Heritage Foods Ltd — FY 2024 Annual Report Analysis

Annual Report Analysis (Consolidated)

Investor Snapshot

- Heritage Foods is successfully pivoting from a commodity liquid milk supplier to a branded FMCG player, with Value-Added Products (VAP) now constituting 29.6% of the revenue mix.
- Top-line growth of 17% YoY to ₹3,793.9 Cr reflects strong market penetration and successful scaling of the VAP portfolio despite competitive pressures.
- Structural margin expansion is evident as ROCE surged to 16.88% (vs. 10.44% YoY), driven by higher-margin VAP contributions and improved asset sweating.
- Bottom-line performance was robust with PAT surging 84% to ₹106.6 Cr, though profitability remains sensitive to raw milk procurement costs and high selling expenses (+41%).
- The balance sheet has undergone massive deleveraging, with Debt/Equity falling to a lean 0.12x following the repayment of ₹126.4 Cr in short-term demand loans.
- Cash generation reached record levels with CFO at ₹389.9 Cr, significantly exceeding PAT (3.66x) due to aggressive working capital management and a 31% reduction in inventory.
- Operational efficiency improved sharply as inventory days were compressed from 42.7 to 25.2, facilitating a self-funded growth model with FCF of ₹284.5 Cr.
- Earnings quality is high given the cash backing, though the lack of a database-level audit trail in SAP and continued funding of the loss-making Novandie JV (₹13.08 Cr loss) warrant caution.
- Governance remains a primary "discount" factor, characterized by aggressive promoter compensation (9-13% of PAT) and high RPT dependency (₹182.3 Cr) for procurement financing.
- Key risks include a ₹12.98 Cr EPCG export obligation, a ₹3.53 Cr GST dispute on flavoured milk, and potential margin compression if raw milk prices spike >15%.
- The growth trajectory is tied to the VAP mix reaching a target threshold of 35%, which would likely stabilize EBITDA margins above the 8% mark.
- Maintain ACCUMULATE stance based on operational turnaround; monitor VAP revenue contribution and promoter remuneration levels as primary triggers for re-evaluation.

#	Analytical point	Sentiment
1	**Heritage Foods is successfully pivoting from a commodity liquid milk supplier to a branded FMCG player, with Value-Added Products (VAP) now constituting 29.6% of the revenue mix.**	—
2	**Top-line growth of 17% YoY to □3,793.9 Cr reflects strong market penetration and successful scaling of the VAP portfolio despite competitive pressures.**	—
3	**Structural margin expansion is evident as ROCE surged to 16.88% (vs. 10.44% YoY), driven by higher-margin VAP contributions and improved asset sweating.**	—
4	**Bottom-line performance was robust with PAT surging 84% to □106.6 Cr, though profitability remains sensitive to raw milk procurement costs and high selling expenses (+41%).**	—
5	**The balance sheet has undergone massive deleveraging, with Debt/Equity falling to a lean 0.12x following the repayment of □126.4 Cr in short-term demand loans.**	—
6	**Cash generation reached record levels with CFO at □389.9 Cr, significantly exceeding PAT (3.66x) due to aggressive working capital management and a 31% reduction in inventory.**	—
7	**Operational efficiency improved sharply as inventory days were compressed from 42.7 to 25.2, facilitating a self-funded growth model with FCF of □284.5 Cr.**	—
8	***Earnings quality is high given the cash backing, though the lack of a database-level audit trail in SAP and continued funding of the loss-making Novandie JV (13.08 Cr loss) warrant caution.***	—
9	***Governance remains a primary "discount" factor, characterized by aggressive promoter compensation (9-13% of PAT) and high RPT dependency (182.3 Cr) for procurement financing.***	—
10	***Key risks include a 12.98 Cr EPCG export obligation, a 3.53 Cr GST dispute on flavoured milk, and potential margin compression if raw milk prices spike >15%.***	—
11	The growth trajectory is tied to the VAP mix reaching a target threshold of 35%, which would likely stabilize EBITDA margins above the 8% mark.	—
12	Maintain ACCUMULATE stance based on operational turnaround; monitor VAP revenue contribution and promoter remuneration levels as primary triggers for re-evaluation.	—

