

Management Discussion and Analysis

CORPORATE OVERVIEW

Heritage Foods Limited (the Company) has now consolidated its position in Dairy Industry with deeper penetration into remote rural areas to procure raw milk and supply processed milk and milk products to consumers in urban areas. Your Company now has over 26 years of legacy in the Indian dairy space.

The Financial statements are prepared in accordance with accounting principles generally accepted in India, including the Accounting Standards notified under the Companies Act, 2013 ("the Act") read with Section 133 of the Companies Act, 2013.

Your Management accepts responsibility for the integrity and objectivity of the financial statements, as well as for the various estimates and judgments used therein. These estimates and judgments relating to financial statements are prudently made to reflect in a true and fair manner the form and substance of transactions. This also enables in reasonably presenting the Company's state of affairs and profits and cash flows for the year ended March 31st, 2018

ECONOMY OVERVIEW

The Economic Survey 2018 has pegged FY19 GDP growth at 7-7.5%. The Survey said that India can be rated as among the best performing economies in the world as the average growth during the last three years is around 4 percentage points higher than the global growth.

"A series of major reforms undertaken over the past year will allow real GDP growth to reach 6.75 percent this fiscal and will rise to 7 to 7.5 percent in 2018-19, thereby re-instating India as the world's fastest growing major economy," said the Survey.

INDUSTRY STRUCTURE AND DEVELOPMENTS

The Indian dairy industry estimated current at ₹ 5.4 trillion (according to a research report) is one of the fastest growing dairy segments across the world. Needless to say today agri farmers too consider dairy farming as a reliable source of revenue.

India is the world's largest producer of milk, producing about 160 Mn tonnes per annum with a compounded annual growth of 15%. However, India is also the largest consumer of milk too as dairy products are considered as a main source of protein for large segment of the Indian population.

INDIAN DAIRY INDUSTRY: PRODUCT-WISE SCOPE AND DYNAMICS

Liquid milk

Liquid milk, which constitutes largest segment of Indian dairy industry, is valued at ₹ 3.5t and accounts for 65% of industry sales. While 77% of liquid milk is sold through unorganized segment, the organized segment is growing much faster.

Milk Powder

Milk powder manufacturing is a simple process now carried out on a large scale. It involves the gentle removal of water at the lowest possible cost under stringent hygiene conditions while retaining all the desirable natural properties of the milk - color, flavor, solubility, nutritional value.

Ghee

Ghee, the second most consumed product of Indian dairy industry (-₹ 800b), contributes 15% to industry sales, within which organized sector contributes 20%. Players from cooperatives are strong in this segment.

Paneer

The Indian paneer market is huge at ₹ 325b with organized players contributing mere 2-3% to industry sales. The segment has humungous potential being majorly dominated by unorganized segment. Going forward, demand from the institutional segment is expected to drive strong growth led by rising demand from restaurant and cafeteria businesses. The organized segment is expected to grow faster at 20-22% CAGR.

Curd

The Indian curd market (worth ₹ 235b) offers huge potential for private players as the organized segment accounts for mere 6- 8% of overall market. Curd category is expected to grow to ₹ 500b by 2020 growing at 15% CAGR.

Cheese

Cheese entails humungous potential, having clocked 27% CAGR over 2007-14 and further expected to post a robust 31% CAGR over FY15-20E to ₹ 59.4b in 2020. The spurt will be led by strong growth in India's fast food market driven by pizzas, burgers, sandwiches, etc.

Buttermilk

Buttermilk category, valued in 2014 at ₹ 13.8b, is expected to explode to ₹ 43bn by 2020 growing at 21% CAGR.

Whey

Whey is the by-product that is left after casein and milk-fat are separated from milk by coagulation, while manufacturing cheese.

UHT milk

UHT milk, valued in 2014 at ₹ 26b, accounts for less than 1% of the total milk market and 5% of the organized milk market. However, the category is expected to explode to ₹ 104bn by 2020 growing at 26% CAGR due to rapid urbanization and changing consumer preferences. UHT milk sells at 30% premium to fresh milk and provides higher margins.

Flavored milk

Flavored milk market in India saw 26% CAGR during 2007-2014 to touch ₹ 12.6bn in 2014; it is expected to grow to ₹ 47.8bn in 2020 (25% CAGR).

