



“Heritage Foods Limited
Q3 FY2019 Post Results Conference Call”

February 01, 2019



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Heritage Foods Limited
February 01, 2019

Moderator: Good day ladies and gentlemen and a very warm welcome to the Heritage Foods Limited Q3 FY2019 Post Results Conference Call, hosted by Sunidhi Securities Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shailesh Kumar from Sunidhi Securities Limited. Thank you and over to Shailesh!

Shailesh Kumar: Good evening ladies and gentlemen, on behalf of Sunidhi Securities, I extend a very warm welcome to all of you in Heritage post results Q3 conference call. Management team is being represented by Dr. M. Sambasiva Rao, President; Ms. Brahmani, Executive Director; Mr. A. Prabhakara Naidu, CFO; Mr. Samba Murthy, Dairy Division Head; and Mr. Umakanta Barik, Company Secretary. I trust you must have got the opportunity to go through the numbers.

Company has delivered pretty stable numbers in this challenging environment in order to put more highlight and address your queries. Now I would hand over to the call to Dr. Rao. Thank you and Over to you Dr. Rao!

M. Sambasiva Rao: Good afternoon to all the participants, I welcome all of you once again for the earnings call of Q3 FY2019. I am happy to announce the quarterly results for Q3 standalone numbers, we have achieved a turnover of Rs.610 Crores, which is a 6.7% growth over the previous year’s corresponding quarter, which was Rs.571 Crores, but this quarter EBITDA achieved is Rs.45.5 Crores, which is 23% growth over the corresponding quarter of last year that is Rs.37 Crores. PBT number is Rs.30 Crores, which is 26.5% growth against Rs.23.75 Crores last year. PAT is Rs.19.5 Crores with 30% growth over the last year.

Coming to nine-month performance of the standalone dairy and renewable energy part of the business, the net turnover is Rs.1857 Crores, which is 3.76% growth, this is lower because of the Q2 performance was flat though Q3 achieved 6.7% growth in turnover, Q2 pulled us down to 3.76%. EBITDA for the nine months of the standalone Rs.140 Crores, which is 63% growth over the previous year Rs.86 Crores, PBT is Rs.94 Crores for the current quarter against 66% growth versus Rs.56 Crores of the nine-month of the previous year and PAT is Rs.59.46 Crores, which is 49% versus Rs.40 Crores of the last year’s nine months.

Now I turn to consolidated numbers, which includes dairy and renewable energy of HFL Heritage Foods Limited and feed business of the Heritage Nutrivet Limited, a 100% subsidiary and Heritage Farmers’ Welfare Trust. The net turnover is Rs.619 Crores, which



Heritage Foods Limited
February 01, 2019

is 6.88% growth against Rs.579 Crores of the previous year Q3. EBITDA is close Rs.46 Crores versus Rs.38 Crores of the last year; PBT is Rs.30.6 Crores, 25% growth over Rs.24 Crores of last year. PAT stands at Rs.20.25 Crores which is 21% higher than last year's Q3 Rs.16.71 Crores.

Now we look at nine months consolidated numbers, our turnover stands at Rs.1880 Crores which is 3.74% growth versus last year Rs.1812 Crores. EBITDA for nine months consolidated Rs.144 Crores versus Rs.89 Crores last year it is 62% growth. PBT is Rs.96.58 Crores versus Rs.58 Crores of last year, 66%. PAT is Rs.62 Crores versus Rs.42 Crores with a 46% growth.

Volumes, milk procured during this Q3 is 14.5 lakh liters per day, which is 6.6% growth over last year's Q3 that is 13.6 lakh liters. Milk sales volume is 11.09 lakh liters, which is 5.3% growth. Value-added products grew at 24% in nine months. This is a quarterly growth for Q3 value-added products revenue is Rs.134 Crores versus Rs.108 Crores last year Q3, this is 24% increased. Contribution of value-added products revenue is 22% in this quarter versus 19% in the last year in Q3. For nine months, value-added products delivered 16% growth that is Rs.398 Crores to Rs.463 Crores. Contribution of value-added products during nine months period stands at 25% versus 22% of the last year's nine months.

Our current production capacities at the company level, chilling capacity in various locations is 19.37 lakh liters per day, milk processing capacity is 25.7 lakh liters per day. Milk packing capacity is 17.15 lakh capacities. These are all own capacity besides some small leased premises we are operating still. We have incurred an expenditure of Rs.66 Crores under capex in the past nine months and Rs.10 Crores under the Heritage Nutrivet Limited that is the cattle feed plant. Debt position as of December 31, 2018 is Rs.168 Crores long-term and Rs.80 Crores short-term, the total Rs.249 Crores under the Heritage Foods debt position. These are the details I thought should be enough for at least shaping the current quarter's performance. Now we would open the session for the discussion with the suggestions from the participants and any queries related to this quarter. Thank you very much.

Moderator:

Thank you. Ladies and gentlemen we will now begin the question and answer session. We have the first question is from the line of Himanshu Nayyar from Systematix Shares & Stock. Please go ahead.

Himanshu Nayyar:

Hi Mr. Rao and congratulations on a strong numbers on the operational side. So first just wanted to understand our growth which is 7% this quarter so can you share how much would this growth be X of Reliance Dairy, I think which was not there in the base quarter?



