# "Heritage Foods Limited Q1 FY17 Results Conference Call"

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**Moderator:** Ladies and gentlemen, good day and welcome to the Heritage Foods Limited Q1 FY17 Results Conference Call, hosted by Sunidhi Securities & Finance Limited. As a reminder, all participants' 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 Mr. Kumar!

**Shailesh Kumar**: Good evening ladies and gentleman. On behalf of Sunidhi Securities & Finance, I extend a very warm welcome to all of you. As you are aware company has already declared its numbers on Friday and result presentation is uploaded on the website. To put more light on that we have with us from management side, Dr M Sambasiva Rao, who is the President, Mr. A Prabhakara Naidu, who is CFO of the company, Ms. N. Brahmani, Executive Director, Mr. Mr. Dharmender Matai, COO of Retail Division and Mr. Samba Murthy who is the CEO of the dairy division. Without much ado, now will hand over the call to Dr. Rao to brief you about the performance and then we will proceed with the question and answer session. Over to you Dr. Rao!

**M Sambasiva Rao**: Thank you. Good afternoon ladies and gentlemen. We have announced our quarter one results on Friday. As you must have noticed on our presentation our turnover reached Rs.634 Crores this quarter with 10% growth compared to the previous year same quarter. EBITDA level profitability delivered is Rs.36.7 Crores to see the 24% higher than last year same quarter, PAT level is 16.5 compared to the 10.7 of the Q1 last year. Coming to the mild procurement, we have handled about 10.3 lakh liters per day in this quarter and sales 8.4 lakh liters per day in terms of liquid milk and value add products contribution to the revenue increased by 29%. It is not increase. It is contribution to the turnover 29%. Our production capacities have been enhanced now the chilling capacity is 16.69 lakh liters, processing capacity is 15.3 lakh liters, packing capacity is 10.6 lakh liters and we have 1500 franchise parlours selling the products in South India in different markets.

Coming to the retail business, our turnover has reached Rs.169 Crores with 26% growth over the Q1 of last year, EBITDA level at store level we have got Rs.9.38 Crores positive compared to Rs.7 Crores last year. At chain level it is -3.8 Crores compared to Rs.3 Crores of last year there is Rs.80 lakhs, Rs.85 lakhs last increased at chain level.

Gross margin percentage we have 40-basis points higher than last year at store level and at chain level it is 50-basis points higher that is 20.6% at store level and the 18.8% at chain level. We have now 112 stores in three cities with trading space of 3.96 lakhs square feet. Productivity at store level is Rs.11083 per square feet per month and chain level is Rs.14029 per month. In quarter one, we have opened two new stores in Hyderabad, our same store growth taking a 90 stores base is 4.6% compared to last year. This is broadly the retail performance. Now I open it for discussion and interaction. Thank you.

**Moderator**: Thank you very much. We will now begin the question and answer session. The first question is from the line of Dhiral Shah of GEPL Capital. Please go ahead.

**Dhiral Shah**: Good afternoon Sir. Congratulation for great set of number. Sir during the quarter, we saw that there was milk procurement was down at 7.3%, now also milk prices were down around 0.5% so why so?

**M Sambasiva Rao**: Last year we have procured higher volume for converting into powder. In Haryana we have taken a plant on lease and converted milk into powder, this year we have stopped that activity of conversion from milk to milk powder because of the price scenario in the market of mild powder that has led to the drop. Otherwise for business requirements, we have procured whatever is required.

**Dhiral Shah**: Okay and also in terms of mild prices were down, realization were down around half a percent?

**M Sambasiva Rao**: Certain markets we have reduced the sale price of the milk and sale price of the curd also in line with the competition. As you must have noticed, milk procurement prices were down last one and a half year and milk powder prices also down, so certain competitors have reduced the prices in markets we have also reduced to keep in.

**Dhiral Shah**: By how much?

**M Sambasiva Rao**: It varies from market to market.

**Dhiral Shah**: Curd prices were down by how much Sir?

**M Sambasiva Rao**: Curd prices also will down by about Rs.2 a kg, milk were down by 0.60 paisa a litre average.

**Dhiral Shah**: Okay that is it from my side, thank you.

**Moderator**: Thank you. The next question is from the line of Deepak Madhavdas of Lead Sharacks Associates. Please go ahead.

**Deepak Madhavdas**: Good evening Sir. Thanks for hiring the question. There is an enhancement of this inventory, stock in trades for this quarter to Rs.19.91 Crores. Can we show the reason why we have enhanced the inventory here Sir, any specific reason?

**A Prabhakara Naidu**: Total inventory of the company as on June 30, is Rs.137 Crores corresponding year it was Rs.139 Crores there is no increase actually.

**Deepak Madhavdas**: But if you just see that inventories and finished goods in the last quarter like we have used it, now we have increased it, is it because of the again conversion of milk to powder or something?

**M Sambasiva Rao**: Where are you picking up this numbers from?

**A Prabhakara Naidu**: From balance sheet side actually as on June 30 we have inventory of Rs.137 Crores.

**Deepak Madhavdas**: So the speech is not clear Sir that is the problem.

**M Sambasiva Rao**: There are you picking up this number from because we are not able to see that number Rs.19 Crores increase.

**Deepak Madhavdas**: This is the standalone number of the latest quarter?

**A Prabhakara Naidu**: No that has been consumed from actual opening stock. Opening stock has been consumed during this year powder.

