

CMP: INR 372

Outlook: Positive

Stock Info

BSE	519552
NSE	HERITGFOOD
Bloomberg	HTFL:IN
Reuters	HEFI.NS
Sector	Dairy Products
Face Value (INR)	5
Equity Capital (INR cr)	809
Mkt Cap (INR cr)	1,670
52w H/L (INR)	250 / 452
Avg Daily Volume (in 000')	137

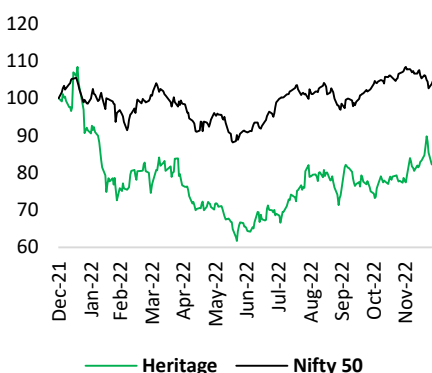
Shareholding Pattern %

(As on Sept, 2022)

Promoters	39.4
FII	2.4
DII	15.5
Public & Others	42.7

Stock Performance (%)	1m	3m	12m
Heritage Foods	12.9	7.3	(12.6)
Nifty 50	(2.8)	6.7	6.0

Heritage Vs Nifty 50



Heritage Foods (Heritage) is engaged in the business of procurement and processing of Milk & Milk products and also the generation of power through solar & wind for captive consumption. The company has a reach to over 1.5mn households in India across 11 states (with procurement across 8 states). It is one of the largest private dairies in South India and has significant market shares in Andhra Pradesh, Telangana, Karnataka, and Tamil Nadu and they are also present in a few North- Indian states. Products include milk, curd, buttermilk, lassi, ghee, paneer, doodh peda, milk cake, ice creams, and other dairy items. Its focus products are sweets, cheese, curd, paneer, drinkables, and ice cream. Heritage also has a presence in animal nutrition wherein they produce cattle feed.

Investment Rationale:

Aggressive growth: Heritage has targeted a revenue of INR 6,000 Cr in the next 4 years and 7-8% margins in the short run. In the next 3-4 years they have targeted 10% margins. This indicates a CAGR of 22% from FY22 levels. The dairy industry is currently growing at 15%.

Strong relationships with dairy farmers: The core strength of the company is its long-standing relationships with 300,000+ dairy farmers from whom they can procure 1.47MLPD of milk (to grow to 2.2-2.3MLPD in the next 3-4 years). Direct Payments are made into their accounts on a timely basis and transparency is maintained. Farmers are also provided with aid through welfare activities which ensures their stickiness. Heritage is looking to add 40,000 more farmers to the procurement network to increase procurement. It has one of the strongest distributor networks in South India. Strong relationships with a large farmer network are the reason players like Heritage and Dodla flourished in southern markets, and players like Amul could not.

Increasing shares of VAP: Value Added Products have higher margins compared to milk and comprise ~25% of sales as of FY22. Since VAP sales bring stability to margins, the company is aiming to consistently increase its overall revenue share to 40% in the next 4 years. Recently, they launched 'Glucoshakti'- a whey-based energy drink to the VAP product mix. Curd is 75% of all VAP sales and is the fastest-growing product. They also are looking to further expand their presence into RTC/ RTE products.

Valuation & Outlook: We believe that the company is on a strong growth trajectory and its performance in the near future looks very promising. Heritage is working toward attaining a pan- India presence once they have gotten a lock on their current markets, increasing the share of value-added products, penetrating new geographies, expanding their manufacturing facilities, and also empowering farmers at the same time. They are well on track to deliver INR 6,000 Cr of revenue in 4 years with 8% margins aided by good management working toward strengthening all verticals. We are positive about the stock, and it is currently valued at a TTM P/E of 24.50x.

INR Mn	FY19	FY20	FY21	FY22
Revenue	25,148	27,259	24,731	26,813
EBITDA	1,850	1,284	2,669	1,907
EBITDA Margin	7.36%	4.71%	10.79%	7.11%
PAT	826	-1694	1,483	961
EPS (INR)	17.55	-34.55	32.32	20.81
P/E (x)	20.51	-10.42	11.14	17.30

Source: Company Filings & Arihant Capital Research

Abhishek Jain

Abhishek.jain@arihantcapital.com

022 67114872

Anushka Chitnis

anushka.chitnis@arihantcapital.com

Investment Rationale:

Leveraging distribution strength: Another key strength of the company is its wide distribution network across India. Its products are sold across 11 States, through 6,500 milk distributors (they have also added 190 product/ FMCG distributors that also serve reputed players like Unilever, P&G, etc.), 121 Heritage Distribution Centers across 9 states, 130,000+ Retail Outlets (to be increased to 300,000 going forward), 27 modern retail chains, and 859 Heritage Parlors. It also has a strong presence across 16 e-com websites. They have a very small D2C business. Heritage is working toward improving relationships with B2B customers in the Horeca segment.