Flavored and frozen yoghurt

Flavored and frozen yoghurt market in India saw 36% CAGR during 2011-2014 to touch ₹ 2.3bn in 2014; it is expected to grow to ₹ 12.1bn in 2020 (32% CAGR). Growth in the category has been driven primarily by increasing health consciousness among the urban middle class.

KEY INDUSTRY GROWTH DRIVERS

Young India and increase in population

India is the second most populated country in the world with nearly a fifth of the world's total population. According to the 2017 revision of the World Population Prospects, the population stood at 1.32b grew at CAGR of 1.9% over 1960-2016 and India is relatively young country with rising expectations. 65% of India's population is below 40 and working age population (between 15 and 64 years) is expected to touch 1b mark surpassing China by 2030. With 50% of the population under 25 years of age, the large Indian young population is ready to experiment and try out new milk products. The opportunity is there for domestic players to capitalize on their understanding of taste and preferences of Indians.

Dual income households leading to higher usage of VAP due to lack of time

The number of dual household incomes is gradually increasing, leading to higher disposable incomes and readiness to try out value added products. Both rural and urban households have increased their expenditure on VADP at -16% CAGR compared to liquid milk CAGR of 10-12%.

Traditional milkmen selling curd have disappeared today at least in urban areas with many of branded dairies launching their better quality curds and buttermilk. Dairy sector will be one of the key beneficiaries of Indian consumption story. Value-added products have been gaining importance due to changes in demographic and dietary patterns. While demand for branded milk has grown at 15%, growth in value added products has been even stronger at 23% in last decade

Rising urbanization and disposable income

With rising urbanization and disposable income, there is growing brand awareness amongst consumers, which is driving demand for branded products. Also, there is a growing preference for clean, hygienic and ready-to-eat milk & dairy products that will boost organized dairy industry. India's per capita income grew by 9.7% to ₹ 1,03,219 in FY17 from ₹ 94,130 a year ago. In FY16, the rate of growth of India's per capita net income was 7.4%.

Rising health awareness

Over the last decade, there has been a growing awareness towards health and nutrition as cases of untimely deaths have increased due to heart attacks. This has led to increasing quality and safety concerns increasing demand for packaged food. Younger consumers are especially trending towards more health conscious eating habits driving growth of value added dairy products.

Rising vegetarian population

India has ~28% of population who follow vegetarianism and this number is gradually increasing over last decade. A large vegetarian population is a key driver for dairy industry.

KEY SUCCESS FACTORS FOR DAIRY BUSINESS IN INDIA

Strategically located manufacturing units

As most of the dairy products have low shelf life, it is difficult to manufacture them at a central location and distribute pan-India like FMCG products. Hence, it is crucial to have a network of multiple production units across the country to have maximum reach.

Procurement of raw milk

One of the ways of ensuring high quality milk is by taking care of the cattle that produce it. For dairy companies it is crucial to have direct raw material sourcing from farmers. So developing strong relationships with farmers by aiding them to produce high quality milk from cattle is important as more than 70% of India's milk production is still produced by small farmers and owning 2-5 cattle unlike foreign countries.

Consistency in taste

To gain mind share of consumers' consistency of taste of any food product along with hygiene is essential. Building a credible brand in any business takes time.

Distribution reach and availability of products

Some dairy products require chilled temperatures. Products such as ice creams require backup of freezers. Fresh milk products are perishable in nature. Establishing distribution is extremely crucial so that products are available to consumers. If product is consistently available to consumers they will try and will come for repeat purchases if they like.

An optimum product portfolio to ensure higher profitability

A range of products is crucial to attract consumers across income levels and across needs. It is important to have a right mix of milk business as well as value-added products so as to minimize working capital requirements and to maximize the return ratios. A right mix of fresh milk products and premium VAP will aid margins and return ratios.

KEY RISKS:

Climate change and scarcity of water

Climate change and scarcity of water is a major threat to the dairy industry. Milk production could go down by 3 million tonnes over the next three years as the average temperatures rise, creating problems of water scarcity and reduced availability of green and dry fodder for the cattle. Dairy company's manufacturing operations are largely dependent on the supply of milk, which is the primary raw material for all the dairy products. Given the seasonal nature of the dairy industry, cattle farming patterns, availability of raw milk keeps on fluctuating which thereby could adversely impact the running of its operations.

