"Heritage Foods Limited
Q4 FY2019 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Heritage Foods Q4 FY2019 Earnings Conference Call, hosted by Sunidhi Securities And Finance Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shailesh Kumar from Sunidhi Securities and Finance Limited. Thank you and over to Mr. Kumar!

Shailesh Kumar: Good evening ladies and gentlemen, on behalf of Sunidhi Securities, I extend a very warm welcome to all of you. Heritage Food has declared its results couple of days back. They have come out with fantastic set of numbers. To throw light on the same we have management team of Heritage Foods Limited represented by Dr. M. Sambasiva Rao, President; Ms. Brahmani, Executive Director; Mr. A. Prabhakara Naidu, CFO; Mr. Samba Murthy, Dairy Division Head; and Mr. Umakanta Barik, Company Secretary. Proceeding will start with initial remarks from Dr. Rao and then we will go head with question and session. Over to Dr. Rao!

M. Sambasiva Rao: Thank you Mr. Shailesh. Good evening to all the participants and I welcome all of you for the Q4 earnings call of Heritage Foods today. As you all must have seen we have uploaded our investor presentation and notified the results. But I will attempt with you some highlights on a standalone basis for quarter four we have achieved 625 Crores turnover which is 13% higher than the previous year same quarter, at EBITDA level we have got 51.75 Crores which his 9.7% higher, PBT 34.82 Crores which is 9.46% higher.

Coming to the full financial year standalone basis, the net turnover is 2482 Crores, which is 6% compared to the previous year's turnover. At EBITDA level, there is a growth of 44% from 133 Crores to 192 Crores during the current financial year. At PBT level, 46% growth from 88 Crores to 128.69 Crores. PAT also increased from 62 to 83 Crores on the continuing operations.

We will take the consolidated figures for the Q4 net turnover is 6735 Crores which is 13% higher. EBITDA is 48 Crores. PBT is 31 Crores. For full financial year 2018-2019 consolidated numbers, net turnover is 2515 Crores which is 6% higher than the previous year. EBITDA for 2018-2019 at consolidated level is 193 Crores compared to 133 Crores of the previous year. PBT is 127 Crores compared to 90 Crores of the previous year. PAT is 82.85 Crores versus 62.68 Crores.

Coming to other details of dairy business during the quarter four, our dairy milk procurement is 14 lakh liters versus 13.24 lakh liters of the previous year same quarter. Sales volume of liquid milk was 11.15 lakh liters per day versus 10.42 lakh liters per day of the previous quarter.

Value added products during Q4 achieved 22% growth and the turnover is at 155 Crores. The contribution of value added products during this quarter was 25% to the total revenue. If you take full financial year 2018-2019 for value added products, we achieved the growth of 18% that is total revenue from value added products stood at 619 Crores with the 25% contribution to the total revenue.

As on March 31, 2019 our infrastructure production capacities stand at 19.54 lakh liters per day chilling capacity, 25.74 lakh, processing capacity, 17.10 lakh liters per day packing capacity. We also have 13065 franchise operated exclusive Our capex for the year 2018-2019 stood at 103 Crores for dairy and 25.4 Crores per our subsidiary Heritage Nutrivet which handles cattle feed. Compared to last year, we have incurred 164 Crores in the dairy division and 16 Crores in the renewable energy division in the previous financial year.

Our debt position as on March 31, 2019 long term loans 132 Crores, working capital 92 Crores. HNL also had some long term debt of 13.72 Crores and working capital loan of 2.3 Crores. These are the highlights of the quarterly performance and certain insights into annual performance.

Now we will open for discussion. Thank you very much for your patient hearing.

Moderator: Thank you. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Vikrant Kashyap from Kedia Securities. Please go ahead.

Vikrant Kashyap: Good evening and congrats on a good set of numbers. First question relates to Amul had recently increased their selling price by Rs.2 so I want your perspective how industry is getting and what is your strategy going forward regarding price hike?

M. Sambasiva Rao: Yes. We have also taken the price hike in certain markets already and we will be taking the Rs.2 hike in almost all the markets during the coming two days. Most of the players have started increasing the sales price of milk price to rupees a liter because of the increase of the milk price at the farm gate level In the matter of few days may be by first week of June more or less all markets, all players will be doing that.

Vikrant Kashyap: Right and should this reflect into margins or is there any change in procurement prices in this quarter?

M. Sambasiva Rao: Procurement prices also have gone up in several milk shades, not uniformly but in different areas, different price hikes are there, more or less it take care of the price hike only, there is no addition margin available because of this.

Vikrant Kashyap: Sir in your presentation you have also highlighted that you will be doing 6000 Crores of revenue by 2024 instead of 2022, so I want to know what is the strategy going forward since we are not able to dispatch by 2022 and how do we achieve, how confident we are that at this time we are going to achieve 6000 Crores?

