"Heritage Foods Limited Q1 FY2018 Post Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Heritage Foods Q1 FY2018 Post Results 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 on Q1 FY2018 post result concall of Heritage Foods Limited. Company management is being represented by Dr. M. Sambasiva Rao, President, Mr. A. Prabhakara Naidu, Chief Financial Officer, Mr. Samba Murthy, Dairy Division Head, and Mr. Umakanta Barik, Company Secretary. Ms. N. Brahmani is not keeping well, so she is not able to participate in the call. The call will start with Dr. Rao providing brief performance report of the quarter. Then we will go ahead with the question and answer session. Without taking much time, now I hand over the call to Dr. Rao so that we can proceed further. Over to you Dr. Rao!

M. Sambasiva Rao: Thank you very much. I welcome all the participants to the quarter one call. I will begin with consolidated financials of the company, which were announced on August 10, 2017 and the same details are uploaded on our website on August 12, 2017. You all must have got a chance to go through that.

In brief, the net turnover at company level is Rs.617 Crores comparable turnover of Q1 last year was Rs.49 after deleting the discontinued in business, which is a 34% growth of topline led by dairy division. At EBITDA level, the earnings for Rs.28.4 Crores compared to Rs.41 Crores in the previous financial year of Q1. PAT level it is Rs.10.37 Crores compared to Rs.17 Crores in the Q1 last year.

Coming to the dairy segment, alone which constitutes the major portion of the business. Net turnover is Rs.609 Crores 34% growth over the same quarter previous year that is Rs.453 Crores out of this while component is coming from renewable energy, which is a captive supply for the dairy business.

EBITDA level it is Rs.25.36 Crores and PAT level it is Rs.7.6 Crores and both these are lower than the Q1 of the last year. These are financials.

Coming to the volumes. There is a 22% growth in volumes both in procurement as well as a sale. The procurement volume is 12.6 lakh liters and sale volume of milk was 10.25 lakh liters. Value added products contribution both branded, unbranded together is 26.8%. In this, a small component less than 1% is unbranded product and in terms of growth over the previous year it is 22% growth of the value added product.

The production capacity from the company now, chilling capacity is 16.9 lakh liters per day, processing is 18.9 lakh liters and packing of milk is 11.35 lakh liters. Debt position long-term capital loan around Rs.112 Crores in the Heritage Foods Parent Company and Rs.5.75 Crores in the subsidiary, HFRL, which is dealing with the cattle feed.

Working capital is Rs.55 Crores short-term. This quarter you all must have noticed, there was margin drop due to increase in cost of raw material that is milk and milk powder, we had gone through low production season in the summer. The prices of milk at farm gate have increased. We could not pass on the entire increase to the customers. 61% of the increased cost in the milk and milk powder was passed on to the consumers. Another 39% was not passed on. It should be possible in the coming period. The difference in terms of rupee value was Rs.16 Crores, which could not be passed on out of the Rs.41 Crores; total increase in raw material was Rs.41 Crores. We could not pass on Rs.16 Crores that impacted significantly the margins.

In addition to the milk procurement price, we also have incurred certain additional expenses during this period because of these branding activities we have initiated for rejuvenating our own logo change of the packing materials and we started celebrations of Silver Jubilee during this quarter. Last three months we have been conducting stakeholder meetings and interactions with them certain activities have been carried out to strengthen our relations both sides, farmer side, consumer side. These activities also we have spent certain amount.

These are the important reasons, which have caused pressure in the margin side. In addition to the impact of operations, we have started after acquisition of Reliance Dairy, there were some areas where the margins were low and losses continue at the EBITDA level in the acquired business.

During this quarter, we also have completed couple of integration of Reliance Dairy operations have been totally completed in all the areas and future retail also allocated the shares meant for the demerger transaction. These are the highlights now I stop here and open the session for interaction. Thank you very much once again.

Moderator: Thank very much Sir. Ladies and gentlemen we will now begin with the question and answer session. We take the first question from the line of Prashant Kutty from Sundaram Mutual Fund. Please go ahead.

Prashant Kutty: Thank you for the opportunity Sir. Firstly with regard to the acquired businesses of Reliance Dairy if you look at it obviously as per the numbers given by you it seems to be like almost 10% kind of negative EBIT on the Reliance business. So just wanted to understand which are these reasons, which is actually loss making and what is the timeline for reaching break even number as far as the Reliance dairy business is concerned?

