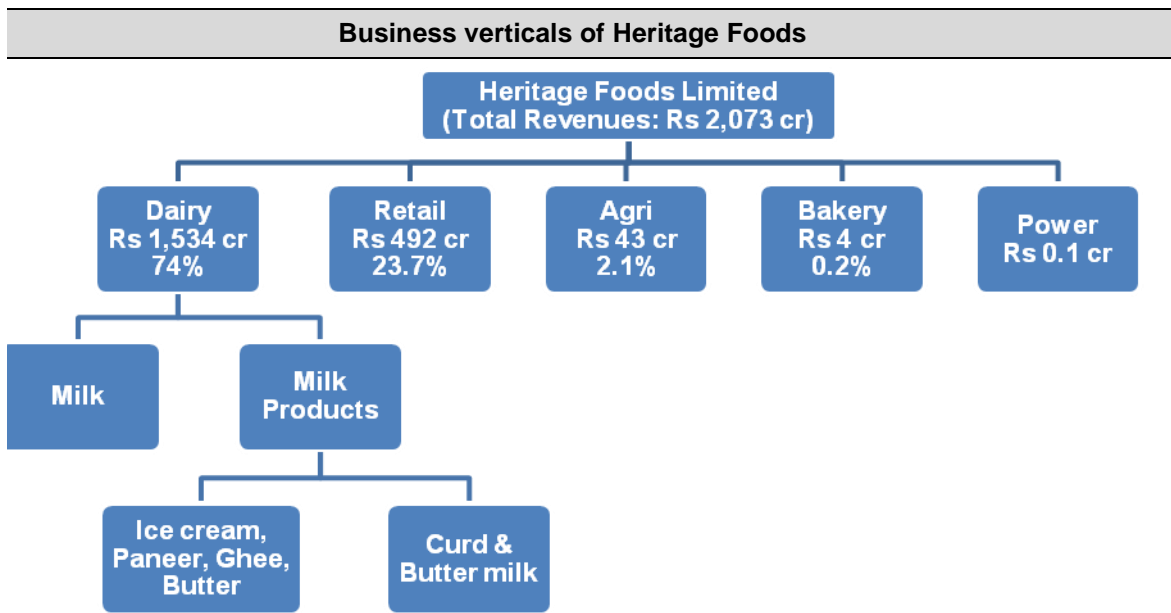

Key Financials (₹ in Cr)

Y/E Mar	Net Sales	EBITDA	PAT	EPS (₹)	EPS Growth (%)	RONW (%)	ROCE (%)	P/E (x)	EV/EBITDA (x)
2015	2,073.0	83.7	28.4	12.2	-37.4	14.7	16.2	42.1	15.7
2016E	2,389.7	122.6	49.4	21.3	74.1	21.4	23.2	24.2	10.7
2017E	2,790.5	163.5	76.3	32.9	54.5	25.9	27.5	15.6	8.0
2018E	3,328.4	216.3	113.0	48.7	48.2	28.7	31.4	10.6	6.1

- **We expect a faster turnaround of the retail operations given the restructuring undertaken by the company and enhanced focus to beef up operations in existing markets and strategic initiatives to thwart the challenges of online market places.**
- **At the CMP of Rs 510 the stock is trading at 15.6X and 10.6X its estimated earnings for FY17 and FY18 which is attractively valued considering the rich valuation of its listed peers and other consumer stocks.**

❖ Company Background

Heritage Foods Limited is engaged in dairy, retail, agri, and bakery businesses in India. The company's Dairy division is involved in procuring, manufacturing, packing, and distributing milk and milk products whereas the Retail division operates a chain of retail stores that offer fresh fruits and vegetables, grocery, processed food etc. Heritage Foods Limited operates through 1,332 Heritage parlors and 103 Heritage fresh stores.



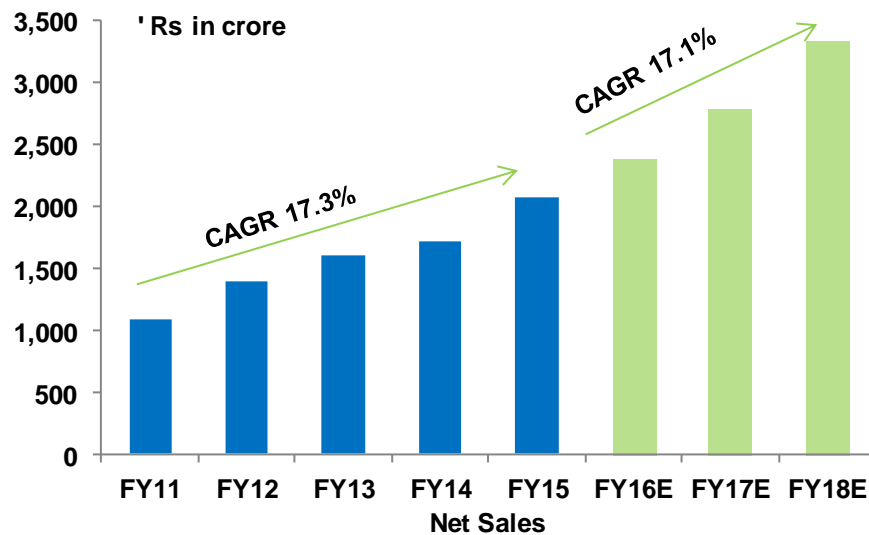
Source: Heritage Foods Ltd, Ventura Research

❖ **Key Investment Highlights**

➤ **Improved volumes in the dairy business to drive revenue growth**

We expect revenues to grow at a CAGR of 17.1% (from Rs 2,073 cr in FY15) to Rs 3,328 cr in FY18 driven by robust growth across traditional dairy (CAGR 12.4%), value added dairy products (VADP) like curd, cheese (30%) and retail (18.3%). VADP is expected to be the key focus area for the company as it enjoys twice the EBITDA margin of the traditional dairy business

Historical revenue growth to be sustained over forecast period



Source: Heritage Foods Ltd, Ventura Research

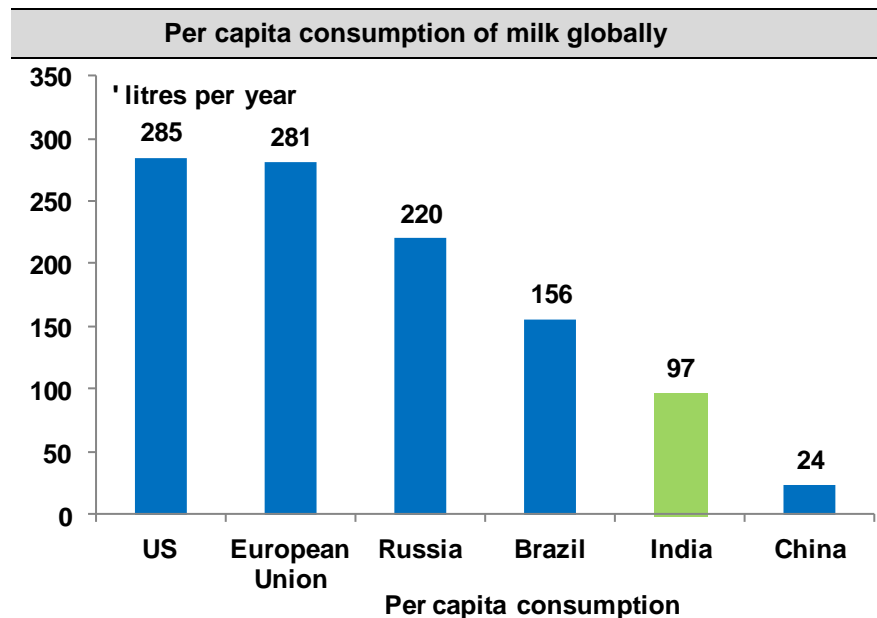
Strong growth to continue in dairy operations...