**M Sambasiva Rao**: It has not increased.

**A Prabhakara Naidu**: It has been consumed.

**M Sambasiva Rao**: It is not increase in inventory.

**Deepak Madhavdas**: The speech is becoming little vague Sir.

**M Sambasiva Rao**: According to our numbers, there is no increase in inventory.

**Deepak Madhavdas**: Okay I will just take once again and there is an interest outgo for the company in this quarter, how much is the interest outgo Sir for the company in the quarter?

**A Prabhakara Naidu**: Interest is Rs.2.64 Crores.

**Deepak Madhavdas**: Can you just break into two and just say like how much it is for the dairy and how much it is for the retail?

**A Prabhakara Naidu**: For dairy Rs.1.48 Cores, for retail Rs.70 lakhs, 69.5, renewable energy Rs.42 lakhs, remaining for agri and other Vet Ca business is small amount around Rs.5 lakhs.

**Deepak Madhavdas**: Last question Sir. On January 21, 2016 we have announced that KPMG for the suitable partner investor in the retail business like how far have we go ahead Sir in that?

**M Sambasiva Rao**: It is still work in progress.

**Deepak Madhavdas**: And the last question Sir, is there any valued added product which has to be like any value added product which the company wants to get in the market now to sell for through some collaboration or something? We are into cheese and other things.

**M Sambasiva Rao**: Our intention is to try for cheese and protein drinks. We are working on that.

**Deepak Madhavdas**: Thanks a lot. I will come back again Sir.

**Moderator**: Thank you very much. We have the next question from the line of Aakash Manghani of BOI AXA Investment Managers. Please go ahead.

**Aakash Manghani**: Good evening. Thanks for taking my question. Firstly, on the retail part of the business I would like to understand in spite of sales being similar on a sequential basis, why has the EBITDA margin dropped substantially from Q4 to Q1 EBITDA margin has dropped from 9.3% to 5.6%?

**M Sambasiva Rao**: Q4 to Q1 are not comparable in any year. For the reason, Q4 accumulates substantial off invoice incentives from all the vendors which are based on annual quantitative sale targets that could give higher margins in the Q4 it is a trend for every year the reason is that when we achieve our annual target vendors give 1%, 0.5%, 2% incentive for the entire sale conducted during the year so that gives to Rs.4 Crores to Rs.5 Crores of additional incentive off-invoice in the quarter four that advantage will not begin in quarter one.

**Aakash Manghani**: Followup on that is in your investor presentation for Q1 you mentioned that you expect retail to become break even in FY2017 and so when you say breakeven at the store level or breakeven at the company EBITDA level and how far you away from achieving that is it on track?

**M Sambasiva Rao**: It is at company level when we are talking. I request Mr. Dharmender Matai to elaborate on the annual breakeven plan.

**Aakash Manghani**: Also what is the capex for this year in retail, this year and next year?

**Dharmender Matai**: Regarding breakeven I think in the region level we are almost there. We do not have the problem at the region level. At the company level, we have already made plans as compared to last year. We have made plans to want to bridge through the sale, second to improve our margin. If we see our margins have already improved and third is we have taken some internal measure for the second quarter and third quarter which is the festival period. We would like to improve our performances as compared to last year. In the internally we have got planning, which is leading to vendor negotiations, joint business plan with all the top suppliers which will help us to improve our margins further. Fifth is the new store-opening plan. We plan to open 1.1 lakh square feet for the year. We would like to add out of which two regions, which is Hyderabad and Bangalore where we have supposed to add 60,000 square feet for the year we are planning to complete it within the first half and we are already on track for it, so that we get this advantage in the second quarter and third quarter which will help us to improve our sales performance which will also help us to add profitability for the company to achieve the break even.

**M Sambasiva Rao**: Capex is around Rs.20 Crores per year, this year or next year to cover this Rs.1 lakh plus trading space addition.

**Aakash Manghani**: So by end of FY2017, how many stores would you be having after this expansion?

**M Sambasiva Rao**: We are actually guided by the trading space not number of stores. Number of stores could vary in depending on the size, but Ballpark figure would be 125 stores at the end of year.

**Aakash Manghani**: Okay, the next question is on the dairy business, what has led to the EBITDA margin uptick in the dairy business YOY?

**M Sambasiva Rao**: EBITDA margin increase reasons?

**A Prabhakara Naidu**: EBITDA margin increased is because we have procured around 10.26 lakh liter which are sufficient to sell as liquid milk as well as use it for value added products. If that balance maintains the profitability is maintained and because of that actual fat losses has come down. If we take for the fat losses used to be around Rs.15 Crores now it is only Rs.5 Crores.

**Aakash Manghani**: What was the fat loss last year and what is it right now?

**A Prabhakara Naidu**: Right now Rs.5 Crores. The same period Rs.15 Crores it was actually Rs.15 Crores.

**Aakash Manghani**: If you do not mind me asking you what was the fat loss for entire FY2016?

**A Prabhakara Naidu**: FY2015-2016?

**Aakash Manghani**: Yes.

**A Prabhakara Naidu**: It used to be around Rs.45 Crores.

**Aakash Manghani**: Loss of Rs.45 Crores?

**A Prabhakara Naidu**: Yes.

**Aakash Manghani**: Why has the fat loss come down, fat price is improved?

**A Prabhakara Naidu**: There was surplus fat, because the procurement volume also we have actually reduced from 11 lakh liters to 10.26 lakh liters, fat generates itself is low. So the fat products are cream, butter and ghee when we sell actually we incur loss is the byproduct. Because the fat generate itself has been controlled that is the reason the loss had come from 15 to 5 Crores.