Heritage Foods Limited
February 01, 2019

M. Sambasiva Rao: Thank you Mr. Himanshu. This segregation of Reliance-acquired business is now impossible. I have been explaining in the last quarter also. They got merged into our operations at all levels chilling center level, processing level, packaging levels and they are also in different parts of the country. Some of the volumes have come from Hyderabad some are in the... certain volumes are definitely in the new states where we have entered like Punjab, Haryana, Rajasthan there we have exclusive numbers available, but many areas they got merged into the system. So we have stopped monitoring that separate accounting, which is typically not feasible to give you exact numbers X Reliance-acquired business at this point in time and we would not be able to give in future also that numbers have got merged seamlessly into the system. Having said that I would like to give you some perspective what it is, our efforts to rationalize Reliance business component acquired during the last year have resulted in reduction of volumes in certain States as part of our last control activity. We have been able to exit certain localities both in procurement and sales and stopped the bulk commodity business, which Reliance Life was involved in Reliance Pure, was involved in. The Dairy Life and Dairy Pure because of that certain volume have dropped certain activities have been reduced that could have impacted in a little way because in the Q3 of the last year, the rationalization was almost over. This year Q3 has no impact on the acquired business whereas the H1 to H1, there was an impact we have cut down substantial revenues and activities in the H1 of current year so the H1 growth was not visible.

Himanshu Nayyar: Got it Sir. Secondly for this quarter I mean we believe that a lot of cooperative have become more aggressive and have been selling at discounts etc., so can you throw some more light on the competitive intensity from the co-operatives in our key markets and till how long you think this will continue because I am sure till the time they be this aggressive it will be difficult for us to grow in double digits which is our targeted growth rate correct?

M. Sambasiva Rao: This is quite relevant in the last nine months, the past nine months we went through significant glut scenario in the country as such wherein carry forward stocks of HNP from the previous year to this year were very high. Finally government had to step in and give subsidies export incentives and state-level supports to liquidate inventory through Exports and the season also aggravated the situation because of good production year we went through. As the milk availability was very high with co-operatives particularly, they had to dispose instead of going through the conversion to milk powder and butter, which we also did. We did not actively pursue the procurement growth in the season in the last eight months particularly, we have slowed down or expansion and we have also not intensified our extension work, which would have lead to higher milk procurement and conversion of milk into powder and butter leading to lower realizations and lower margins. So we were cautious in this tsunami period to lie low till the wave moves out of us overall. In the



Heritage Foods Limited
February 01, 2019

process we could strengthen our bottom line. If we have looked at the growth we could have definitely managed to grow by procuring more milk and convert it and sell it as commodities because liquid milk sale was not easy during this period for two reasons, one unorganized sector milk is reaching the urban areas in the loose form that also was available plenty for the institutions and caterers and hotels etc., those segments. Then the co-operatives have started discounting their prices and particularly this happened in Tamil Nadu where lower priced milk, quantity was substantially hiked. I will take a minute to explain here. All the private brands including Heritage sells, toned milk at Rs.40 per liter in Tamil Nadu, Tamil Nadu co-operative namely Aavin sells milk at two price points, Rs.37 and Rs.34.5 per liters while others were at Rs.40. So the first level itself is Rs.3 difference is there between Rs.37 and Rs.40. The second level milk that is Rs.34.5 per liter milk was a restricted quantity in the previous years. They used to cap about 5 lakhs liters, 4.5 lakh liters was made available under that monthly card scheme, they introduced, a consumer can subscribe for one month acquirement in one shot get a monthly card and the milk was available at lower price that ceiling they have removed and enhanced the supplies to get let us say from 4.4 lakhs to 7.4 lakhs or 8 lakhs, so this surplus milk were disposed through this route and that came and impacted us particularly Heritage because we sell toned milk in Tamil Nadu in large quantity like Aavin wherever other private brands sell full cream milk and standardized milk in greater quantities. Impact on those variance is lesser compared to the impact on the toned milk. So this impacted has in the last few months where we degrew by about 10%-15% in that market that also impacted our overall growth. Similar situation happened in Maharashtra where the glut was very high. Milk procurement was easily available and there are no offtakes. The Government of Maharashtra gave Rs.5 subsidy per liter of milk used by the private companies, co-operatives if they belong to Maharashtra this is where we had a setback. This Rs.5 per liters was made available only for Maharashtra-based companies, where we are Telangana-based Company so we could not avail that Rs.5 benefit. So we have not aggressively pursued our growth there. So there also we have degrown significantly in Maharashtra market in the sale volumes and the third market was Punjab and Haryana that sector also had the glut. You might have seen farmers agitating in Punjab and going up to Delhi also seeking remunerative prices. There also we have faced the significant surplus milk and the price competition. Coming to other states like Karnataka, Telangana and Andhra Pradesh, we have seen normal growth 10% to 11% volume growth in these markets where the glut was not significant and markets behaved normally the competitors and the co-operatives have shown normal marketing practices. There was nothing significant to worry in these markets. So there is differential growth rate or degrowth in the differential markets because of circumstances and conditions prevailing in those market in the last few months and now we have seen for the last two weeks in almost all the markets production milk availability has got to normal levels and the carry



Heritage Foods Limited
February 01, 2019

forward inventory was more or less liquidated by everybody. We see the green shoots coming up in everywhere.

Himanshu Nayyar: Great Sir. Thanks for the detailed explanation. Sir just my final question.

Moderator: Thank you. The next question is from the line of BV Bajaj from Bajaj Shares & Securities. Please go ahead.

BV Bajaj: Good evening. I have two questions, the positive quarter financial trend is very good appreciated, but a simple comment on that income from nonbusiness activities are very high, which is no sustainable. So I want your comment on that and the second question is out of all our complete dairy business, fresh milk is one basic sector other than the consumer products and SMP. So how you divide the percentage of total 100% turnover in these three categories that is fresh milk out of total dairy business, consumer products which is more margin incentive and SMP?

Brahmani N: Can you please clarify what exactly you mean by nonbusiness revenue. What line item are you looking at?

BV Bajaj: Other than that some share activity, which is given, which is added and accordingly your quarterly results have been up and down. So income from this business activity other than dairy product, which adds and subtracts in our quarterly result, it is not sustainable in long-term that is one question?

