

# Hatsun Agro Product Ltd

Bloomberg Code: HTSMF IN

India Research - Stock Broking

**BUY**

## Branded Play on Milk and Ice Creams

### Launch of new premium products & diversify its product portfolio:

Hatsun receives 90% of its revenues from dairy products and remaining from ice cream business. Milk and curd are sold through the brand Arokya and value added products are sold under brand "Hatsun". Products include panner, curd, ghee and butter which receive twice the margins of liquid milk. Arun Ice creams has been one of the well known brands in Tamil Nadu and is continuously launching new flavors.

### Efficient procurement system reduces supply risk:

Hatsun, in the last few years, has strengthened its procurement by expanding its Hatsun Milk Banks (HMBs) from 4500 centers to 8500 and increasing its coverage to 10000 from 8000 villages.

Indian dairy volumes have been growing at CAGR of 4% in last five years whereas organized sector is growing at 8% CAGR in the same period. Evolving Indian consumerism will likely lead to volume growth of 13% for the organized segment by 2018 whereas the sector volumes are likely to grow at CAGR of 5%, according to industry estimates.

## Valuation and Outlook

Hatsun is the leading branded player in southern India and is taking steps to penetrate deeper in these markets. Value added products and ice cream business are likely to support margins and drive revenues for the company. Stock is currently trading at 26.0x FY17E EPS and we value the company at 30.5x and arrive at target price of Rs. 476 for holding period of 9-12 months with upside potential of 17%.

## Key Risks

- Increase in debt and working capital.
- Entry of large players.
- Rise in input costs.

### Exhibit 1: Valuation Summary

YE Mar (Rs. Mn)	FY13	FY14	FY15	FY16E	FY17E
Net Sales	21683	25020	29391	34916	42039
EBITDA	1511	1862	2043	3094	3998
EBITDA Margin (%)	7.0	7.5	7.0	8.9	9.5
Adj. Net Profit	447	817	392	1038	1697
EPS (Rs.)	4.1	7.6	3.6	9.5	15.6
RoE (%)	37.7	52.9	19.5	40.9	49.2
PE (x)	97.9	53.5	94.7	42.5	26.0

Source: Company, Karvy Research, \*Represents multiples for FY13, FY14 & FY15 are based on historic market price

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### Recommendation (Rs.)

CMP (as on Feb 05, 2016)	406
Target Price	476
Upside (%)	17

### Stock Information

Mkt Cap (Rs.mn/US\$ mn)	44112 / 652
52-wk High/Low (Rs.)	487 / 300
3M Avg. daily volume (mn)	8650
Beta (x)	0.7
Sensex/Nifty	24617 / 7489
O/S Shares(mn)	108.7
Face Value (Rs.)	1.0

### Shareholding Pattern (%)

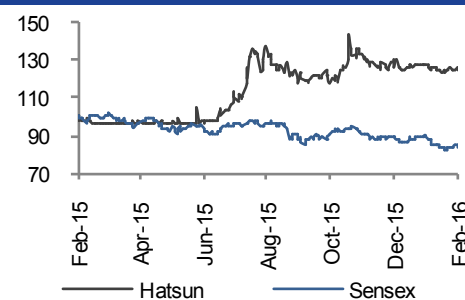
Promoters	74.7
FII	3.0
DII	3.3
Others	19.0

### Stock Performance (%)

	1M	3M	6M	12M
Absolute	0	(4)	(5)	27
Relative to Sensex	2	3	9	48

Source: Bloomberg

### Relative Performance\*



Source: Bloomberg; \*Index 100

### Analyst Contact

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**Company Financial Snapshot (Y/E Mar)**
**Profit & Loss (Rs. Mn)**

	FY15	FY16E	FY17E
Net sales	29391	34916	42039
Optg. Exp (Adj for OI)	27348	31823	38041
EBITDA	2043	3094	3998
Depreciation	940	1088	1153
Interest	634	708	746
Other Income	4	16	22
PBT	474	1314	2121
Tax	99	276	424
Adj. PAT	392	1038	1697
<b>Profit &amp; Loss Ratios</b>			
EBITDA margin (%)	7.0	8.9	9.5
Net margin (%)	1.3	3.0	4.0
P/E (x)	94.7	42.5	26.0
EV/EBITDA (x)	19.7	16.1	12.5
Dividend yield (%)	0.4	0.7	1.0

Source: Company, Karvy Research

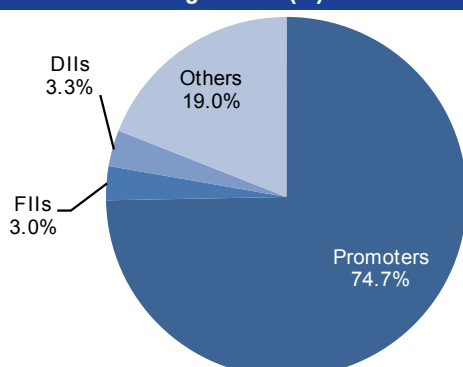
**Balance sheet (Rs. Mn)**

	FY15	FY16E	FY17E
<b>Total Assets</b>	<b>10556</b>	<b>10978</b>	<b>12657</b>
Net Fixed assets	6556	6168	6516
Current assets	3549	4293	5564
Other assets	451	516	577
<b>Total Liabilities</b>	<b>10556</b>	<b>10978</b>	<b>12657</b>
Networth	2215	2860	4034
Debt	4733	5285	5485
Current Liabilities	3324	2547	2853
Deferred Tax	285	285	285