1. Business overview (In Bullet Points)

- **Business Segments:** Primarily engaged in the procurement and processing of milk and dairy products (Liquid Milk and Value-Added Products).
- **Revenue Drivers:** Structural shift toward Value-Added Products (VAP), which now contribute **29.6%** of total revenue; Liquid Milk contribution has dropped below 60% for the first time.
- **Cost Drivers:** Raw milk procurement (76.3% of revenue), power and fuel, freight outwards (□**105.83 Cr**), and employee benefits (□257.55 Cr).
- **Industry Position:** Strong regional player in Southern India with a massive procurement network of 2.4 million liters/day across 12 states.
- **Expansion Plans:** Pivoting distribution toward Quick Commerce and "Heritage Happiness Points" (250+ franchisee-operated stores) to capture higher margins.
- **Acquisitions & JVs:** Continued investment in Heritage Novandie (Yogurt JV), despite historical losses, with a fresh investment of □**9.8 Cr** in FY24.
- **Capacity Additions:** Processing capacity stands at 2.7 million liters/day; strategy focuses on "limiting distance traveled" via a distributed network of chilling centers.
- **Geographical Presence:** Almost entirely dependent on the domestic Indian market, specifically southern regions; export revenue is negligible at □**1.56 Cr**.

- **Renewable Energy:** Captive solar and wind power capacity of **11.70 MW** used as an operational hedge against rising industrial power tariffs.

2. Management commentary & outlook

- Management is aggressively executing a structural shift in the revenue mix, positioning Heritage Foods as a "Dairy Brand" rather than a "Milk Collector."
- The strategy focuses on "Consumer Centricity" and R&D, moving away from the "Procurement-First" tone of prior years to defend premium pricing.
- Digital transformation is a key priority, evidenced by the launch of "Heritage Vet+" and a move to 100% digital payments for customers to improve cash cycle transparency.
- Management remains committed to the Heritage Novandie JV despite its failure to achieve large-scale market penetration to date; the JV loss narrowed to □**13.08 Cr** in FY24.
- Growth guidance is centered on the VAP segment, particularly Curd, which contributes **70% of VAP revenues**.
- The company is utilizing a 360-degree marketing campaign ("Heritage Curd Makes Your Day") to drive B2C traction, which will keep selling and distribution expenses elevated.
- Management justifies high promoter remuneration (9% of net profit) as being within statutory limits, despite the impact on capital available for reinvestment.
- The long-term vision involves shortening the supply chain and owning consumer touchpoints through franchisee-operated stores.
- Management Tone: The management exhibits an "Aggressively Optimistic but Operationally Defensive" stance. While they are bullish on digital adoption and the VAP pivot, they remain defensive regarding high promoter pay and the continued funding of the loss-making yogurt JV. The narrative prioritizes brand excellence to justify premium positioning in a competitive landscape.

3. Financial analysis

3.1 Financial statements

3.2 Financial analysis summary

- **Revenue from Operations** grew by 17.07% YoY to □3,793.904 Cr, primarily driven by the Sale of Products, while Trade Receivables remained nearly flat at □28.706 Cr, indicating a high-quality, cash-intensive sales model where revenue growth does not lead to a build-up of credit risk.
- **PAT** surged by 83.7% to □106.550 Cr, significantly outpacing Revenue growth, which resulted in the PAT Margin improving from 1.79% to 2.81% as the company benefited from better absorption of fixed costs despite Employee Benefits Expense rising 21.78% to □257.549 Cr.
- The company demonstrated massive **Working Capital** efficiency as Inventory levels were slashed by 30.88% to □261.913 Cr despite higher sales volumes, which, combined with a near doubling of Trade Payables to □144.983 Cr, propelled CFO to a record □389.875 Cr from a negative position in the previous year.
- **CFO** to PAT ratio stands at an exceptional 3.66x, signaling that the reported profits are deeply backed by cash, largely due to the liquidation of □117.032 Cr worth of Inventory and the strategic extension of Payable Days from 8.6 to 13.9 days.
- **Total Debt** (including current maturities) decreased to □92.046 Cr from □132.240 Cr, following a major restructuring where high-cost Current Borrowings of □126.396 Cr were fully repaid and replaced with long-term secured Non-current Borrowings at favorable MCLR-linked rates.