Revenue from traditional dairy operations are expected to grow at a CAGR of 12.4% from Rs 1,227 cr in FY15 to 1,741 cr in FY18 on the back of

- Strong growth outlook for the Indian dairy industry
- Milk procurement volumes which are set to rise significantly due to expansion in geographies
- Rapid growth in the number of milk parlors to improve brand awareness

- **Indian dairy industry set to take a quantum leap**

India is the world's biggest producer and consumer of milk accounting for ~18% of the global milk production and ~60% of Asia's milk production. However, the per capita consumption of milk at 97 litres per year is well below that of other major milk markets (except for China).



Source: IMARC Report, Ventura Research

Milk production volumes in India have grown at a rapid pace from 17 MMT during the financial year 1952 to reach 147 MMT during the financial year 2015. In line with the production growth, milk consumption has trended to reach 138 MMT in FY15 from 54 MMT in FY 1992.

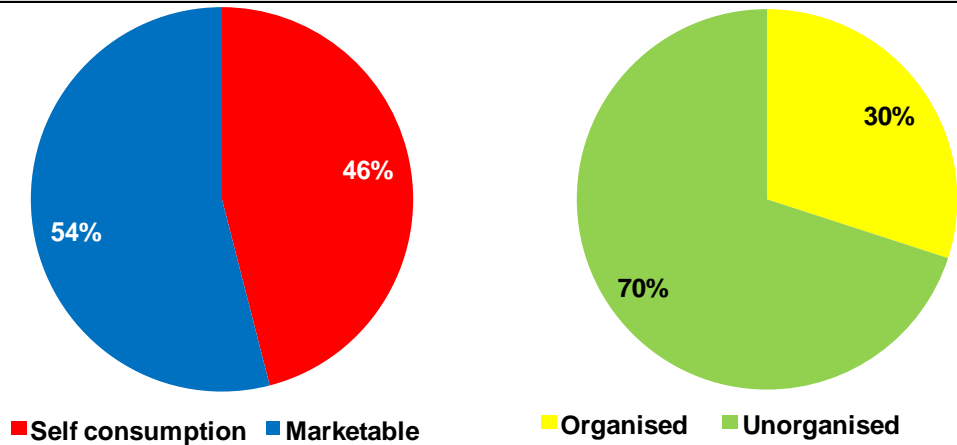
Total production of milk and dairy products in India is expected to increase from 147 MMT in 2015 to 189 MMT in 2021, while total consumption of milk and dairy products is expected to increase from 138 MMT in 2015 to 192 MMT in 2021. India's dairy industry is expected to maintain growth at a CAGR of approximately 14.9% between 2015 and 2020, to reach a value of Rs 9,397 billion by 2020 from Rs 4,061 billion clocked in FY14.

However the sector is largely unorganized.... representing significant growth prospects for the organized sector

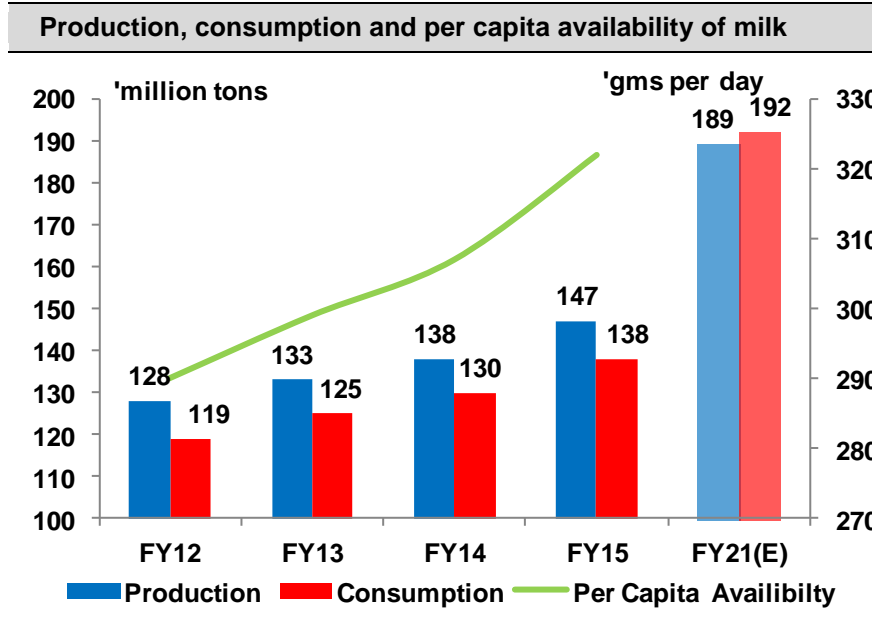
The Indian dairy industry is divided into the organized and unorganized segments. The unorganized segment consists of traditional milkmen, vendors and self-consumption at home and the organized segment consists of cooperatives and private dairies. The Indian dairy industry is majorly dominated by the unorganized segment, which contributes around 70% of the total milk consumption.

In 2014, 30% of the total marketable milk in India was processed by the organized segment, with private players processing 55% and cooperatives processing 45% of the total marketable milk in the organized segment

Unorganized sector plays a dominant role in the dairy industry



Source: Heritage Foods Ltd, Ventura Research



Source: IMARC Report. Ventura Research

Heritage has a presence in two of the three largest markets...

At the state level, Uttar Pradesh, Rajasthan and Andhra Pradesh were the largest milk producers' accounting for 17.7%, 10.5% and 9.8% of total milk production in 2014, respectively. Heritage by virtue of a stronghold in Andhra Pradesh and its foray into milk procurement from Rajasthan is well poised to benefit from this stupendous growth

In addition to increasing its footprint in its existing market, Heritage is focusing on newer markets like Delhi, Haryana & Maharashtra. Liquid milk sales in the Delhi region was just 3,991 LPD in Q3 FY15 which has grown to 14,053 LPD in Q3 FY16. Heritage recently started selling curd in Delhi which is a part of its expansion strategy in newer territories. Growth in this markets is not an extraordinary challenge as in its initial years, Heritage is seeking to add volumes which are part of the incremental volume growth in the consuming centres.