M Sambasiva Rao: Prashant, this is a business, which we had initiated somewhere in the middle of April month. There are operations, which are spread over several states, which we understood, viability point of view certain operations have been rationalized. We have started rationalization operations and it has not yet yielded the expected results yet. It is about two months past the rationalization started, but the impact will be seen maybe another two, three months down the line in full. Important aspects of rationalization are certain states where operations were not at all viable due to the volumes and the distances particularly Uttar Pradesh and Madhya Pradesh. We have completely withdrawn the operations in those states already and there are other areas though operations will continue in the states, but certain chilling centers are located in distances which are not very optimal, so there are also being owned up. There are certain notice periods contract requirements to be followed. Certain milk procurement routes have also been closed. The Reliance is procuring milk in 184 routes in all those five states and we have now closed 20 routes. The cost optimization has gone up in terms of logistics and operations. Second is the milk balancing. They were procuring large volume of milk than what they were selling in the retail or consumer market. Using the excess milk for production of Dairy Whitener, milk powder, ghee, etc., so these additional volumes are also causing certain losses. We have more or less balanced now our procurement volumes and the sale volumes are almost matching that additional volumes we have been able to restrict by wining of these operations and also season also helped certain natural drop was there in this period that also led to balancing factor. Those bulk quantities, which they were selling, are also cause of losses. These quantities will be sold may be by end of September whatever stocks we have generated before we took over and after we have taken over also certain volumes were added. So by end of September this bulk volumes will dispose and they also had caused certain losses. The milk balancing the minimizing these bulk productions, also the cost optimization in logistics and operations, manpower rationalization, these are all things going on. We do expect at 10% PBT minor should be able to bring it to breakeven by end of Q3 aided by the expected price drop of the milk. The season also is changing from October most probably the milk procurement prices see downtrend that would further hasten up these activities.

Prashant Kutty: In the places where they are profitable what will be the kind of EBIT margins they would be operating at?

M Sambasiva Rao: This I can let you know later. Geography wise we have not collected yet.

Prashant Kutty: Second question over here is with regard to the fresh with the Reliance Dairy business are only completely milk operations or is there a breakup over here in terms of what is milk and what is except milk?

M Sambasiva Rao: Around 10000 liters of curd is there in addition to the liquid milk and they have substantial volumes of Dairy Whitener, milk powder, ghee.

Prashant Kutty: All these would be roughly what about another 20% of the topline or lower than that?

M Sambasiva Rao: We are now reducing the production, our intention is to restrict this milk and curd as a predominant categories unless we have certain excess milk to convert into bulk products that percentage was high when we took over as we sell off the stocks it is coming down.

Prashant Kutty: On the base business, if you look at the base business margin also if we strip of the Reliance dairy businesses profitability even the base business margin seems to have kind of come off as well?

M Sambasiva Rao: You are right that is what I was explaining in the call earlier that entire price hike of raw material that is milk and milk powder was not passed on only 60% was passed on. Another 40% we have adjusted in our margins hoping the milk prices will cool off in the coming month and we can adjust that the price drop.

Prashant Kutty: That even happened with curd also?

M Sambasiva Rao: When milk price goes up margin errors will happen in every product.

Prashant Kutty: Thank you very much and all the very best to you.

Moderator: Thank you. We take the next question from the line of Dhawal Mehta from Emkay Global. Please go ahead.

Dhawal Mehta: Good evening Sir. Thanks for the opportunity. Sir you told that Reliance Dairy businesses expected to breakeven by end of Q3 assuming that the milk prices are likely to decline. What will be a long term EBITDA margin which we are envisaging in this business?

M Sambasiva Rao: We would like to achieve whatever our earlier heritage margins are there that is close to 7%, 8% on the milk and 15% on the value added products that is a buildup face from breakeven we have to build up systematically in those markets also.

Dhawal Mehta: Okay and when you expect that this kind of margins will be achievable for the Reliance Dairy business?

M Sambasiva Rao: It will be next financial year.

Dhawal Mehta: By FY2019 you expect to be at least in mid single digit in the margins?

M Sambasiva Rao: Yes, sure, because we are also adding our capacities in our plant, right now all the processing and packing is happening in the third party packing stations for their volumes all over India. That is being now shifted into our Heritage own plants in every place we have to create our own infrastructure and shift it to own packing session, which is already in action. So each markets we are trying to adjust into our plants in the next few months' time. When entire integration happens the optimization will be at its best that we foresee sometime in the next financial year.

Dhawal Mehta: Let us say last quarter, we had procured somewhere around 2 lakh liters per day from the Reliance Dairy unit, this quarter we have procured on 1.5 lakh liters per day. So I understand that we are consolidating the business, so what you expect that what will be the average run rate of procurement of this business going forward?

M Sambasiva Rao: This is right now lean season, so the drop is substantially due to the seasonal change, also certain operational we have withdrawn in some areas. So average we can expect around 2 lakh plus 10 to 20 or something like that for a full year. This is 150 on the lower side of the season.

Dhawal Mehta: My second question is a more bookkeeping questions. If you see a segmental performance, are other income has increased by substantial amounts especially the EBIT part of the other income which is around 27.8 million. So what constitutes that amount can you just help me with that? In the segmental performance, the EBIT amount, the other income is around 25.8 million vis-à-vis?