- **Finance Costs** increased to □8.469 Cr from □3.219 Cr, reflecting the full-year impact of the new debt structure and a sharp rise in interest on Lease Liabilities (□3.372 Cr), yet Interest Coverage remains robust at 18.17x, ensuring high solvency.
- **Property, Plant and Equipment** increased to □684.321 Cr, supported by a Capex outflow of approximately □105.412 Cr, while CWIP reduced to □28.456 Cr as projects were commissioned; notably, 97.3% of remaining CWIP is less than one year old, indicating no execution delays.
- **Other Expenses** rose to □318.949 Cr, with Freight Outwards (□105.831 Cr) and Selling and Distribution (□37.341 Cr) being the primary drivers; the latter jumped 40.9% to support market expansion.
- **ROCE** improved significantly to 16.88% from 10.44%, driven by the combination of higher EBIT and a leaner Balance Sheet resulting from the massive reduction in Inventory and the impairment of the underperforming Heritage Novandie Non-current Investments.
- **Free Cash Flow (FCF)** turned strongly positive at □284.463 Cr, allowing the company to self-fund its growth, repay expensive short-term debt, and maintain a steady Dividend payout of □23.205 Cr without external capital dependency.
- **Other Assets** and **Other Liabilities**: Statutory dues payable rose by 40.5% to □13.253 Cr, reflecting higher GST liabilities on increased volumes. Security deposits increased to □14.692 Cr, while capital advances decreased to □2.353 Cr.
- **Other Expenses** Insight: Consumption of stores (□33.27 Cr) and Repairs & Maintenance (□16.10 Cr) saw moderate increases. "Miscellaneous Expenses" at □5.88 Cr remains vaguely defined but is not yet materialistic.
- The dominant financial theme of the year is a structural transformation in **Working Capital** management, where aggressive inventory liquidation and debt restructuring converted a high-growth top-line into record Cash Flow from Operations, significantly strengthening the Balance Sheet and ROCE.

3.3 Contingent liabilities & commitments

- **GST Penalty (Flavoured Milk): □3.528 Cr** dispute regarding 12% vs 18% classification; represents a systemic industry risk.
- **EPCG Export Obligations: □12.981 Cr** (up from □4.927 Cr); failure to meet targets risks clawback of saved custom duties.
- **Milk Cess (Haryana): □2.893 Cr** pending before the Supreme Court.
- **Income Tax Matters: □0.743 Cr** pending before CIT(A).
- **Capital Commitments: □22.160 Cr** in unexecuted contracts.
- **JV Funding Commitment: □7.500 Cr** remaining for Heritage Novandie.

3.9 Earnings quality & forensic checks

#	Check	Impact	Status	Notes detail
1	PAT vs CFO trend	Profit ↑ — high cash conversion; CFO of ₹389.88 Cr is 3.6x PAT of ₹106.55 Cr.	—	Record CFO driven by massive inventory liquidation and efficient receivable collections.
2	Receivables & channel-stuffing signal	Revenue ↑ — high quality growth; combined WC assets fell while revenue grew 17%.	—	No evidence of channel stuffing; inventory reduction suggests superior supply chain churn.
3	Revenue timing (unbilled/advances)	Revenue ↓ — slight dip in demand; contract liabilities decreased by 10.3% year-on-year.	—	Note 22: Minor reduction in advances from customers suggests slightly lower forward bookings.
4	Revenue from related parties %	Neutral — negligible direct revenue; RPTs focus on operational support rather than sales.	—	Revenue is primarily domestic B2C/ distributor-led; RPTs are focused on farmer financing.
5	Inventory vs revenue growth	Profit ↑ — efficiency gain; inventory fell 30.8% despite a 17% increase in sales.	—	Note 13: Significant reduction in finished and semi-finished goods improves working capital.
6	Inventory valuation method change	Neutral — consistent application; weighted average cost used with standard NRV write-downs.	—	Note 13: Write-downs increased from ₹4.157 Cr, reflecting high perishability risk management.
7	Exceptional items in operating profit	Neutral — no major one-offs; operating profit is clean of significant non-recurring items.	—	Profit growth is driven by core dairy operations and volume expansion.
8	Depreciation rate vs useful life policy	Profit ↑ — expense smoothing; technical lives for machinery (up to 20 years) exceed Schedule II.	—	Note 3(g): Use of technical evaluations to justify longer lives may lower annual depreciation.
9	Provision reversals boosting PAT	Profit ↑ — minimal impact; credit impaired receivables remained largely static at ₹7.99 Cr.	—	No significant reversal of provisions used to artificially inflate the current year's PAT.
10	Tax rate consistency	Neutral — statutory dues rose 40.5%; aligns with higher volumes and GST obligations.	—	Note 22: Increase in statutory payables reflects higher throughput and tax compliance.
11	CWIP age and stalling projects	Neutral — active deployment; 97.3% of CWIP is aged less than one year.	—	Note on CWIP: No evidence of stalled capital projects or asset impairment risks.
12	Deferred tax asset recognition	Neutral — standard recognition; DTA/DTL balances consistent with timing differences.	—	No aggressive recognition of DTAs on losses; JV losses handled via impairment testing.
13	RPT quantum and trend	Neutral — high dependency; ₹182.34 Cr remitted to Heritage Finlease for cattle loans.	—	Note 41(b): Significant operational link to promoter entity to secure raw milk supply.
14	Dividend paid vs FCF adequacy	Profit ↑ — sustainable returns; record CFO easily covers debt servicing and dividends.	—	Massive cash generation allows for debt restructuring and shareholder returns.
15	Auditor KAM: JV Impairment	Profit ↓ — potential write-down; Heritage Novandie has continuous losses and eroded net worth.	—	Auditor flagged carrying value; management relies on external valuation for impairment testing.
16	Audit Trail Integrity	Neutral — technical compliance risk; audit trail not enabled at the database level for SAP.	—	Technical red flag regarding data integrity and system-level logs.