**Moderator**: Thank you. We have the next question from the line of Hardik Bohra of Union KBC Mutual Funds. Please go ahead.

**Hardik Bohra**: Thanks for the opportunity and congratulations on a good set of numbers. Just following up on the retail strategy turnover to basically breakeven, I am noticing that the corporate overhead costs have increased also 30% year-on-year, which probably did not help in achieving the breakeven as well, so what is the strategy in incurring more cost, are we going to do that as well. I am trying to understand when will the operating levels when effects are playing in the retail business?

**M Sambasiva Rao**: EBITDA level if some corporate cost increased during the financial year, substantially due to statutory correction in the employee benefits. You may recall Government of India increased the bonus for the employees both in terms of increasing the salary slab and also increasing the basis for calculation of bonus. Similarly our provisions are gratuity, leave, etc., have gone up. There is a substantial chunk coming from the statutory requirements for welfare side and the strategy for increasing EBITDA level profitable, EBITDA level performance and make it profitable just now Mr. Dharmender explain to other member the expansion of the trading space by creating new stores and improving the margins and rationalizing the cost etc., various steps we have initiated which would help in the coming three quarters to achieve the EBITDA level profitability at corporate level and business.

**Hardik Bohra**: Okay, more specifically these corporate overhead that we have right now. Will they be growing at the same pace as the growth in sales or do you expect Rs.13 Crores number for the quarter to kind of stagnate?

**M Sambasiva Rao**: The cost will remain same.

**Hardik Bohra**: Second question is on the capex you said Rs.20 Crores per year for the retail side. There is no capex requirement for the dairy business?

**M Sambasiva Rao**: Dairy has its own requirement. That was actually specific answer for the retail. Dairy has substantial approximately around Rs.80 Crores if the Capex requirement for dairy.

**Hardik Bohra**: Same for two years for this year and the next year. That is all from my side right now. I will come back in the queue.

**Moderator**: Thank you very much. We have the next question from the line of Damodaran Kutty of Birla Sunlife. Please go ahead.

**Vishal Gajwani**: I am Vishal Gajwani his colleague. I had a question on value added products within that curd sales have gone up. So is there the contributor to increase margins in this quarter?

**M Sambasiva Rao**: This is one of the important factors. Increased contribution has helped us to improve more profitability.

**Vishal Gajwani**: Do we consider these margins to be sustainable going forward EBITDA margins for dairy business?

**M Sambasiva Rao**: Things will remain more or less same.

**Vishal Gajwani**: On the previous question regarding lower fat sale, just wanted to understand means your procured less milk, but if you are toning the milk you will get the byproducts right?

**M Sambasiva Rao**: Yes you are right.

**Vishal Gajwani**: Anyway you will have to sell those products at a loss?

**M Sambasiva Rao**: Yes.

**Vishal Gajwani**: How far you able to reduce sale of butter and other products?

**M Sambasiva Rao**: I think the presentation made earlier was if there is a surplus milk and it goes for the conversion of the milk into powder and butter that butter is causing certain losses by selling at a lower price and the cost price. During this quarter, we have not undertaken that conversion activity which we have done last year. The conversion activity is beneficial in case milk powder prices are higher even if the butter losses are there. The butter is sold or the fat is sold at a lower price. So this year milk powder prices also remains subdued, so we have not resorted to the conversion of milk into powder and butter that decision helped us to avoid that additional surplus fat and consequent losses on that.

**Vishal Gajwani**: Incrementally you have mentioned in the presentation that the curd can go ahead 25% to 30%, so are we on track that way of course Q1 was very good?

**M Sambasiva Rao**: That is true.

**Vishal Gajwani**: Sorry.

**M Sambasiva Rao**: It is true, it is continuing.

**Vishal Gajwani**: Okay, sure, thanks a lot.

**Moderator**: Thank you very much. We have the next question from the line of Prashant Kutty of Sundaram Mutual Funds. Please go ahead.

**Prashant Kutty**: This is Prashant Kutty over here. Thank you for taking the question. First question is regard to your branded sales. So if you look at the growth rate, the branded sales have grown to be about 20% moreover it is a good number, but if you look at the earlier run rate, it used to be in the range is about 25 plus kind of a growth rate number. Any specific reasons, is there to any other segments is actually led to that moderation or how do we look at it going forward in terms of the overall branded sales in terms of growth?

**M Sambasiva Rao**: This is because of quarter one effect. As you know the quarter one is the summer month. The ambient temperature will be higher. Consumption of the dairy products like buttermilk, ice cream, curd would be relatively higher. This quarter will be always high and then we get into winter, the value ad product sale would be little lower. The annual average will come back the same. The Q1 cannot be the annual trend. It is a trend of the Q1 only.

**Prashant Kutty**: That is the reason as to why that growth is lower?

**M Sambasiva Rao**: Growth is higher.

**Prashant Kutty**: If I make an assessment as compared to the previous quarter, the growth is almost about 25% vis-à-vis branded sales is concerned, the branded or the value added share, if I look at the growth rates in the previous quarter that would have come down to somewhere about closed to 20% any specific reason?

**M Sambasiva Rao**: We are talking about volume metric versus value, volume metric growth is there, but value growth is less, because prices cuts have been taken.