- **Milk procurement volumes set to rise significantly.**

In its catchment areas, Heritage has always been the trusted partner for farmers. Milk procurement was 20,000 litres per day in 1997 which has risen to above 12 lac litres per day in 2016. The major reason for such a stupendous growth is the relationship maintained by Heritage Foods with the cattle owners. As part of its relationship management, Heritage undertakes numerous activities which have led to a mutually beneficial relationship, not only for farmers, but for Heritage itself. The company has been:

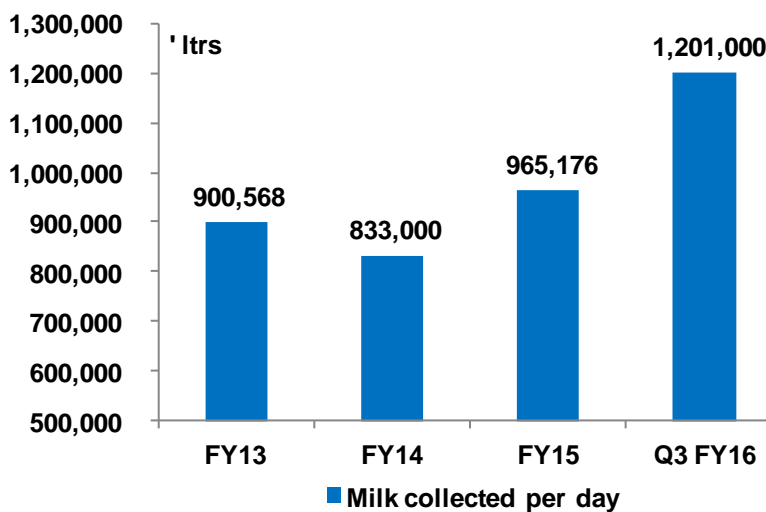
- i. procuring high quality feed and supplying it to farmers,
- ii. providing soft loans to farmers & crop insurance,
- iii. setting up mobile veterinary clinics and
- iv. conducting certification programmes in dairy

All these activities have helped Heritage build strong bonds with the farm community

Heritage is constantly adding machinery to cater to increasing volumes

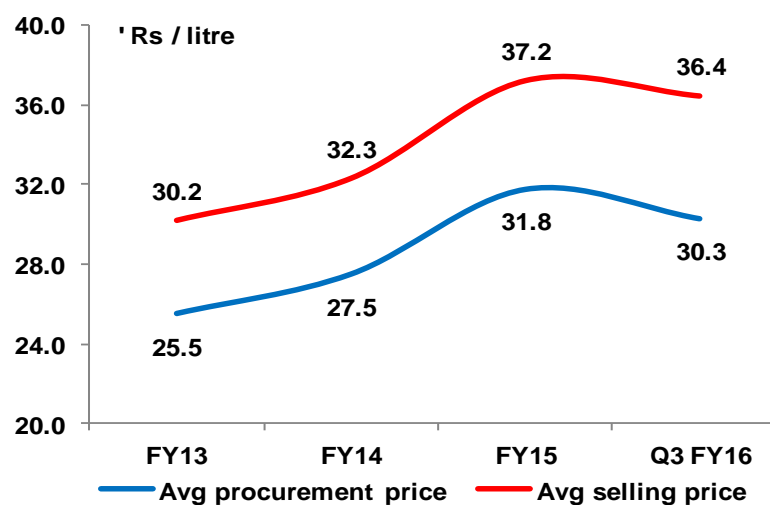
During the FY 2014-15, the dairy division has increased its milk Chilling capacity by 35,000 LPD to 16,39,000 LPD by commissioning 22 units which includes Bulk & Mini Chilling units, which are either managed by the company or its franchisees. We expect this trend to continue into FY18 with forecast milk volumes expected to scale upto 15,00,000 LPD by FY18.

Milk procurement set to rise



Source: Heritage Foods Ltd, Ventura Research

Average procurement and selling prices

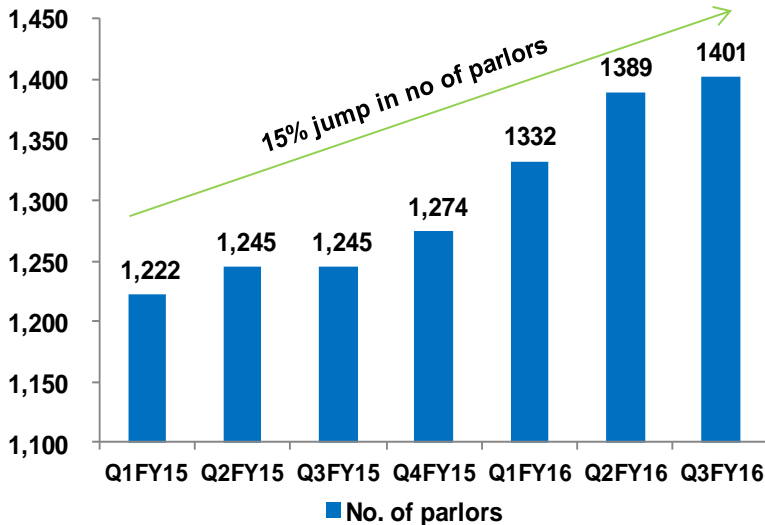


Source: Heritage Foods Ltd, Ventura Research

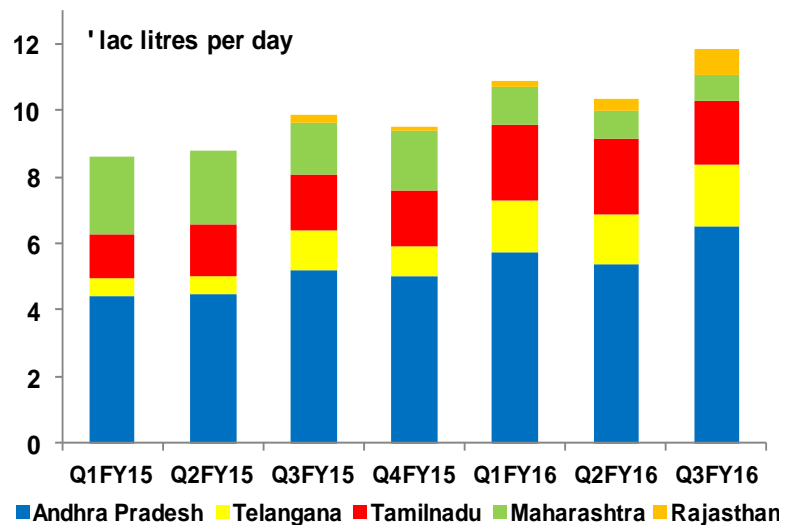
Average procurement price and average realization prices have traditionally moved in tandem and thus any rise in procurement price will not have any major impact on EBITDA margins in our model. In our model we have assumed prices of Rs 38.3/litre and 40.4/litre for FY17 and FY18.

- **Rapid growth in the number of milk parlors and dominance in Andhra Pradesh to improve brand awareness**

Heritage is constantly expanding its footprint across Andhra Pradesh. Over the last couple of years it has added 179 parlors taking its total franchises outlets to 1,401. These 200 sft outlets are expected to more or less grow at the historical pace.