Survival of the fittest

It is expected that the competition will increase steadily as more and more companies targeting dairy sector and few MNCs too eyeing for increasing market share. Large established players are launching new products.

New Product Risk by MNCs who have better brand equity

Over the years a few private players have been able to anticipate and respond to changing consumer preferences which helped in building strong consumer demand for their brands. However continuous investment in research and development along with introduction of new products and different variants of existing products by MNCs, based on consumer preferences and demand, can be a risk for smaller players.

Rising labor cost

Over the last decade labor cost has also increased significantly. Cost of keeping and maintaining bovine is very high.

THE BACKDROP

Over the last 26 years, Your Company so far underwent three major stages ever since the deregulation of Milk in 1990s. The three stages that Your Company so underwent include: Penetration; Scale; and Focus. Now we are in the next stage that includes the Consolidation Curve.

Your Company Penetrated into Dairy business with a milk procurement level as low as 20,000 litres per day (LPD) in a single state. After successfully penetrating into Dairy industry, Your Company Scaled up its business in the areas of Milk procurement from 20,000 LPD to over 13.02 lakh LPD from Nine states. Your Company will continue to grow in Milk procurement year on year @ 10% through organic route and is also exploring inorganic route as well.

Having Scaled up the level of business, there was a need to get more Focused. Towards this end, Your Company hived off its the Retail business to Future Retail Ltd and has acquired about 3.65% equity stake in the Company.

We are currently in Consolidation phase. We have successfully acquired Reliance Dairy and integrated the same this year. We are now exploring further inorganic growth opportunities. Towards this end, we have engaged E&Y.

INTEGRATION WITH RELIANCE DAIRY

Since the Reliance Dairy was procuring milk in 184 routes in five states and Your Company had closed over 20 routes. We now have balanced our milk procurement volumes and sale volumes. As a part of rationalization, we have closed 19-units; (chilling centers and bulk coolers) and we have closed the operations in MP and UP and we are closing our operations at two co-packing stations which are at Ludhiana and Kundli.

STRENGTHENING PACKAGING

In line with Your Company's thinking of rationalizing the new businesses operations, measures have been undertaken to move the packing of some of Dairy Life's volumes into Your own company's packing units. Hence, Vaman Foods assets is another acquisition in that direction in order to move the volumes from a third party packing station into Your Company's own procurement processing unit is expected to achieve a lot of efficiencies in terms of operations.

Towards this end, Your Company had not only acquired assets of Vaman Foods, but also acquired assets of Shah Motilal in the Hyderabad region mainly to move major part of the volumes that we have acquired : In line with our future growth to achieve ₹ 6,000 crores revenue by 2022 and in line with Your Company’s thinking of rationalizing the new businesses operations, we have moved the packing of some of Dairy Life’s volumes into our own packing units.

NEW PRODUCTS

New product that has been finalized is yogurt with the help of the joint venture partner Novandie SNC from France. The product is expected to be launched in FY19. As per the initial plan, this yogurt product line will have a 20 tonne capacity and first full year revenue of ₹ 25 crores. This JV has a set of identified products basically yogurt in different flavours, probiotic, non-probiotic, high-fat, low-fat, stirred and unstirred.

In the ice cream front Your Company has launched new premium ice-cream brand ‘Alpenvie’ as part of the strategy to strengthen existing product range. The target group for the newly launched products is young consumers. The premium ice-cream products are priced in the range of ₹ 10-45 with majority of products under ₹ 25. The Ice cream market is growing at the rate of 20 per cent per annum and sizeable revenues are expected from this segment.