Prabhakara Naidu: Last year when we have dematted our retail business through future retail, they have allotted the shares actually 178000 lakhs share on that every quarter we need to value it actually is in the investment schedule, it has to be paid valued. So the actually in the quarter results, there is actually paid value gain on sales value through P&L Rs.53 Crores, Rs.11 lakhs they has shown in the income side similar amount is shown in the expenses side on actually 2J that is your last due to changes in paid value. There is no impact on the P&L. So this is as per Indian Accounting Standards we need to value our investment in the equity share as paid values and every reporting period so these difference is coming to actually paid value as on December 31, 2018 and actually paid valuation is on September 30, 2018 every quarterly difference has been reflected in the P&L both as expenditure side and actually income side. Expenditure side is because of actually we need to do some upside sharing to the future retails whenever the shares are sold. It has nothing to do with these P&L account because there is no impact on the income side as well as expense side same amount is shown.



Heritage Foods Limited
February 01, 2019

- BV Bajaj:** Second question about segments of dairy fresh milk consumer products which is high margin value and SMP how you segregate?
- M. Sambasiva Rao:** I will give you broad strokes. Our revenue from milk will be 65% of the total revenue in the dairy and revenue from value-added products, which are high margin products is about 25% and 10% comes from other commodities like butter, ghee, cream, some small quantities of milk powder etc.
- BV Bajaj:** So is there any possibility after Bombay capex plant JV and along with that the products, which are dairy consumer products, it will be increased from 25% to coming quarters by some appreciable amount?
- M. Sambasiva Rao:** We have internally taken a kind of certain initiatives to take the contribution from value-added products revenues to 40% in five years. On a year-on-year basis, we have been growing 3% in the last four, five years. Currently we stand at 25%; we wish to go to 40% in the five years. Different investments in the value-added product segment either in the processing, packaging, marketing, front-end infrastructure will help in this. The products you are referring to with the French company in Maharashtra would not be very significant; it would perhaps give us Rs.30 Crores, Rs.40 Crores per annum kind of contribution in the total revenue. It is one of the many products that will help in building this 25% to 40% revenue.
- BV Bajaj:** Thank you.
- Moderator:** Thank you. The next question is from the line of Bhargav Buddhadev from Kotak Mutual Fund. Please go ahead.
- Bhargav Buddhadev:** Thank you very much for the opportunity. Sir first question is that there has been an increase in milk procurement prices on a Q-on-Q basis so just wanted to check what is the reason for, is that reason procurement milk from states where their procurement price was already higher or whether they milk procurement prices in individuals states have increased on a sequential basis?
- M. Sambasiva Rao:** Could not follow, could you repeat please you are saying milk procurement price increased from?
- Bhargav Buddhadev:** Sir there has been an increase in milk procurement prices in Q3 versus Q2?
- M. Sambasiva Rao:** Q2 versus...?



Heritage Foods Limited
February 01, 2019

- Bhargav Buddhadev:** In this quarter versus Q2 so... Is this because we have procured milk from states where the procurement prices was higher or whether in our individual states, the procurement price has gone up in these three months?
- M. Sambasiva Rao:** In Q3 there was no significant price hike except the mix changed as you identified one is geographical mix and also type of milk. So in this quarter we typically get higher share of buffalo milk which is more expensive compared to the cow milk. This cow milk is Rs.25 liter or Rs.26; buffalo milk will be Rs.38 or Rs.39. So winter months buffalo yield more milk so that share will go up average prices will look higher similarly the territories, certain territories milk price will be higher certain territories lower that share also will show this distortion but per liter in the same segment for the same type of milk, there was no price hikes.
- Bhargav Buddhadev:** Okay so essentially going forward, do you see the strain continuing or this will normalize?
- M. Sambasiva Rao:** This year we may have price hikes for the procurement as the season changes now upward revision will happen.
- Bhargav Buddhadev:** Okay so correspondingly will we also increase our selling price?
- M. Sambasiva Rao:** There will be some lag time definitely it will be passed on, the coming months we have to see, there is also political situation around, elections around the corner so the price hikes may take sometime compared to the procurement price hike to sale price hike, there will be some time lag.
- Bhargav Buddhadev:** Okay secondly Sir you mentioned that in Tamil Nadu when you sold the toned milk obviously there was a volume decline because Aavin worsening at lower price but I believe you also introduced standardized milk and full cream milk where the competition from Aavin is not that higher because they do not sell like discounted prices. So how is the response towards standardized and full cream milk and whether these two products can help us arrest the decline going forward?
- M. Samba Murthy:** Both valid standard milk and SM milk that the volumes are sort of increasing, it is in the increasing trend.
- Bhargav Buddhadev:** Sir do we expect the volume decline trends to sort of get arrested in FY2020 or even in FY2020, there is a volume decline in Tamil Nadu?
- M. Samba Murthy:** We have already started growing now as I touched upon green shoots are feed now may be it comes in the quarter for discussion as of now situation is changing towards growth.