4. Management & governance

A. Auditor Report & Key Audit Matters * **Audit Opinion:** Unqualified. The financial statements present a true and fair view. * **KAM 1: Impairment of Investment in Joint Venture:** The auditor flagged the carrying value of Heritage Novandie Foods (**17.671 Cr**) due to continuous losses and erosion of net worth. * **KAM 2: Revenue Recognition (Cut-off):** Risk of revenue being recognized in the incorrect period due to high transaction volumes. * **KAM 3: Inventory Valuation:** Perishable nature of dairy requires critical NRV estimation; write-downs increased to **6.68 Cr** in FY24. * **Auditor:** M/s. Walker Chandiok & Co. LLP. Fees bundled under Legal and Professional Fees of **14.705 Cr**.

B. Related Party Transactions | Party | Relationship | Nature | Amount (Cr) | Concern | | :--- | :--- | :--- | :--- | :--- | | Heritage Finlease Ltd | Significant Influence | **Loan Remittance (Cattle)** | 182.336 Cr | ***High operational dependency on promoter entity for farmer financing*** | | Heritage Novandie Foods | Joint Venture | **Investment/Guarantee** | 9.800 Cr | ***Continuous capital drain into loss-making yogurt venture*** | | Heritage Finlease Ltd | Significant Influence | **Lease Rentals Paid** | 8.193 Cr | ***Significant increase from 2.652 Cr in FY23*** | | Heritage Nutrivet | Subsidiary | **Cattle Feed Purchases** | 99.890 Cr | Captive revenue stream; arm's length pricing verification complexity | | N Bhuvaneswari | VC & MD | Remuneration | 7.770 Cr | Aligned with 83.7% PAT growth; 282:1 median ratio | | N Brahmani | ED | Remuneration | 6.210 Cr | Aligned with 83.7% PAT growth; 225:1 median ratio | | NTR Memorial Trust | Significant Influence | CSR Expenditure | 1.112 Cr | Related party implementing CSR |

C. Shareholding * **Promoter & Promoter Group:** 41.30% (3,83,27,742 shares). * **Public:** 58.70% (5,44,71,258 shares). * **Promoter Pledging:** 0%. * **Note:** Five individuals reclassified from Promoter to Public in Dec 2023 due to lack of management involvement.

D. Board Composition + KMP Compensation * **Total Directors:** 7 (57.14% Independent). * **Women Directors:** 3 (Mrs. N. Bhuvaneswari, Mrs. N. Brahmani, Mrs. Aparna Surabhi). * **KMP Compensation:** * **N Bhuvaneswari (VC & MD):** 7.762 Cr (61.74% YoY growth). * **N Brahmani (ED):** 6.210 Cr (62.06% YoY growth). * **Note:** Promoters are related (Mother-in-law and Daughter-in-law). Combined pay represents 4.53% of EBITDA. While growth is high, it is capped by the 9% net profit limit under Section 198.