M. Sambasiva Rao: See earlier if you recall my previous presentations we used to say it is 2022 as a target timeframe in the last few months we have reviewed particularly based on the performance of finance year 2019. Overall, if you see there was glut in the market, the milk prices have come down at the farm gate level, we had reduced the sale prices also for certain market both for milk and milk products, so it has resulted in a subdued growth, our average growth was only 6%, though certain quarters have shown higher growth like last quarter we had reported 13% but here average has come to 6%, so which indicated a year, we could have done 20% or 15% we missed, we ended up with 6%, but now the markets have changed, situations has changed, all over India glut situation disappeared, most of the opening stocks at the milk powder got exported, liquidated, now we feel the scarcity scenario is building up as drought is progressing, temperatures are high, certain areas they were finding a difficult even to get drinking water. So in this kind of scenario, the price hikes will result in higher revenues, also demand will increase in the urban markets as the free milk flowing from the unorganized sector is almost out now. So we anticipate the growth rates to be higher during the current financial year or the coming financial years. Having reviewed the situation we thought, we should be able to deliver our targeted number of 6000 Crores. We did not want to alter our target number, our mission 6000 Crores remained as it is but the timeframe we moved a bit to 2024, so that we can deliver this number by that time. As part of this mission 6000 Crores, we have started expanding into more states. Earlier our focus was starting with Andhra Pradesh and later on it went into Tamil Nadu, Karnataka, then Telangana, we have also gone into Maharashtra, later through the acquisition of the Reliance Dairy, we went into Northern states like Punjab, Haryana, Rajasthan for procurement, Uttarakhand, Uttar Pradesh, Himachal, Delhi for sales apart from those states. Our territorial expansion to high milk consuming, high milk producing areas the new states we entered milk availability was very high and consumption is also very high. So with the expansion into the geographies, and introduction of more value added products, penetrating deeper into existing territories, to Tier 1, Tier 2, markets. Possibly considering certain opportunities for acquisitions in the coming three to four years, we are very reasonably sure that we will achieve this number by 2024.

Vikrant Kashyap: Right Sir and are we introducing more products as you are saying?

M. Sambasiva Rao: Yes. This number we have introduced to lassi products, Ragi and Sabja Lassi Products, we have also lined up a few more products to come, in the pipeline and our Yogurt plant is getting ready in Maharashtra, which should be in the market soon in this year itself and we are looking at other drinkable dairy products also to be taken into market soon. Our territory geographical expansion, more new products and increase of the existing product capacities, penetrate into deeper existing states, also higher allocation of the capital, you much have noticed in the last couple of years, our allocation of capital for the expansions was substantially high compared to the previous five years, so we would be putting up for higher capital into the business, our demerger of retail business also brought greater focus into the dairy business and we stay committed to the dairy business and whenever we monetized our investments in the future retail limited that money also will help us to grow the business faster.

Vikrant Kashyap: Right, so it is safe to assume that you will grow at CAGR of 15%-20% next five years?

M. Sambasiva Rao: Yes.

Vikrant Kashyap: What would be our safer side on the EBITDA margin that we can presume for five years, I am not talking about a quarter or two, I am talking five year?

M. Sambasiva Rao: Yes. As we speak we are not playing on a quarterly and we are looking at a long term policies or five year plans are always developed basing on this. Our EBITDA margins are fluctuating between 6.5 and 7.5. We continue to maintain in the same range.

Vikrant Kashyap: Same range. Okay Mr. Rao. Thank you very much and wish you best of luck.

Moderator: Thank you. We move to the next question, which is from the line of Aditya Mehta an Individual Investor. Please go ahead.

Aditya Mehta: Good evening. I just wanted to know is it viable to revamp the operations at Chittoor Dairy in Andhra Pradesh, so what would be its impacts if it is revived?

M. Sambasiva Rao: Chittoor District is one of the highly milk producing districts in Andhra Pradesh. It currently gives on a daily basis around 25 lakh marketable surplus through the organized sector. And we continue to get around 1.5 to 2 lakh liters per day out of the 25 lakh liters procured in the district. Along with us there are number of private companies like Tirumalai, Jersey, Dodla, Prabhat, Hatsun all of them procured the remaining milk. About a lakh of liters is procured by the Balaji Dairy which is subsidiary of NDDB Mother Dairy combination. They have taken over the cooperative dairy of Chittoor District which was closed almost 20 years back. So they have capacity of 2.5 lakh liters. They are procuring 1 lakh liters. So the balance 1.5 lakh liters perhaps they will be able to handle if the entire capacity is utilized fully out of 24 lakh liters. So if you see the numbers of the district milk production and Chittoor dairies capacity and other private player's capacities, we are talking around 10% of the milk from the district. So I do not see any issue and more and more players will enter the district more milk is demanded anyway, more milk is needed. Chittoor dairy also gets into action. They can take the share of another 1 to 1.5 lakh liters, which does not have any impacts on anybody for that matter.

Aditya Mehta: Okay and any other cooperatives dairy societies, which could affect our margins?