No of Parlors selling Heritage milk


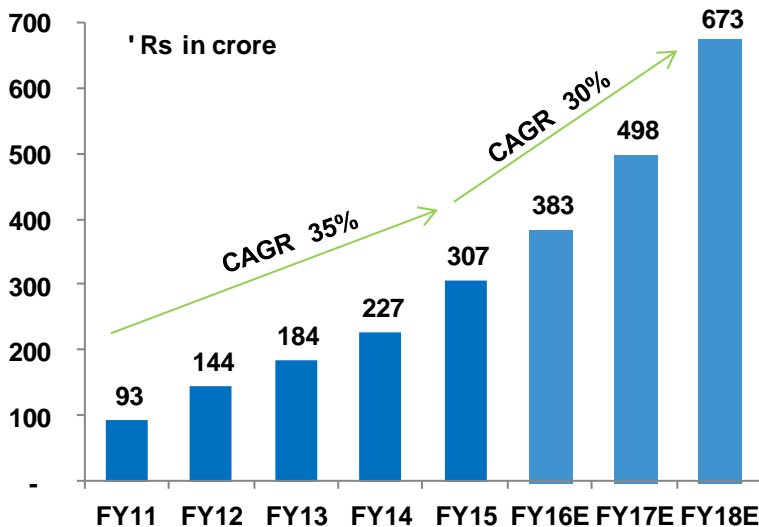
Source: Heritage Foods Ltd, Ventura Research

State wise milk collection


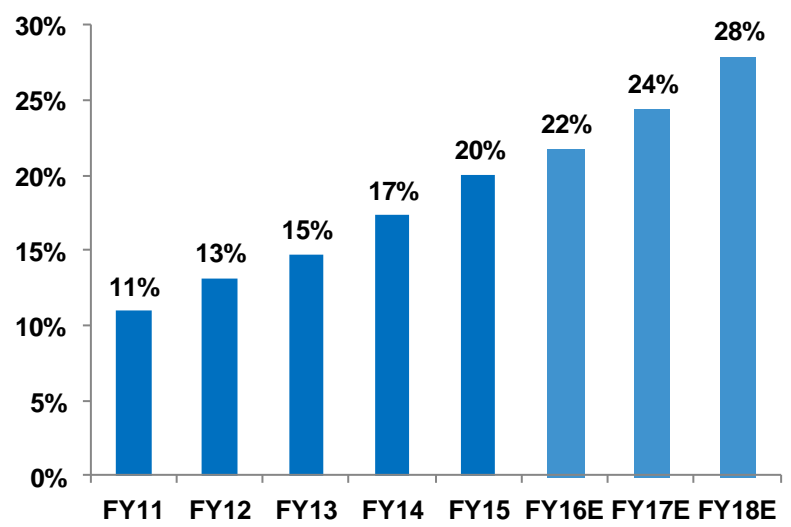
Source: Heritage Foods Ltd, Ventura Research

 ➤ **Revenues from VADP set to take a quantum leap**

VADP revenue share in the total dairy business has increased for Heritage from 11% in FY11 to 22% in Q3 FY16 driven by its product portfolio which consists of curd, ice cream, paneer, lassi, cooking butter etc. A key product for Heritage in the VADP segment is curd which contributes around 80% of the VADP revenues. Margins for ADP are twice (~15%-16%) that of the traditional dairy business and this makes the VADP segment the prime focus area for Heritage.

Revenue growth from VADP


Source: Heritage Foods Ltd, Ventura Research

Strong VADP revenue growth on the cards


Source: Heritage Foods Ltd, Ventura Research

All the major value added products grew at healthy rates of 20%-29% for FY15. The sale of curd pouches grew 21.8% YoY, curd cups grew 28.5% and cooking butter and paneer grew at 25.6%.

➤ **Potential JV with a European partner to enhance VADP portfolio besides strengthening the brand.**

The management of Heritage guided that they are in talks with some European dairy giants to set up a state-of-the-art manufacturing facility in India which would focus on Value-added dairy products like cheese, beverage and butter etc. The JV would be investing around Rs 300 cr to set up the facility. Management has not provided any revenue guidance for the same and we have not considered the potential revenue growth from the said facility. Successful conclusion of these talks is expected to lead to an enriched product offering for Heritage besides helping to building the brand.

➤ **Rejuvenated retail business to boost revenue and EBITDA**

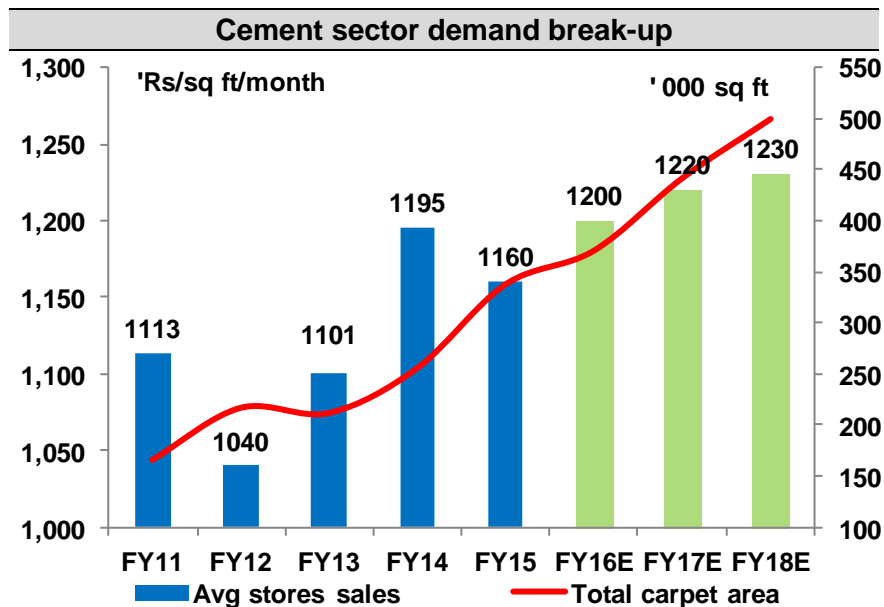
Heritage fresh retail stores are designed to meet the needs of the modern consumer. Retail stores are spread over an average of 3,000 sft having a merchandise mix of vegetables, grocery, processed food, cleaning aids, dairy, beverages and frozen foods. Heritage's retail stores are strategically located in prime areas of Andhra such that it helps Heritage operate just like online market places wherein Heritage can home deliver products to its clients. In our view, this strategy should nullify the impact of the onslaught of online marketplaces that provide similar services.

Revenues from the retail business has grown at a CAGR of 21.6% from Rs 225 cr in FY11 to Rs 492 cr in FY15 on the back of rapid expansion in number of retail outlets from 75 in FY11 to 92 in FY15.

Negative margin trend to be reversed soon

However EBITDA was negative (Rs 2.3cr) due to higher regional and corporate overheads. Management expect to breakeven on the EBITDA front by FY17 and turn positive at the PAT level by FY18. Towards this end, Heritage has appointed KPMG as strategy partners for its retail business.

We expect revenues from the retail business to clock a CAGR of 18.3% from Rs 492 cr in FY15 to Rs 815 cr in FY18 driven by strategic expansion of the number of outlets (which are expected to reach to 143 by FY18). Total carpet area of stores is expected to grow by 16.1% to 5,00,000 sft by FY18 from the existing 3,71,000 sft at the end of Q3 FY16.