**Balance Sheet Ratios**

RoE (%)	19.5	40.9	49.2
RoCE (%)	17.4	26.8	32.5
Net Debt/Equity	2.0	1.7	1.2
Equity/Total Assets	0.2	0.3	0.3
P/BV (x)	15.5	15.4	10.9

Source: Company, Karvy Research

**Exhibit 2: Shareholding Pattern (%)**


Source: BSE, Karvy Research

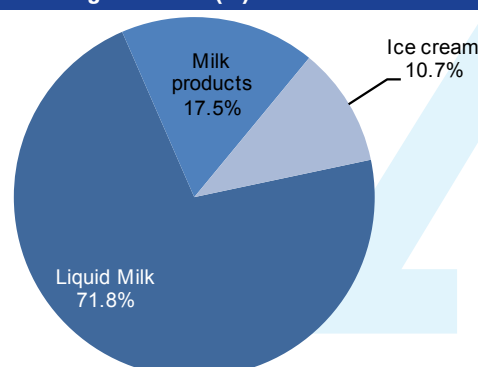
**Company Background**

Hatsun has been in the dairy business since four decades and has become India's largest private sector company in the dairy industry. Arun Icecreams and Arokya Milk, India's largest private sector milk brands, immensely popular across millions of households are also produced and marketed by the company. Dairies are present in 10 locations possessing state-of-the-art facilities, international know-how and personnel with sound experience & expertise enable creation of products of excellent quality, meeting the very highest norms of hygiene and health. The company is producing and marketing a wide range of dairy products - Dairy Whitener, Skimmed Milk Powder, Agmark Certified Ghee, Butter, Cooking Butter, Milk, Varieties of Curd, Paneer and Buttermilk through the brand Hatsun Milk & Milk products.

**Cash Flow (Rs. Mn)**

	FY15	FY16E	FY17E
PBT	474	1314	2121
Depreciation	940	1088	1153
Interest (net)	621	708	746
Tax	(110)	(276)	(424)
Changes in WC	(1281)	(1491)	(498)
Others	(28)	0	0
<b>CF from Operations</b>	<b>615</b>	<b>1343</b>	<b>3097</b>
Capex	(1247)	(700)	(1500)
Investment	0	(0)	(393)
Others	4	0	0
<b>CF from Investing</b>	<b>(1243)</b>	<b>(700)</b>	<b>(1893)</b>
Change in Equity	300	0	0
Change in Debt	1169	552	200
Interest & Dividends	(713)	(1100)	(1269)
<b>CF from Financing</b>	<b>756</b>	<b>(548)</b>	<b>(1069)</b>
Change in Cash	128	95	135

Source: Company, Karvy Research

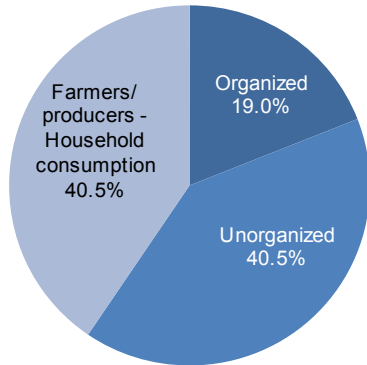
**Exhibit 3: Revenue Segmentation (%)**


Source: Company, Karvy Research

## Dairy Industry in India

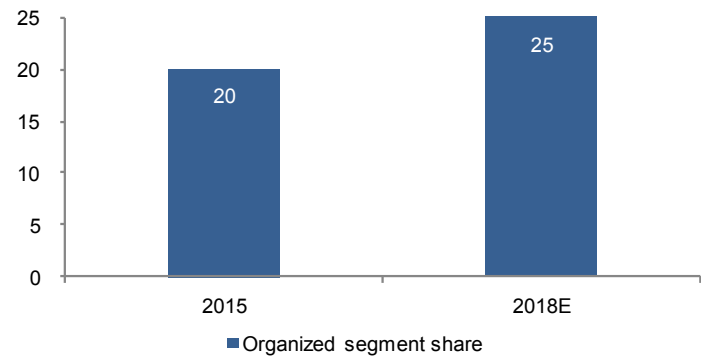
India is the largest milk producing nation in the world with production of 147 mn tones in 2015, accounting for one fifth of the world's production. Out of the total production, unorganized sector has majority of the market share with 41% and organized sector with market share of 20%. There is another major segment, which is the farmers/producers, which has 40% market share and uses for household consumption. Indian dairy market is worth Rs. 4.3 Trillion (Tn) and among that organized sector is worth Rs.750 Bn. Revenue share of organized segment is likely to reach 25% in 2018 from 20% in 2015 on the back of shift in consumer preference towards branded products.