M. Sambasiva Rao: Andhra Pradesh is a different structure compared to many states in terms of cooperatives. Earlier there used to be one state federation under the brand name Vijaya that is prior to 1995. During 1994, during that year the AP Federation with Vijaya brand was given freedom to form district level companies for improving efficiencies of the dairy. So most of the district opted to branch out of these states federation and they have started their own brands under their management. Some of them have moved subsequent into another Companies Act from that Cooperative Act, hardly there is any dairies in Andhra Pradesh today under Cooperative Act. They all have moved into Companies Act and they are appointment their own board of directors, their own managements under cooperative act, state government has authority to appoint MDs and appoint directors, conduct elections, etc. Now these individual district unions like we have Vizag District Union, we have Krishna District Union, we have Guntur District Union, Nellore Union, Nandiya Union like the Balaji Union, number of district dairies have come, with their own brands and they are selling. So every district about 50% to 20% of the milk goes to the district cooperative or the newly district unions under companies act, remaining 78-80% milk goes to private sector companies. In fact it is not like Karnataka, Tamil Nadu where a single brand, single state federation is operating in the entire states, they are all split into more district level organizations under Companies Act.

Aditya Mehta: Okay. I got it. So there will not be any impact even as a ruling parties, now which has won the elections, is offering rupees four more than the procurement price that was being offered, so there were not be any impact?

M. Sambasiva Rao: Yes. I think all of us will share. All the private players are handling 70% of the milk will share the impact or the milk. And our exposure in that state is also around one third of our procurement.

Aditya Mehta: Okay. That is it from my side. Thank you.

Moderator: Thank you. We moved to the next question, which is from the line of Shiv Kumar from Unifi Capital. Please go ahead.

Shiv Kumar: Thank you for the opportunity. Sir as an industry veterans, what is your reading of the milk that will currently now that you have mentioned that the glut situation is disappearing, do you think the cycle is turning and you would actually get better pricing power as we move forward because recently when there is a glut situation, there were many marginal players, who were missing up the pricing power of the private dairies, do you think now you will get back that pricing power?

M. Sambasiva Rao: Yes, I would say pricing power, the economies are getting stable; both sides will be getting benefit like when the glut is so high and the milk availability is so high. Farmers were getting less money. And their interest level goes up and subsequent year's product level goes down, this is what exactly happened. The previous year there was so much of surplus milk, their agitations you all must have seen in Mumbai and Maharashtra how farmers have responded to the situation, the government had to step in and add certain support price, so in the subsequent year, there will be natural drop in the production because they lost interest. Now again the remunerative prices will go to them, they will start taking care of animals and they start acquiring more animals and milk market gets stabilization. So we do expect things to improve in terms of the farmer economics and also dairy economics.

Shiv Kumar: Right and Sir in Q4 your procurement levels reached 14 lakhs liters per day, till what level the current capacity take care of your procurement?

M. Sambasiva Rao: My procurement installed capacities that is chilling capacities 19.5 lakh liters as of now, and we continued to expand year after year with our additional capex coming in, it has to cross 30-35 lakh liters in the next five years, our investments and net work.

Shiv Kumar: Okay. So you would gradually expand the capacity in organic way, it is not like you need to do an inorganic acquisition to be able to increase the procurement, it is not like that?

M. Sambasiva Rao: Our primary route for growth is organic, and we continue to evaluate the opportunities that coming in our way, we have also engaged as I explained earlier, we wait for evaluating this opportunities, they continue to evaluate. If you find something interesting and appropriate for us, we will definitely take or any existing players, but that is a secondary route for us.

Shiv Kumar: Sir and we have seen that the value added products have increased their share from 23% last year to 25% this year, and your aspiration is to grow this to 40%, so can we expect another 2% accretion over this year, say 25% moved to 27% in FY2020, is that positive?

M. Sambasiva Rao: Our planning is aimed at incremental increase of 3% to 4% per year. So we have been able to do that in the last three years, we wish to do little more additional efforts in terms of creating backend infrastructure for more products and front end shelf based for chillers, freezers in the retail outlet, also some additional efforts in the marketing and brand building through conventional and digital media, so to gear up to that 3 to 4% level and, and we are bullish on that.

Shiv Kumar: Right Sir and overall your comment on liquid milk margins for FY2020, you will be able to hold on to this year's margins or will you actually better them?

M. Sambasiva Rao: We are not very specifically keeping guidance, but the average around 6.5% to 7.5% EBITDA margin, together with products and milks.

Shiv Kumar: Great. Thank you Sir.

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

Prashant Kutty: Thank you for the opportunity Sir. Couple of questions, firstly Sir on your target which is being shifted, you vision is being shifted from 2022 to 2024, while if we look at that number, it is almost the ask being about 19% kind of revenue run rate, could you probably tell us what are the factors that we are looking over here to this kind of 19% revenue CAGR and secondly would this be across the next five years or you are looking at it more front ended or back ended, how we are looking at it in terms of growth rates?