**Prashant Kutty**: That has been taken, that is one of the reasons. Secondly Sir I am sorry I did not get this part first one clarification was that you said the chilling capacity is only increase at 16.69, crushing capacity how much now you said?

**M Sambasiva Rao**: Last year it was 15.1. This year it is 16.69.

**Prashant Kutty**: The processing capacity is 16.69.

**M Sambasiva Rao**: It is a chilling capacity. Processing is 14.55 and this year it is 15.3.

**Prashant Kutty**: The question next was actually with regard to the fat part actually, so this is more of an effect of the actual fat content being lower which is why your margin has turned out to be better, but going forward how do we really look this actually, is there serious efforts from our end as well to actually if the fat losses reduced and then probably look at increasing minor because the another way are actually increasing a margin apart from your value added products as well, because I think this probably very good margin have almost about 7.5% in the dairy business. How do we look at it going forward as well?

**M Sambasiva Rao**: We tried to maintain the similar level of performance keeping in view the global outlook of the milk powder prices, which continued to be low. We will not resort to conversion of milk this year? We will try to minimize our conversion activity. So the performance would be continued like this.

**Prashant Kutty**: Just lastly from my end, this reason was the revenue for this particular quarter largely because of the out of which sales are not being the right, the conversion out of which you are seeing just about 5% growth rate and also because of price cuts?

**M Sambasiva Rao**: That is only powder butter particularly the fat sales were high last year, this year they are low. Revenue contribution from fat sale is also less.

**Prashant Kutty**: Thank you Sir. I will come back in the queue.

**Moderator**: Thank you. We have the next question from the line of Shubhankar Ojha of SKS Capital. Please go ahead.

**Shubhankar Ojha**: I just wanted to understand your way forward light? You talked about Rs.6000 Crores turnover by 2020. Can you please some idea on the possible in a segment wise target by 2020 out of 6000 Crores how much it come from segment?

**M Sambasiva Rao**: Dairy business is supposed to contribute 4150 or so and retail business is supposed to contribute around 1700 and balance would come from the agri and Vet Ca business.

**Shubhankar Ojha**: By 2020 what kind of margin target that have in your mind in terms of 6000 Crores of revenue separately dairy would contribute what margin and retail would contribute what margin? So by the end of this year as you said retail have been broken even, what kind of margin that this can achieve by 2020?

**M Sambasiva Rao**: This is to difficult to predict in cyclical business and every year there are number of factor that influence the business like I have been repeatedly quoting every time this is influenced by weather substantially, availability of milk and prices of milk and the policies of government regarding export, import, certain years they are banning, certain year they are incentivising, certain year they are bringing duty free and the global prices of the milk powder also influence us. So these are unpredictable and beyond our control, so we tried to maximize without our operational efficiencies and decision-making in terms of raw materials and inventories management. This is very difficult to say certainly this is going to be the margin and coming to retail we are seeing we are just coming out of the EBITDA level losses, so we have to perform and see as the years come by how much we can achieve at the margins. But certainly it would not be dramatically different from what we have been doing in the last 10 years, history or is any benefit we can look back into the performance.

**Shubhankar Ojha**: Thank you for that. At the end of June quarter what is your balance sheet in terms of the gross borrowing number?

**Prabhakara Naidu**: Debt position as on June 30, term loans outstanding Rs.73.44 Crores, working capital outstanding Rs.28.88 Crores.

**Shubhankar Ojha**: Not much change basically compared to last quarter?

**Prabhakara Naidu**: Rs.102 Crores total.

**Shubhankar Ojha**: On the capex you said Rs.20 Crores per annum for the retail business and Rs.80 Crores for the dairies this year?

**Prabhakara Naidu**: For this year only.

**Shubhankar Ojha**: This kind of capex require for dairy business every year going forward?

**M Sambasiva Rao**: Absolutely because our growth aspirations are high, we have to invest in the back end infrastructure and also front-end infrastructure.

**Shubhankar Ojha**: So that is about Rs.100 Crores per annum sustainable basis over the next few years?

**M Sambasiva Rao**: Yes.

**Shubhankar Ojha**: Thank you so much and all the best Sir.

**Moderator**: Thank you. We have the next question from the line of Alok Agarwal from Striver Capital. Please go ahead.

**Alok Agarwal**: Dr. Rao, How are you, this is Alok here. I have a question, industry is in quite a limelight and competition intensity is increasing, likes of Creamline, Godrej or Lactulose or Danone or Nestle has come back or even Parag. There is a lot of more or extra marketing for the sales spend which is going to happen possibly forced by these players. So what is the game plan for the next 20 to 24 months anyway you have been fighting this competition, but there is any extra marketing spend that you are planning and if I go back to the annual report, you are focusing lot in the world FMCG now, so what is the game plan going forward?

**M Sambasiva Rao**: You want to see the game when it is played or you want to know before it?

**Alok Agarwal**: I want to know before it, because Creamline is spending aggressively when Godrej have got the majority stake.

**M Sambasiva Rao**: We are also on the job. We are also trying to do our best to see our customers are happy with our quality products. Our strongest campaign point is our quality and that is how it was adhere to the Heritage brand in spite of the competition and we try to live by that and improve further on the service. The quality and service are two pillars of our growth and we continue to pursue them. Marketing efforts are incidental as long as we are fundamentally strong and quality serviced, I expect customer to patronize the heritage brand. On top of it, we are moving forward in the marketing activities as you progress into the year I am sure you will notice us also in the market in that space.