**Exhibit 4: Indian Dairy Industry size (%)**



Source: Industry, Karvy Research

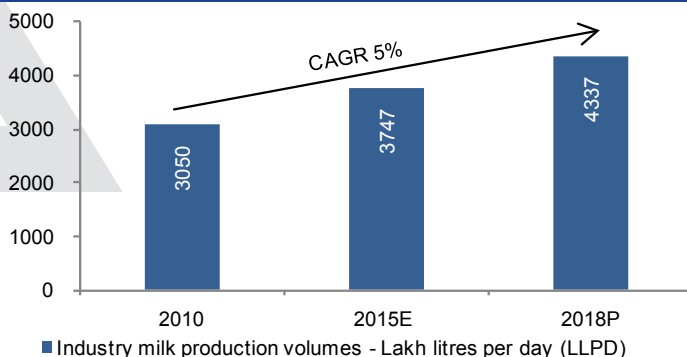
**Exhibit 5: Organized segment share (%)**



Source: Industry, Karvy Research

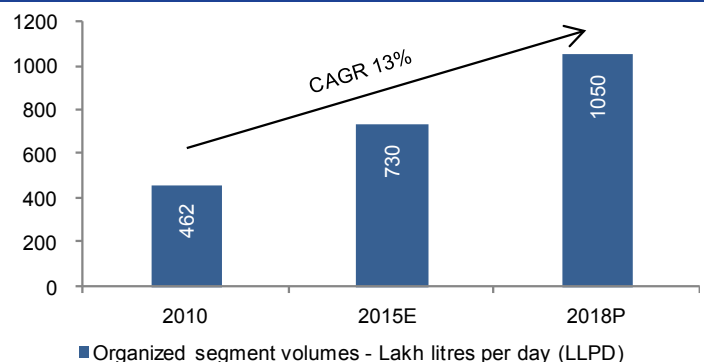
Indian dairy volumes have been growing at CAGR of 4% in last five years whereas organized sector is growing at 8% CAGR in the same period. Evolving Indian consumerism will likely lead to volume growth of 13% for the organized segment by 2018 whereas the sector volumes are likely to grow at CAGR of 5%, according to industry estimates.

**Exhibit 6: Industry Milk Production Volumes**



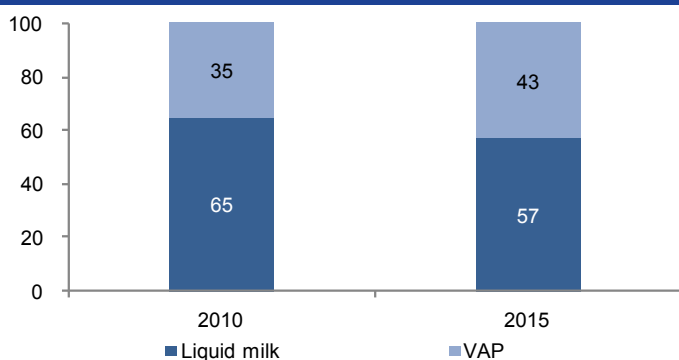
Source: Industry, Karvy Research

**Exhibit 7: Organized Segment Volumes**



Source: Industry, Karvy Research

**Exhibit 8: Market share (%) shift towards VAP**



Source: Industry, Karvy Research

However, in terms of value, it has grown at CAGR of 17% in the last five years, driven by Value Added Products (VAP) which has seen higher growth of 23% in the same period compared to 15% for liquid milk. Organized players are focusing more on VAP products such as panner, cheese, curd, butter, ice cream & lassi as they get twice the margins of liquid milk products. Share of VAP has shot up to 43% in 2015 from 35% in 2010. Over the next few years, branded milk and VAP are likely to grow at 14% & 23% respectively.

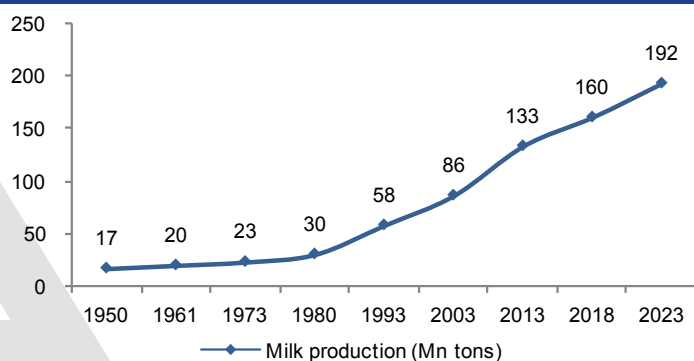
**Exhibit 9: VAP Segment Sales (Rs. Bn)**