M. Sambasiva Rao: The last question first, it is almost evenly spread. The asking rate is evenly spread around five years, in any particular year if you are able to deliver because you have seen the number of years last five years, fluctuations are there in prices and availability of milk in the global market, etc., so there could be some adjustments during the five years, but as of now we have planned and even basis the rate of growth to achieve this number by 2024 and as I earlier explained in the call our strategies are focusing around entering the milk rich states and densely populated markets in the quick manner, so that we can capture our share of it. The second is to further penetrate deeper in the existing market, so that existing state, so that our infrastructure can be put to better use with less investments in the existing states. Third is go for more value added products capacities creations for existing products, and also introduced new products. To deliver this rate of growth, we have also wish to spend little more on the marketing communication brand building activities. Earlier we were spending less than 1%, now we are aiming at 1.5% of our revenue towards the marketing activities, so that the consumer awareness and product communications can be better.

Prashant Kutty: Sir when you talk about over the 19%, I am assuming a large part of it would be volume led growth, and how would the breakup you are looking at in terms of how would liquid milk will be growing at and how would value added products will be growing at because here you said the strategies to focus both on entering milk with states as well. So can one assume that the growth rates are going to be pretty similar across both the segments or if you could probably throw some light over there?

M. Sambasiva Rao: The value added products rates will be higher. It will be around 25% year-on-year because that is where our focus is and our margins will be. Milk rate of growth will be there.

Prashant Kutty: But still Sir it will be at about 15% if I am not wrong because that is the number which you are looking at excess milk is also concerned right, is that the right assumption to make?

M. Sambasiva Rao: Sorry, could you repeat?

Prashant Kutty: I said even milk you would be assuming about a 15% kind of growth rate number right?

M. Sambasiva Rao: Yes. That will be around 15% and products will be around 25%.

Prashant Kutty: Okay. and Sir if you just could tell us, you have actually in the past tried to maintain that your margins would be around at 7% to 8% kind of range in the past, you somehow seem to have probably moderated down to about 6.5% to 7%, just is asking any specific reason as to why probably there is a little bit of moderation over there, especially when you talk about growing at such a high pace?

M. Sambasiva Rao: That is the reason actually. The growth phase there are two issues which we are encountering, one issue is underutilization of the capacities as we put up larger facilities, so there will be certain inefficiency for one or three years in every plant every facility that will increases our operation cost. Second is communication branding cost suggested that we are trying to hike about half a percent here and half a percent in operations will be higher cost because of the rapid expansions, higher investment. So about 50 to 75 basis points, I see as a cost of growth, which would stabilize once the facilities are all up and running its better capacities. This has seen as a cost of the accelerated growth effort.

Prashant Kutty: But here Sir, does not operating leverage really help you, I understand you would want to be spending towards ad spends and probably initially we are incurring the cost of growth but again so one of the question of the earlier participants asked, more on a longer term basis, would have the benefits of operating leverage kicking given the fact that they are putting up so much capacity?

M. Sambasiva Rao: Yes. It will, but may not be in these three or four years. See as I put up let us say, put up a plant in Punjab, which is very, very less utilization, 30% capacity utilization is there in the first year, second year it may go to 50, and third year it may go 70. so every new market we entered this one or two, three years of the lag will be there for plants to become as efficient as any other mature plant, so that is the little bit of pull let us say 30, 40 basis points pull will be there in those plants and this ad spend will take another half a percent, if we look at maybe 1.5% of the revenue, so we will be too happy to deliver better numbers, but this is what something which would impact in the period of growth. Once our value added contribution goes to 40%, then we reap the benefit of this effect. Their margins will be higher and that would contribute greater for the EBITDA and PBTs later. So three to four years, we would be moderating the EBITDAs.

N Brahmani: This is Brahmani here. Just to add to what our President had said, most of our processing facilities are about 15 to 25 years old, so most of them are reaching that capacity utilization in terms of milk and also value added products. So we see that we have to invest much more in newer capacities or expanding existing capacities to keep up with the growth and value added products, which has been about 25% to 30% year-on-year. While that is one, our growth strategy is also pretty recentralized as mentioned earlier, we believe and giving fresh milk and products into the market for which our processing facilities probably smaller, but we are closer to our areas of procurement as well as market. So that is another reason why we perceive that, we have to keep on investing and it will take little longer time for operation efficiencies.

Prashant Kutty: Last question from my end in terms of the geographies, have you already we have been actually expended geographies especially markets like Delhi and Mumbai and all. Currently how is the procurement to fill gap at this point of time in these markets as of now?

M. Sambasiva Rao: Yes. The last one year was different year where we were trying to balance the procurement to match the sales. The procurement was easier in the last one year than the sales that you must have understood by now, the situation has changed now. We have to match the procurement and sales. The sales are moving faster than procurement. So season has changed. The droughts summer prices so, we will be now accelerating the procurement also to match the same. Earlier we were not pushy about the procurement. We were holding on expansions and more volumes. So now the procurement also will start moving up.

Prashant Kutty: To gap in these markets have also reduced. The procurement sales gaps have also been reduced as what you are trying to say right?