Source: Heritage Foods Ltd, Ventura Research

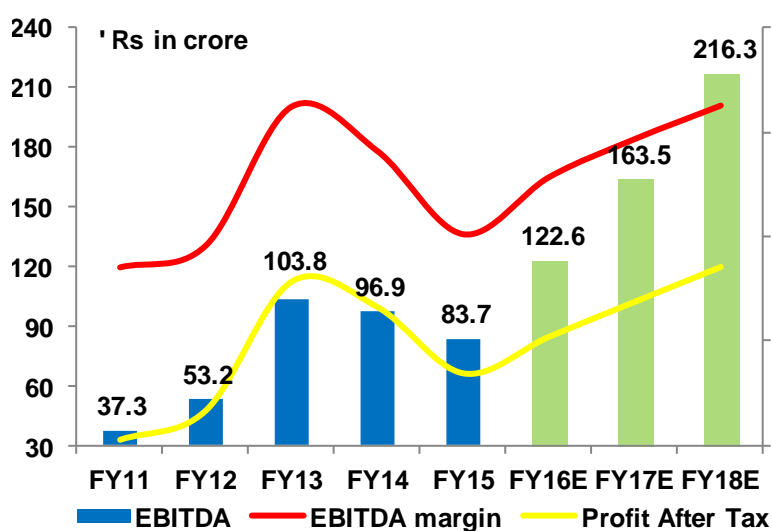
However same store sales growth continues to remain sluggish

Same store growth (considering 68 comparable stores) has stood at 6.14% in Q3 FY16. Low same store growth rate has been a concern for Heritage and the management is highly focused on increasing the same over the next few quarters. The Average bill value has remained flat at Rs 251 despite the billing numbers having grown by 6.1% YoY to 35.9 lacs (33.8 lacs in Q3 FY15). Heritage has appointed KPMG for strategic consultation to script a faster turnaround.

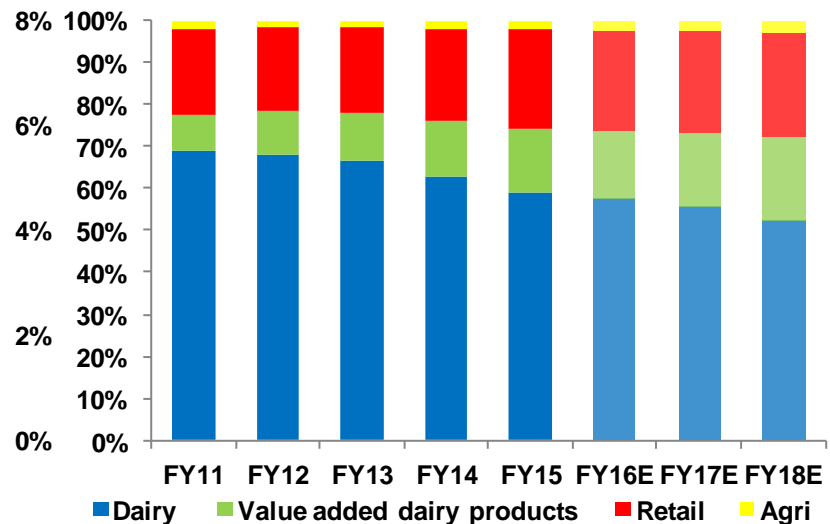
➤ Improving product mix to ameliorate EBITDA and PAT margins

Heritage is aggressively focusing on improving its product mix in favor of VADP which will not only enhance its operating margins but also help grow its brand. The Share of value added products in the dairy revenue is expected to rise significantly to 28% by FY18 from the existing 22% in FY16. The Jump in the share of value added dairy products would simultaneously improve the overall EBITDA from Rs 84 cr in FY15 to Rs 216 cr in FY18. This coupled with the expected turnaround of retail operation should help overall EBITDA margin to rise from 4.0% in FY15 to 6.5% in FY18. The PAT margin is expected to improve by 200 bps from 1.4% in FY15 to 3.4% in FY18.

Heritage is constantly innovating to improve its efficiency in milk procurement, processing and distribution which will help them boost operating margins in the dairy operations.

Strong revival in EBITDA and PAT margins


Source: Heritage Foods Limited, Ventura Research

Improving product mix in favor of VADP


Source: Heritage Foods Limited, Ventura Research

 ➤ **Increasing consumption to drive revenue growth of Agri division**

Heritage Agri was started with the aim of sourcing fresh fruits and vegetables from farmers. A team of agriculturists works closely with the farmers to transform agricultural lands into productive farms with respect to output-per-unit of land and energy. Heritage has also established a few advanced, fully integrated Pack Houses to handle fresh produce. Revenues from the Agri division are expected to grow at a flourishing rate of 26.6% from Rs 43 cr in FY15 to Rs 88 cr in FY18.

 ➤ **Cash only business model expected to keep receivables and debt low**

A major part of Heritage's business is on cash basis which helps it keep receivables low (4 days) and enables a low working capital cycle requirement.

 ❖ **Key Risk**

 • **Availability of milk in the short term**

Summers are the lean months for milk production, and as such supplies fall around this time every year. This year, coupled with the rising fodder and cattle feed costs (owing to the drought like situation in many parts of the country) could impact volumes. Moreover, the commodity prices of fat and skimmed milk powder have started firming up after remaining stable for a long time. Dairies thus are under pressure to raise the procurement prices to farmers to boost production.

❖ Financial Performance

The company displayed robust growth in its topline and bottomline numbers during Q3 FY16. Net sales grew by 14.1% YoY to Rs 583 cr from Rs 511 cr in Q3 FY15 on the back of growth across all the major segments, viz., dairy (11%), VADP (25%) and retail (22%). EBITDA jumped 63.4% YoY from Rs 18.4 cr in Q3 FY15 to Rs 30 cr in Q3 FY16. EBITDA margins improved by 150 bps to 5.1% from 3.6% in Q3 FY15. The PAT jumped 108.2% YoY to Rs 11.4 cr due to higher EBITDA margins.

In 9M FY16, Heritage's net sales stood at Rs 1,715.67 cr, registering a growth of 14.1% YoY. The EBITDA jumped 73.2% YoY to Rs 93.1 cr due to higher EBITDA margins in the dairy and VADP segment. PAT surged 140% to 37.4 cr from 15.61 cr in FY15.