	2010	2014	2015	2018P	2020P	CAGR % (2010-2020)	CAGR % (2015-2020)
Curd	124	217	251	331	493	14.8	17.8
Butter	91	168	195	259	382	15.4	17.9
Ultra-High-Temperature (UHT) milk	10	26	33	53	104	26.4	32.0
Flavored milk	5	13	16	25	48	25.4	29.9
Butter milk	6	14	17	25	43	21.8	25.2
Lassi	5	13	15	23	39	22.8	24.6
Cheese	5	12	14	21	36	21.8	24.6

Source: Industry, Karvy Research

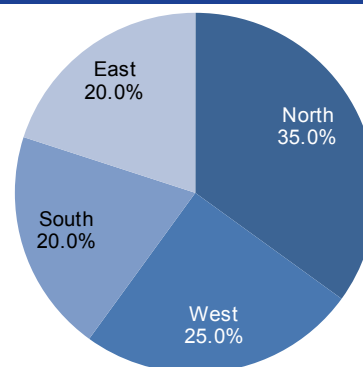
Domestic demand for milk is likely to increase by CAGR of 4% annually and to reach 172 mn tons by 2022 from the current levels of 138 mn tons in 2015. Production has been increasing in order to meet the rising demand from growing Indian population. Production grew at CAGR of 4% annually from 81 mn tons in 2001 to 147 mn tons in 2015. In order to ensure stable supply of milk, more number of processing centers have to be set up near procurement locations as the shelf life of products is less. We expect more number of plants will be set up near major milk producing locations as organized players expand rapidly in next few years to ensure uninterrupted supply. North India produces 35% of India's milk production with the likes of major states such as UP, Punjab, Haryana & Bihar followed by west which contributes 25% and major states include Rajasthan, Gujarat & Maharashtra.

**Exhibit 10: Milk production in India (Mn tons)**



Source: Industry, Karvy Research

**Exhibit 11: Geography-wise milk production (%)**



Source: Industry, Karvy Research

**Efficient procurement system reduces supply risk:**

The company collects milk directly from farmers through their 8500 Hatsun Milk Banks (HMBs) which are present in 10000 villages and receive milk from 3.2 lk farmers every day. Hatsun, in the last few years, has strengthened its procurement by expanding its HMBs from 4500 centers to 8500 and increasing its coverage to 10000 from 8000 villages. From HMBs, it's been taken to chilling centers where the chilling process leads to higher shelf life of milk and then to the dairy for further processing. To meet the demand of northern parts of Karnataka & Telangana, milk procurement has been extended to Maharashtra. New dairy plant has been set up in Tirunelveli to strengthen its presence in Southern Tamil Nadu.

**Stringent Quality control leads to promising brand image on products:**

Milk analyzers have been placed in every HMB to test the quality of milk through two major parameters which are: fat-content and solids-not-fat-content. Gerber & Lactometer methods are used to find out the content range in milk for the above parameters. Quality check process is continuous and is put under various stages and Methylene Blue Reductase Test (MBRT) is conducted in milk chilling centers in order to access the quality of milk and to decide upon the acceptance and rejection criteria for the milk. In the final stage, Clot on Boiling (CoB) test is conducted which helps to check whether the milk should be rejected or it can sustain further heat during the further processing. Such rigorous test has lead to strong brand image in southern India especially in Tamil Nadu which is their main market. The company's ice cream brand 'Arun' is one of the well recognized brands in Tamil Nadu.

**Launch of new premium products & diverse its product portfolio:** Hatsun receives 90% of its revenues from dairy products and remaining from ice cream business. Milk and curd are sold through the brand Arokya, value added products are sold under Hatsun brand; and value added products include panner, curd, ghee, butter which receive twice the margins of liquid milk. Arun ice creams has been one of the well known brands in Tamil Nadu and is continuously launching new flavors. Arun ice cream direct store has new distribution model in AP, Telangana and Karnataka. The company's direct store allows retailers to buy directly without going to any dealers. This model has helped several customers who can buy products at exclusive whole sale prices. Hatsun has created new brand called IBACO under which customers can walk in and choose from various flavors and combinations. Under IBACO, ice cream cakes have been launched which was instant hit in its key markets and it's a go-to solution for any occasion.

### **Educating farmers and long standing relationship with them:**

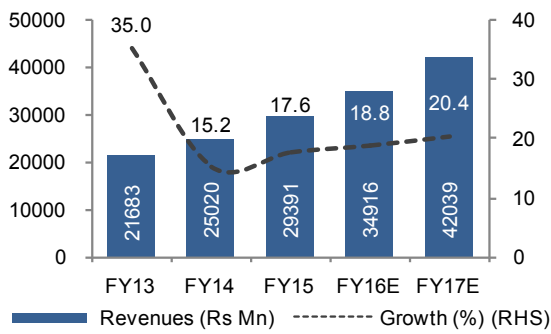
Hatsun has been expanding its highly qualified employee base in order to increase the productivity and profitability of dairy farmers. The company manufactures and sells cattle feed to the farmers and have initiated trial on feasibility on producing and feeding silage to cattle with complete nutrition and concentrates. Hatsun roped in veterinary doctors, trained inseminators for regular visits to villages and carryout artificial insemination on animals to ensure milch animals produce at least one calf every year. To compensate for the shortage of number of milch animals holding in the shed due to shortage of man power, Hatsun is sourcing appropriate technology to help farmers to automate his farm to the optimum level.