M. Sambasiva Rao: Yes. We have all been trying to bring both to close together. Both to be equal, but we are not doing commodity business. See what happens if you procure more milk, we end up doing milk powder and butter commodity business so we are always trying to do the consumer business, so we make only consumer packs, so we do not want to take excess milk at any point that end up over the last year scenario. But now situation has changed. We will have to put more efforts and increased the procurement of the milk and build the sale volumes accordingly.

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

Moderator: Thank you. We moved to the next question, which is from the line of Deepak Madhavdas from LSA Securities. Please go ahead.

Deepak Madhavdas: Good afternoon to all Sir and thanks for giving the opportunity. Sir I would just take a couple of questions from you, couple of answers from you, how the geographically like how do we procure the milk and what is the geographical procurement ratio or whatever is this like how much do we procure from Karnataka, Telangana and UP, what is the ratio, you can just?

M. Sambasiva Rao: What we do is as Brahmani was trying to explain earlier we do milk procurement closer to the markets. We do not do long distance movement for the reasons of freshness and cost of transportation. Suppose we are going to do in one city, 50000 liters plant will set up closer to the city and starts processing packing in the plant and milk required for that market will be sourced in the villages which are within 150 km or 170 km kind of distance. We do not go beyond those distances to ensure milk collection from the farmer today comes to the plant get process and goes to the consumer tomorrow. The shortest possible time, shortest possible distance is designed to ensure freshness and the transport cost is under control. Once market keeps building up and volumes increased, we will occupy more villages and more chilling centers will be setup to support the client requirement and plant also gets expanded to meet the market needs that is how our growth has been over a period of time 25 years. Every market we enter with a small plant and expand the plant year-on-year to meet the market requirements. In the process, we started procuring milk in the neighboring states. BENGALURU for example is very close to Tamil Nadu and Rayalaseema of Andhra. So we can procure milk in Karnataka, or in Tamil Nadu or in Andhra, or in three places, two places depending on the availability and cost factors etc., so we tried to take advantage of all the factors of price and cost of transport and distance to the market.

Deepak Madhavdas: But Sir there are subsidies which are paid by different states like subsidies differ from state to state like how do we managed that Sir?

M. Sambasiva Rao: Which one?

Deepak Madhavdas: The subsidy differs from state to state, like the farmer subsidy?

M. Sambasiva Rao: Yes. They keep changing. These are the policies keeps changing like if you read the Maharashtra policy last two years, then there was a massive glut in Maharashtra, Government of Maharashtra said we will give Rs.5 per every leader of milk procured in Maharashtra and used for making milk products. If you are selling milk and milk that Rs.5 support will not come. If you convert the milk into milk products the support price of Rs. 5 will be given to everybody including cooperatives and private companies. And they insisted everyone to pay minimum Rs.25 per liter to farmer. These are conditions. The procuring company or cooperative shall pay Rs.25 to farmer per every liter and then we reimburse Rs.5 from the state if you use that milk for a product. So the companies and cooperatives have to make it claim to government saying I paid this much, I got this much, I reimbursed with this much, this went up for a period where the farmer prices were not remunerative they were agitating., Now from April the situation has changed, government has stopped the funding. The support price ended I think March 31, 2019 or so from April 1, 2019 onwards, the companies and cooperatives continue to pay Rs.25, but do not get support from the state government. So the scheme of Maharashtra ended in this summer, early April and now everybody is paying Rs.25 happily and we have increased our sale prices, and we are increasing our sale prices, so this scheme support prices keep changing from state to state from time to time. So we have to factor our milk procurement volumes from different markets and tailor-made to the sale prices in those markets, bring milk from the neighboring states, which are closer to the market. As I explained earlier Bengaluru, we moved milk from three states to Bengaluru because all three states milk sheds are within 180, 150 km range. So we have a mix of milk coming from different states and different distances, so this is a kind of business metrics we have developed to meet such situations.

Deepak Madhavdas: One more thing Sir like the procurement like the state wise procurement and the village like procurement that there has been some difference of rate, right?

M. Sambasiva Rao: Yes.

Deepak Madhavdas: So like from which state do you procure in the largest Sir?

M. Sambasiva Rao: We have, I will give later right now I do not have details. There are different prices. See we get buffalo milk at different price, cow milk at different price, cow milk with 8%, HNF, 9% HNF, 8.5% HNF, the criteria for pricing is total solids in the cow milk and fat in the buffalo milk. The rate charts are different from different districts and we normally set our price marks along with the market leaders, who are nothing but cooperatives in that area. Our pricing rate charts and pricing policies more or less are equal to everybody else whether cooperatives or private players.

Moderator: We will move to the next question, which is from the line of Shashank Palan from Rockstud Capital. Please go ahead.

Shashank Palan: Thank you for the opportunity Sir. I wanted to ask which is the major product that being sold in the value added product is it curd that gives us major sale and what is the margin approximately on that product?

M. Sambasiva Rao: Yes. Curd is our major product and value added segment. CFO is handling the second part of your question.