**Alok Agarwal**: Plan is more parlours, local level promotional activity or even some TV advertisement?

**M Sambasiva Rao**: I thought you got sense of it that I am not opening up.

**Alok Agarwal**: Just one question like which has been like investor and analyst community both on the value added collaboration and KPMG being appointed. It has been almost six months for both the things and the sense was that by now I think we will have some kind of a clarity. If it is work in progress I appreciate by the work in progress, but what is the time line in your mind to wrap it up that is why what I want to know.

**M Sambasiva Rao**: Our appetite is high, but not other side.

**Alok Agarwal**: Is it you are looking for some kind of technical collaboration alone or some kind of financial collaboration?

**M Sambasiva Rao**: Preference is the both if not both at least one.

**Alok Agarwal**: Lastly, why will the Europe, if these people are being lazy or slow in bringing about some kind of action or game plan together, anybody outside of that?

**M Sambasiva Rao**: We have no restriction in Europe, we have started in one continent that itself is too big to cross, nothing more we will go to some other areas. There is no such strong feeling, but we are trying to identify those who are capable of addressing Indian market requirement.

**Alok Agarwal**: That is causing some kind of delay, particularly why I am seeing this competition is heating up I mean they should not get ahead of you because you have done a fantastic job over the previous years I mean keeping the branch chill in high and with somebody coming up in the cheese or other value added category, you should not take away market share?

**N. Brahmani**: Mr. Alok. This is a Brahmani here. On this topic, we are actively pursuing discussions with some companies and it has reached at certain stage and because of confidentiality issues we are not able to give you too much information at this point, but in certainly there are some activity going on in the next couple of months.

**Alok Agarwal**: Thank you Brahmani and secondly on the retail front right. I am sure like it is once again work in progress, it is once again going to be some kind of I think government policy now permit even some kind of majority stake in the food retail or I think it is 49%. Is there plan to go even up to 49% to the partner?

**M Sambasiva Rao**: Regulations are not so clear that food retail means our kind of stores where nonfood component is equally high, it is close to 25% is nonfood in our stores and many groceries stores have 25%, 30% of nonfood. The clarifications are expected and feeble noises are coming that to we will allow the nonfood component in the grocery stores that is not very clear to understand whether FDA is allowed in this multi-brand stores, nonfood component in it. We are waiting for more clarity.

**Alok Agarwal**: Thank you. That is it from my side.

**Moderator**: Thank you very much. We have the next question from the line of Aakash Manghani of BOI AXA Investment Managers. Please go ahead.

**Aakash Manghani**: Thanks for the followup question. I had a question on the value added segment. You mentioned that you have taken Rs.2 price cut in the curd business. What percentage price cut would that be and followup on that is what sort of competitive intensity or you witnessing over the last 6 to 12 months in your home states where you are setting value added products that is my first question?

**M Sambasiva Rao**: On the curd percentage drop is around 4% and competition is continuing. There is nothing very special about any competitor.

**Aakash Manghani**: Has the number of players operating in Andhra Pradesh increased over the last year or so? What is the price point to operate at and how much lower or higher are there as compared to your price points on an average?

**M Sambasiva Rao**: Competitors are same and prices are also more or less same.

**Aakash Manghani**: What prompted you to take this price cut? Was it the sales volume of velocity had reduced or is that competition came in at a lower pricing?

**M Sambasiva Rao**: Ghee prices and milk powder prices came down in the market first, procurement prices, at the palm gate and the milk powder price came down. The cost of production of the product has come down, so some competitors have reduced, so it is to keep up with our market share we had to do that.

**Aakash Manghani**: I thought I would assume that this is the more or less a branded play and where you would be having some sort of pricing power over the longer term hence you would be able to hold on to the margins?

**M Sambasiva Rao**: Into which but that is not a reality.

**Aakash Manghani**: Also you alluded to you guys getting into cheese and protein supplement, could you just elaborate on strategy over there and by when do you plan to four years into this and what is the capex and what?

**M Sambasiva Rao**: That is what just now our Executive Director, Ms. Brahmani explain that discussions are in progress active stage. We should be able to highlight more in the quarters to come.

**Aakash Manghani**: Lastly probably give me your sales spirit for value added across your states? How much should be AP, how much should be Tamil Nadu, Karnataka, so on and so forth?

**M Sambasiva Rao**: In value terms, it is not readily available. We will share with you later.

**Aakash Manghani**: Would AP be in north of 75%, 85% in that sense?

**M Sambasiva Rao**: It is not very clear the number. We will let you know later. It would not that high may be around 60 or so.

**Aakash Manghani**: Okay, thanks a lot. That is all from my side.

**Moderator**: Thank you. The next we have a followup question from the line of Prashant Kutty of Sundaram Mutual Funds. Please go ahead.

**Prashant Kutty**: Thank you Sir. With regard to the retail part, you did speak about that this year you are looking at like an EBITDA breakeven, just wanted to understand typically we have talked about retail model for any other apparels or any kind of companies, obviously SSG becomes a very important factor over here in order to probably improve your throughput or improve your margin as well. But typically what is the measure over here in terms of improving your yearly EBITDA margin number are improving a bottom line number, if you could just help me to understand the particular thing as to what typically the measurably if you look at it over here to improve your margin profile?