TANGIBLE RESULTS:

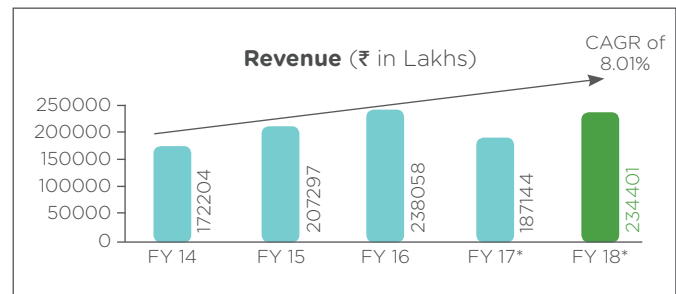
Total Revenue (₹ in Crore)	EBIDTA (₹ in Crore)	PAT (₹ in Crore)
FY18* ₹ 2,344.01	FY18* ₹ 141.65	FY18* ₹ 60.38
FY17 * ₹ 1,871.44	FY17* ₹ 357.49	FY17* ₹ 292.60
FY16 ₹ 2,380.58	FY16 ₹ 136.50	FY16 ₹ 55.43
FY15 ₹ 2,072.97	FY15 ₹ 88.10	FY15 ₹ 28.21
FY14 ₹ 1,722.04	FY14 ₹ 95.00	FY14 ₹ 45.31

* Figures are from continuing operations

Your Company has set its aspiration to emerge as a 1 Billion dollar company by 2022. At the moment, all efforts are being made in that direction. Apart from the organic growth both in the liquid milk and value added products space, the acquisition of dairy business of RRL has been in the direction to scale up in the dairy space. Your Company is looking for growth both through the organic and inorganic route.

REVIEW OF OPERATIONS:

Your Company maintained a forward looking approach to ensure that it is well prepared to seize new opportunities and handle new challenges with speed. Since the success of your Company depends on the ability of the business to keep understanding the changing environment and to keep adapting its responses in a seamless manner it continued to focus on realigning its initiatives internally and externally. Your Company focused on the principles of continuous excellence to drive efficiencies. Therefore your Company has grown at CAGR of 8.01%.



* Figures are from continuing operations

Moving up value chain: The Company is rapidly moving up the value chain as the contribution of Value Added Products (VAP) in Dairy vertical is improving on a Y-o-Y basis. The margin in VAP is almost double than that of Liquid Milk.

Making Rapid Strides: Was successful in making rapid strides in Maharashtra and Delhi markets in Dairy business vertical. Attempts are on to add further processing capacities in Maharashtra and Delhi market.

Renewable Energy: Although the Company increased its Renewable Energy Capacity to 10.39 MW with 4.09MW Solar Power and 6.30MW Wind Power in the states of Andhra Pradesh, Telangana, Maharashtra, Tamil Nadu and Karnataka for the captive consumption.

Farmers Welfare Trust: Since the company believes in adding value to its stakeholders, it has successfully created Farmers Welfare Trust for Farmers empowerment who form an important constituent among its key stakeholders.

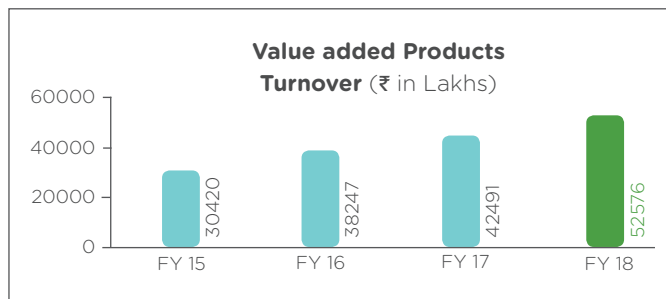
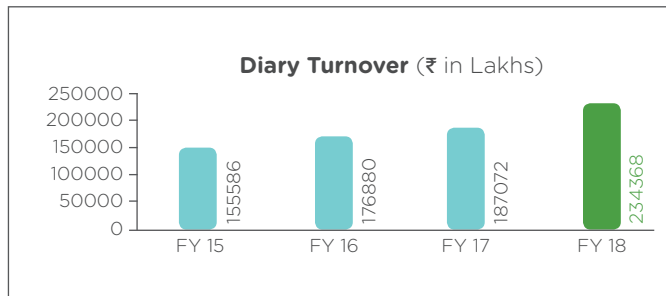
Dairy Business Vertical:

(Including feed and others)

₹ 2,34,368 Lakh Revenue	99.71 % Revenue Contribution
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₹ 12,732 Lakh EBITDA	₹ 52,576 Lakh Revenue from Value Added Products
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The Dairy division accounting for 99.71% of revenue (₹ 2,34,368 Lakh) is the flagship business vertical for your Company. The Last 4 financial year’s revenue of the Dairy vertical is given below:



With a surge in the value added products, from ₹ 30,420 lakhs in FY15 to ₹ 52,576 lakhs in the current fiscal year, the percentage of contribution to the dairy revenue has improved from a mere 19% to nearly 22.43% in the current year. The value added products have been growing at a CAGR of 20.01% over the last 4 years.

