"Heritage Foods Q2 FY'18 Post Result Conference Call"

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MODERATOR: **MR. SHAILESH KUMAR – SUNIDHI SECURITIES & FINANCE**

Moderator: Ladies and gentlemen, good day and welcome to the Heritage Foods Q2 FY'18 Post Result Conference Call hosted by Sunidhi Securities & Finance Limited. As a reminder, all participant lines will be in the listen-only mode and 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 & Finance. Thank you and over to you, sir.

Shailesh Kumar: Good Evening, Ladies and Gentlemen. On behalf of Sunidhi Securities, I extend a very warm welcome to all of you for this Post-Result Conference Call of Heritage Foods Limited. Management side is being represented by Dr. M. Sambasiva Rao – President; Ms. Brahmani – Executive Director; Mr. A. Prabhakara Naidu – Chief Financial Officer; Mr. Samba Murthy – Head of Dairy Division; and Mr. Umakanta Barik – Company Secretary.

Dr. Rao will start with the brief synopsis of the performance and then we can head towards "Question-and-Answer Session."

Now, I will hand over the call to Dr. Rao for further proceeding. Over to you, Dr. Rao.

Dr. M. Sambasiva Rao: Thank you, Mr. Shailesh. Good afternoon to all the participants and a warm welcome to Heritage Foods Call.

I would take you through the Q2 Financial Highlights: In this quarter, standalone basis, which includes Dairy business and Renewable Energy business achieved Rs.608 crores of the net turnover with 34% growth over the Q2 of the last financial year that is Rs.454 crores, this is one of the highest growth phases we have been going through. During this quarter, we have achieved Rs.23.87 crores at EBITDA level as margin with a degrowth of 36% compared to Q2 of last year which was Rs.37 crores. At PAT level, we achieved Rs.8.88 crores during this quarter compared to Rs.23.68 crores in the previous year same quarter. There is significant drop in the margins during this quarter… perhaps we will get opportunity to explain the situation why the margins have been dropped, though our Q2 gross margin percentage is similar to Q1 gross margin percentage.

There is no change either in the procurement prices of Milk or sale prices of Milk during these two quarters, the procurement average price was at Rs.33.83/litre, sale price average was Rs.38.81/litre at the same level, both the quarters have performed in terms of gross margins.

At the consolidated level, which includes Heritage Foods Limited handling the Cattle Feed business we achieved a turnover of Rs.616 crores over the previous year with 34% growth, the previous year's Q2 revenue was Rs.459 crores. At EBITDA level the Q2 of current year consolidated level we have achieved Rs.22.76 crores Vs Rs.38.41 crores last year, at PAT level it is Rs.7.42 crores Vs Rs.24 crores last year Q2.

Value-Added Products have contributed 24.8% for this quarter's revenue. Milk procurement has gone up by 30% from 10.3 lakh litres per day to 13.3 lakh litres per day, almost 3 lakh litres increase is there in the last year to this year in terms of volumes and sales volume we have achieved about 2 lakh litres increase, that is 8.9 lakh litres per day of last year to 10.9 lakh litres per day current year quarter. These are the significant contributions in terms of Milk procurement volume growth, sales volume growth and the Value-Added products contribution to the revenue.

At the debt level, we remain at Rs.127 crores long-term loans and Rs.34.5 crores working capital and total of Heritage Foods is Rs.162 crores debt. In HFRL, that is subsidiary, we have Rs.5.5 crores term loan and about Rs.4 crores of working capital, Rs.9.5 crores of the debt is there in the subsidiary company which is handling the Cattle Feed business with one plant.

The prices of Milk have started declining from the October as expected and the season is quite good in terms of production and Milk availability and Milk prices are further declining. There was also spike in the expenses in Q2 which we will be explaining during the discussion. It is essentially because of one-time expenses we have in this quarter and also because of the volume increase when we have to handle 3 lakh litres increase in the procurement, the freight cost gets added into the other expenses, that also contributed to the spike.

Now, this is open for discussion. We hope to clarify the doubts in this next part of the call. Thank you.

Moderator: Thank you. We will now begin with the Question-and-Answer Session. The first question is from the line of Resha Haria from GreenEdge Wealth Services. Please go ahead.

Resha Haria: We have grown handsomely as far as our volumes are concerned, but clearly our margins have taken a beating. Could you please elaborate on that?

Dr. M. Sambasiva Rao: Sure, I would request our CFO to give details of how much margins declined and for what reasons.

CA A Prabhakara Naidu: As far as gross margins are concerned, the current quarter overall gross margin is 18.02%, whereas in the first quarter when we have acquired Dairy Life, 2% is the impact on gross margins, because of that ex Dairy Life actually, then Heritage gross margin is 19.83% as well as PBT and EBITDA level around 2% impact due to acquisition of Reliance Dairy as of now, then there are certain expenses which have been accounted during the current quarter. Because the top line has gone up by 34%, freight increase in the current quarter as compared to the last year is Rs.6.26 crores, the new packing material, entire packaging has been decimated, that is the reason new packing material we have incurred additional expenditure on the cylinders and all around Rs.1 crore, then total stores and spares has gone up by Rs.2.15 lakhs, then towards branding Rs.2.8 crores we have incurred in this quarter additionally, then there is professional charges which includes Rs.1 crore GST impact as compared to the last year and around Rs.60 lakhs we have incurred towards appointment of GST consultancy charges as well as IND AS consultancy, so Rs.1.60 crores is toward professional charges, there is Rs.50 lakhs we have incurred towards silver jubilee expenses during this quarter, then other expenses is around Rs.66 lakhs, HFRL that is Vetca business which we are doing, last year it was trading business, now from 1st of April we have entered into the manufacturing, we have commissioned one plant during that actually then around Rs.3 crores we have incurred during this quarter additionally as compared to the last year. So total around Rs.16.96 crores is the additional expenditure, out of this around Rs.4.5-5 crores is one-time expenditure which may not be repeated in the third quarter.