**Exhibit 12: Business Assumptions**

Y/E Mar (Rs. Mn)	FY14	FY15	FY16E	FY17E	Comments
Revenue	25020	29391	34916	42039	Top line is expected to grow strongly at CAGR of 19.6% on the back of change in product mix towards value added products.
Revenue Growth (%)	15.2	17.6	18.8	20.4	
EBITDA	1862	2043	3094	3998	We expect the margins to improve from the current levels of 7.0% in FY15 to 9.5% in FY17E on the back of decline in raw material prices and higher degree of operating leverage.
EBITDA Margins (%)	7.5	7.0	8.9	9.5	
PAT (normalized)	817	392	1038	1697	
Fully Diluted EPS (Rs.)	7.6	3.6	9.5	15.6	
Fully Diluted EPS Growth (%)	82.9	(52.5)	165.1	63.5	
Capex (ex. Acquisition) - cash capex	2362	1247	700	1500	Operating cash flows are likely to improve from Rs. 615 mn in FY15 to Rs.3097 Mn in FY17E on the back of change in revenue mix and higher operating margins.
Net CFO	2006	615	1343	3097	
Net Debt	3849	4498	4955	5020	
Free Cash Flow	(356)	(632)	643	1597	

Source: Company, Karvy Research

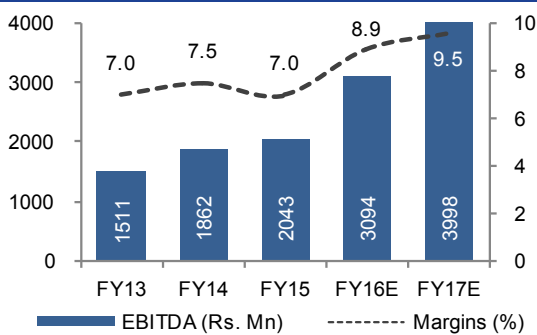
**Exhibit 13: Revenue Growth**



Source: Company, Karvy Research

Top line is expected to grow strongly at CAGR of 19.6% on the back of change in product mix towards value added products. Sale of VAP is increasing which should increase the visibility on the company's products. In the last three years, the company's revenue grew at CAGR of 22.3%.

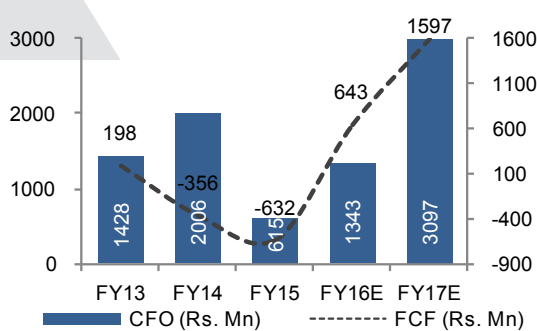
**Exhibit 14: EBITDA margins to improve**



Source: Company, Karvy Research

Shift towards VAP is likely to support the margins of the company as percentage of VAP sales is on the rise. VAP products fetch twice the margins of liquid milk segment and the company has launched VAP products and pushing it hard through promotional activities. We expect the margins to improve from the current levels of 7.0% in FY15 to 9.5% in FY17E on the back of decline in raw material prices and higher degree of operating leverage.

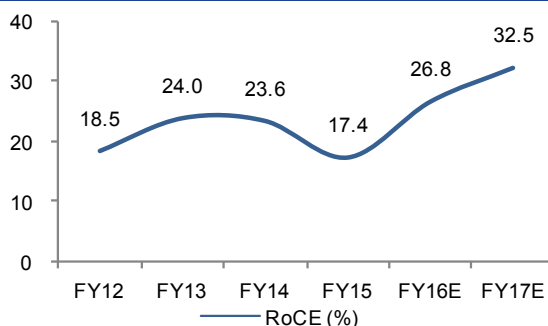
**Exhibit 15: Operating and Free cash flows**



Source: Company, Karvy Research

Operating cash flows are likely to improve from Rs. 615 mn in FY15 to Rs.3097 Mn in FY17E on the back of change in revenue mix and higher operating margins. However, on the back of capex, most of the cash is likely to be utilized for this purpose.

**Exhibit 16: Healthy Return Ratios**



Source: Company, Karvy Research

The company has maintained its RoCE at healthy levels in the last three years and is likely to reach 32.5% in FY17E. With operating cash flows improving and lower capex, return ratios are likely to improve going forward.