These products indeed attract the attention of stakeholders as their profit margins are almost double compared to that of the liquid milk. Among these value added products, it’s the curd that forms a significant portion. The rest include: ice cream/ Forzen Desert, paneer, butter milk and flavored milk.

Renewable Energy Business Vertical:

Your Renewable Energy Division strongly recognizes the responsibility towards protecting the environment. As a forward- looking enterprise, it is strongly committed to extending our ‘Green’ footprint. In line with this thinking, the division has increased its Renewable Energy Capacity to 10.39 MW with 4.09MW Solar Power and 6.30MW Wind Power in the states of Andhra Pradesh, Telangana, Maharashtra, Tamil Nadu and Karnataka for the captive consumption:

₹ 686 Lakhs Revenue from Renewable Energy	10.39mw Renewable Energy Capacity
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Way Forward

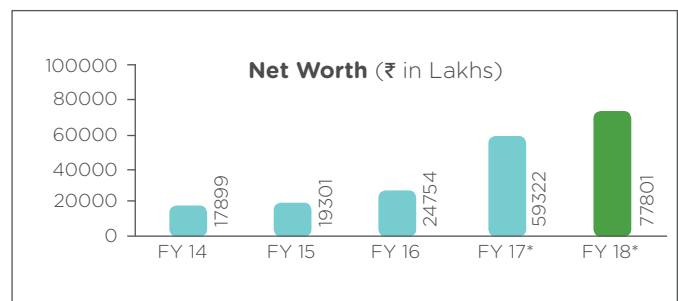
Your Company has the Right Channel Mix (over 90% milk is directly supplied to consumers), Right Product Mix (a good mix of fresh milk and value added products), High Capital Efficiency, and Branding (Heritage brand has a legacy of over 26 years).

Discussion on financial And Operational performances

Your Company has created significant wealth for its shareholders as the Company continues to maintain its growth momentum to become a nationally recognized brand for healthy and fresh products. Given below is the Company’s performance for the last five years in various parameters.

Net worth Trend:

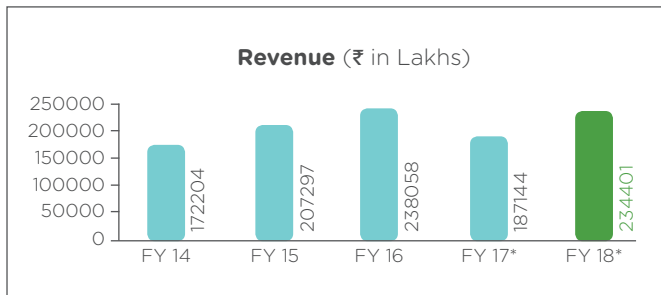
The net worth has shown a steady and constant ascent from ₹ 17,899 lakhs to ₹ 77,801 lakhs in the last five years.



* Figures are from continuing operations

Revenue Trend

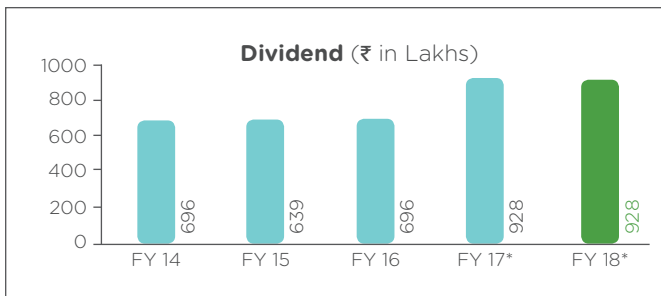
The focused approach helped the Company to deliver an industry leading performance with a revenue growth of 25.25% in FY18.



* Figures are from continuing operations

Dividend Payment History

The Dividend and the payout ratio computed on consolidated profits have remained high. The dividend payout ratio in last five years.