Heritage Foods Limited
February 01, 2019

- Bhargav Buddhadev:** And lastly Sir is it possible to share what has been your operating cash flow in Q3 and Q4 this year? And how has it grown on a Y-o-Y basis?
- M. Samba Murthy:** Operating cash flow it will more or less same trend the last year to this year you have seen the EBITDA trend and PBT trend, operating cash flows will be in sync with that, but we could give you separately, right now I do not have the numbers.
- Bhargav Buddhadev:** And Sir the reason why I was asking that essentially the inventory on the balance sheet would have reduced in December because the price of SMP have gone up globally and even in India as you mentioned that there was subsidy given for exports. So that is the reason why I was checking?
- M. Samba Murthy:** We can share perhaps later but it would be in the same trend, trend of PBT, EBITDA and cash flows will be the same.
- Bhargav Buddhadev:** Okay Sir I will come back in the queue. Thank you very much and all the best Sir.
- Moderator:** Thank you. The next question is from the line of Sangeeta Tripathi from Edelweiss. Please go ahead.
- Sangeeta Tripathi:** Good evening Sir. Thanks for this opportunity just taking the growth thing you explain that apart from two, three markets wherein environment was not the normal and rest of the market growth was the range of 10% to 15% that is how we have grown so first and foremost now with things normalizing to certain extent, can we expect in FY2020 this kind of growth at the company level to be in the range of double digit and secondly also in these markets wherein you have grown at 10% to 15% what is the kind of volume that we have pegged if you can give some understanding on the demand environment and the growth momentum ahead?
- Brahmani N:** As you rightly mentioned things are normalizing when it comes to external factors, milk procurement and competition etc., so we definitely are targeting double digit growth expecting that it is a normal year, the next financial year and your second question was on the growth in other markets and the volume growth is also more or less in line with the value growth of 10% to 15% depending on which state and which market we are looking at?
- Sangeeta Tripathi:** So for FY2020 double-digit growth can be expected on an organic front right?
- Brahmani N:** Surely.



Heritage Foods Limited
February 01, 2019

- Sangeeta Tripathi:** Secondly just wanted to have some understanding on the inorganic acquisitions what we were looking out for so any color or any update that front would be helpful?
- Brahmani N:** The process is still ongoing. Right now we are not seriously evaluating any players likely we said earlier we want to look at players that will not cannibalize our existing volumes. We are looking at... valuation also will make a lot of difference for us and quality standards are exceptionally important as a company and as most of dairy sector is unorganized even within the organized sector in many senses. So right now we are still in the process of evaluating potential opportunities for us, but there is nothing serious that we are considering at this point in time.
- Sangeeta Tripathi:** Okay because we have again stated and we have reiterated that we will reach to Rs.6000 Crores revenue by 2022 so I thought there would be some understanding in the inorganic part because organically we cannot take the levels to Rs.6000 Crores right?
- Brahmani N:** I mean definitely if we look at any interesting opportunities, we will reevaluate them but you must also keep in mind that this year is more or less a flat year for the dairy industry and for our company included. Of course in Q3 we are seeing some growth. In Q4 we expect growth to happen because of value-added products, better weather condition etc., so the target of achieving the number is still there. However we might extend our timeline by a year or so because this year has been an exceptional year for the company.
- Sangeeta Tripathi:** Okay that is quite clear, also the capex....?
- Moderator:** Thank you. The next question is from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.
- Nitin Gosar:** Sir you explained about the different state having different outcomes would you mind sharing the contribution of those states like AP, Karnataka, Tamil Nadu and North India on nine month basis what is their overall contribution revenue?
- M. Sambasiva Rao:** I can give approximate numbers, may not be exactly accurate, AP would be contributing around 30%, Telangana would be 30%, Karnataka around 10% and Tamil Nadu around 10% and northern states would be around 8%.
- Nitin Gosar:** Okay and Andhra Pradesh would have seen growth but Karnataka, Tamil Nadu would have not seen any growth kind of growth and in fact they would have degrown?
- M. Sambasiva Rao:** No, Karnataka has seen growth. Tamil Nadu, Maharashtra and Punjab, Haryana, Rajasthan these are the three pockets where we went through the tsunami.



Heritage Foods Limited
February 01, 2019

Nitin Gosar: Okay and going forward I think last quarter you discussed about territorial expansion not being the core strategy for FY2019 because of the excess milk supply that the system is seeing, current situation now the way it is playing out what assessment on the geography expansion going forward?

M. Sambasiva Rao: If we continue to operate in the same geographies, we are now actively present in 15 states. We have created infrastructure required and particularly in the northern states like Haryana and Punjab, Delhi surroundings, we have got two plants of our own, we moved out of the third party packing stations transition from Reliance, we have moved out of them and we started our own packing stations, Rajasthan also we are looking at own packing station but currently we are operating out of third party and all the milk procurement in these states is also now happening, half of it is happening through our own chilling centers and half is still happening through the franchisees. That also we will be moving out soon. So we have absolute control on the milk chain from farmer to the consumer, which will help us in improving quality further and cost management also will be better. So in another six months to nine months, we will have much superior handling capacities in these states and we will start pushing the volume growth from this summer onwards. So market is changing the surplus scenario is vanishing, inventories are coming down, summer is going to start. The growth triggers are also in place and we are also improving our internal efficiencies in those markets. We will see how to grow in the existing states only.

Nitin Gosar: Okay got it Sir. Thank you.

Moderator: Thank you. The next question is from the line of Sandeep Jain from Shrinathji Investments. Please go ahead.

Sandeep Jain: Sir my question is difference between selling and costing price of milk in this quarter is around Rs.6.4 per liter despite surplus milk supply in the market as you said, so going forward what price can we expect?

M. Sambasiva Rao: Yes it is something to see the spread keeps changing based on the procurement price, sale price and also contribution coming from value-added products. As sale of value added products increase, revenue per liter will also be showing higher. The liquid milk to liquid milk spread would be more or less same it can be half rupee plus or minus.

Sandeep Jain: Okay my next question is what is the status of our joint venture with Novandie?

Brahmani N: The joint venture is progressing smoothly. We are in the process of building the processing facility in Maharashtra and we are also in the process of finalizing our marketing strategy. There has been a little delay in terms of product launch, we are looking at Q2 of next



Heritage Foods Limited
February 01, 2019

financial year, Q2 or Q3 of next financial year in terms of launching the product because of several approvals and agreements when it came to the plant design etc., but everything is on track apart from that.