Prabhakara Naidu: I will explain. This is in consolidated financial statement, so actually we have consolidated HFL and HFRL and two trusts. When we are consolidating HFL and HFFRL that is subsidiary, there is a diminution value of investment of HFRL because during these five months the last month when we have implemented this composites scheme so there was some capital expenditure that we have incurred before demerging of the retail undertaking. At that time we have Rs.10.57 lakhs in the last year and current year Rs.6 Crores, total Rs.16 Crores we have spent, so for that HFRL is issuing the shares to HFL. In this process HFRL that is subsidiary company networth has become negative. In that case we have provided diminution value of investment of Rs.2.58 Crores. In the consolidated financial statement that has been reversed that is Rs.2.58 Crores. This is not another income.

M Sambasiva Rao: In HFL it is…?

Prabhakara Naidu: Diminution has been provided and consolidated it is nullified that has been shown as a public line item.

Dhawal Mehta: Thank you and all the very best.

Moderator: Thank you. We take the next question from the line of Nitin Siddamsetty from Big Investor Blog. Please go ahead.

Nitin Siddamsetty: Can you still manufacture curd for Nestle, which you used to do earlier?

M Sambasiva Rao: Yes, it continues.

Nitin Siddamsetty: Going to some other concall everybody is talking about inviting the other person's territory like Hatsun is coming into Andhra, and you all are saying that you are going to Telangana and to Tamil Nadu, how do you securitize the milk supplies?

M Sambasiva Rao: Can you repeat please, I could not follow the question?

Nitin Siddamsetty: How do you securitize the milk supplies in future, because it is such fluctuation in the prices and more private coming in getting aggressive? How will you securitize the milk supplies?

M Sambasiva Rao: This is I think long subject which I had earlier couple of time touched. It is farmers companies understanding of the business. There are no retained legal agreements to enforce some either side. The both have to there is win-win situation by associating with each other. The farmers have tried to understand why he should work with Heritage and Heritage as to extend that additional support to the farmer besides paying the price. In terms of Heritage procurement policy we believe there shall be some value addition to the farmer besides paying to the milk price. We have a policy of matching with the market price in the same geography all cooperatives are the price setters in any state you go, the cooperative price forms the basic price for everybody. We also pay around the price to the farmer. In addition to this market price, we have three, four unique policies which farmers understand when we meet them, discuss with them number one after getting assurance of 100% marketing of the milk farmer supply to us. There were many instances in the past few years, when there is a surplus milk in the market, nobody takes their milk saying tomorrow or next week one day there is a milk holiday, we are not going to procure milk from the farmers. We have never created the situation to farmers. We have found a way of disposal or we have found a way of conversion of our milk into various products and support the farmer when there is a necessity particularly flush season when milk is high. So we are known for that, we do not leave their milk on any day, assurance 100%. The second important thing we do is a transparency and fairness in measurement of their milk in terms of quality and quantity. So where every one-point our 10-basis points make difference to the farmer when the measurements happen. We have introduced electronic gadgets which automatically display the milk quantity, quality and price payable to them that is where they feel comfortable that there is no manipulation in the purchases and the thirdly is punctuality in payment. We ensure on payday the money reaches their hand through the net banking system. Many companies continue arguing on these three. Then we have a set of welfare policies like supplying feed, tieing up credits, veterinary care, then insurance for cattle insurance for the farmer, there is a host of activities we conduct to see his productivity of the animal goes up, his ultimate income improves and this standards are better. This is a larger package we offer to the farmer, so who get attracted will stick to us the success rate is very high wherever we went and started setting up our milk procurement operations. This is a policy, which attracts farmers to stay with us or join us.

Nitin Siddamsetty: NABARD also have set of subjected to about Rs.8000 Crores to be spent on milk processing capacity over the next three years. Will that help you or will it be against you? NABARD, the Amul report by the Chairman he has quoted that NABARD is spending about Rs.8000 Crores or milk processing capacity in the country?

M Sambasiva Rao: Former Prime Minister Rajiv Gandhi statement that Rs.10 of the Rs.100 only reach the end point. That was through public sector. The public sector delivery system is like that, so it will have very limited impact on anybody.

Nitin Siddamsetty: It is not actual clean up of capacity, it is just subsidy?

M Sambasiva Rao: I would perhaps talk to you in private what happens to that.

Nitin Siddamsetty: Will you continue manufacturing for Nestle and other people?

M Sambasiva Rao: Yes that is a long-term arrangement for their South India's requirement they operate through our plant because they have no facility in South India for their products. There is no issue.

Nitin Siddamsetty: Last question, do you see that dairy farming going up in the future for corporate bonding?

M Sambasiva Rao: As of now it is not commercially viable. We are yet to see any commercial farm, corporate farm making gains except the farmer managed personally manage farms of 50, 100 animals, but much beyond that there is a no commercial value at the moment, so we have to wait and see how it takes shape in future, but that seem to be the long term, not in immediate, may be another two, three decades it will take for India to reach those commercial farm levels.

Nitin Siddamsetty: Okay. I will come back in line Sir. Thank you.