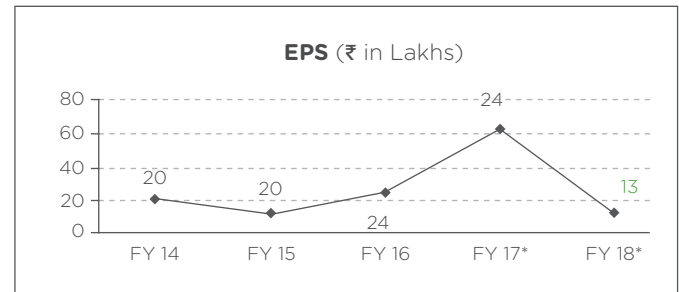


Overview of Standalone Financial Results

Particulars	2017 - 18		2016 - 17		FY 18 vs 17 % of Growth
	₹ In Lakhs	% of Revenue	₹ In Lakhs	% of Revenue	
Net Sales	234385.51	99.99	187069.23	99.96	25.29
Other operating income	15.59	0.01	74.34	0.04	(79.02)
Total Revenue	234401.10	100.00	187143.57	100.00	25.25
Less: Total Expenditure	221699.95	94.58	172548.72	92.20	28.49
Add: Other Income	1550.15	0.66	2186.82	11.32	(92.68)
Profit before Finance Cost, Depreciation and Tax	14251.30	6.08	35781.67	19.12	(60.17)
Less: Finance costs	1745.45	0.74	963.24	0.51	81.21
Depreciation & Amortisation	3698.54	1.58	2487.07	1.33	48.71
Profit / (Loss) before tax	8807.32	3.76	32331.36	17.28	(72.76)
Less: Provision for current taxation (Incl. tax. earlier yrs)	2829.39	1.21	2600.07	1.39	8.82
Less: Provision for deferred taxation	(60.23)	(0.03)	471.15	0.25	(112.78)
Profit / (Loss) after tax	6038.16	2.58	29260.14	15.64	(79.36)

Earnings per Share

Earnings per share (EPS) (Equity Shares of the face value of ₹ 5/- each)



* Figures are from continuing operations

STANDALONE FINANCIAL PERFORMANCE REVIEW

A. FINANCIAL PERFORMANCE

The following information is a Standalone information of your company and it should be read in conjunction with the financial statements and related notes for the Financial Year ended March 31, 2018.

Standalone Segment results:

Particulars	2017 - 18		2016 - 17		FY 18 vs 17 % of Growth
	₹ In Lakhs	% of Revenue	₹ In Lakhs	% of Revenue	
1. Total Revenue					
a. Dairy	229671.55		180959.67		26.92
b. Renewable energy	685.93		521.30		31.58
c. Feed	3591.71		3110.58		
d. Others	1104.40		3001.45		
Total (a+b+c+d)	235053.59		187593.00		25.30
2. Inter-segment Revenue					
a. Dairy					
b. Renewable energy	652.49		449.43		45.18
c. Feed					
d. Others					
Total (a+b+c+d)	652.49		449.43		45.18
3. External Revenue					
(Incl other operating income)					
a. Dairy	229671.55		180959.67		26.92
b. Renewable energy	33.44		71.86		(53.47)
c. Feed	3591.71		3110.58		
d. Others	1104.40		3001.45		
Total (a+b+c+d)	234401.10		187143.57		25.25
4. Segment Results					
Profit (+) / (Loss) (-) before tax and finance costs					
a. Dairy	10096.16	4.40	12491.50	6.90	(19.18)
b. Renewable energy	317.81		250.24		27.00
c. Feed	(359.89)		(309.47)		16.29
d. Others	44.65		118.03		(62.17)
Total (a+b+c+d)	10098.73	4.31	12550.30	6.71	(19.53)
Less: Finance Cost	1745.45	0.74	963.24	0.51	81.21
Fair Value loss on derivative liabilities	38703.86		3854.87		
Others	420.96		113.22		
Add: Interest income	37.77	0.02	27.38		
Fair Value gain on Equity Securities (FVTPL)	39537.07		24681.01		
Dividend Income	4.02		4.00		
Total Profit before Tax	8807.32	3.76	32331.36	17.28	(72.76)

Segment wise Revenue Break-up :