**M Sambasiva Rao**: Can you repeat we were not able to?

**Prashant Kutty**: What I meant was that when we typically talked about retail companies or retail as an operation, we typically either talked about mix improvement or we typically talked about an SSG number, so while this particular quarter we talked about 4.8%. What is typically the measure look at, what is the key measurable to look at when you talk about improving our margin business you spoke about FY2017 as our target for this year? What is that which you will look at as a key variable, which should improve in order to get into that break-even or to that fat breakeven?

**M Sambasiva Rao**: First sales increasing the sale number that can be two channels. One is the existing stores like-to-like increase. New store expand addition by adding more trading space that both together will give us higher sale number. Once the sale number is achieved rupee gross margin will automatically come. Second is increasing the gross margin percentage even by 50-basis points year-on-year would help us that is a function of change of the product mix renegotiation with the vendors adding more high value products etc., that is on margin increase. Third is cost control while we expand the stores to the extent possible we have to minimize our cost increase, of course newer stores means new rentals, new electricity, apart from that in existing stores wherever we can optimize the costs and bring down the cost of operation particularly the electricity's manpower rent and next is the wastage and shrinkage managements to the extent possible we must handle our fruits and vegetables efficiently because we have substantial revenue coming from the fruits and vegetables which are perishable in nature. One-day rain means that day sale will go down, the three, four hours of nonstop rains will lead to lot of material wastage next day, we cannot sale next stay and these are unpredictable kind of things the sales offtake's on those days. The perishable component is high for us. We have to be more carefully indenting in supplying and holding the stock, similarly shrinkage management, so we have to be careful on the inventory loss either shrinkage or wastage or dump etc., and increasing the footfalls into the store by efficiency improvement and the service levels. The faster we check out greater than relief to the customer in the queue and help we extend in picking up the stocks in the store, carrying and billing it fast and delivery at the vehicle outside parking area having better parking arrangements and wallet parking these are all the service element, customers get satisfied and more and more walk-in will come. This walk-in improvement by proper marketing etc also helps. These are various activities we undertake to bring higher sale, higher margin, less cost, less loss, more walk-ins.

**Prashant Kutty**: If I expedite typically not the corporate overhead, which you spoke about employee cost, has been increased. Is 5% kind of SSG number or the number, which kind of clogged? Is that reasonably good number to probably maintain a good level of profitability in this format?

**M Sambasiva Rao**: It should be double digit same store growth, but last one year what happened is your commodity prices are down, lot of commodity prices compared to previous year are down, even FMCG product prices are down. The food products like milk except sugar which is moving up recently, every product is going downwards and the prices due to the market changes, so that did not help us to grow in revenue value though our footfalls have increased. Our bill values have come down that is the year we went by. So now the prices are moving up for the last couple of months, we could see vegetable prices are up and commodity prices are up may be some amount of price movement also helps in building that revenue growth. Otherwise 4%, 5% it is not adequate.

**Prashant Kutty**: Typically what is mix in terms of retail stores, what is that typically have it in terms of mix in terms of food, nonfood, perishable, non-perishable, how is it mix actually usually across all stores?

**Dharmender Matai**: In food per se we have got commodities and fruits and vegetables, fruits and vegetables anywhere between 14% to 16% contribution, about 23% to 25% is what the commodities contribute and anywhere between 60% and 65% is what the FMCG food and nonfood contributes.

**Prashant Kutty**: Is there any special effort to move any of these or improve any of these the mix over here actually?

**Dharmender Matai**: One big wish is we are trying to take the FMCG to the contribution levels of 18% and also the commodities if you can pull up 28% to 30%. So the dependency on FMCG comes down. Focus on FMCG is to renegotiate the terms these are majorly with FMCG players, if we can get higher margins to negotiation. It will help it to a top line as well as also in the bottomline.

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

**Moderator**: Thank you. We have the next question from the line of Mr. Shailesh Kumar of Sunidhi Securities. Please go ahead.

**Shailesh Kumar**: Thanks for the opportunity. I have few questions. First thing is have we weeded out certain number of distributor from the system? If I go through your quarterly presentation, this quarter number distributor is 5700 versus 5900 for Q4 FY2016. Have we removed this couple of 100 of distributors? It is typographical errors. There has been announcement that board has approved setting of second 2.1-megawatt wind power capacity, we have recently done 12.1 megawatt. So could not be fine better uses of cash?

**M Sambasiva Rao**: We have concluded this is not better usage.

**Shailesh Kumar**: I am just seeking your opinion, because when other dairy companies are going for equity dilution for cash and all these things?

**M Sambasiva Rao**: Shailesh, we have certain advantages on going for wind power, immediately as we know appreciated accelerated depreciation benefit is there which is almost equal to my equity that is the first thing. Second, today this is of course we must have noticed this project is meant for captive power only, nothing else. So our power tariff today what we buy from the state utilities is anywhere Rs.7.50 per unit of power and this wind power generation, we are valuing at Rs.4.30. We have Rs.3 benefit per annum, 0.50 paise per unit and per annum this project is supposed to generate 50 lakh units. 50 lakhs into Rs.3 is a gain per annum in my operations cost of dairy. Crores and half by safe every year from now minimum, after five years, the state power, state utilities power tariff it sure will go up by another 25%. It will become Rs.10. By this time my wind power cost will come to Rs.3, gas is going to be Rs.7 per unit. On 50 lakh units we generate it is going to be Rs.3.5 Crores per year. After eight years. My power cost is going to be zero, may be 10 paise per unit will be the operations maintenance cost, insurance, etc., 0.20 paise will be my unit cost by the time state must be selling at Rs.11 or Rs.12. Rs.5 Crores per annum is going to be saving after 10 years and it is for 25 years. So there is a huge future benefit that is going to accrue from these captive power plants we do today because of the policies of government in the renewable and the sector apart from immediate tax break and I do not see any disadvantage in this and it is substantial contribution for the green footprint in India, we contribute for that.