A. Prabhakara Naidu: Curd EBITDA margin for the full year 2018-2019 is 15.09%.

Shashank Palan: Sir how much does it make a percentage of revenue, 25% is over all value added, how much this curd makes?

A. Prabhakara Naidu: Value added product especially curd contributes 75% of value added products.

Shashank Palan: Sir going ahead where do you see the growth from value added coming from, is it from curd or is it from other products that we are planning to launch?

M. Sambasiva Rao: All, products including curd. Every product will grow. It is not that one will not grow.

Shashank Palan: Okay and Sir my another question is regarding the competition that is going on so there are new players that have been acquired by Lactasis I just wanted to know that how is the scenario in the milk is that company planning to acquire more company, is there more consolidation that is going to come ahead, what is your view on that?

M. Sambasiva Rao: I mean you are referring to Lactasis acquisition.

Shashank Palan: Yes. He has already acquired two, three companies and how do you see the scenario going ahead, can this impact Heritage as such or is it better for the industry?

M. Sambasiva Rao: It is too early to say whether the industry will be benefited or Lactasis will be benefited as far as Heritage is concerned, we do not see any issue of that, we have been coexisting with the Tirumalai since the beginning. Tirumalai is the largest milk selling brand which they acquired in our own operating area. We have been there for last 20 years coexisting with them. I understand the Tirumalai actually lost the market share after the acquisition by Lactasis which needs validation, but this is only unconfirmed information which I received. If that is the case we are benefited.

N Brahmani: This is Brahmani here. More probably speaking as we cannot comment on other companies specifically it is not fact that organized sectors growing, organized sectors about 25% to 30% of the market, within this private sector dairy company have reached over 50% in terms of shares whereas the rest of them are our cooperatives. So I think there is heavily competition as private sector increases and as organized sector increases and it is a huge opportunity. So the pie of the rest of 75% is still available for many players.

Shashank Palan: Just last question if I can add on the JV, when do you see the JV of yogurt that is going to coming in Mumbai what is the revenue expected and when do you feel you can start selling from that JV?

N Brahmani: We are in the process of building to be facilities or the plant to make fruit based yogurt and the next one half to two months we expect to complete the processing facility which is very close to Mumbai. And end of the calendar year, when we expect to launch the product and that is progressing well.

Shashank Palan: Right and the revenue expected from the plant is full capacity?

N Brahmani: On the revenue bit we cannot comment on it too much, right now because we have a JV partner, so there are rules and guidelines, at the right time we will share that information with you. I can share with you that the capacity of the facility that they building is 20 tonnes per day of yogurt.

Shashank Palan: Thank you so much and all the best.

Moderator: Thank you. We moved to the next question, which is from the line Ashi Anand from Allegro Capital Advisors. Please go ahead.

Ashi Anand: Thanks for the opportunity. I just wanted to understand if I may understanding on your margin guidance is clear, so what I understand you have two major adverse impact happening on your margin, one is the lower operating leverage when you entered on your market, and the increased marketing spends and you are hoping to be able to compensate this with the rising share of value added products should be at a higher margin, so would it therefore be fair to say that you are looking at trying to maintain the 6.5% to 7% band each over the next three to four years or could there be a certain amount of front loading of the scores and therefore we initially see margins dip and then to kind of move towards, - 8% target that we had early in our vision?

M. Sambasiva Rao: See next two to three years is a accelerated growth period, we expect the margins to hover around 6.5, 7.5% after three years, once our initial plants get stabilized or the marketing activity gets stable, at some particular level, we hold, we can expect 8% after three years or four years time. By which time our value added component will be 40% of the revenue.

Ashi Anand: So have we hit 2024 we should be closer to the 8%, but could we take the initial next year, could we fall below 6% because of accelerated spends in the near term or will be make sure that the kind of?

M. Sambasiva Rao: It will fall below 6.5%. See that kind of irresponsible spends would not be there.

Ashi Anand: Thanks.

Moderator: Thank you. We moved to the next question which is from the line of Shradha Sheth from Edelweiss Capital. Please go ahead.

Shradha Sheth: Good evening Sir and thank you for the opportunity. Two to three questions, just wanted to understand in terms of capex guidance because you also highlighted that one as we are looking at inorganic opportunity as well as investing in larger sized plants, so wanted to understand, capital intensity increased going forward?

M. Sambasiva Rao: For achieving the growth numbers we have taken, we require to invest around 110 to 120 Crores per annum in the next five years in our infrastructure starting from village where we do our milk analyzer for the milk collection center then the chilling centers, bulk coolers then the processing packaging station and in the front end infrastructure in the markets. Anywhere it will be around 110 to 120 estimate, for the next five years' time this is on the organic mode of growth.

Shradha Sheth: This is only on the organic mode. Incrementally Sir you also highlighted we might be looking at inorganic opportunities, so if you could give some more color to reach our stated 30-35 lakh liter target, what could be that portion?