Resha Haria: Our Pouch Milk traditionally it has enjoyed Re.1-2 premium over the other brands. But over the last one, two quarters, this premium has gone away if I am correct. So do you think this is possible to get back anytime soon to charging that Re.1-2 premium over our peers?

Dr. M. Sambasiva Rao: I will just add one more factor before answering this premium part; for the Q2 drop in the margins another important factor that contributed was Milk procurement price. There was increase in the procurement price in the first quarter also. We could not pass on entire procurement price to customer. Now, that also contributed to the decrease in the margins. That partly addresses the margin drop, one part is the increased cost, another part is increased Milk prices. Coming to your question of premium, even right now, we have premium prices in certain markets like Bengaluru, Chennai. In certain markets we have not taken the premium pricing stand for this season. We may be taking a couple of months down the line. That advantage is waiting for the next quarter.

Resha Haria: In Hyderabad basically we are not currently charging premium, right?

Dr. M. Sambasiva Rao: There were certain local issues. We thought we would wait for the season to change. After this winter, we would be able to do that.

Resha Haria: Last quarter can you please share these Reliance Dairy’s breakup in terms of sales, EBITDA or Milk of yours?

Dr. M. Sambasiva Rao: In this Q2, the Dairy Life revenue contribution is Rs.65 crores, the rest of it is from the Heritage Organic business. In terms of margins, Dairy Life of Reliance impacted about Rs.15 crores at the PBT level in the Q2, out of that about Rs.5 crores is due to the sale of bulk Dairy products we inherited from the transaction, the rest of the Rs.10 crores is from the normal business.

Resha Haria: How much do we procure through the land in terms of volume?

Dr. M. Sambasiva Rao: Volume procurement was around average 1.2 lakh litres per day during the Q2, it used to be 1.5 lakh litres when the business got transferred, the Q2 being a lean quarter there was a seasonal drop and there were also certain facilities we have closed as part of rationalization, we have closed around 10 chilling centers out of 31 chilling centers we have received during the transaction and also 9 bulk coolers we have closed out of the 19 bulk coolers we have received from them. As part of the realization exercise keeping the distances from the markets and plants in view and also the logistics cost, etc., so the volumes have come down because of closure of certain procurement operations also the seasonal drop. Now, it has already crossed 1.5 lakh litres per day in this month.

Resha Haria: What is the Milk sold volume for Q2 through Reliance?

Dr. M. Sambasiva Rao: Milk sale through Dairy Life was over 1 lakh litres in the Q2.

Moderator: Thank you. The next question is from the line of Prashant Gopi from Sundaram Mutual Funds. Please go ahead.

Prashant Gopi: First thing is you just said that there were Rs.16.5 crores impact. This was for the entire business you are referring to, right or is it just with regard to the base business because you just spoke about again Reliance Dairy also having an impact on your PBT. If you could just clarify that part?

Dr. M. Sambasiva Rao: It is overall for the entire quarter.

Prashant Gopi: You highlighted that the total impact on expenses which has got added in the quarter was about Rs.16.5 crores. So that is all inclusive of Reliance Dairy as well, right?

Dr. M. Sambasiva Rao: Yes, some of the expenses come from the Dairy also.

Prashant Gopi: The question is pertaining because if we look at let us say if we adjust that particular cost as well, my margins are still down on YoY basis. What reason can we assign to this because even if we adjust for this particular cost and even if we assign a little bit of gross margin adjustment as well, my margins still look at little lower, just if you could help us understand this particular thing?

Dr. M. Sambasiva Rao: That is mostly because of the procurement price. During this quarter, the Milk procurement price hike compared to the corresponding quarter last year was 6.8%, sales price increase was only 4.4%, another 2.2% the increase in the raw material cost was not passed on to consumer, that has actually impacted the margin plus there were certain branding and celebration expenses during this year, we have revived our brand and altered the art works, packaging material, conducted the engagement programs with the stakeholders as part of silver jubilee, all this is an additional cost which would not be there in the coming months but the procurement price was the major impact on the margins if you have to single out one factor.

Prashant Gopi: So incrementally I think the prices have actually started coming down because if we look at the procurement price actually sequentially there is no change in the procurement prices, in fact, it has actually come down, if I look at the procurement price per litre, which is given by you in the presentation, the prices have actually come down. So is that what you are referring to that probably come down before October itself?

Dr. M. Sambasiva Rao: There was certain mix change that there was a small drop in the procurement price in certain geographies but not all over.