**Shailesh Kumar**: Got it. My next question is almost 76% of V-ADP revenue is curd, what about the 24% if we could have the breakup for first quarter?

**M Sambasiva Rao**: Prabhakara will explain the breakup of important top four top four items.

**Prabhakara Naidu**: Curd contributing 75%, ice cream contributed 8.9%.

**Shailesh Kumar**: 8.9% is ice cream?

**Prabhakara Naidu**: Yes, and buttermilk 5.7%, flavoured milk 3.6% and paneer is 3.1%.

**Shailesh Kumar**: I would appreciate if you could give me EBITDA margin of these product segments like curd last quarter you have said it is 17.7%?

**M Sambasiva Rao**: I will add in on the curd is 16.5% in EBITDA margin and buttermilk is 18.8%, ice cream is 15% and paneer is 7%.

**Shailesh Kumar**: What about ice cream and flavoured milk?

**M Sambasiva Rao**: Ice cream is 15%, paneer is around 7.8%, flavoured milk 12%. It keeps changing with season again, some seasons, the SND cost will increase if volume is less, in some seasons SND cost will decrease if volume is high, weather etc., this is not uniform for the year, so it will be averaging around 14%, 15%, all put together as a basket.

**Shailesh Kumar**: If possible can I have break up of other operating income for first quarter FY2017 and 2016?

**M Sambasiva Rao**: Operating income in retail right? You mean in the retails? In the retail division, Prabhakara?

**Prabhakara Naidu**: Operating income for this first quarter of 2016-2017, promotional income is Rs.13.16 Crores versus last year same year actual Rs.9.09 Crores. Display and visibility income Rs.0.76 Crores, purchase point 0.47, one more concessionary income is Rs.0.59 Crores, and Rs.0.61 Crores.

**Shailesh Kumar**: Have you also taken some price hike in liquid milk segment, I have been told that in Tamil Nadu we have taken some price hike?

**M Sambasiva Rao**: From today only on the two variant milk cream is standardized milk we have increased by Rs.2 from today onwards.

**Shailesh Kumar**: Today itself?

**M Sambasiva Rao**: Similarly, in Mumbai we have increased by Rs.2, Delhi also increased last month, Mumbai, Delhi and Chennai partly not all the variants.

**Shailesh Kumar**: What is our current installed capacity of curd as on June 30, 2016?

**M Sambasiva Rao**: 358 tonnes of curd.

**Shailesh Kumar**: 3.58 lakh tonnes?

**M Sambasiva Rao**: 3.58 lakh kg per day.

**Shailesh Kumar**: Thanks.

**Moderator**: Thank you. The next question is from the line of Siddharth Bhattacharya of Suyash Advisors. Please go ahead.

**Karthikeyan**: Good afternoon Sir. This is Karthikeyan here. I wanted to clarity couple of things. One is you spoke about the losses in fact last year of about Rs.45 Crores. I just wanted to clarify one is this is based on the decision of make or buy of milk powder did I understand that correctly?

**M Sambasiva Rao**: You are right.

**Karthikeyan**: So going shall we say completely avoid this loss or how should one thing about that?

**M Sambasiva Rao**: This will continue to be there in **(inaudible) 54.22** scenarios. If we require milk powder for our business and we get surplus milk in the winter. Our farmers who are analysts with us they continued to supply and their volumes increased in winter as cows and buffaloes yield more milk, at that time we cannot deny the milk from them. We assured getting of their production so we access that that milk we convert into powder. This is the business requirement to maintain relationship with them. Normally, milk powder prices would be increasing and covering substantial cost of it and the loss we incur due to that byproduct fat products at par to some extent, last one-and-a-half-year mild powder prices are going down. They could not cut off the fat losses to some extent that has increased over period in one year. In addition to this, we also undertook one additional operation in Haryana by hiring a plant for converting milk into powder during the last year that operational are suspended now. Because of that we could reduce our accumulated byproduct of fat and we intent not to do it again this year unless the prices move up, so this is about optional decision of conversion. Second is compulsory edition of conversion that additional milk coming from farmers that we need to convert and we will incur fat loss to some extent that it cannot added totally.

**Karthikeyan**: You are saying that the net benefit of converting to milk powder minus the losses from fat is something that will always remain negative normally?

**M Sambasiva Rao**: Yes.

**Karthikeyan**: Second issue is that when we spoke last sometime ago you talked about ghee being a very seasonal product and therefore there are losses in this business, has that changed you do not talk about that too much?

**M Sambasiva Rao**: That is the same. It is fat, that it is ghee is part of that and fat products we broadly classify keeping cream, butter and ghee together.

**Karthikeyan**: Right and ghee continues to be loss-making product for you in spite of being strong brand?

**M Sambasiva Rao**: Any product in the fat farm is loss making.

**Karthikeyan**: I ask you this question again only because one of the competitors who have listed recently, they say it is their star product therefore I mean I just thought I should take with your things have changed there.