- Sandeep Jain:** Okay and what kind of revenue can be generated from this joint venture?
- Brahmani N:** As mentioned earlier about Rs.30 Crores maybe in the beginning to start with because we are beginning midway through the year and also it is the first year.
- Sandeep Jain:** Okay thank you.
- Moderator:** Thank you. The next question is from the line of Kartikeyan V K from Suyash Advisors. Please go ahead.
- Kartikeyan V K:** Sir good afternoon, I wanted a clarification couple of things one is in terms of perspective on fat losses what would be the breakeven SMP price Sir for you to not incur fat losses at current product mix, sale price and so on?
- M. Sambasiva Rao:** We will have to work out and see how it fluctuates in the SMP price being not static that is also moving we cannot keep one price static because these are the two products coming out of milk when we convert milk. So sometimes SMP gives higher realizations and fat also gives higher realization that is the year where scarcity is around the country so you get both the products giving higher margin and higher realizations and sometimes fat prices go down SMP price remains high. In certain situation it is converse. So there is no formula which says at what price fat achieves breakeven. It is a very tricky situation, you have to be part of dairy team to understand and help us.
- Kartikeyan V K:** At 2400 would you still me making losses Sir or does the equation then become more favorable of SMP price?
- M. Sambasiva Rao:** \$2400, fat price has to go move up realization has to move up even then even at \$2400 a ton and fat price have to go by another 25% increase and increase of another 25% of the price of fat in our language in our prices will have certain...
- Brahmani N:** I think it really depends on how company is account for it; the way in which we account for it for our internal purposes and MIS, fat prices also and realization is also has to go up significantly.
- M. Sambasiva Rao:** There is slightly accounting matter here. Different companies follow weightage for fat and SMP differently. When you convert milk into powder and butter, how much of milk cost



Heritage Foods Limited
February 01, 2019

you attribute butter, how much of milk cost you attribute to SMP that there is no standard here. Different companies have adopted different percentages of weightage. So we have given in a particular manner where the fat is shown generally in the negative trend whereas powder will be showing in the positive trend. We do not want to change accounting policy after forward a particular way for two and a half decades.

Brahmani N: Also we believe that we have to be conservative in the way we account internally. So we are more careful about how we manage these commodities and that is why it appears that something that is more loss making consistently.

Kartikeyan V K: Sure just to clarify what would have in the fat losses in the nine months period versus same time last year of whatever full year last year?

M. Sambasiva Rao: At nine months period, the PBT loss is Rs.33.67 Crores against corresponding nine months Rs.14.2 Crores.

Kartikeyan V K: Okay last year was Rs.14.2 Crores right?

M. Sambasiva Rao: Yes.

Kartikeyan V K: One minor clarification when would you be able to sell user retail share Sir according to the agreement?

M. Sambasiva Rao: It is lock-in till March 2020.

Kartikeyan V K: Okay March 2020. Thank you so much and best wishes Sir.

Moderator: Thank you. The next question is from the line of Sameer Kapadia from Rockstud Capital. Please go ahead.

Sameer Kapadia: Sir my understanding is management has given Rs.6000 Crores of a revenue growth target by 2022 whereas if I look at the historical trend in terms of both merit as well as value-added products, so milk business has grown by 10% whereas your value-added products segment has growth by 25% CAGR for the last five years whereas overall your adjusted net revenue has grown by just 14%. So does the management intend to revise the target downward and if so what would that number be?

Brahmani N: Rs.6000 Crores is definitely a target we will achieve as mentioned earlier this year though was an exceptional year being relatively flat. However, we shown strong growth when it comes to value-added products and expecting the same rate of growth about 10% in milk



Heritage Foods Limited
February 01, 2019

and 25% to 30% growth in value-added products and the contribution of value-added products increasing from the current 25% to 40% in the next few years. We are confident that we will be able to achieve Rs.6000 Crores target it might just be a year or so extra then what was expected earlier, but the target is clear for us?

Sameer Kapadia:

As you know around 10% to 11% kind of growth rate in the milk and 25% growth rate, your sales would be coming at like around Rs.4000 odd Crores and like perhaps that would be somewhere around 15% kind of growth rate overall. Is that understanding right and secondly I understand that our company has already rate down the capex but then in the initial commentary you had revised, you have slow down a bit, can you explain as a bit more in detail in terms of what kind of capex the company is looking for and what could be the revenues which would be generated from it, I understand our management has given guidance of Rs.100 Crores revenue per annum for the next four years?

Brahmani N:

I think yes to clarify for the dairy division around Rs.100 Crores is what we are looking at when it comes to capex, when it comes to the backend, when it comes to our processing as well as front end deployment of freezers, chillers, coolers and other kind of capex and to answer your question on growth again that is why we are looking at an extra year to be able to achieve our target rate numbers and secondly your realizations will also increase as a contribution of value-added products grow and that is another driver towards achieving the number of Rs.6000 Crores. We have been quite cautious about our growth or you might also call it conservative sometimes because we are more focused on our bottom line, we do not want to grow for the sake of growing, we want to grow healthily while protecting our bottom line that has been the strength of the company that also reflects in the different operational ratios if you look at return on capital employed etc., that continues to be pretty strong because bottom line approach is something that is really important for us. So we want extremely healthy in the way we grow.

Sameer Kapadia:

I completely understand on that just wanted to get perhaps because this figure which according to you is perhaps post your acquisition of Reliance Dairy but then any which ways I got your point. Other thing is I wanted to know is like this revenue target which you have specified it is for completely organic growth, you have not considered any inorganic acquisitions for this revenue target is that understanding right?