F. Capital Allocation & Capex | Action | FY current (Cr) | FY prior (Cr) | % of CFO | Signal | | :--- | :--- | :--- | :--- | :--- | | Dividends | 23.20 Cr | 23.20 Cr | 5.95% | — | | Capex (Capital Advances) | 2.353 Cr | 4.868 Cr | 0.60% | — | | Acquisitions (JV Investment) | 9.800 Cr | 5.550 Cr | 2.51% | — | | Net Debt Change | -54.968 Cr | 126.090 Cr | N/M | **Positive** | | Working Capital Release | 184.260 Cr | -173.110 Cr | 47.26% | **Positive** |

CAPEX Analytical Notes: * **CFO Coverage of Capex:** Ratio is 165.69x. **CFO (389.88 Cr)** is more than sufficient to fund minimal maintenance Capex. * **Capex Nature:** Primarily maintenance and efficiency-led; **CWIP** reduced to 28.46 Cr as projects were commissioned. * **Deployment Efficiency:** 97.3% of **CWIP** is < 1 year old, indicating high deployment efficiency. * **Key Takeaways:** The company successfully utilized a massive working capital release to deleverage and fund dividends without external borrowing. **ROCE** improved to 16.88%.

H. Risks * ***JV Impairment*** (Strategic): Heritage Novandie has eroded net worth. Potential write-down of 17.67 Cr. * ***GST Classification*** (Regulatory): Dispute over 12% vs 18% on flavoured milk (3.53 Cr); risks future margins. * **Milk Price Volatility** (Commodity): Raw milk procurement is 76.3% of Revenue; fluctuations directly impact gross margins. * **EPCG Obligations** (Regulatory): Potential clawback of 12.98 Cr in custom duties if export targets are missed. * **Inventory Perishability** (Operational): Short shelf-life led to write-downs of 6.68 Cr in FY24.

5. Scorecard & verdict

Part a: scorecard

Dimension	Rating (1–5)	Delta	Key evidence	One-line rationale
Business quality	4	→	VAP 29.6% of Rev; 2.4M LPD procurement	Strong procurement moat and successful structural shift to higher-margin VAP.
Financial health	5	↑	D/E 0.12x; CFO ₹389.9 Cr > PAT ₹106.6 Cr	Exceptional deleveraging and record cash generation from working capital efficiency.
Earnings quality	4	↑	CFO/PAT 3.66x; Inventory -30.8%	High cash backing of profits, though technical lives of assets and JV losses require monitoring.
Management & governance	2	→	Promoter pay 9% of PAT; RPT ₹182 Cr	High promoter compensation and deep operational dependency on promoter-led Finlease.
Capital allocation & earnings visibility	3	↑	ROCE 16.88%; FCF ₹284.5 Cr	Improved returns and self-funded growth, offset by continued funding of loss-making JV.

Business positives (for this company this year) * **Record Cash Conversion: CFO** of ₹389.88 Cr is 3.6x PAT, driven by massive inventory liquidation. * **Structural Margin Shift:** Value-Added Products (VAP) reached **29.6%** of revenue, reducing reliance on commodity liquid milk. * **Deleveraging:** Repaid **₹126.4 Cr** in short-term demand loans, reducing Debt/Equity to a lean 0.117x. * **Operational Efficiency: Inventory Days** improved from 42.7 to 25.2 days despite a 17% revenue growth. * **Return Ratios: ROCE** surged to 16.88% from 10.44% due to better asset sweating and higher EBIT.

Business negatives / concerns (for this company this year) * **Promoter Compensation:** MD and ED pay grew **~62%**, consuming nearly 9% of Net Profit, which is high for a thin-margin business. * **JV Capital Drain:** Continued investment of **₹9.8 Cr** in Heritage Novandie despite its eroded net worth and ₹13.08 Cr loss. * **RPT Dependency:** **₹182.34 Cr** remittance to Heritage Finlease creates a "promoter-lock" on the farmer procurement supply chain. * **Audit Trail Flag:** Auditor noted that the audit trail is not enabled at the database level for SAP, a technical data integrity risk. * **Regulatory Risk:** **₹12.98 Cr** in EPCG export obligations and ₹3.53 Cr GST dispute on flavoured milk.