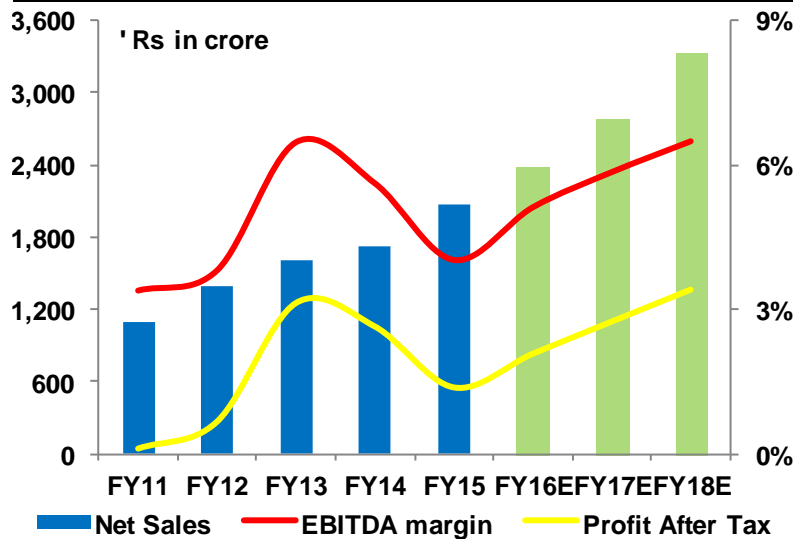
Consolidated Quarterly Financial Performance (Rs crores)				
Description	Q3FY16	Q3FY15	FY15	FY14
Net Sales	582.6	510.8	2073.0	1722.0
<i>Growth (%)</i>	<i>14.06</i>		<i>20.38</i>	
Total expenditure	552.6	492.4	1989.3	1625.1
EBITDA	30.0	18.4	83.7	96.9
<i>Margin (%)</i>	<i>5.1</i>	<i>3.6</i>	<i>4.0</i>	<i>5.6</i>
Depreciation	8.6	8.6	34.0	25.0
EBIT (Ex. OI)	21.4	9.7	49.7	71.9
Non-Operating Income	1.2	0.8	7.2	5.1
EBIT	22.6	10.5	56.9	77.0
<i>Margin (%)</i>	<i>3.9</i>	<i>2.0</i>	<i>2.7</i>	<i>4.5</i>
Finance Cost	3.3	3.5	17.6	15.3
Exceptional Items	-1.4	0.0	0.0	-0.5
PBT	18.0	7.0	39.3	61.2
<i>Margin (%)</i>	<i>3.1</i>	<i>1.4</i>	<i>1.9</i>	<i>3.6</i>
Provision for Tax	6.6	1.5	10.9	15.9
Profit after Tax	11.4	5.5	28.4	45.3
<i>Margin (%)</i>	<i>2.0</i>	<i>1.1</i>	<i>1.4</i>	<i>2.6</i>

Source: Heritage Foods Limited, Ventura Research

❖ Financial Outlook

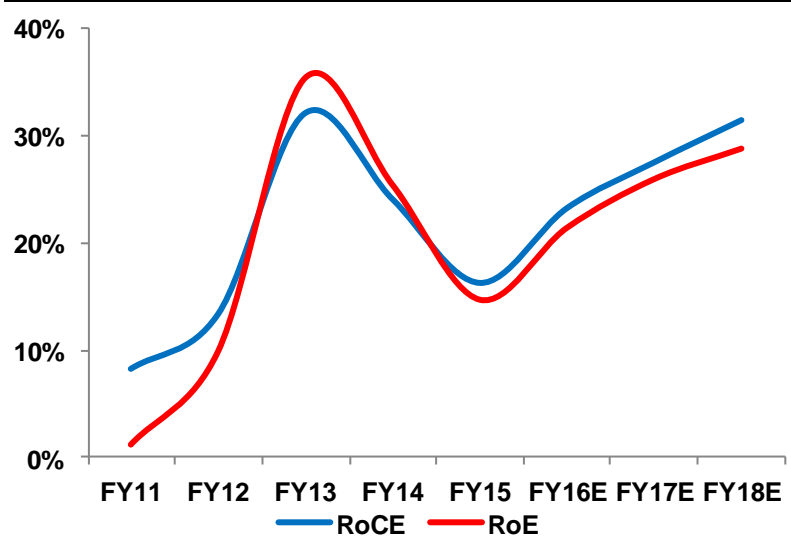
Expansion into different geographies coupled with an improving product mix in favor of value added products (VADP), should help sustain the revenue growth trajectory. We expect sales to grow at a CAGR of 17.1% from Rs 2,073 cr in FY15 to Rs 3,238 cr by FY18 while net consolidated earnings are expected to grow at a stupendous CAGR of 58.6% to Rs 113 cr. The EBITDA and PAT margins are expected to reach 6.5% and 3.4% respectively by FY18.

Strong Business growth visible



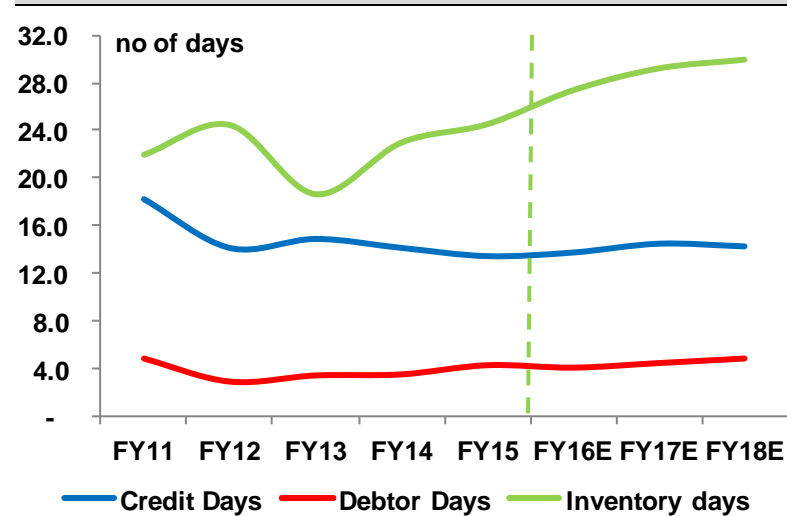
Source: Heritage Foods Limited, Ventura Research

Improving return ratios



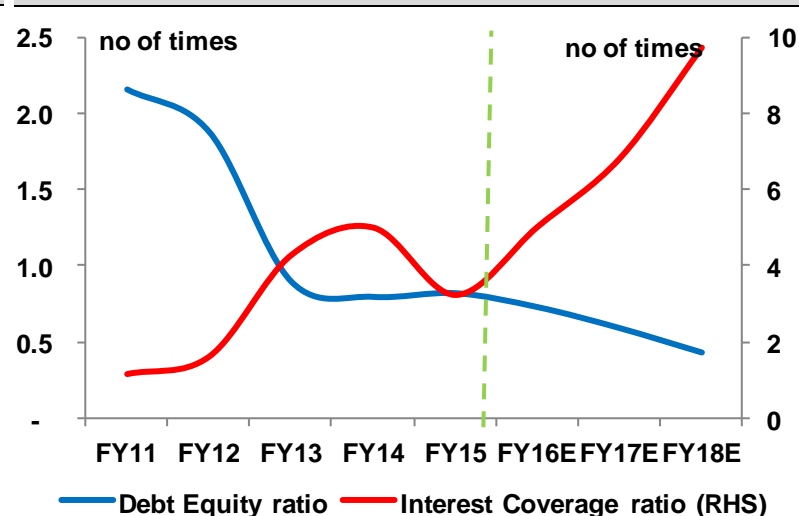
Source: Heritage Foods Limited, Ventura Research