**Exhibit 17: Company Snapshot (Ratings)**

	Low				High
	1	2	3	4	5
Quality of Earnings			✓		
Domestic Sales			✓		
Exports	✓				
Net Debt/Equity			✓		
Working Capital Requirement			✓		
Quality of Management			✓		
Depth of Management			✓		
Promoter			✓		
Corporate Governance			✓		

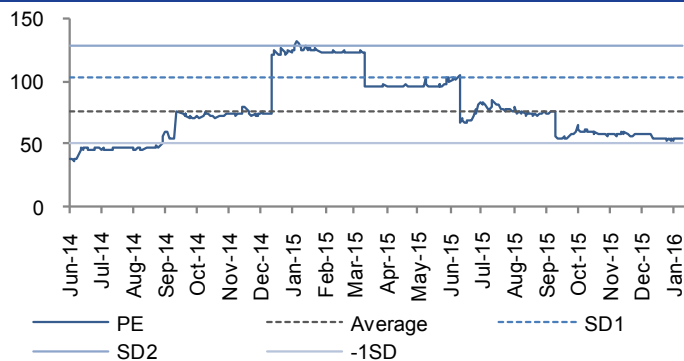
Source: Company, Karvy Research



## Valuation & Outlook

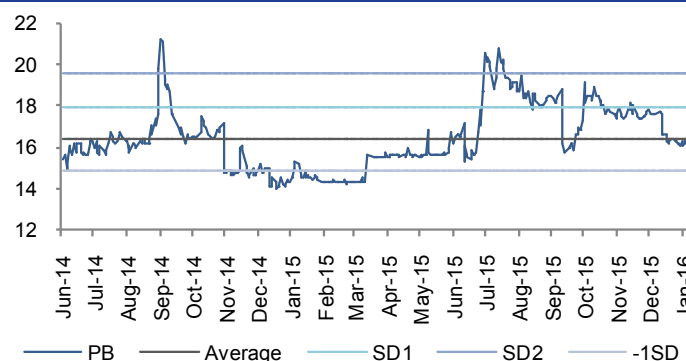
Hatsun is the leading branded player in southern India and is taking steps to penetrate deeper in these markets. Value added products and ice cream business are likely to support margins and drive revenues for the company. Stock is currently trading at 26.0x FY17E EPS and we value the company at 30.5x and arrive at target price of Rs. 476 for holding period of 9-12 months with upside potential of 17%.

**Exhibit 18: PE Band**



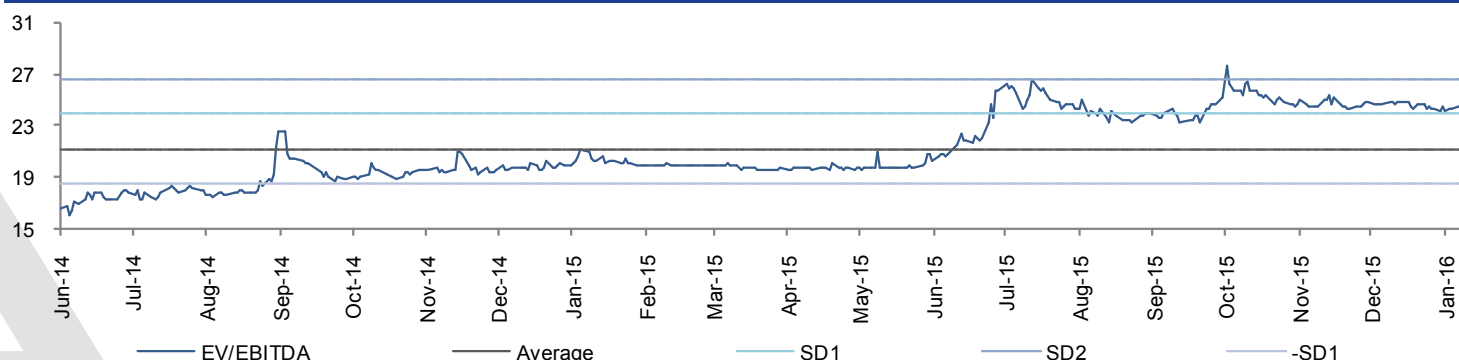
Source: Bloomberg, Karvy Research

**Exhibit 19: PB Band**



Source: Bloomberg, Karvy Research

**Exhibit 20: EV/EBITDA**



Source: Bloomberg, Karvy Research

**Exhibit 21 (a): Comparative Valuation Summary**

	CMP (Rs.)	Mcap (Rs. Mn)	EV/EBITDA (x)			P/E (x)			EPS (Rs.)		
			FY15	FY16E	FY17E	FY15	FY16E	FY17E	FY15	FY16E	FY17E
Hatsun	406	44112	19.7	16.1	12.5	94.7	42.5	26.0	3.6	9.5	15.6
Kwality	114	25372	5.7	9.0	7.3	5.9	11.7	8.9	7.6	9.8	12.8
Vadilal Industries	558	3896	7.6	6.5	5.7	180.3	35.1	24.3	3.3	17.1	24.7