Capex and Facilities: Capex upward of INR 100-125 Cr per year for the next 3 years is planned. They are investing in villages and setting up collection and cooling infrastructure- in line with their goal to increase village-level milk collection and strengthen processing facilities. The company currently has 18 processing facilities with a processing capacity of 2.65 MLPD, 198 Bulk Coolers, and Mini Chilling & Chilling Units with 2.08 MLPD capacity.

Organized vs Private: The split between co-op and private is near 50-50. However, it is more consolidated on the cooperative side as the private industry is highly fragmented. Private dairies are growing in share mostly because of consumer preferences toward higher quality products.

Cost pressures: High procurement costs from a weaker flush season were passed on and were well received by customers. However, these are expected to abate soon (by the same time next year) and lead to margin expansion from current levels.

Relationships with farmers are well maintained: Heritage procures at higher prices than state cooperatives in some states, which benefits the farmers. It also provides them with timely payments thrice a month. This ensures that farmers from whom they procure stay loyal to Heritage.

VAP Advantage: The GM of VAPs is rough 2x that of milk products. Hence they want to grow its revenue share by 15% in the next 4 years. It should provide a 5% benefit to Gross Margins on a weighted average basis. It will also improve consumer centricity. All categories of VAP are clocking in growth in the high teens.

De-Risking the Business: They are doing this by focusing growth in areas like Maharashtra where throughput and profitability are low, as the regions mainly have milk sales.

Fat Disposal: The company is now focusing on turning excess fat from milk processing into consumer products like butter and ghee rather than selling them off in bulk and incurring losses.

SMP Prices: Prices of Skimmed Milk Powder in India remain stagnant even though they have declined globally. India doesn't import SMP, and domestic prices are higher than they were in March 2022.

Fastest-growing Markets: Outside of focus markets in the south, Mumbai and NCR are the fastest-growing regions.

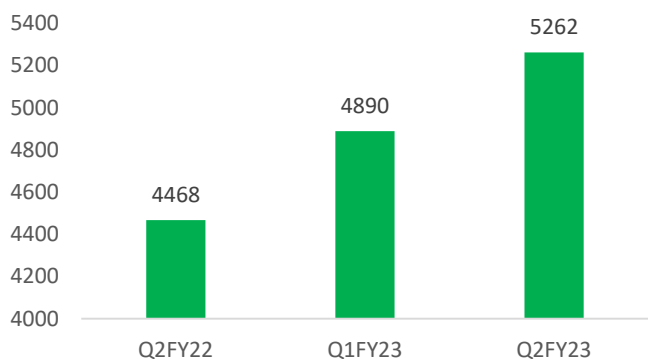
Synergies with Animal Feed business: In most markets, farmers choose their cattle feed. It is netted against payments due to them.

Business Overview

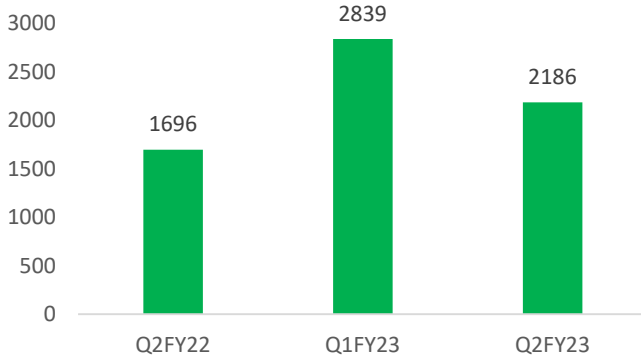
Business Model	The company procures raw milk from dairy farmers, post which it is tested, processed, and chilled. It is then manufactured into a whole range of dairy products. Currently, ~25% Of their revenue comes from Value- Added Products, and the rest comes from milk sales.
Strategic Positioning	Over the years, the company has created strong long-lasting relationships with 300,000+ dairy farmers for milk procurement across 8 states.
Competitive Edge	A well-diversified product portfolio and a growing share of value-added products combined with their market leadership in southern markets.
Financial Structure	The company enjoys a net debt-free status and is steadily expanding its capabilities and capacities through internally generated funds.
Future Revenue Drivers	Growing share of VAP to bring stability to margins whilst simultaneously expanding them. Growing distribution and procurement into newer territories like Maharashtra and Orissa to attain pan- India status.
Shareholder Value Proposition	The company has thriving operations in the African Market as their business is growing in double digits. They also boast an extensive product portfolio of milk-based products.
Earnings Visibility	Heritage is poised to grow at a CAGR of 22% over the next 4 years, and deliver double-digit EBITDA margins in the range of 10%.