Overall scorecard summary Heritage Foods has delivered a year of exceptional financial recovery, characterized by a 17% revenue growth and a massive 84% surge in PAT. The company's financial strength is at a multi-year high, with a near-total repayment of short-term debt and record-breaking cash flow generation. However, governance remains a "discount" factor due to aggressive promoter compensation and complex related-party linkages for procurement financing. The business is on an improving trajectory operationally, but capital allocation toward the loss-making yogurt JV remains a persistent drag on value.

Part b: governance check matrix

#	Check	Status
1	Audit opinion clean?	—
2	Promoter pledge = 0?	—
3	KMP pay < 5% of PAT?	—
4	RPT quantum < 5% of revenue?	—
5	Board > 50% independent?	—
6	At least 1 woman director?	—
7	No statutory dues outstanding?	—
8	No fraud reported?	—
9	Audit trail enabled?	—
10	Frequent Auditor change	—

Final line: "Total: 7/10 — Governance Rating: 2"

Part c: investor verdict

Thesis: A high-quality dairy procurement play successfully transitioning into a branded FMCG (VAP) model, currently undergoing a massive balance sheet deleveraging phase.

Overall stance: ACCUMULATE

Rationale: Strong operational turnaround and record FCF generation outweigh governance concerns regarding promoter pay. Re-evaluate when: VAP contribution drops below 25% OR promoter remuneration exceeds 10% of PAT. BULL CASE: VAP crosses 35% of revenue mix, leading to sustainable EBITDA margins > 8%. BEAR CASE: Raw milk prices spike > 15% without corresponding retail price hikes, or a full write-off of the Novandie JV. Key monitorable: VAP Revenue Mix: 29.6% → Watch threshold: 35%.

7. Year-over-year analysis

7.1 Changes

Metric / theme	Summary a status	Summary b status	Forensic takeaway
Working Capital & CFO	Negative CFO (-□60.51 Cr) driven by a massive 84% inventory explosion.	Record CFO (□389.88 Cr) fueled by a 31% inventory liquidation and extended payables.	The company successfully executed a massive inventory-to-cash conversion cycle to restore liquidity.
Capital Allocation	Dividends and operations were debt-funded; short-term debt rose to □129.85 Cr.	Dividends and Capex are self-funded; short-term debt was fully repaid and restructured.	Management shifted from a precarious debt-reliant model back to a self-sustaining capital structure.
Margin Trajectory	EBITDA margin collapsed to 4.27% due to a "scissors effect" of high costs and inventory traps.	PAT margin recovered to 2.81% as VAP reached 29.6% of revenue, improving fixed cost absorption.	Profitability is transitioning from commodity-sensitive milk volumes to higher-margin branded products.
Management Tone	Defensive and "Procurement-First," focused on navigating raw milk inflation and supply disruptions.	"Aggressively Optimistic," pivoting toward a brand-led FMCG identity and digital transformation.	The narrative has shifted from operational survival to aggressive brand-building and premium positioning.
Asset Efficiency	ROCE fell to 9.51%, uncomfortably close to the cost of debt.	ROCE surged to 16.88% due to leaner working capital and higher EBIT.	Capital efficiency has seen a structural rebound, significantly widening the spread over the cost of capital.

7.2 Persistent patterns

- **The Heritage Novandie JV remains a chronic capital drain, with losses widening from □8.52 Cr to □13.08 Cr despite continuous equity infusions.**
- **Promoter remuneration remains aggressively high, consistently consuming ~9-14% of PAT, which represents a significant leakage of minority shareholder value.**
- **There is a deep structural dependency on Heritage Finlease (a promoter entity) for farmer financing and loan remittances, creating a permanent related-party lock on the procurement supply chain.**
- The company maintains a robust and growing procurement moat, consistently handling over 2 million liters of milk per day across its Southern Indian stronghold.
- **Promoter pledging remains at 0%, reflecting a clean equity structure and a lack of personal leverage risks among the core promoters.**
- The auditor consistently identifies the complexity of discount schemes and revenue recognition cut-offs as a Key Audit Matter (KAM).
- **Value-Added Products (VAP) continue a steady upward trajectory as a percentage of revenue, confirming a successful long-term structural shift in the business model.**