Healthy working capital cycle



Source: Heritage Foods Limited, Ventura Research

Improving solvency ratios

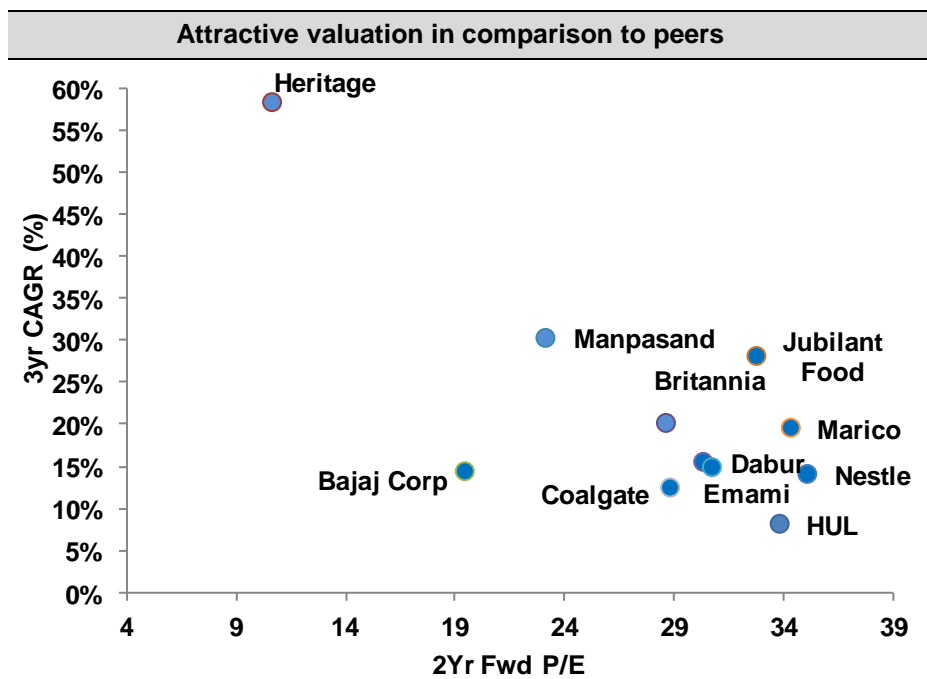


Source: Heritage Foods Limited, Ventura Research

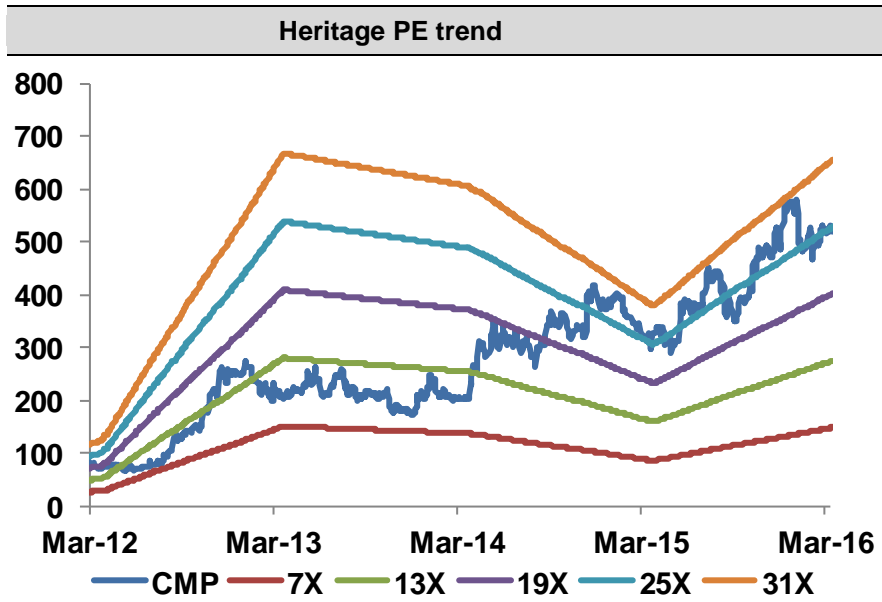
❖ Valuation

We initiate coverage on Heritage Foods as a BUY with the price objective of Rs 925 representing an potential upside of 80% from the CMP of Rs 510. At the CMP of Rs 510 the stock is trading at 15.6X and 10.6X its estimated earnings for FY17 and FY18. We have assigned a PE multiple of 19X on FY18 EPS of Rs 48.7 to arrive at the target price. We are positive on the company given that:

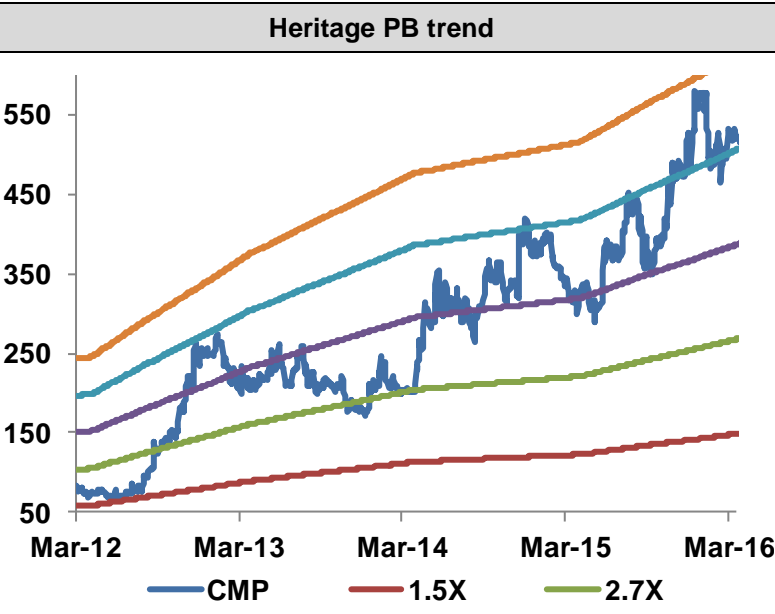
1. Strong revenue growth should continue
2. Increasing share of VADP to improve profitability
3. Impending JV with European dairy major will enhance the product basket and improve the brand
4. Restructuring of operations to ensure faster turnaround of retails operations



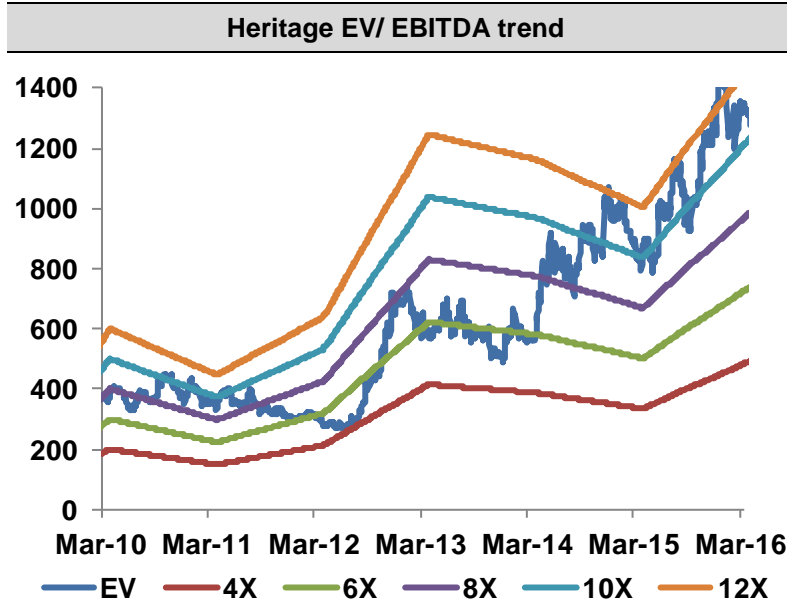
Source: Heritage Foods Limited, Ventura Research