Source: Bloomberg, Karvy Research

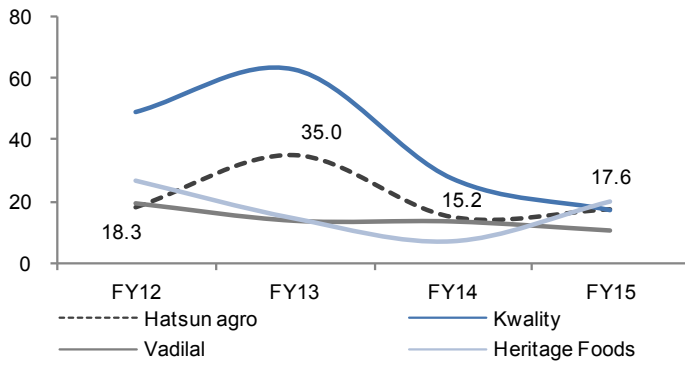
**Exhibit 21 (b): Comparative Operational Metrics Summary**

	CAGR % (FY15-17E)			RoE (%)			Price Perf (%)			Net Sales (Rs. Mn)		
	Sales	EBITDA	EPS	FY15	FY16E	FY17E	3m	6m	12m	FY15	FY16E	FY17E
Hatsun	19.6	39.9	108.2	19.5	40.9	49.2	(3.9)	(4.7)	26.7	29391	34916	42039
Kwality	16.0	23.0	29.7	30.5	27.8	27.6	13.1	35.3	192.0	58784	67601	79093
Vadilal Industries	12.9	22.8	172.2	2.1	10.2	13.4	(13.7)	(35.3)	105.3	4063	4587	5179

Source: Bloomberg, Karvy Research

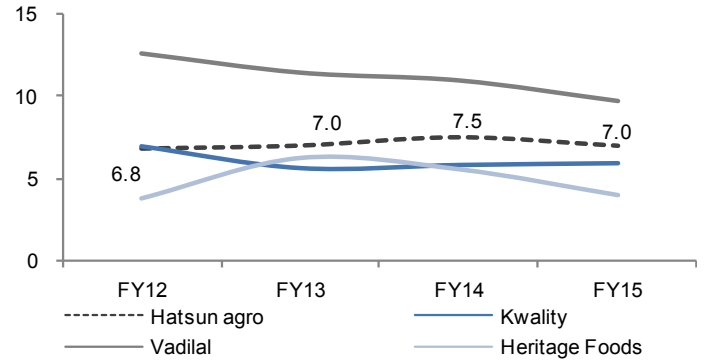
## Peer Comparison

**Exhibit 22: Revenue Growth (%)**



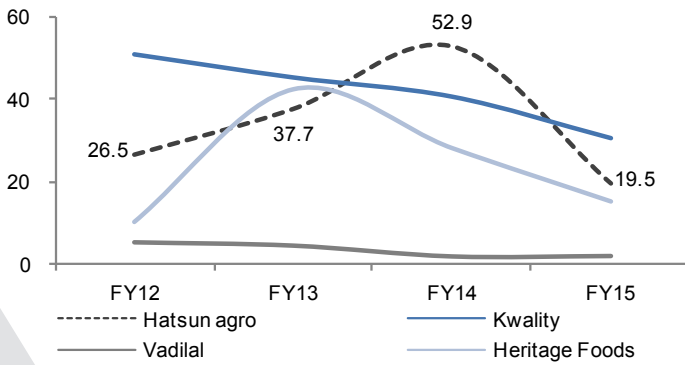
Source: Company, Karvy Research

**Exhibit 23: EBITDA Margin (%)**



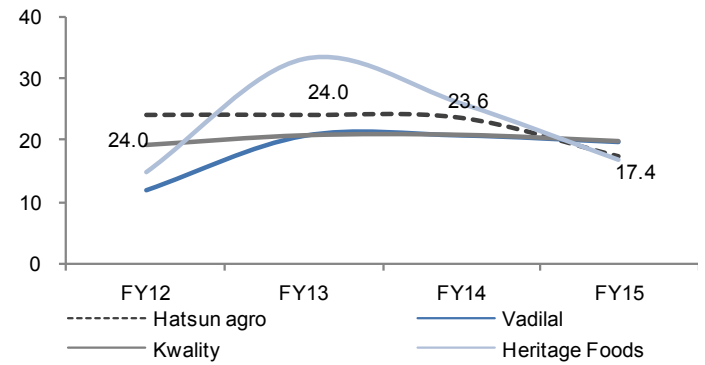
Source: Company, Karvy Research

**Exhibit 24: RoE (%)**



Source: Company, Karvy Research

**Exhibit 25: RoCE (%)**



Source: Company, Karvy Research

## Key Risks

- Increase in debt and working capital.
- Entry of large players.
- Rise in input costs.