Revenue Share

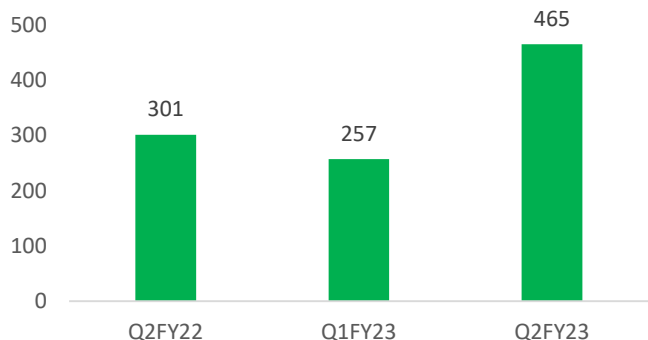
Milk Revenue (INR Mn)



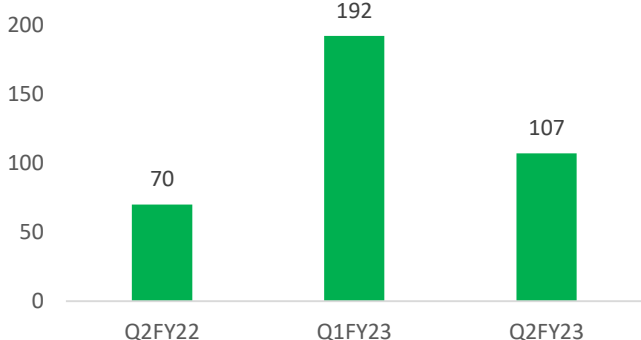
VAP Revenue (INR Mn)



Fat Products Revenue (INR Mn)



Ice- Cream Revenue (INR Mn)



Source: Company Filings & Arihant Capital Research

Revenue and Product Mix as of FY22



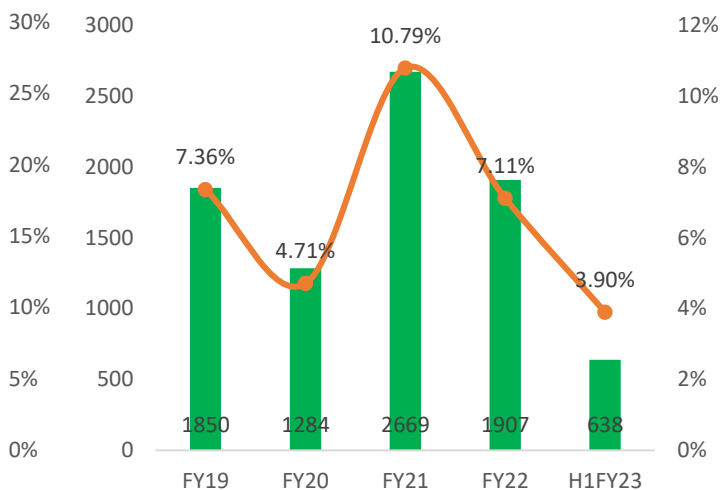
Source: Company Filings & Arihant Capital Research

Story in Charts

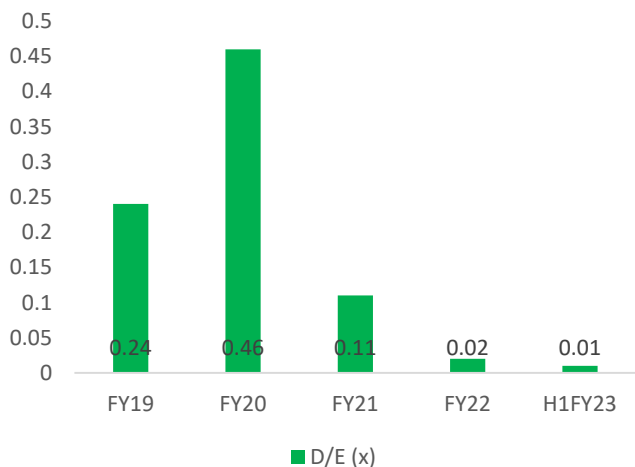
Revenue (INR Mn) & Gross Margins (%)