M. Sambasiva Rao: That is not yet quantifiable as of today. We have got a few proposals through our consultants, they have been evaluated and not yet concluded either ways or none of us can give any numbers on the inorganic. It is based on the opportunity and suitability for us. We consider a few aspects before concluding that is quality of the brand and quality of the infrastructure, quality of processes people whether it matches with our standards. Second is there should not be cannibalization our own market share than the size of the deal whether we can accommodate in our growth plan, then the values and expectations and expectance. These are broad areas of consensus we have to arrive it then we will be able to say this is a cost, this is a possibility for potential. It is to make sure for me to say anything at this stage.

Shradha Sheth: Sir if you have 6000 Crores target, this is purely organic or this also has some inorganic flows built in?

M. Sambasiva Rao: As it is, it is organic only, if something inorganic happens, that can get accelerated.

Shradha Sheth: Sir secondly on the fat products if we can get some color how much was the loss for the quarter and for the year and how are we looking at it going forward as the milk prices are improving?

A. Prabhakara Naidu: For fourth quarter, fat products EBITDA margin, EBITDA loss 10.3% and for full year 15.9%. 10.3% loss for the fat product for the fourth quarter, for full year almost 16% loss.

Shradha Sheth: 16% was an operating margin loss right?

A. Prabhakara Naidu: Yes. EBITDA loss.

Shradha Sheth: Sir how much was degrowth we are seeing in the fat products because of higher cost? Have we seen any decline in the fat products sales or how was the sales performance?

M. Sambasiva Rao: In volume terms or revenue terms?

Shradha Sheth: Revenue terms. Lastly Sir wanted to understand how is our like-to-like procurement growth have been we adjust for any new facility, how is our old facility procurement growth in 2019?

A. Prabhakara Naidu: In value terms, fat products degrowth for the full financial year 2018-2019 is 12.78%.

Shradha Sheth: It is around 8%.

A. Prabhakara Naidu: 12.78%.

Shradha Sheth: Sorry Sir. I did not get the number.

M. Sambasiva Rao: 12.78%.

Shradha Sheth: Okay. Sure. Sir as I asked how much has been in the like-to-like procurement growth if possible to quantify that?

M. Sambasiva Rao: Yes. Procurement as we said while we were trying not to grow much because of the glut scenario, we were trying to match our requirement and we have not put additional efforts to add any new routes, new facilities So it is almost equal to our growth 6% procurement volume growth for the full year, but now growth will start for this year as the demand is changing.

Shradha Sheth: Lastly one from my end, Sir we are seeing competitive intensity increasing across our products as well as value added products but the players like Dodla and all trying to enter our territories, so within the private space also we are seeing good amount of competition Sir, with such a high base of value added products like curd and all, how do we see that over the next few years, at such a high base?

M. Sambasiva Rao: You said somebody entering our market who is that, I could not hear, Dodla, Dodla is already there. You mean Dodla Dairy.

Shradha Sheth: I mean trying to increase the distributors and all across the existing geographies and more private guys also trying to increase the penetration how do we see on a high base of our own value added products, how do we see the growth ahead because we have said such a high target, so is there enough to cope all the players?

M. Sambasiva Rao: Yes. There is enough place as Brahmani was explaining there is lot of opportunity and more than 70% unorganized markets still exists and value added products are also demand is increasing and there are many territories we have not reached yet. We will be having lot of open space to go around and sell more. I do not see competition alone is a challenge as long as we made in our quality standards and distribution efficiencies which we are trying to maintain the status.

Shradha Sheth: Great Sir. Thank you and all the best.

Moderator: Thank you. We moved to the next question, which is from the line of Rupen Masalia from R N Associates. Please go ahead.

Rupen Masalia: Thank you for the opportunity. Congrats for good set of numbers. I have a couple of questions one is just a book keeping question like in Q4 if I look at the other expenditure, it has gone up by Rs. 7 Crores, is there an element of one time expenditure or one of kind of stuff?

A. Prabhakara Naidu: Each one impairment we have provided, because we have acquired the Reliance Dairy, there are four intangible assets are there, these procurement network and margin network and noncompete agreement and brand, there are two brands in our assets so in this year actually, so we have been actually, for brand five years we have taken this, but it is due to operational then we cannot actually, we will provide some more apart from regular amortization, this year actually round, this quarter around 3.5 Crores, actually impairment we have provided based on our evaluation because we are actually pushing our Heritage brand then the brand of Reliance that is the reason we have provided impairment onetime cost, 60.5 Crores to be precise.

Rupen Masalia: Okay and for the full year also it remains the same 3.5 Crores.

A. Prabhakara Naidu: Yes left over is only 1 Crores, that is going to be amortized in this current financial year 2019-2020.

Rupen Masalia: Second question is more strategic like vision 2024, would you hear organically we are going to incur a capex of around 110 to 120 Crores to take our capacities to around 30 to 35 lakh liter per day, and proposal of high margin value added dairy products going all the way up from current 25% to 40%, so in the light of this strategy where do you see overall working capital efficiencies and return ratios in the form of return on capital employed over next three to four years.