## Financials

### Exhibit 26: Income Statement

YE Mar (Rs. Mn)	FY13	FY14	FY15	FY16E	FY17E
Revenues	21683	25020	29391	34916	42039
Growth (%)	35.0	15.2	17.6	18.8	20.4
Operating Expenses	20172	23158	27348	31823	38041
EBITDA	1511	1862	2043	3094	3998
Growth (%)	35.4	23.3	9.7	51.4	29.2
Depreciation & Amortization	503	650	940	1088	1153
Other Income	5	8	4	16	22
EBIT	1012	1221	1107	2022	2867
Interest Expenses	444	407	634	708	746
PBT	568	814	474	1314	2121
Tax	114	171	99	276	424
Adjusted PAT	447	817	392	1038	1697
Growth (%)	67.9	82.9	(52.1)	165.1	63.5

Source: Company, Karvy Research

### Exhibit 27: Balance Sheet

YE Mar (Rs. Mn)	FY13	FY14	FY15	FY16E	FY17E
Cash & Bank Balances	302	107	236	330	466
Sundry Debtors	428	219	126	287	346
Inventory	1107	886	2585	2982	3561
Loans & Advances	562	1083	1025	1181	1348
Investments	7	8	8	8	401
Gross Block	4421	5686	7263	7022	7434
Net Block	3918	5037	6322	5934	6282
CWIP	448	1063	234	234	234
Miscellaneous	100	34	20	20	20
<b>Total Assets</b>	<b>6871</b>	<b>8437</b>	<b>10556</b>	<b>10978</b>	<b>12657</b>
Current Liabilities & Provisions	1981	2403	3319	2542	2848
Debt	3317	3956	4733	5285	5485
Other Liabilities	277	284	290	290	290
<b>Total Liabilities</b>	<b>5575</b>	<b>6643</b>	<b>8342</b>	<b>8118</b>	<b>8623</b>
Shareholders Equity	108	108	109	109	109
Reserves & Surplus	1188	1686	2106	2751	3925
<b>Total Networth</b>	<b>1295</b>	<b>1794</b>	<b>2215</b>	<b>2860</b>	<b>4034</b>
<b>Total Networth &amp; Liabilities</b>	<b>6871</b>	<b>8437</b>	<b>10556</b>	<b>10978</b>	<b>12657</b>

Source: Company, Karvy Research

**Exhibit 28: Cash Flow Statement**

YE Mar (Rs. Mn)	FY13	FY14	FY15	FY16E	FY17E
PBT	568	814	474	1314	2121
Depreciation	503	650	940	1088	1153
Interest	430	436	621	708	746
Tax Paid	(104)	(238)	(110)	(276)	(424)
Inc/dec in Net WC	58	394	(1281)	(1491)	(498)
Other Income	(5)	(9)	(5)	0	0
Other non cash items	(22)	(42)	(24)	0	0
<b>Cash flow from operating activities</b>	<b>1428</b>	<b>2006</b>	<b>615</b>	<b>1343</b>	<b>3097</b>
Inc/dec in capital expenditure	(1231)	(2362)	(1247)	(700)	(1500)
Inc/dec in investments	(7)	(1)	0	(0)	(393)
Others	(193)	240	4	0	0
<b>Cash flow from investing activities</b>	<b>(1430)</b>	<b>(2124)</b>	<b>(1243)</b>	<b>(700)</b>	<b>(1893)</b>
Inc/dec in borrowings	628	937	1169	552	200
Issuance of equity	0	0	300	0	0
Dividend paid	(188)	(365)	(78)	(392)	(523)
Interest paid	(426)	(441)	(634)	(708)	(746)
Others	(9)	(0)	0	0	0
<b>Cash flow from financing activities</b>	<b>5</b>	<b>131</b>	<b>756</b>	<b>(548)</b>	<b>(1069)</b>
<b>Net change in cash</b>	<b>3</b>	<b>13</b>	<b>128</b>	<b>95</b>	<b>135</b>

Source: Company, Karvy Research

**Exhibit 29: Key Ratios**

YE Mar	FY13	FY14	FY15	FY16E	FY17E
EBITDA Margin (%)	7.0	7.5	7.0	8.9	9.5
EBIT Margin (%)	4.7	4.9	3.8	5.8	6.8
Net Profit Margin (%)	2.1	3.3	1.3	3.0	4.0
Dividend Payout Ratio (%)	41.0	33.0	50.0	31.4	25.6
Net Debt/Equity (x)	2.3	2.1	2.0	1.7	1.2
RoE (%)	37.7	52.9	19.5	40.9	49.2
RoCE (%)	24.0	23.6	17.4	26.8	32.5

Source: Company, Karvy Research

**Exhibit 30: Valuation Parameters**

YE Mar	FY13	FY14	FY15	FY16E	FY17E
EPS (Rs.)	4.1	7.6	3.6	9.5	15.6
DPS (Rs.)	1.7	2.5	1.8	3.0	4.0
BV (Rs.)	12.0	16.7	20.4	26.3	37.1
PE (x)	97.9	53.5	94.7	42.5	26.0
P/BV (x)	33.7	24.4	15.5	15.4	10.9
EV/EBITDA (x)	26.6	21.6	19.7	16.1	12.5
EV/Sales (x)	1.9	1.6	1.4	1.2	1.0

Source: Company, Karvy Research; \*Represents multiples for FY13, FY14 & FY15 are based on historic market price

Stock Ratings	Absolute Returns
Buy	: > 15%
Hold	: 5-15%
Sell	: <5%

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