Particulars	2017 - 18	2016 - 17
Dairy		
Finished goods sold		
Milk	146,781.20	116,975.86
Value Added Products	52,478.06	42,394.33
Fat Products	26,034.03	16,077.81
Skimmed milk powder	485.74	983.13
Total	225,779.03	176,431.14
Traded goods		
Milk	2,672.85	-
Value Added Products	97.85	97.03
Other Products	630.00	429.74
Total	3,400.70	526.77
Sale of Service	488.74	239.65
Other operating income	3.09	2.48
Total Dairy Revenue	229,671.55	177,200.04
Add: Revenue from transaction with discontinued operations	-	3,759.63
Total Dairy Revenue	229,671.55	180,959.67
Renewable Energy		
Finished goods sold	20.94	-
Other operating income	12.50	71.86
Total Renewable Energy Revenue	33.44	71.86
Feed	3,591.71	3,110.58
Others	1,104.40	3,001.45
Total Revenue	234,401.10	187,143.57

CASH FLOW ANALYSIS
Cash inflows

₹ in Lakhs

Particulars	2017 - 18	%	2016 - 17	%
Operating Cash flow	13544.44	50.48	14863.24	80.20
Change in working capital (net)	3004.55	11.20	0.00	0.00
Interest & Dividend on Investments	32.14	0.12	31.38	0.17
Earmarked balances redemption	0.00	0.00	2.22	0.01
Proceeds from Long Term Borrowings	10248.36	38.20	3636.94	19.62
Total	26829.49	100.00	18533.78	100.00

Cash Outflows

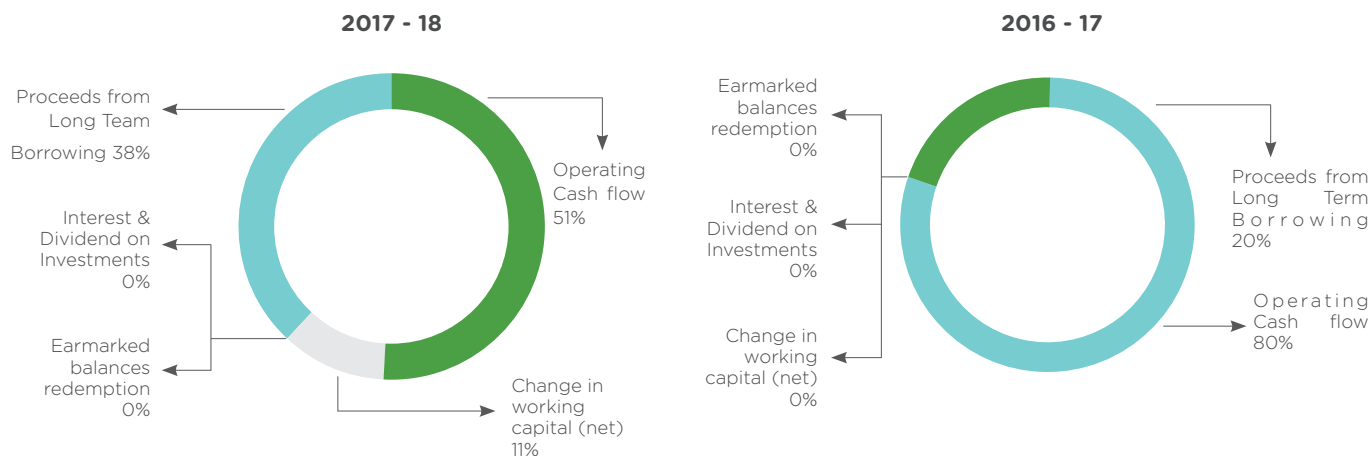
Particulars	2017 - 18	%	2016 - 17	%
Repayment of Long Term Borrowings	1708.34	5.90	1489.48	9.84
Change in Working capital (net)	-	-	1522.07	10.05
Taxes paid	2777.25	9.59	2910.00	19.22
Payment for purchase of property, plant and equipment	13818.35	47.71	7434.15	49.10
Payment on account of business combination	6151.01	21.24	-	-
Net Investments	1764.27	6.09	38.95	0.26
Unclaimed Dividend	-	-	16.44	0.11
Exceptional items	-	-	-	-
Interest Paid	1628.48	5.62	891.12	5.89
Dividend & DDT Paid	1116.87	3.86	837.65	5.53
Total	28964.56	100.00	15139.86	100.00