Prashant Gopi: Obviously, the prices have started coming off, but do you think we need to take any price increases is required at this point of time in order to probably weather the impact of gross margin?

Dr. M. Sambasiva Rao: This is not the right season to take any price hike particularly when the Milk is in plenty and unorganized players will be entering the market with the loose milk, etc., The price hike will be considered in early part of the Q4.

Prashant Gopi: My last question is on the Reliance Dairy part sir. Obviously, there are still some cost which are apportioned to it at this point of time. Most of the facility quotients which you are referring to or in reference to the bulk chillers and the coolers, and apart from that, the procurement is supposed to be reduced. Is it completed as of now and incrementally how much cost do we think could actually get apportioned because of Reliance Dairy let us say over the next two to three quarters?

Dr. M. Sambasiva Rao: Mr. Murthy will explain on the rationalization activities and last reduction activities undertaken by the Dairy.

Samba Murthy: 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 going to withdraw procurement and sale from Nagpur market also, and we are closing two packing stations which are Ludhiana and

Kundli and that packing stations will be merged with our own plants at Rai plant and forthcoming this plant at Chandigarh.

Prashant Gopi: When do you expect this cost to kind of completely go up and are you expecting like margins to probably turning EBITDA positive or EBITDA breakeven?

Dr. M. Sambasiva Rao: Volume realization, procurement drop, price drop and sales price increase, etc., will culminate towards the early part of the Q4 wherein we expect the acquired business also stop making losses towards the end of the financial year.

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

Aniruddha Joshi: Sir, last quarter we had given a guidance of EBITDA margin for the full year at 7-8%. So where do we stand on that front now considering we are not taking price hike, also the Milk prices are remaining at elevated levels?

Dr. M. Sambasiva Rao: Last discussion was also based on the assumption that the procurement prices will drop and certain sale price increases could happen. As far as Q3 is concerned, we are on track as per the margins of last year. We would be getting benefit of the procurement price drop in this quarter. The Q4 will get two benefits – one is the price hikes wherever possible in all the Milk and Milk Products plus the reduction of the losses being caused by the acquired Dairy Life brand that also should come down. A combination of procurement price drop, sale price adjustments and the rationalization reorganization of Dairy Life business leading to no loss scenario, should help us to achieve 6.5-7.5% of PBT margins in the full year. This is what is our estimate, but still we will keep our fingers crossed. As every month passes, our ability to effect these changes will determine.

Aniruddha Joshi: Can you share some light on the new acquisition of Vaman Foods, you have given the turnover details, but how are the business, litres per day or the profitability of that business, etc., and the acquisition price as well?

Brahmani Nara: In line with our future growth to achieve our Rs.6,000 crores revenue in five years and in line with our thinking of rationalizing the new businesses operations, we have moved the packing of some of Dairy Life's volumes into our own packing units. So Vaman Foods is another acquisition in that direction wherein in about a month's time we expect to move volumes from a packing station in the Chandigarh area into our own procurement processing unit wherein we expect to receive a lot of efficiencies in terms of operations and also more control over our operations. Not only have we acquired Vaman Foods, but very recently we acquired another plant in the Hyderabad region mainly to move major part of the volumes that we have acquired from the Reliance business into that particular processing facility. So that is the idea to increase efficiencies of our operations through the acquired new volume and also to have more control over operations.

Aniruddha Joshi: Roughly, what was the acquisition price we have paid for both these companies?

Brahmani Nara: With respect to Vaman Foods, the acquisition price is Rs.20 crores and with respect to the Hyderabad plant it was Rs.12 crores.

Aniruddha Joshi: Both were cash acquisitions?

Brahmani Nara: Yes.

Moderator: Thank you. The next question is from the line of Dhaval Mehta from YES SECURITIES. Please go ahead.

Dhaval Mehta: Sir, my first question is in terms of Reliance Dairy business. Last quarter we did a loss of around Rs.4 crores at the EBITDA level and this quarter despite the measures which we have taken our loss increased. So exactly what went wrong over there, I have excluded Rs.5 crores?

Dr. M. Sambasiva Rao: Yes, that is because of the sale of the bulk materials inherited from the business. They were disposed during this period which was accumulated over a long period of time. Not the current quarter. operations. There were certain stocks received at the time of transaction. They got disposed substantially during this quarter. That has created certain lower realization than the inventory valuation at the time of transfer.

Dhaval Mehta: But even if I take ex of that, the total loss is around Rs.10 crores, right?

Dr. M. Sambasiva Rao: We were talking at two levels – the Q1 you are comparing PBT, Q2 you are taking EBITDA.

Dhaval Mehta: So at the EBITDA level, it is less than Rs.4 crores in this quarter?

Dr. M. Sambasiva Rao: It is more or less same, there is no increase actually.

Dhaval Mehta: My second question is on the Vatca business. I understand that we started the plant recently and that is why we have reported EBIT loss because of a lower operating leverage. So when do we expect that plant to breakeven?

Dr. M. Sambasiva Rao: Most likely in the Q4.

Dhaval Mehta: The best-case EBIT margin from that plant will be in the range of 2-3%, right?

Dr. M. Sambasiva Rao: Yes.