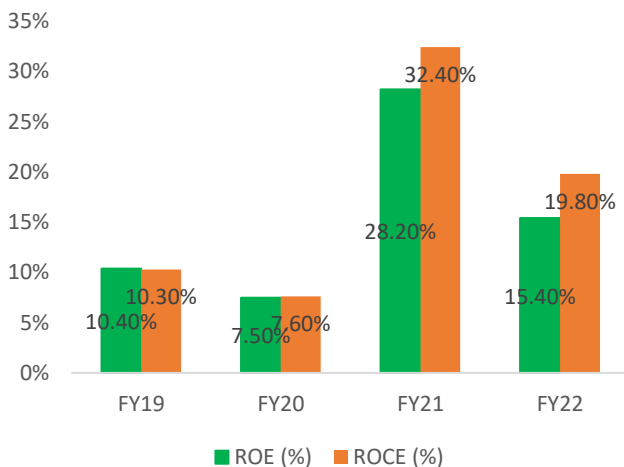
EBITDA (INR Mn) & Margins (%)



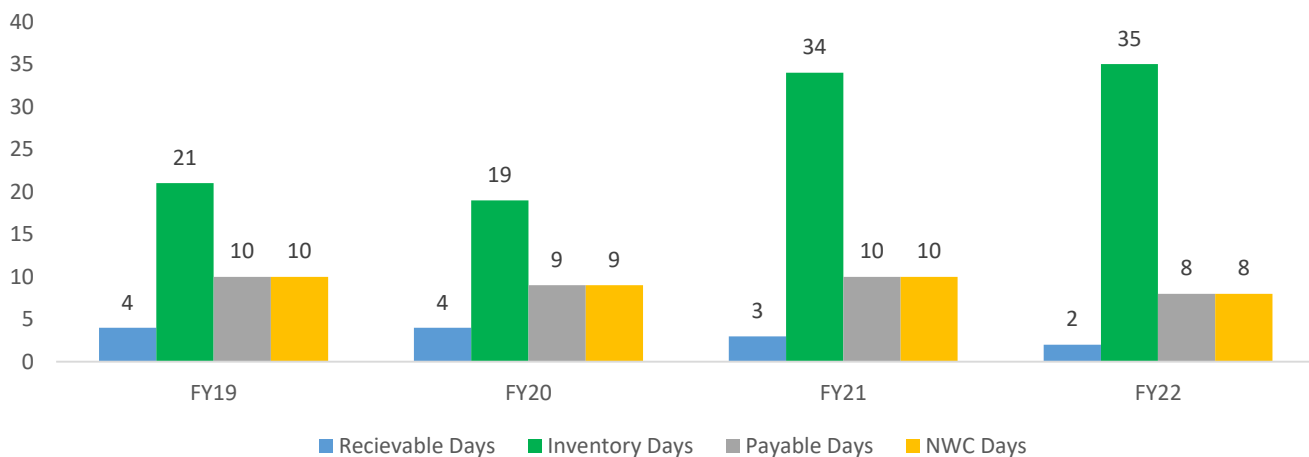
Leverage Ratio



Return Ratios



Working Capital Days



Source: Company Filings & Arihant Capital Research

Arihant Research DeskEmail: instresearch@arihantcapital.com

Tel. : 022-42254800

Head Office	Registered Office
#1011, Solitaire Corporate Park Building No. 10, 1 st Floor Andheri Ghatkopar Link Road Chakala, Andheri (E) Mumbai – 400093 Tel: (91-22) 42254800 Fax: (91-22) 42254880	Arihant House E-5 Ratlam Kothi Indore - 452003, (M.P.) Tel: (91-731) 3016100 Fax: (91-731) 3016199

Stock Rating Scale	Absolute Return
BUY	>20%
ACCUMULATE	12% to 20%
HOLD	5% to 12%
NEUTRAL	-5% to 5%
REDUCE	-5% to -12%
SELL	<-12%

Research Analyst Registration No.	Contact	Website	Email Id
INH000002764	SMS: 'Arihant' to 56677	www.arihantcapital.com	instresearch@arihantcapital.com

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Arihant Capital Markets Ltd.
1011, Solitaire Corporate park, Building No. 10, 1st Floor,
Andheri Ghatkopar Link Road, Chakala, Andheri (E)
Tel. 022-42254800 Fax. 022-42254880