Brahmani N:

We will be quite opportunistic when it comes to acquisition.

Sameer Kapadia:

Earlier call you had specified this is completely from an organic growth in Q4 FY2018 con call?

Brahmani N:

Yes it will be organic growth and anything that comes will be in addition to this.



Heritage Foods Limited
February 01, 2019

Moderator: Thank you. The next question is from the line of Anirudha Joshi from ICICI Securities. Please go ahead.

Anirudha Joshi: Thanks for the opportunity. Sir one of the earliest question you answered that procurement prices will go up, but the selling prices may not go because of the election and all this, so are you saying that probably we will have margin pressure in FY2020 or at least in H2 FY2020 we will have margin pressure considering we will end FY2019 on a very high note?

M. Sambasiva Rao: There will be lag extra time if the procurement prices go up; sales prices will also go up. In certain situations, we will be able to pass on the increase immediately, in certain circumstances we may take one or two months more to pass on because in this election year, cooperatives will hesitate and they will not get permissions from government to increase the sale prices. So we will wait for certain things to happen and do. There will be certain delay in passing on the extra cost of that Rs.1 or Rs.2. Meanwhile in the coming six months, we have advantage of the summer coming in the value-added products will grow at a higher pace and their contributions will be higher. In those items, we will be passing on to increase cost to some extent quickly so that would neutralize or nullify the price impact substantially and we will have some to carry on for Q2 to implement, the election scenario should be over by June. The Q2 will be open quarter for all the cooperatives and private companies to look at the prices. This purely some kind of pragmatic view we have to take during the coming quarter.

Anirudha Joshi: Okay but I mean in general considering the expectation of increasing milk procurement by say where do you see if 20 margins planning out whether it will be higher than what we are seeing right now or it will be the lower level than current?

M. Sambasiva Rao: It will be lower because this year is an exceptional year where the glut situation has come and prices at Farm Gate have come down. So this is kind of one-off the exceptional year growth wise and margin wise. We will be getting into the normal rates most probably from the summer.

Anirudha Joshi: This is the last question considering we have got additional profits this year, so what are the activities that we would have done to increase the connect with the consumers that is giving some freebies like 10%, 20% extra gramage or offering small value-added products with milk or any such consumer offers, which you would have done or any increase in ad spent that you would like to highlight?

M. Sambasiva Rao: Nothing of that sort. We maintained our integrity of pricing and except in certain modern retail format where passing on is possible.



Heritage Foods Limited
February 01, 2019

Brahmani N: Also considering the season that specifically Q3 of every year is colder months and value-added products sell much lower. We did not aggressively push any promotion, discounts or any of those things apart from what happens in the normal course of business. So it is nothing exceptional because it is offseason to be spending on any other activities and any incremental benefits we believe can be temporary.

Anirudha Joshi: Okay thank you.

Moderator: Thank you. The next question is from the line of Namit Arora from Indgrowth Capital. Please go ahead.

Namit Arora: The question was on the recent acquisition of Prabhat and any impact because there was some operations which were getting outsourced to that company? You can help me understand that?

M. Sambasiva Rao: We have existed from co-packing operations from Prabhat about six months back, we have tied-up with some other company in Pune, our operations are already out of that company. That is all we did not have any idea of what is happening.

Namit Arora: Okay. Thank you.

Moderator: Thank you. The next question is from the line of Shraddha Seth from Edelweiss. Please go ahead.

Shraddha Seth: Sir wanted to understand your margin guidance as you said obviously this was a good year because of glut and all, but also as I understand why we are not sharing Reliance Dairy number separately, but are we breaking even there and in the previous quarter you did share losses figure. So would it not also be a buffer next year in terms of the margins should not be coming down from here on because this year also has some processes of Reliance Dairy?

M. Sambasiva Rao: It is not he, you either I am not able to hear that.

Shraddha Seth: No what I am saying is as you said to the previous participant that the margins this year are very high and should not sustain but just wanted to understand this year also had some losses of Reliance Dairy which might not continue in the next year so would not that be a buffer to the margin guidance next year?

M. Sambasiva Rao: First thing I was trying to bring up to you an indirect way even I was not able to hear whether there are any losses because numbers got seamlessly merged and it is unfair on my part to say it is profitable or loss making, but I at a superficial level there are no more losses



Heritage Foods Limited
February 01, 2019

in any operation, we are able to significantly rationalize the businesses everywhere and the margins themselves speak of that. Coming to the guidance yes there will be procurement price hike and there will be some delay in passing on the price hikes to consumer through liquid milk whereas through value-added products, we will be able to pass on at the earliest. So there would be some amount of drop in the margins to the levels of a normal year.

Shraddha Seth: Sure, second procurement just wanted to understand while we still say that we want to go to 28 million liters from current 13, 14, 15 million liters, so just wanted to understand this year we just add 4% procurement growth year to date. So what is the annual target we are looking at since you said it will be from existing states itself. So what could be the growth in procurement to reach our target?

M. Sambasiva Rao: The procurement growth of current year is a kind of decision not to actively pursue the volume increase right by delaying commissioning of chilling centers not going into more villages to procure more as a caution because of the glut around us. We could have got more volume, but we would have ended up in converting the milk into powder and butter and selling at lower realizations. So it was a kind of conscious call that we did not want to grow too much in this year we have not grown. In the coming years if you want to grow procurement, we have enough triggers for growing volumes at least 2 to 2.5 lakh liters a year, we will be able to add with the existing momentum.

Shraddha Seth: Sure that is helpful. Sir just on the capex guidance if you can reiterate what will be guidance for the next few years?

M. Sambasiva Rao: I think earlier our executive director answered saying it will be around Rs.100 Crores plus or minus 10 per annum in the coming four, five years, which would help us to achieve these volumes, the allocation of resources is again connected to the growth aspirations we have articulated.