Moderator: Thank you. We take the next question from the line of Ashi Anand from Allegro Capital Advisors. Please go ahead.

Ashi Anand: Good evening. The first question is with relation to you are expecting milk procurement prices to fall in the second half, just want to get some kind sense in terms of how have monsoons progressed in our key catchment areas. I understand monsoons are kind of all over India, but in terms of key catchment areas how our monsoons have been and any kind of outlook in terms of how much we see our procurement prices falling by?

M Sambasiva Rao: For the purpose dairying monsoon is good in all the states, may be from agriculture point it is inadequate in certain states, but for the limited purpose of dairying this is good enough and the season begins sometime in the middle of September that is cowing and milk production starts in a big way. We do not see any challenge in this year as far as production is concerned. Production is expected to be quite normal. Coming to prices the usual trend is 10% drop in the procurement prices from lean season to flush season. We expect this year a little over 10% drop in the procurement prices. It will stagger. All 10% may not come in the beginning of the season, it will be in two, three stages, but it will drop.

Ashi Anand: Sir second question is which I am trying to get some sense on what the dairy margins would look like over FY2018 and 2019? Are there really multiple moving parts? One we have the impact of the Reliance acquisition. Secondly we have higher procurement prices in this first half, we also looking at certain higher branding expenses as we spoken of in previous concalls, what is the possibility, there is some kind of guidance and some kind of re-engine terms of what we could look at in terms of EBITDA margins for FY2018 and FY2019?

M Sambasiva Rao: 2018 and 2019, 2019 it may be little too early to talk about, 2018 we can look at 7%, 8%.

Ashi Anand: We could look at 7% to 8% EBITDA margin for the full year?

M Sambasiva Rao: Yes.

Ashi Anand: Thanks a lot Sir.

Moderator: Thank you. We will take the question from the line of Mahavir Jain from Aditya Birla Money. Please go ahead.

Mahavir Jain: My question is since acquisition of Reliance Dairy we have been proceeded with that two brands, Dairy Life and Dairy Pure, so are we looking to pitch our Heritage brand and products in the northern region?

M Sambasiva Rao: Yes, we are looking at each state differently. For example, in Delhi we have converted Halder milk into Heritage brand. In Punjab and most of Haryana we are continuing with Dairy Life. In Rajasthan we have started in Jaipur with Heritage brand. As the packing material of Dairy Life is exhausted we would move the entire Rajasthan into Heritage brand soon, but Punjab Haryana we intend to continue Dairy Life as the penetration is deeper and volumes are higher than Heritage brand. In Telangana, we have converted certain areas into Heritage brand, which are in the city and the suburbs and the rural area is still continuing in Dairy Life. Here also we intend over a period of time to transition into Heritage brand and Dairy Pure is continuing in the market for the buffalo ghee purpose whereas other products are coming in the heritage in terms of cow ghee etc., is going in Heritage, there will be sometime the Dairy Life will continue wherever it has good network and sales.

Mahavir Jain: Are we also pitching our other customers like flavored milk and butter?

M Sambasiva Rao: Flavored milk is not going that far because it has logistic issue, but butter and ghee both are going to northern markets.

Mahavir Jain: Sir one last question, could you throw some light on the impact of Reliance Fresh, we keeping our products on Reliance Fresh shelf so there is a three years contract right with

Reliance Fresh that Heritage will be keeping its product on their shelves so any impact on sales from that side?

M Sambasiva Rao: Data is not readily available, but we could share with you later, but as far as Reliance is concerned all their stores are opened for Heritage after acquisition, earlier our products were not placed in the Reliance Chain. Now they have opened up and there were certain hiccups during the GST introduction period, there was a few days of suspension again they restarted and second issue we are also looking at this and Reliance was selling milk, and milk products they were delivering at every store as a direct store delivery. We are now trying to reorganize through their warehouse delivery to optimize the cost. There were some hiccups in different market, may be next quarter we would be able to give you better information on this. The activities are on, but there was some disruptions due to these changes in the taxation then the supply chain alterations.

Mahavir Jain: Fair enough Sir. Do we have similar contract with Future growth?

M Sambasiva Rao: It is not a contract, it is an understanding we have started placing in Future group also, they have warmly welcomed all our products, not only in Heritage Fresh outlets, in other outlets managed by the Future group, there also placements started, we should be able to have significant numbers in the coming month.

Mahavir Jain: That is it from my side. Thank you.

Moderator: Thank you. We take the next question from the line of Dikshit Mittal from Subhkam Ventures. Please go ahead.

Dikshit Mittal: Can you tell us what was the sales contribution from Reliance Dairy for the quarter?

M Sambasiva Rao: Can you please repeat we could not hear properly?

Dikshit Mittal: Sir I wanted to know the revenue contribution from Reliance Dairy for the last quarter?

M Sambasiva Rao: Rs.67 Crores is the revenue that accrued from these two brands, Reliance Dairy Life and Dairy Pure.