**M Sambasiva Rao**: These are accounting issues there are certain ways one can see each product ghee and fat in a particular manner, ghee also is profitable by taking loss in some other product.

**Karthikeyan**: The other question is that in terms of the capex that you have talked about Rs.80 Crores each of these next two years, is there any particular item which gets maximum allocation?

**Prabhakara Naidu**: This goes into standard products on the milk procurement, processing and packaging.

**Karthikeyan**: Not into keys or any of those other products?

**M Sambasiva Rao**: Cheese is not part of it. Cheese and all are existing products including curd and buttermilk etc.

**Karthikeyan**: Thank you very much and best wishes Sir.

**Moderator**: Thank you. Next we have a followup question from the line of Hardik Bohra of Union KBC Mutual Funds. Please go ahead.

**Hardik Bohra**: Thank you for the followup. Dr. Rao one question on the procurement. Just to clarify first, would milk procurement price be higher or lower than cooperative?

**M Sambasiva Rao**: It depends on location-to-location and state-to-state, depending on the competition, milk requirement by us, so it will be higher in some places, lower in some places, equal in some places. It would not be uniform.

**Hardik Bohra**: In the instance where it is lower than what cooperative probably would offer to farmer could you please elaborate what would incentivize the farmer to deal with us?

**M Sambasiva Rao**: Cooperative not being present there first scenario, cooperative may not be operating in that area. Second scenario, they may not be paying properly, their measurements are not accurate, their payment is not mutual, inefficiencies in various forms would drive away the farmer or politics of area. Various reasons are there for farmer not to go to cooperative plus the value added services we provide in addition to the milk price. We have high value veterinary care services, input supplies, credit tie up with the banking system, social security schemes like insurance for the cattle, insurance for the farmers. So there are number of things what attract farmer to stay with us.

**Hardik Bohra**: That is all I wanted to ask. Thank you.

**Moderator**: Thank you. Due to time constraints, we will be able to take one last question. Last question is from the line of Ritesh Vaidya of Ambit Capital. Please go ahead.

**Ritesh Vaidya:** I just had one or two questions, according to your plans do you plan to achieve Rs.4000 Crores of dairy sale by 2020, would not the sales, what is the quantum of milk procurement you will have to do and which are the states, which will possibly look to enter to achieve that milk procurement?

**M. Sambasiva Rao:** Yes it should be closed to 2.5 million liters per day, current prices are factored, if prices go up then volumes would not be that high.

**Ritesh Vaidya:** And which regions or the current regions will be?

**M. Sambasiva Rao:** We are focusing now on the Western North India. West includes Gujarat, Maharashtra, North includes Haryana, Rajasthan.

**Ritesh Vaidya:** Is not the competitive intensity in terms of some regional private players and cooperative already very high in these states, so how do you think, you will be able to break into these procurement network?

**M. Sambasiva Rao:** With the same way we have come this far on the value proposition to farmer. We continue to give the remunerative price and add our package of practices, which attract them towards us particularly the accurate payment, accurate measurement of fact SNF for value, for deciding the value of the milk and punctual payment and the packages of veterinary services and inputs and social security schemes, this is what our success formula, wherever we go we operate on the schemes with the farmers. Farmers take sometime, but they move towards us and stay with us and the second is in terms of consumer we offer the best quality without any compromise on the standards, freshness and purity of milk and the service, service means the delivery of milk at door steps on time whatever is the agreed time at the right temperatures, these are what we offer to consumer as a value and they are patronizing us on this lines and we try on the same models and one additional activity we have been contemplating now and to the future is to have some marketing campaign supporting our strength, which would help us to create awareness for this.

**Ritesh Vaidya:** Have you already started any kind of milk procurement not on commercial basis, but in the state of Haryana because you were having milk powder plant over there, so I just wanted to know that are you already testing milk out there?

**M. Sambasiva Rao:** Yes we have already started the four locations in Rajasthan, which is now supplying milk to our Delhi plant and we are getting close to 30000 liters now and we either went up to 40000 sometime back and we had to close down certain operations due to quality feedback in that area, but now we are at 30000 liters own procurement. In Haryana when we operated the plant for conversion of powder we bought milk from the bulk suppliers, but our own marketing requirements we procure from farmers directly, which is in operation Rajasthan right now, Haryana we do not have procurement after closure of that power plant operations.

**Ritesh Vaidya:** And Sir normally in these new areas when you try to procure milk, what is the kind of higher pricing that you offer to farmers versus the incumbents over there, any differential you can share?

**M. Sambasiva Rao:** No addition price, we are operating on the same price, for example in Rajasthan we operate at par with Amul.

**Ritesh Vaidya:** Sir just one last question, if you could share the EBITDA margin you make on your pouch milk business?

**M. Sambasiva Rao:** 8%.

**Ritesh Vaidya:** And Sir for the cheese business do you have target EBITDA margin?

**M. Sambasiva Rao:** No, not yet, we will come out with you later with those details.

**Ritesh Vaidya:** Okay Sir, thank you, that is all from my side, very helpful.

**Moderator:** Thank you very much. That was the last question. I would like to hand the conference over to Mr. Shailesh Kumar for closing comments.

**Shailesh Kumar:** I would take this opportunity to thank the management of Heritage Foods Limited to decently respond to the queries raised by investor. I would also like to thank our investor brothers and sisters for showing interest in the company. Now we may disconnect the line. Thanks.

**M. Sambasiva Rao:** Thank you very much.

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