Shraddha Seth: Sure and lastly Sir just wanted to understand this Rs.6000 Crores target in our earlier call I think you have said this is along with our erstwhile retail division so is my understanding correct that Rs.4500 Crores is the right target and not Rs.6000?

M. Sambasiva Rao: It was correct, but we have taken this by additional two years to cover that gap of Rs.1500 Crores when we declared Rs.6000 Crores as a company, dairy was taken Rs.4500, retail was taken as Rs.1500. So when we demerged the retail to future group that revenue of Rs.700, 800 Crores I think 700 plus Crores versus move out of the Heritage Foods Company. So we have to cover that Rs.1500 also conceived the original thought of Rs.4500 to dairy. So to capture the entire Rs.6000 Crores, we are now seeking additional timeframe then reducing the targets because the moment I reduce the target all the internal deficient



Heritage Foods Limited
February 01, 2019

like capital allocation, geographical spreads, team building, technology additions all these things will get affected. So we are moving in the direction of achieving Rs.6000 Crores required internal arrangements have been made. So we will only seek 1, 1.5-year more. Again it depends on the season, suppose this year if there was no glut and the price realizations are normal. We would have got our 20% plus I would have gained this year. Now I lost one year in the process and I will be adding this year at the tail end. So if I want to make it clear we are not scaling the number of Rs.6000 Crores for the demerged retail business. We are trying to take additional timeframe to achieve Rs.6000 Crores, which could be 1. 1.5-year beyond 2022.

Moderator: Thank you. The next question is from the line of Bhargav Buddhadev from Kotak Mutual Fund. Please go ahead.

Bhargav Buddhadev: Just one last question Sir you mentioned that in Karnataka there has been growth if not in Maharashtra in terms of milk sales, but I believe in Karnataka also and Nandini enjoys subsidy. So how did we manage to sort of grow in Karnataka and whether this growth is sustainable?

M. Sambasiva Rao: In Karnataka the policy of Nandini and government was to support farmers with Rs.4, Rs.5 per liters of the milk given to Nandini; Rs.5 per liter Karnataka Government gives to Nandini brand for the milk they procure from the farmers. If we procure from the same farmers in Karnataka we will not get Rs.5, we have to fund that Rs.5 from company. So there is no spread of Rs.5 per liter there. So what we do this we procured milk around Karnataka in the states of Andhra Pradesh and Tamil Nadu, we move the milk into Bengaluru and sell. That is where we are able to withstand the competition and grow.

Bhargav Buddhadev: So Nandini is not very strong in Bengaluru is it?

M. Sambasiva Rao: It is almost monopolistic brand because no one else is procuring milk in Karnataka except Nandini with Rs.5 support

Bhargav Buddhadev: And Sir do you expect the growth in Karnataka to continue?

M. Sambasiva Rao: Yes.

Bhargav Buddhadev: Okay Sir thank you and all the best.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.



Heritage Foods Limited
February 01, 2019

Nitin Gosar: Sir just a clarification on the margin guidance. In the past we used to do a 5.5% margin then there was also time and we used to do 7% EBITDA margin and 5.5% used to come in a normal air while also we have also seen 5.5% when we acquired Reliance asset, so what is the number to grow by?

M. Sambasiva Rao: It has several factors I mean this is not a simple output. It has weather impact. It has national policy, state policy, international prices, and global trade wars. There are multiple factors we have to evaluate to declare a number and it is changing quarter by quarter, season by season, year by year. So we have to always take a range. It maybe 6 to 8, depends on the conditions, it can be 1% plus or minus. We cannot pinpoint that will be exactly 5.5 or 7.5. With our experience over the last two decades we see dairy margins are fluctuating, it is not unidirectional like FMCGs. So we have to accommodate that fluctuation of 1%, 1.5%, and 2% in the margins season to season, quarter to quarter, it is not scientific or there is no model available to suggest this is going to be year's guidance, but guidance is limited to range not to a point.

Nitin Gosar: According to you the range could be between 6% to 8%?

M. Sambasiva Rao: Yes.

Nitin Gosar: Okay and one more clarification you talked about SMP loss of around Rs.33 Crores for nine months this year?

M. Sambasiva Rao: Not SMP. It is fat. Fat includes butter, ghee and cream. These are the three products in our accounting methodology they end up in losses and there the realizations would be lower than the cost of production. We attribute certain weightage for the fat in the milk when we take surplus milk.

Nitin Gosar: Okay but their losses would be higher versus last year because the realizations have been poor?

M. Sambasiva Rao: This year particularly fat prices crashed significantly compared last year, almost 25% drop in the realization of the fat during the current nine months compared to last year that has impacted the revenue growth also, that has impacted the bottom line also.

Nitin Gosar: And in a typical year when the supply normalizes, the fat prices also normalize?

M. Sambasiva Rao: More or less they come back to normal price and then our losses would be there, but marginal, it would not be have significant as this.