Dikshit Mittal: You mentioned that 10% is the loss on the PBT level or is it at EBITDA level?

M Sambasiva Rao: Rs.6 Crores PBT level.

Dikshit Mittal: Secondly, you mentioned that 40% of the cost you could not pass on, so how are the current procurement prices standing vis-à-vis last quarter, have they moderated or still ruling at higher level?

M Sambasiva Rao: More or less same level except in one state that is Tamil Nadu, Karnataka side some parts, the price drop is expected from mid September once the production improves after this lactation cycle starts.

Dikshit Mittal: Because first two quarters will be relatively weak than in terms of margin, so still you can get 7% to 8% margins for the full year?

M Sambasiva Rao: Yes that is what the price drop impact, which we will have.

Dikshit Mittal: In terms of new product introduction can you tell us like what are the new products that you are looking to introduce and what kind of incremental revenues can we see in value added?

M Sambasiva Rao: New product is at the moment finalized only one yogurts with the help of the joint venture partner Novandie FMC from the France, it just signed up last week only, so it will take at least nine months to bring the new product into market may be next year sometime we can expect the new product to come into market. As per the initial plan, this yogurt product line will have a 20 tonne capacity and first year revenue of around Rs.30 Crores building up into Rs.300 Crores in five years that is the kind of revenue plan we have agreed upon, it depends on the production marketing, speed, etc., but that is the first plan.

Dikshit Mittal: Thank you Sir.

Moderator: Thank you. We take the next question from the line of Ronak Shah from SJC Capital. Please go ahead.

Ronak Shah: Thanks for the opportunity. What is the investment plans for the yogurt JV you just mentioned?

M Sambasiva Rao: It has plan for five years, the first year investment will be around Rs.16 Crores first project and every alternate year we propose to have another project, so it may take kind of may be Rs.75 Crores is the investment over six years that is a 50:50 equity partnership this SPV.

Ronak Shah: So Rs.75 Crores is the total, so you will be investing 50% of that?

M Sambasiva Rao: Yes.

Ronak Shah: Got it and Velapointe if I look at the number of parlors that is dropped to 1279 from almost 1680 last quarter, so I missing something here or is this drop actually been?

M Sambasiva Rao: You have noticed it right. We had done some rationalization some of the parlors who are – there are two, three types of problems we have been facing them, one they have started introducing competing products, unauthorized products into the parlors, some of them have introduced and they were unable to withdraw them and we found that as a indiscipline on the brand integrity. Second is some of the parlors who are not able to sell any products, they were only selling milk, they do not see much revenue coming because of their locational situations, so we have removed first set of parlors from our business who are indiscipline and we have withdrawn our authorization and assets. Second set of parlors we have converted them as milk distribution agent instead of categorizing them as parlors because parlors have a different distribution network and different margin structure, we have take out of them. Third set of parlors have not viable because of this flyover construction road widening and encroachments etc., several things happened, so we have streamlined and rationalized all our – not so good, not so efficient parlors and restricted to the high quality assets as parlors and supporting them in that and we continue to expand the parlor network with discipline and may be another 200 or so we had in this year.

Ronak Shah: Got it. I was just confused because there was no corresponding real impact in revenue either, so, I was just wondering why the number is down, okay that is helpful and did we disclose the financial details from Reliance Dairy acquisition in terms of what the cost of acquisition was?

M Sambasiva Rao: Yes, it has been finalized and due diligence was over. Payment is also completed. It is 61.51 Crores is the total acquisition cost.

Ronak Shah: This is paid completely in cash to Reliance.

M Sambasiva Rao: Yes.

Ronak Shah: Got it okay, I will come back in the queue. Thank you.

Moderator: Thank you. We will take the next question from the line of Sangeeta Tripathi from Edelweiss. Please go ahead.

Sangeeta Tripathi: Thank you Sir. My questions have been answered.

Moderator: Thank you. We will take the next question from the line of Dhruv Bhatia from AUM Advisors. Please go ahead.

Dhruv Bhatia: Sir just one clarification on the earlier question you said for the JV you made an invest Rs.16 Crores for yogurt plant of 20 tonnes per day right?

M Sambasiva Rao: For year one.

Dhruv Bhatia: For year one and what is the revenue potential that is there from this 20 tonnes per day?

M Sambasiva Rao: We are just checking the number. Sorry for the delay. It is around Rs.100 Crores on the first plant when it is 100% capacity utilization achieved, supposed to be year to end.

M Sambasiva Rao: For year one.

Dhruv Bhatia: For year one and what is the revenue potential that is there from this 20 tonnes per day?

M Sambasiva Rao: It is around Rs.100 Crores on the first plant when it is 100% capacity utilization achieved, supposed to be year to end.

Dhruv Bhatia: For total six years you are going to be spending Rs.75 Crores in this JV right, cumulatively?

M Sambasiva Rao: Yes cumulatively.

Dhruv Bhatia: What is the stable product that the JV partner brings if you could just help us understand what are the other product opportunities that can be you can enter into?