Dhaval Mehta: My last question is in terms of Heritage Parlour. If I see the presentation, our number of Parlours have decreased drastically from 1574 in last financial year same quarter vis-à-vis 1279. So what is the rationale – are we now opting for different channels for our sales of milk, what is the rationale of decrease in number of Parlours?

Dr. M. Sambasiva Rao: The Parlours number has come down for a number of actions we have taken; there were three, four reasons for this drop – one is certain Parlours who are not delivering the required sales, they were either indisciplined or they were located in certain places where volumes are not growing. So we felt converting those Parlours as distributors or Milk agents would be beneficial than maintaining Parlours. They were also not finding it remunerative to continue. Certain Parlours were taken out on the feasibility grounds and the low volume of sale. Second set of Parlours they were selling mix of brands. These are supposed to be exclusive Heritage branded products only. So some of these franchisees have deviated from the standards given and started selling competition brands and also unconnected products. So on disciplinary grounds, we have knocked off a few. Then certain Parlours were removed because of the road widening in the cities and the U-turns, etc., the viabilities have come. Some of them have migrated for various reasons. We sat through each parlor, evaluated the performance and only viable above particular threshold we are continuing as Parlours, rest of them we have delisted them and allowed them to sell Milk and Milk Products as agents if they want to continue or if they want to discontinue to leave the brand, but not to have those substandard indisciplined manner of doing things. So we have now got quite performing and active healthy Parlours on the rolls, that is the reason and we continue to add Parlours almost 15, 20 every month from now onwards.

Dhaval Mehta: Still the sales to parlor remains our major focus rather, we are not changing the strategy that we will be opting the sales to distribution or…?

Dr. M. Sambasiva Rao: No, our sales continue to be through Parlours and we continue to add Parlours, it is only kind of an exercise to streamline the number of Parlours where performance is not good or they have deviated from the exclusivity of the brand.

Moderator: Thank you. The next question is from the line of Vikrant Kashyap from Kedia Securities. Please go ahead.

Vikrant Kashyap: Sir, I have two questions; one is on our Value-Added product. We understand that you have done European acquisition and coming up with Yogurt for tie up. you have also mentioned in your presentation that you are scouting for more Value-Added products. Can you throw some light on that? Another thing is that what has been our revenue from Value-Added product – did our margin is maintained as it was previous quarters or it has been improved or deteriorated?

Brahmani Nara: In terms of the new Value-Added products that we are looking at through the JV with Novandie, we are basically looking at fruit and favored yogurts and we are actually in the stage of finalizing our marketing study and we have garnered some serious timeline for the launch of this particular product. The plant will be commissioned and we expect that the product will be in the market next financial year end of second quarter, beginning of third quarter, that is the timeline that we are looking at, so that is progressing really quickly. In terms of other Value-Added products, we are looking for opportunities; however, we continue to be focused on our core products wherein we are not just increasing the sales of this product but we are also improving the look and feel of the products, for instance, when it comes to flavored milk, which we have been selling in glass bottles, now we are also selling the same product in PP bottles which is basically a more convenient sterile way of selling the product, we are also looking at several business development initiatives for existing products, we are looking at new flavors, better differentiators, etc., We are also revamping our ice cream line for the coming season. So to put it in a nutshell, while we are looking at new Value-Added products and we expect commercial launch in the next financial year, we are also working on improving our existing Value-Added product to contribute towards the 40% revenue contribution that we are looking at by 2022 from Value-Added products.

Dr. M. Sambasiva Rao: Adding to that, our revenue growth from Value-Added products if we compare the Q2 of last year it was Rs.101 crores, now it has gone to Rs.126 crores, that is 24.8% growth in terms of revenue and margins we are a bit down compared to the last year; last year about 2.5-3% margin drop is there and it is essentially because of the increase in the Milk procurement price and also Milk powder price which we use in making products. So the raw material prices have gone up. All that was not passed on. So the margin also there was a drop which we should be normalizing with the drop in the prices of the Milk and Milk powder right away.

Vikrant Kashyap: Mr. Rao again, since we are doing a lot of rationalization in our company starting from hiving off Retail business, then acquiring Reliance business, now coming up with new JV, so taking all things in count, though our margins have been dropped, there has been some phases on growth, in terms of like sequential growth and margins should be at least steady not improving, so when do we think that 5-6 years time, how long it will take is anything in your mind?

Brahmani Nara: The long-term vision for the company is driven by growth. So if you remember, we have been mentioning that in the next five years we want to do a revenue of Rs.6,000 crores and a lot of it will come from growing YoY at least by 25% in terms of revenue. So that is why this year you will see that the growth of the company is (+30%), the growth in the previous years is nowhere close to this, it has only been about single digit in the last three years, so that is something we are really focused on, we are looking at newer geographies and in that direction, we had acquired a new business, we had acquired some new assets also to increase efficiencies of the new business. So I would say what we are looking at in terms of margins right now is a very temporary issue compounded by a certain seasonal factor due to high procurement prices. So in the long-term we expect to balance out our margins and maintain the margins that we have been maintaining in the last couple of years and that is what we are looking at going forward. In addition to looking at newer geographies and with the focus of being a national brand, we have also been focusing a lot more on Value-Added products and in that direction again we have been putting in a lot of resources in terms of brand building, brand awareness, so this was the first time after the inception of the company in this particular silver jubilee year we went through a complete evolution of our look and feel we changed all our packaging designs. So a lot of the activities that we are doing this year though might have some impact on the margin are towards the long term growth, towards our vision 2022.