Source: Heritage Foods Limited, Ventura Research



Source: Heritage Foods Limited, Ventura Research



Source: Heritage Foods Limited, Ventura Research

Peer Comparison

Y/E March	Sales	EBITDA	PAT	EBITDA Margin (%)	PAT Margin(%)	ROE(%)	P/E	P/BV	EV/EBITDA
Heritage Foods									
2015	2073.0	83.7	28.4	4.0%	1.4%	14.7%	27.0	81.8	15.7
2016E	2389.7	122.6	49.4	5.1%	2.1%	21.4%	24.2	99.6	10.7
2017E	2790.5	163.5	76.3	5.9%	2.7%	25.9%	15.6	127.1	8.0
2018E	3328.4	216.3	113.0	6.5%	3.4%	28.7%	10.6	169.8	6.1
Hatsun Agro									
2015	2933.1	198.3	39.1	6.8%	1.3%	19.5	87.4	15.5	19.6
2016E	3467.6	309.4	97.8	8.9%	2.8%	40.9	48.3	17.0	17.4
2017E	4064.8	399.8	124.4	9.8%	3.1%	49.2	33.0	12.0	13.5
Vadilal Industries									
2015	415.8	39.5	2.4	9.5%	0.6%	4.6	79.0	3.6	8.0
2016E	458.7	52.4	12.3	11.4%	2.7%	10.2	42.4	4.3	12.7
2017E	517.9	59.6	17.8	11.5%	3.4%	13.4	29.3	3.9	11.2
Kwality									
2015	5878.3	352.2	166.5	6.0%	2.8%	31.0	4.9	1.3	5.6
2016E	6789.5	437.0	209.4	6.4%	3.1%	27.8	13.1	1.1	8.9
2017E	8046.0	559.3	283.4	7.0%	3.5%	27.6	9.7	0.9	7.0
2018E	9982.8	778.7	419.3	7.8%	4.2%	27.0	6.6	0.8	5.0

Source: Heritage Foods Limited, Ventura Research

Financials and Projections

Y/E March, Fig in ₹ Cr	FY15	FY16E	FY17E	FY18E	Y/E March, Fig in ₹ Cr	FY15	FY16E	FY17E	FY18E
Profit & Loss Statement					Per Share Data (Rs)				
Net Sales	2073.0	2389.7	2790.5	3328.4	Adj. EPS	12.2	21.3	32.9	48.7
% Chg.		15.3	16.8	19.3	Cash EPS	26.9	37.3	51.6	70.2
Total Expenditure	1989.3	2267.1	2627.0	3112.0	DPS	3.0	4.0	4.5	5.0
% Chg.		14.0	15.9	18.5	Book Value	81.8	99.6	127.1	169.8
EBDITA	83.7	122.6	163.5	216.3	Capital, Liquidity, Returns Ratio				
EBDITA Margin %	4.0	5.1	5.9	6.5	Debt / Equity (x)	0.8	0.7	0.6	0.4
Other Income	7.2	7.2	8.4	10.0	Current Ratio (x)	0.9	0.9	1.1	1.3
PBDIT	90.9	129.8	171.9	226.3	ROE (%)	14.7	21.4	25.9	28.7
Depreciation	34.0	37.3	43.4	49.8	ROCE (%)	16.2	23.2	27.5	31.4
Interest	17.6	18.4	18.8	18.1	Dividend Yield (%)	0.6	0.8	0.9	1.0
Exceptional items	0.0	0.0	0.0	0.0	Valuation Ratio (x)				
PBT	39.3	74.1	109.7	158.4	P/E	42.1	24.2	15.6	10.6
Tax Provisions	10.9	24.7	33.4	45.3	P/BV	6.3	5.2	4.0	3.0
Reported PAT	28.4	49.4	76.3	113.0	EV/Sales	0.6	0.5	0.5	0.4
Minority Interest	0.0	0.0	0.0	0.0	EV/EBIDTA	15.7	10.7	8.0	6.1
PAT	28.4	49.4	76.3	113.0	Efficiency Ratio (x)				
PAT Margin (%)	1.4	2.1	2.7	3.4	Inventory (days)	24.5	27.4	29.2	29.9
Other opr Exp / Sales (%)	0.0	0.0	0.0	0.0	Debtors (days)	4.2	4.0	4.4	4.7
Tax Rate (%)	29.8	30.0	29.0	28.0	Creditors (days)	13.4	13.7	14.5	14.3
Balance Sheet					Cash Flow Statement				
Share Capital	23.2	23.2	23.2	23.2	Profit Before Tax	39.3	74.1	109.7	158.4
Reserves & Surplus	166.5	204.7	268.4	367.5	Depreciation	34.0	37.3	43.4	49.8
Share Warrants	3.2	3.2	3.2	3.2	Working Capital Changes	-31.2	-9.3	-16.7	-42.7
Long Term Borrowings	55.7	59.3	61.2	59.5	Others	9.5	-5.4	-13.3	-27.1
Deferred Tax Liability	18.8	21.3	22.9	23.9	Operating Cash Flow	51.6	96.6	123.0	138.4
Other Non Current Liabilities	11.6	13.3	15.5	17.7	Capital Expenditure	-47.9	-69.0	-73.0	-81.0
Total Liabilities	279.0	325.0	394.5	494.9	Other Investment Activities	0.5	0.4	0.4	0.4
Gross Block	462.3	532.3	602.3	682.3	Cash Flow from Investing	-47.5	-68.6	-72.6	-80.6
Less: Acc. Depreciation	-181.7	-218.4	-261.8	-311.6	Changes in Share Capital	0.0	0.0	0.0	0.0
Net Block	280.7	313.9	340.5	370.7	Changes in Borrowings	15.9	9.1	5.0	-4.5
Capital Work in Progress	9.0	8.0	11.0	12.0	Dividend and Interest	-23.7	-29.6	-31.4	-32.1
Non Current Investments	0.8	0.8	0.8	0.8	Cash Flow from Financing	-7.9	-20.5	-26.4	-36.6
Net Current Assets	-33.0	-20.0	18.7	87.4	Net Change in Cash	-3.8	7.5	24.0	21.2
Long term Loans & Advances	21.6	22.3	23.4	23.9	Opening Cash Balance	43.8	40.0	47.7	71.7
Total Assets	279.0	325.0	394.5	494.9	Closing Cash Balance	40.0	47.7	71.7	92.9

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