M Sambasiva Rao: This JV has a set of identified products basically yogurt in different flavours, probiotic, non-probiotic, high-fat, low-fat, stirred, unstirred, so there are number of variants within the yogurt category. Second is western deserts like custards, puddings, mousses, caramel sauce with and without flan, rice based desserts, they have quite a number of dessert category and yogurt category, these are the two categories, which will come in different variants.

Dhruv Bhatia: The plant is going to be set up in Maharashtra?

M Sambasiva Rao: Yes.

Dhruv Bhatia: Sir my second question is what is the growth in milk procurement you are expecting ex-Reliance for FY2018?

M Sambasiva Rao: Right now it is 22% together, our original Heritage operations including the inorganic acquisition opportunities, we will be able to maintain around 20% for full year.

Dhruv Bhatia: But if I look at it ex-Reliance what type of milk procurement growth can we expect for FY2018?

M Sambasiva Rao: About 15%, 20%.

Dhruv Bhatia: Just last question I wanted to understand a book-keeping question if I just multiply the liquid milk price realization into the liquid milk sales that is lakhs per day and add on the branded value sales and export sales there is still a difference of almost around Rs.190 odd Crores of revenue, so I am not understanding where the gap is, so it is around Rs.360 odd Crores of liquid milk sales you have Rs.160 odd Crores of branded value sales and Rs.12 Crores of export sales of total Rs.609 Crores of Dairy sales, so could I know where the difference is, is that the fat product sales is a very high component this quarter?

A. Prabhakara Naidu: Breakup of the tonne and all, Rs.609.25 Crores can you note down the breakup? Milk Rs.362.09 Crores, value added products both branded and unbranded Rs.163.5 Crores, fat products Rs.59.14 Crores and SMP Skimmed Milk Powder is Rs.2.83 Crores and other operating revenues Rs.21.69 Crores, total Rs.609.25 Crores.

Dhruv Bhatia: What are the other operating revenues?

A. Prabhakara Naidu: Other operating in the sense actually feed sales we are selling feed we are procuring from subsidiary company and selling to our farmer.

M Sambasiva Rao: In consolidated it will get netted off.

A. Prabhakara Naidu: Yes consolidated gets netted off, but as a dairy alone actually Rs.21.69 Crores includes major portion is feed sales.

Dhruv Bhatia: For the Reliance dairy business you said the milk procurement you expect is 2.5 lakh liters per day, is that right?

M Sambasiva Rao: No, 2 lakhs.

Dhruv Bhatia: 2 lakh liters per day, all right Sir. Thank you.

M Sambasiva Rao: Currently it is 1.5 lakh it may go up to 2 lakhs.

Dhruv Bhatia: Thank you so much Sir.

Moderator: Thank you. We take the next question from the line of Nandita Parker from Karma Capital Management. Please go ahead.

Nandita Parker: Couple of questions please. The new capacity that you are setting up with the French partner I am sorry I was not able to get the name of the French company?

M Sambasiva Rao: Novandie SNC I think we uploaded on the website.

Nandita Parker: Would you be using basically part of your milk procurement and converting that from the liquid into this yogurt front?

M Sambasiva Rao: Sorry can you repeat again?

Nandita Parker: This milk processing capacity will use the existing milk that you are already procuring?

M Sambasiva Rao: No, we are going to set up a new plant where the processing of milk will be done in that plant and after processing the milk will be transferred to the yogurt plant.

Nandita Parker: In terms of how it should look at it, would this be an additional overtime I do not mean in the first year, but over the next five years or let us say after five years would be an additional Rs.300 Crores of revenues on top of your already various growth streams of that are adding up to Rs.600 Crores or would some of the current milk we used for this new capacity?

M Sambasiva Rao: In a 50:50 joint venture we may not get entire credit of the topline.

A. Prabhakara Naidu: Only net worth proportion as a profitability because it is a JV arrangement, from the accounting point of view line by line consolidation will not happen, only single line consolidation that is profitability, our share only is going to be consolidated with HFL.

Nandita Parker: What is the IRR you are expecting on it and the margins on this and at what point this break even on which year?

M Sambasiva Rao: Year two is break-even year, IRR will let you later.

Nandita Parker: May I ask one more question, so if you look at your entire milk procurement could you give us a breakdown of the distance, radius from your milking centers to your procurement area meaning what is the furthered out that you have gone to procure this 12.6 LLPD?