Vikrant Kashyap: So if not FY'18, can we take double-digit margin in FY'19 at least, you are going through a lot of changes, actually we are focusing of Value-Added products?

Dr. M. Sambasiva Rao: They get nullified with the Milk na, the Milk is a significant revenue contributor, double-digit margin was never in the history of Dairy industry of companies anywhere in India because 80% of the sale realization goes back to farmer, it could be (+/-2%).

Brahmani Nara: To your point, we will continue to get a double digit margin in Value-Added products, and that contribution towards the revenue will increase; however there are some increased expenses that we see going forward in terms of geographical expansion, marketing initiatives, etc., So we will continue to maintain our margins that we maintained in the last few years.

Moderator: Thank you. The next question is from the line of Akshit Gandhi from Kotak Mutual Funds. Please go ahead.

Akshit Gandhi: If I exclude the Reliance Dairy volume, then our procurement volumes have grown by 18% YoY for Q2 FY'18. So if you can just highlight which are the regions we are getting such a strong volume growth?

Dr. M. Sambasiva Rao: We got the growth in procurement particularly Andhra Pradesh, Tamil Nadu and Maharashtra.

Akshit Gandhi: Is it fair to say that the Reliance Rs.65 crores top line, the Value-Added products contribution would be very low over there?

Dr. M. Sambasiva Rao: Yes.

Akshit Gandhi: If I look at the working capital for March versus right now, we have seen a significant reduction in inventory days and the debtor days have increased. Is this a seasonal effect or can we expect this trend to go forward?

CA A Prabhakara Naidu: Inventory has come down drastically because whatever the products, the entire things have been liquidated. As of now around Rs.70 crores is the inventory in Dairy division. Trade receivable is almost around two days, we are maintaining that. Trade payables are around nine days, come next to around three days only. Inventory is the major contributor; inventory has been actually on the factory has been disposed off and Whitener which we have acquired from Reliance Dairy that also has been liquidated during this quarter.

Akshit Gandhi: Shall we maintain inventory at similar levels or can it increase by March-end?

Dr. M. Sambasiva Rao: Inventory management is again a seasonal issue. During this Q2, ideally this is a period of consumption of all the fat because the festivals that pass-through and consumption of the Milk powder for making the products. All the inventories accumulated will be consumed or sold in the Q2. Towards the end of Q3, again, the purchase of Milk powder starts and accumulation of surplus fat in the form of butter and ghee will start. It will be held for three, four months. Again, as summer sets in, the sales will start in a big way.

CA A Prabhakara Naidu: Inventory is going to be around 18-20-days.

Dr. M. Sambasiva Rao: What I am trying to tell him is cyclical nature of inventory also. Our inventory management during the Q3 it gets built up, during the Q1 and Q2 it gets consolidated. So therefore the utilization will not be of same level in terms of working capital or inventory management.

Akshit Gandhi: You gave us the margin breakup of Dairy, Value-Added Products and Fat for Q1 which was 3%, 12% and (-5%). Can we have it for this quarter also?

CA A Prabhakara Naidu: EBITDA margin for Q2 is around 3.46% including Reliance, then Value-Added Products is 11.67%, Fat products is (-6.48%).

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

Sangeeta Tripathi: Just one clarification; you gave a guidance that PBT margin for full year would be in the range of 6-6.5%, that is what we are looking for. Now my question is for the first half of FY'18, our margins have been very low because of various reasons as you pointed out. So is this the guidance that you have given for second half of FY'18 or for full year you are saying that 6% we can maintain at PBT level?

Dr. M. Sambasiva Rao: This is for H2.

Sangeeta Tripathi: Adjusting could be somewhere around 4%-4.5%, is my understanding right?

Dr. M. Sambasiva Rao: Adjustment, I am not sure, how much it will turn out to be, but H2 we are anticipating that.

Sangeeta Tripathi: Secondly, we are driven by growth and by FY2022 we expect to take the turnover to Rs.6000 crores, all our acquisition as well as organic growth geared towards that direction, so top line guidance is already given at Rs.6000 crores. At this Rs.6000 crores, at the EBITDA level, can we have around 8.5% kind of margin, so Rs.500 crores of EBITDA can we expect over a longer period of time that increase in Value-Added products what we are yielding for, so understand on the long-term EBITDA?

Dr. M. Sambasiva Rao: Yes, that is the aspiration and that is how we are working on that.

Brahmani Nara: The last few years also, that is the EBITDA margin that we have maintained, so we expect to maintain the same.

Sangeeta Tripathi: So we are aiming for Rs.500 crores EBITDA for 2022?

Brahmani Nara: It is really hard to say the exact number, but those are the kind of margins that we expect to maintain.

Moderator: Thank you. The next question is from the line of Deepak Madhavdas from LSA Securities. Please go ahead.

Deepak Madhavdas: How we are moving towards this Ice Cream business because all the unorganized and organized players I believe are doing very well in Ice Creams, like they are talking about 40-50% growth YoY?