Net increase /(decrease) in cash and cash equivalents (2135.07) 3393.92

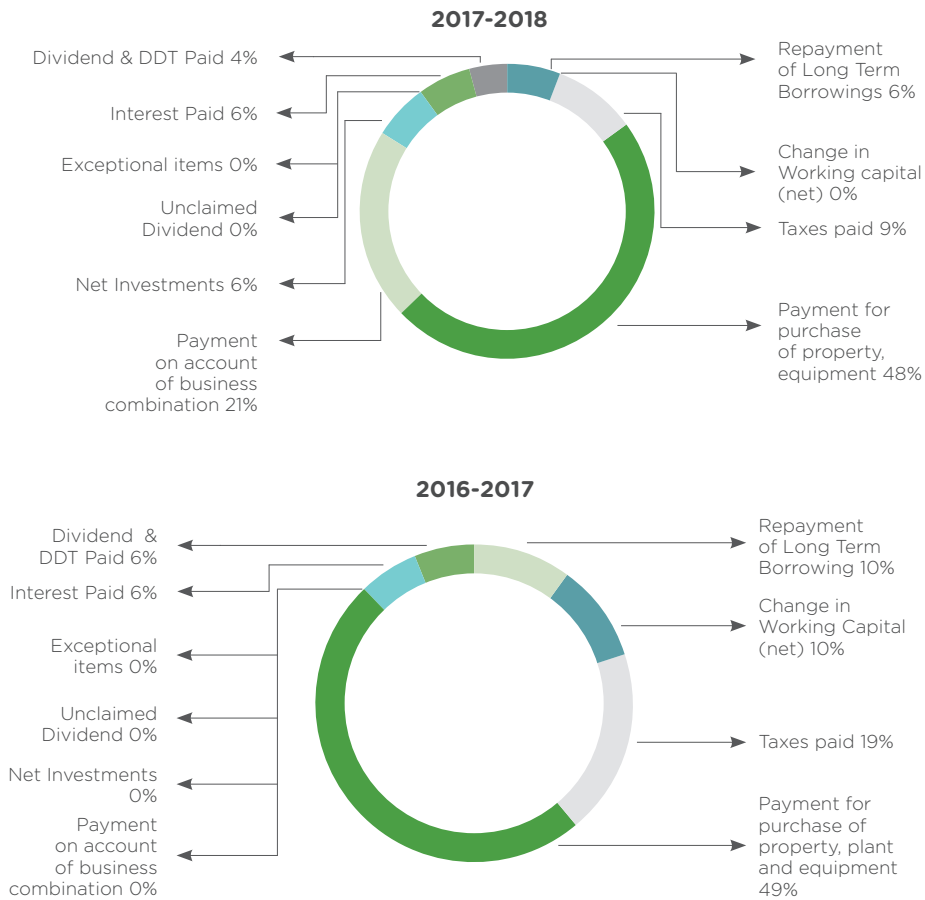
Cash flow related to Discontinued Operations :

Net cash generated/(used) from/ in Operating activities		(1575.99)
Net Cash used in Investing activities		(1559.26)
Net Cash flow in Financing activities		(2015.97)
Add: Opening Cash and Cash Equivalents	(2102.14)	515.02
Cash and cash equivalents adjustment in pursuant to the Composite Scheme of Arrangement (Ref Note 43)	-	(859.86)
Cash and Cash Equivalents at the end of the period	(4237.21)	(2102.14)
Cash on hand	243.33	151.47
Balances with banks in current accounts	5742.36	4334.10
Loans repayable on demand from banks	(10222.90)	(6587.71)

Cash Inflow



Cash Outflow



FORWARD LOOKING STATEMENTS

Statements in this report describing the Company's objectives, projections, estimates and expectations may constitute "forward looking statements" within the meaning of applicable laws and regulations that involve risks and uncertainties. Such statements represent the intention of the Management and the efforts being put into place by them to achieve certain goals. Actual results might differ materially from those either expressed or implied in the statement depending on the circumstances. Therefore, the investors are requested to make their own independent assessments and judgments by considering all relevant factors before making any investment decision.