Heritage Foods Limited
February 01, 2019

- Nitin Gosar:** Okay Sir the previous year number which was around Rs.14 Crores could be the number to go by in a normalized environment?
- M. Sambasiva Rao:** That is nine months trend.
- Nitin Gosar:** Okay got it Sir. Thank you.
- Moderator:** Thank you. The next question is from the line of Dhiraj Mistry from Emkay Global. Please go ahead.
- Dhiraj Mistry:** Hi Sir only one question from my end, what would be the curd sale for the quarter?
- M. Sambasiva Rao:** As an average per day is around 270 tonnes for the quarter.
- Dhiraj Mistry:** Value?
- M. Sambasiva Rao:** Value it is around Rs.110 Crores for the quarter.
- Dhiraj Mistry:** Okay. Thank you that is it from me.
- Moderator:** Thank you. The next question is from the line of Shailesh Kumar from Sunidhi Securities please go ahead.
- Shailesh Kumar:** Thanks for the opportunity. I have a couple of questions mainly housekeeping in nature, what is our EBITDA margin in liquid and value-added products on nine-month basis and quick milk?
- M. Sambasiva Rao:** Quick milk and value added product EBITDA margin nine months right?
- Samba Murthy:** Milk is 7.95%, value-added products 14.96%.
- Shailesh Kumar:** In the value added product what are the number 2 and number 3 largest products after curd?
- M. Sambasiva Rao:** Buttermilk, flavored milk.
- Shailesh Kumar:** Okay and what has been the revenue on nine-month basis?
- M. Sambasiva Rao:** We do not have right way, we will give you later.
- Shailesh Kumar:** Great and Sir we are seeing some minority interest in our P&L so if you could help me where does this minority interest come from? What is it attributable to?



Heritage Foods Limited
February 01, 2019

M. Sambasiva Rao: We have Farmers Trust, which has all the milk supply farmers as member of the trust. In consolidation I think they become minority.

Shailesh Kumar: What exactly does this trust do Farmers Trust?

M. Sambasiva Rao: There is a kind of long version if you want to hear from me, but there is a lot of thing to empower farmers to enrich farmers to improve their productivity, quality of life, animal health, nutrition, vaccination, insemination. So we have lot of activities, which will engage farmers throughout the year for their empowerment and their wellbeing.

Brahmani N: It is also large retention activity of milk procurement and farmer base, which has been extremely considerable.

Shailesh Kumar: If possible if you could give me the breakup of Rs.66 Crores capex that has been undertaken.

M. Sambasiva Rao: It goes into I do not have right away, but it goes into the milk chilling facility creation, packing and processing stations, expansion when market infrastructure like chillers, freezers, coolers in the market and enhancing our capacities of effluent treatment plant and internal ISO standard specifications to achieve some amount of upgradation, replacement capex where we have to replace certain aged equipment which was there for more than 10-15 years get the new equipments in place so with the whole expansions and improvement, compliance requirement, replacement, holding the stocks, cold rooms. The line items I would not be able to give you at this stage. It is all activities that going intact.

Shailesh Kumar: And what has been our advertisement expense in nine months FY2019?

M. Sambasiva Rao: It will be around 1% of our revenue.

Shailesh Kumar: And one last question if I may squeeze in though you have utterly cleared the stance, what has been our procurement volume from the acquired business, which we have taken from the Reliance because we have been right sizing it for the last an year and a half so whereas with it now stabilized and we believe it is properly integrated at this level, we need not tinker with it?

M. Sambasiva Rao: We have inherited from Dairy Life business 29 locations where milk procurement was happening through franchisee chilling centers. All the chilling centers we evaluated and now reduced them to 15 chilling centers and to bring the viability freshness, cost management, distance etc., when we acquired we were getting close to 2.25 lakh liters of procurement form them out of which about 70000, 80000 liters was going for a conversion



Heritage Foods Limited
February 01, 2019

plan for powder and butter. That commodity business we have decided to stop because that was not adding any value as of now it would be around 110000 liters or so, the procurement volume coming from those locations on an average. So we will now what I have earlier mentioned out of this 15 locations also half of them are still in the hands of franchisees, half of them will moved out and created our own infrastructure. In the next six to seven months we will move out of the balance franchisees and set up own chilling centers. Then the growth will be built on these 15 centers and possibly we will add a few more at the right locations where we require the milk for supporting the procurement and sales. So it is a kind of process going on. I have stopped monitoring this numbers because people are not getting data correct, so that they are all integrated into normal movement of the operations. So we deliberately and consciously said let us not discuss, it is creating a lot of confusion in the numbers. It has become stable, the purpose has served. We have entry to five new states. This has given good team, good infrastructure we acquired post the acquisition, we have gone into Vaman Foods asset near Chandigarh acquired which has 2 lakh liter capacity and we have also expanded our acquired in Haryana near Sonipat to 2 lakh liters. So the infrastructure is now perfect, people are there and growth will trigger from the coming season. Rationalization process is almost over except this 5, 6 chilling centers to be taken over by us 100% operations. This is where we are today and I request all the members to dissect further into acquired business, it has become small in a 14 lakh liters business, it is now around 110000 liters and got integrated at all levels in the sales, procurement processing, people, so it is difficult task and unproductive task to monitor it separately and then present it separately. So it is integrated fully, it has become part of my body.

Shailesh Kumar: Got it. Thank you very much Dr. Rao, you have been very patience and very generous with your explanation. Thank you very much.

Moderator: Thank you. Shailesh any further closing comments from your end or from the management.

Shailesh Kumar: We would like to thank all the participants for taking active participation in the call. We would also like to thank the management team of Heritage Foods that they have tried to explain queries of participants in best possible way. Dr. Rao any closing comment would like to say?

M Sambasiva Rao: Thank you very much for the continued interest in Heritage, all the members and I would be more happy, be more transparent and explanatory to all of you to understand the business well and take a call on our business. As I earlier explained dairy has several impact of seasons and policies and which are not predictable and consistent. There is a factor of fluctuation in our performance with the external factors, internal factors we are very perfect and robust and we continue to have the high aspirations to grow and deliver strong top line



Heritage Foods Limited
February 01, 2019

and bottom line and we are hopeful of meeting you with a much further improved performance in the quarter to come. Thank you very much.

Moderator:

Thank you. Ladies and gentlemen on behalf of Sunidhi Securities that concludes this conference call for today. Thank you for joining us. You may now disconnect your lines.