Dr. M. Sambasiva Rao: I prefer to explain to you may be towards the end of the year because we are now going through a kind of strategy workshops with the Ice Cream business, we have also engaged an agency to evaluate the strategies and come out with the branding options, etc., Our ambition is to take a bigger slice of the cake, wanted to grow big in the Ice Cream sector. As part of the mission 2022, Ice Cream is big contributor for that revenue. What would be the volumes? What would be the revenue? What shall be the margin? How is it going to pan out in the next three, four years? We are actually in the middle of finalizing those strategies.

Deepak Madhavdas: We would like to go for JV also for the Ice Creams?

Dr. M. Sambasiva Rao: No, it is parent company only.

Deepak Madhavdas: Here we have had a small loss on Cattle Feed like will this continue or this is the end?

Dr. M. Sambasiva Rao: No, we are looking for the break-even by Q4 as the planned capacities will be utilized substantially and the overheads, etc., gets justified. It is only a kind of low capacity utilization and certain inefficiencies in the production that has led to this loss, but Q4 onwards we should be in a better position and it will be certainly profitable.

Deepak Madhavdas: These are the two new acquisitions what we have taken – one in North and one in Hyderabad. Are we going to face the same hiccup what we are facing for Reliance also?

Dr. M. Sambasiva Rao: No, this is basically a different model as our executive director explained, these two are just assets, there is no business with them, there is no procurement, there is no sale, there is no brand, these are the two stand alone plants, these plants are useful for us to shift the Reliance volume from the third-party packing station to our own packing station, right now, Dairy Life Milk is being packed by third parties, there certain difficulties and challenges we are facing. So that volume gets shifted to these assets. It will also help to handle growing volumes, like for example, we have two plants in Hyderabad, both are doing near 100% capacity utilization and we have got certain volume from the Dairy Life of Reliance and we are also growing now. To pack this milk, I do not have facilities. So we have taken over this asset which would help us to shift the volume of Dairy Life and also meet the next two, three years growth. This plant is about 1.5 lakh liters capacity in the outskirts of Hyderabad. So we have acquired the asset and we will put to use immediately, we have already started operations for shifting the volumes here and meet the future growth. Similarly in Punjab, we are now packing Dairy Life Milk near Ludhiana in a third-party packing station and in Haryana in another third-party packing station. These two packing stations Milk will be shifted to the newly acquired company Vaman Foods, Vaman Foods also is a conversion activity they are doing for Amul, they do not have their own Milk for procurement or sale or brand, it is just a job work unit. The two plants which we are using now in Punjab and Haryana, that Milk gets shifted into this plant for Heritage Milk packing, Heritage procurement packing will be handled here. So these are the assets which will improve our efficiencies, qualities and reduce the cost of operations from the current scenario.

Moderator: Thank you. The next question is from the line of Aakash Manghani from BOI AXA Investment Managers. Please go ahead.

Aakash Manghani: Sir, on this Value-Added products EBITDA margin, you talked about this quarter being 11.6, I believe in Q1 you had talked about 12% EBITDA margin and compared to FY'17 you were at around mid-teens, I think around 14-15% EBITDA margin. So over the last six months, why the EBITDA margins dropped so much in spite of procurement prices if I look at sequentially between Q4 to now or even your selling prices, they have not moved up quite a bit, I thought there would be some element of pricing power available at least in the Value-Added segment hold on to EBITDA margins?

Dr. M. Sambasiva Rao: The procurement price increase as well as the SMP rice increase, the Milk Powder which we use in the value add both increases have cost this drop in the margin plus all other expenses booked in the company in terms of branding, in terms of consultancy, GST, every expense gets allocated to the products margin also, as explained by CFO why the expenses have gone up, the share of that got allocated to the margins of the Value-Added products. So the same reason -- procurement price, SMP price, increases in expenses. They have had impact on the margins of the value-added products compared to last year. This year Q1 and Q2, I do not see much change in the percentage of margins, they are more or less same, but last year to this year, yes, there is a drop.

Aakash Manghani: So I can see Milk procurement prices between Q4 of FY'17 to now are down, so that would not have contributed to the margins, first half EBITDA margin as compared to full of FY'17 margins are down by 3-3.5% for Value-Added?

Brahmani Nara: Just to put this into some perspective; for the first half of FY'18, the increase in procurement price versus the first half of FY'17 was about 9% whereas the increase in the net realization of Curd during the same period was just 6%. So there is a 3% gap between the increase and just procurement price versus what we could pass on to the consumer, so that is just one bit of the cost. Apart from that like our president had mentioned, there are some other costs that were incurred during the first half of this particular year versus last year and there was a Skim Milk Powder equipment element because of which there was an increase in cost, so in terms of procurement price itself there is a 3% gap.

Aakash Manghani: So this other cost that you talked about, I think you alluded to branding expenses going up this quarter. Is this something which is going to be recurring in nature because of heightened competition you need to go out there and get more share of voice and stuff like that or …?