M Sambasiva Rao: We have a standard distance policy from any bulk cooler, if we are using bulk cooler for chilling the milk we shall restrict the distance of 25 km one way from the first village where milk is collected to the chilling center, it is not radiate it is a one way distance, 25 km is a travel distance allowed for the milk to move from the village to the first chilling center that is to ensure the milk reaches the chilling center within two to two-and-a-half hours after milking is done to contain the bacterial growth to the least. Second is in case we are chilling the milk in a chilling center, which is a different chilling capacity of 20000 liters above at a place using high efficiency chilling system. We allowed 50 km of the travel distance from the village to the chilling center that takes 3 to 3.5 hours to reach maximum to the chilling center that is a procurement policy. Second one is the plants for processing and packaging are installed within 200 to 250 km from the chilling center. These are in the outskirts of the cities where milk can reach the consumer in half-an-hour time from the packing station. These are the three types of infrastructure we have two types rather village level collection center, chilling center, the packing station. The first one, the milk collection center is in the village where milk is collected, chilling centers or bulk cooler are at a distance of 25 or 50 km, packing station is within 200 km ideally maximum stretch of 250 and packing station to the customer with a half-an-hour, 25 km, 30 km distance. This is a standard policy; there could be some minor deviations plus or minus 5%.

Nandita Parker: That is why you are rationalizing with Reliance?

M Sambasiva Rao: Correct.

Nandita Parker: Thank you.

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

Aniruddha Joshi: Sir just one question. You gave the EBITDA margin guidance of 7% to 8% is it for FY18 or FY19?

M Sambasiva Rao: FY18, FY19 is too early to predict.

Aniruddha Joshi: It is for the full business means Heritage plus Reliance guidance is 7% to 8%?

M Sambasiva Rao: Yes.

Aniruddha Joshi: Thank you.

Moderator: Thank you. We take the next question from the line of Prashant Kutty from Sundaram Mutual Fund. Please go ahead.

Prashant Kutty: Thank you for the followup Sir! Just one thing Sir! What is the kind of EBITDA margin would we are looking at from the yogurt business Sir?

M Sambasiva Rao: It starts at 10 and goes up to 20 over a period of time as the capacities enhance and optimization happens 10 to 20.

Prashant Kutty: Thank you very much Sir!

Moderator: Thank you. We take the next question from the line of Shailesh Kumar from Sunidhi Securities & Finance. Please go ahead.

Shailesh Kumar: Thanks for the opportunity. My first question is the JV product that we are going to produce under which brand we are going to sell it?

M Sambasiva Rao: We are yet to conclude on that may be as we progress we will announce that.

Shailesh Kumar: What kind of curd volume we have done during this quarter?

M Sambasiva Rao: 291 tonnes per day.

Shailesh Kumar: Sir previously we used to give geography wise, product wise breakup, we have stopped this any specific reason?

M Sambasiva Rao: This information is flying like virus, so we thought we would share with the right people when the need comes then giving into the whole world particularly the competition.

Shailesh Kumar: During this quarter, for how many days Reliance dairy revenue was there with us, was it for the full quarter?

M Sambasiva Rao: Around 80 days.

Shailesh Kumar: If you do not mind if you can share EBITDA margin of liquid milk, value added and fat for the quarter?

M Sambasiva Rao: You want EBITDA margin for milk and value added products?

Shailesh Kumar: Yes and fat as well.

M Sambasiva Rao: It is 3, 12, -5.

Shailesh Kumar: Liquid milk 3, value added 12 and -5. Thank you Sir! That is all from my side.

Moderator: Thank you. We take the next question from the line of Rajesh Ranganathan from Dolat Capital. Please go ahead.

Rajesh Ranganathan: Thanks for the call and all the detailed information you have provided so far. Just one question regarding our expansion now we are present in 15 states and we want to go to tier 2 and tier 3 cities as well, can you help us understand how you choose which states you want to expand into and which cities you want to expand into, is it based on competition from the cooperative, from other private players, how do you look at this and how do you look at market share?

M Sambasiva Rao: This perhaps I can explain when we meet soon I think we are meeting soon, but broad principle is led by the opportunity to grow healthy.

Rajesh Ranganathan: When we look at, there is some confusing data on market share for instance if you look at Tamil Nadu, which seems the whole market in Tamil Nadu may be 5 million liters per day or something like that, 5 to 6 and Hatsun claims they have 50% market share in some places, there is 30% market share and then Aavin claims they have 50% market share, so what is your sense of what is your market position in Tamil Nadu because if these two players have 80%, 90% market share between themselves then all of you like you Tirumala, Dodla all of you basically count for nothing in Tamil Nadu?

M Sambasiva Rao: Unfortunately there is no authentic data, no authority publishes this, so it is all self declared and nobody's numbers are notified except listed companies, so we have to fish out some information from various sources and say this is my percentage. They are all very estimates and not necessarily based on accurate fact, therefore, you keep getting different reports and I wish some of these analysts are notifying the reports coverages are there. We used that as another source of information, so there is no way, nobody can say, which is right.

Rajesh Ranganathan: Internally how do you measure whether you are gaining market share or not in each of these geographies?

M Sambasiva Rao: Gathered information from various sources and seeing where we are and how we are growing or not plus there is a year-on-year growth anyway we can see and the national level estimates are generally given as production of milk is going by 4%, 5% is a kind of standard statement we hear from the answers given in the parliament that is one of the very authentic source of information what answers are coming from the government in these legislatures Similarly they say what is the estimated growth of the demand is 10%, 11%, 14% like that it keeps coming. You understand the growth numbers from the answers you get from the government through parliament, government statements in various occasions. The information available to you through various methods and understand an estimate. They are all estimates.