Dr. M. Sambasiva Rao: There are one-time expenses this year like, we have altered our advertisement logo to communicate that, we have spent lot of money, similarly, we have altered our art works, all the cylinders had to be changed…actually, cylinders themselves cost Rs.1 crore for us this year and post the change of art works, we have to give lot of media spends to communicate, the art work has changed, the package appearance has changed. So we wanted to eliminate the confusion, whether it is a different brand or same brand. These activities will not be there in the coming quarters in terms of cylinders change or logo cost. Also we had almost four months of engagement programs with the farmers, distributors, sales agents, parlor franchisees and employees, had used the opportunity of 25-years completion as "Silver Jubilee", rewarded the long-term employees who have done 20-years of service in the company out of 25 years, we have felicitations, we have lot of engagement programs in this area in this first half year, will not be repeated in the coming quarters. So there is about Rs.5-6 crores of expenses which are accounted for in this quarter. They all had impact on the margins of Milk as well as Value-Added products. So we do assume things would be much different in the coming second half year.

Aakash Manghani: You expect this to normalize to 14-15% level in FY'19?

Brahmani Nara: Yes, that is what we expect.

Moderator: Thank you. We take the next question from the line of Kartik Gada from Val-Q Investment Advisory. Please go ahead.

Kartik Gada: Just lease expenditure, so you mentioned also there were something for GST impact, consultancy, etc., So all of that is in the numbers completely or is there any spillover in 3Q, 4Q as well?

Dr. M. Sambasiva Rao: As far as consultancies are concerned, there are only two exceptions in this first half year or Q2, that is for implementation of GST, we are engaged Ernst & Young and also for IND AS, we have engaged Ernst & Young, those engagements are almost over by second quarter. But there is a GST impact of Re.1 crore which is coming to the company which will continue because earlier regime under service tax, we were paying 15% of tax and all the services engaged from the auditors, consultants, various other professional services like legal. Now, this has become 18% under GST which has an impact. It keeps fluctuating a bit, but this 15% to 18% has impacted in this quarter close to Re.1 crore. It might be plus or minus Rs.20 lakhs, Rs. 15 lakhs as services remain to be used in the coming months. That is on the consultancies and GST impact. Consultancies may also come back in a different form, may not be as big as that and as many as that. Like we are using for ice cream now, we are working on ice cream long term strategy, we have a consultancy and we may have to do the rebranding of our ice cream product package change and the freezers branding, store branding, so we will come up for the summer season, ahead of summer, we will be doing some significant work on ice cream, that might be added to that quarter. So there will be some exceptions to the standard expenses, but there may be certain areas where expenses may come down particularly in terms of manpower engagement we may see some reduction in the coming months.

Kartik Gada: The procurement price which I think you mentioned earlier at Rs.33/litre and it is trending down post-September, so what would be the levels right now?

Dr. M. Sambasiva Rao: As of now, I would say about a rupee drop on an average at the total universe, certain areas it is more, certain areas it is less, certain areas we are yet to implement fully, so may be another Re.1 rupee, Re.0.50 rupee in sight in the next month.

Kartik Gada: The sale price remains at Rs.38?

Dr. M. Sambasiva Rao: They are more or less there. We might consider revision only in end of January post-Pongal in this area and February post winter in north.

Moderator: Thank you. Next question is from the line of Sagarika Mukherjee from Elara Securities. Please go ahead.

Sagarika Mukherjee: Just a couple of things; what should we take as the average per quarter run rate for freight forwarding cost given that the branding exercise might continue also that with expands of Reliance Dairy now? We cannot see this separately, hence asking.

Dr. M. Sambasiva Rao: As far as branding is concerned, whatever we have spent in the first half year, in the second half year, it will be closer to half of that, there will be certain point of sale communications and customer communications, etc., but not through media like we have spent through holdings outdoor and we have done some outdoor, we have done some media through newspapers, etc., All that may not be at that level in the second half of the year…

Sagarika Mukherjee: What was the absolute level in crores if you could tell me in the first half for branding?

Dr. M. Sambasiva Rao: It is around Rs.6 crores which was the additional expense we have seen in the first half year. Coming to the freight of the additional milk, the freight charges will continue to be more or less same because volume is continuing. As long as volume growth is there, freight charges will go unless the fuel prices drop in the coming months which is also possible.

Sagarika Mukherjee: That number right now was how much sir in this quarter?

CA A Prabhakara Naidu: Rs.6.26 crores.

Sagarika Mukherjee: So something like this will be in the second half also for every quarter now?

Dr. M. Sambasiva Rao: Yes, that is the function of volume.

Sagarika Mukherjee: Are we also diverting Reliance Dairy Milk for doing VAT?

Dr. M. Sambasiva Rao: Not for value-added products, but it gets converted into Milk powder and ghee when we have surplus Milk than the Milk required for sale and let us say around 10,000 liters a day is going into curd making, the rest of the milk, 20,000-30,000 liters a day surplus is there at the moment, that is going into the powder and ghee, but otherwise, our balancing is what we are trying to achieve between procurement and sales volume.

Sagarika Mukherjee: So you are saying that in 3Q at least your average Milk procurement prices will be like Rs.31 now?

Dr. M. Sambasiva Rao: Right now 32.7, 32.8 like that, Re.1 drop we have achieved so far, another Re.1 is in sight.

Sagarika Mukherjee: So for the quarter if another Re.1 drops, so total Rs.2 drop, but you will not feel the pressure to pass on this, right?

Dr. M. Sambasiva Rao: There is nothing to pass on, it is only going down, no.

Sagarika Mukherjee: I mean you do not have to cut the prices in MRP?

Dr. M. Sambasiva Rao: Sale price? No.

Moderator: Thank you. Next question is from the line of Ronat Jain from Vibrant Securities. Please go ahead.

Ronat Jain: May I know the proportion of the Milk that we procure directly from the farmers out of your total procurement?

Dr. M. Sambasiva Rao: 94%-95% is directly from the farmers, 5%-6% was through the business associates.

Ronat Jain: What was it the previous quarter and the quarter last year?

Dr. M. Sambasiva Rao: It will be more or less same.

Moderator: Thank you. The next question is from the line of Shailesh Kumar from Sunidhi Securities. Please go ahead.

Shailesh Kumar: Some of the house-keeping questions; what is our planned CAPEX for FY'18, how much we have already done?

Dr. M. Sambasiva Rao: So far expenses are about Rs.60 crores under the CAPEX including the acquisition of the Dairy Life brand and overall CAPEX initially planned was Rs.140 crores, now, these two assets we are acquiring -- Hyderabad plant and Chandigarh plant -- they would be added to the CAPEX cost, significant value of about another Rs.30, 35 crores, even more Rs.40 crores, some renovations, etc.,

Shailesh Kumar: With remaining Rs.40 crores, that is still there, what do we intend to now – any further acquisition on card?

Dr. M. Sambasiva Rao: No, it is meant for internal expansion of the procurement in certain areas and setting up of UHT plant and additional facilities in existing processing stations, packing stations and front-end infrastructure for chillers, freezers, coolers to be given in the market and the analyzers of Milk at the village level where procurement happens, **(Inaudible) 63:31** purpose etc., there are various activities ongoing.

Shailesh Kumar: Any additional procurement capacity that we intend to acquire and is under consideration as of now?

Dr. M. Sambasiva Rao: No acquisition but expansion is required. In certain markets, our sale volumes are higher. Our company quality policy prescribes that Milk has to be procured within the Milk shed which are about five, six hours away from the market. So in those areas, we have to set up the procurement facilities to procure milk, supply to the markets in that area. So there are certain imbalances between sales volumes and procurement volumes which warrant us to set up procurement facilities in those Milk shed. But we do not acquire Milk procurement facilities and we do not have any such plans for this half year.

Shailesh Kumar: What has been our Curd volume during Q2 FY'18 and H1 FY'18?

Brahmani Nara: In Q2 it was about 230 tons per day Vs 203 tons per day Q2 FY'17, and then I think you also want the first half wherein it was 260 tons per day Vs 230 tons per day last year first half.

Moderator: Thank you. Next question is from the line of Tayab Jain from Edelweiss. Please go ahead.

Shraddha: This is Shraddha. In our vision 2022 for being Rs.6,000 crores company, are we on targets for the Value-Added products because I can see that …

Dr. M. Sambasiva Rao: Value-Added products contribution expected by 2022 is 40% of the revenue, we have reached somewhere around 24.8% in this quarter and year average will be 25% for this year, so 25%-40% is our journey in the next five years which we should be able to achieve with additional infrastructure being created in Heritage Foods as well as the joint venture support coming from the Yogurt plant and certain more things will happen in the coming years in terms of setting up more facilities. So we have to raise our contribution from 25% to 40% in the next four years.

Shraddha: Just a small clarification; whether does this also include the fat products which we have in our overall sales which is around 8-9% or this is excluding the fat products?

Dr. M. Sambasiva Rao: Excluding.

Shraddha: So in that case, it is almost 40, 50% CAGR over the next five years from the last year's base of Value-Added products sale. Do you think it will be more back-ended?

Brahmani Nara: Actually, if you look at our track record, we have been growing about 2%-3% in terms of Value-Added product contribution towards our revenue annually and that is what we expect going forward in the next five years as well.

Shraddha: So that is what. If we add by just 2, 3%, then it becomes a little far-fetched in terms of the target, so definitely it will be more back-ended, right, is what I was trying to…

Brahmani Nara: No, that will actually come up to about 15% growth in the next five years and that will take us from 25% contribution to about 40%. So we expect it to happen uniformly.

Moderator: Thank you. We have a follow-up question from the line of Mr. Shailesh Kumar from Sunidhi Securities. Please go ahead.

Shailesh Kumar: In our Vision 2022, out of 40% Value-Added product, what would be the contribution of Curd…how do we envisage that?

Dr. M. Sambasiva Rao: It is a bit too premature to come out with that number. It will be significant lion's share, ranging anywhere above 65%, we will not be able to commit it as of now exactly because it keeps changing year-after-year and we have four more years to go to add up to contributions from various lines, but it will be significantly single largest.

Moderator: Thank you very much. That was the last question. As there are no further questions, I would like to hand the conference back to the management for any closing comments.

Brahmani Nara: Thank you so much for your participation. We expect to be on track in terms of our long-term vision as we have planned in 2022 and we have taken several steps towards that. We expect the external scenario also to be much better in terms of procurement pricing in the next quarters to come. Again, I would like to thank everyone for joining the call today.

Dr. M. Sambasiva Rao: Thank you, all.

Moderator: Thank you very much. On behalf of Sunidhi Securities & Finance Limited that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.