Rajesh Ranganathan: When you say have a target of Rs.6000 Crores by 2022 that is based on you said 50% value added products, 50% milk, so that still leaves you significant growth in milk itself that you need to achieve I think closer to 20% a year, so you have a plan of acquisitions that gets you there how much of that is already identified?

M Sambasiva Rao: First thing is about Rs.6000 Crores is based on the market potential estimated by KPMG. We have engaged KPMG two years back for giving us kind of way forward action plan. They have done lot of studies and analyze reports, etc., projected that Rs.6000 Crores is feasible in a five, six-year time span that is how the mission was carved out and we had internal debates from top to bottom, bottom to top, etc. We all concluded it is possible that is based on a study done by KPMG for us then post that we have now engaged E&Y for exploring the opportunities for inorganic growth. They have been on the roll, they have identified couple of potential possibilities we are evaluating one of them currently. So it goes on there is an organic growth through our efforts to expand into various milk sheds and markets and also add on to the natural growth, organic growth we will try to use the service of E&Y. They are also quite actively pursuing and now our executive director gave couple of interviews in the recent past assorting that we are looking out for inorganic growth that also brought some response from those who are willing, but not ready for open discussion, but there was some amount of interface generated with her public statements and the efforts of E&Y. We are confident that we should be able to identify the target soon. It is an ongoing activity for the next five years.

Rajesh Ranganathan: I hope to pick this up when we meet next. Thank you so much.

Moderator: Thank you. We take the next question from the line of Ramesh Mantri from White Oak Capital. Please go ahead.

Ramesh Mantri: I have two questions. One, do you think over longer term risk from corporative is expanding particularly Amul in your geographies and the government has now started giving specific subsidies to cooperatives for milk procurement. The second question is supply of milk is growing at 4%, demand is growing faster, so can over the medium term can there be a sharp increase in milk prices because it is practically tough to import milk?

M Sambasiva Rao: On the first question, yes you are right. The government support is extended to cooperatives, but if you recall in the year 1992 the cooperatives had 100% market share and by 2017 25 years later they have fallen down significantly and given space for private companies to acquire the market shares. So the trend is continuing. Subsidiaries are not due to cooperatives up the market they were there since independence and they were continuing and I was earlier mentioning to former Prime Minister Rajiv Gandhi statement that out of Rs.110 reach the endpoint he repeatedly said several times and I do not think things have changed. So that competition continues to be there and they are the welfare concepts of the state. So we will continue to operate and thrive because of our efficiencies and alertness in handling the business as compared to them. Coming to the second question. The second point you said?

Ramesh Mantri: A supply of milk is growing at 4% demand is growing faster.

M Sambasiva Rao: Yes, so prices have gone up and they continued to go up. I again repeat when Heritage started its business the milk price is Rs.4 now it is Rs.40 plus, so it will definitely lead to price hike and also some amount of supplementation happens through the milk powder and butter oil imports. In the years of scarcity in the past also governments have imported the milk powder and butter oil to meet the domestic demand those fluctuations will be handled.

Ramesh Mantri: I am talking of a structural change where you have ongoing deficit because supply is growing slower and demand is growing faster.

M Sambasiva Rao: That is being met with this breed improvement, nutrition improvements. In our country the animals are not yielding adequate the productivity is so low compared to many countries. If you improve our veterinary care and the nutrition management may be the same animals can yield. We have close to 300 million cattle, so they should be able to double the production if the adequate carries, I am sure as prices increase farmers also find it attractive to take care of the animal make it a commercial asset, so we do not see that kind of sharp decline in the production. Production is also increasing.

Ramesh Mantri: Thank you.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to Mr. Shailesh Kumar from Sunidhi Securities & Finance for closing comments.

Shailesh Kumar: I would like to take this opportunity to thank the management of Heritage Foods Limited to take time out and address investor's queries. I would also like to thank investor community for taking interest in the company. Before concluding the call I will request Dr. Rao to give his closing remarks.

M Sambasiva Rao: Thank you very much and we will look forward to continue the interactions and share information from time to time, which will help you to analyze understand our growth of the business and also look forward for your coverage, feedback, suggestions from time to time. A few of them are meeting us visiting our facilities; we wish to facilitate more such visits and meetings. Mr. Anand from our side is our IR consultant in Mumbai, he is taking great interest and interacting with all of you and I am sure with this help we can further step up our interaction and understanding of our business. Thank you very much.

Shailesh Kumar: Thank you Dr. Rao. We may now conclude the call. Thank you.

Moderator: Thank you very much Sir! Ladies and gentlemen on behalf of Sunidhi Securities & Finance that concludes this conference. Thank you for joining us. You may now disconnect your lines.