A. Prabhakara Naidu: Working capital, almost around 75% the contribution is going to be from milk only around 25 to 27% is going to value added products. So working capital cycle is almost…

M. Sambasiva Rao: Increases what he think is as the value add share increases…

A. Prabhakara Naidu: Increase proportion will continue, milk proportion will come down, value added product will increase, but process almost same, the working capital cycle is around actually 10 to 12 days in between that only.

M. Sambasiva Rao: Okay may be I will supplement to the point. The value added products in our basket are as good as milk in terms of recovering the sales proceeds. They are also fresh at the best 10-15 days self life, they are also delivered on cash and carry basis as they are all consumer bond, consumer oriented products, we do not have B2B products where we have to wait for the recovery of the sale profit. So therefore as CFO said the nature of working capital requirements would not alter in any way even if the value added product contribution goes to 40%.

Rupen Masalia: Sir secondly on capital efficiencies, like currently if I look at your dairy segment from matured facilities, your ROCE is very decent I mean excluding other comprehensive income through fair value written off FRL stake whatever core capital you have deployed, so on debt back of the envelop can calculation tells me that you are all enduring around 40-45% kind of return on capital employed, so going forward, where do you see this trajectory?

A. Prabhakara Naidu: My guess is it is not going to below 35% even if we deployed actually 100 Crores every year.

Rupen Masalia: I mean that is in the immediate base but once the facility matures then in that case I think this should you should be able to return the current level of FCMC, once the facility matures.

A. Prabhakara Naidu: As of now around 44 to 45% is our capital employed, it is not capital employed.

Rupen Masalia: Yes exactly, I am talking about dairy only. So you mean to say over next four to five years once the Greenfield facilities matures in terms of utilizes, and you would be able to sustain this kind of superior returns?

A. Prabhakara Naidu: Definitely. Because our policies are changed, so whatever the investments we are making actually in two to three years, actually it is going to be around 82% to 90% capacity utilization you were expecting. Your assumptions are going to be utilized or it is going to be around 40, not less than 45% will maintain. Earlier it used to be around 53%.

N Brahmani: I just want to add that for many of our existing value added products, which are basically pasteurization products, the battle is the same as apart from the processing is slow, in such that it is same as milk. So their shared facilities in terms of homogenization, pasteurization as milk. So there are certain pass of the processes itself, which is shared within milk and the fermented products with that cost. So that makes it extra efficient for us in terms of investing in to new facilities that the expanding value added products.

Rupen Masalia: Okay. That is helpful. Thanks and the all best for future. Thank you.

Moderator: Thank you. We moved to the next question, which is from the line of Sameer Gupta from IIFL. Please go ahead.

Sameer Gupta: Thanks for taking my question. Just one question from me, we have been across consumer companies, adding of a slowdown in rural, in that context what is your experience being and how much of our sales are coming from the rural channel currently?

M. Sambasiva Rao: Actually we do not have rural channel at all. It is all rural milk coming to urban. So that is milk producing area, rural is a milk producing area, let us say typical village, half of the milk is mostly taken by the villages for self consumption, remaining half whatever is a marketable surplus is procured by different agencies, cooperatives and private companies, we all transported to urban areas after chilling it, then process pack and sell in the urban markets. The reverse flow is not a usual think except for certain products like ghee where it goes back into some suburbs and taluk headquarters kind of Tier 2, Tier 3 terms, but typical rural area if you defined it as a rural area where agriculture is a main step income and people are involved in the dairying and agriculture. Their sales hardly anything will be there.

Sameer Gupta: And would you say that it would be similar for the whole branded industry?

M. Sambasiva Rao: Yes absolutely.

Sameer Gupta: When we are saying the 30% today is branded and roughly that is what urban population also is, so where is this potential of growth then coming from?

M. Sambasiva Rao: Urbanization is increasing number one. Number two the rising incomes are leading to higher consumption and three the shift towards healthy drinks and health products and four convenience factor where more and more working couples and young generation is moving in the cities so these are the factors driving the growth.

Sameer Gupta: Got it Sir. Thanks.

Moderator: Thank you. We will move to the next question, which is from the line of Amit Agarwal an Individual Investor. Please go ahead.

Amit Agarwal: Good evening Sir. I just wanted to break up of your sales and purchase state wise if you could just give a breakup, as to percentage wise?

M. Sambasiva Rao: What is that can you repeat?

Amit Agarwal: Yes. The revenue procurement you get from each state, the highest three states which you get from?

M. Sambasiva Rao: How does it help you?

Amit Agarwal: No just curiosity.

M. Sambasiva Rao: We will give you later, has been like clarify for the last several times, this data is being utilized by our competition so we stopped sharing in public platform. We can share individually if anyone requests.

Amit Agarwal: Okay. I will email it to you, mail something or what?

M. Sambasiva Rao: Yes. Mr. Shailesh can facilitate it.

Moderator: Ladies and gentlemen that was the last question for today. I would like to hand the conference over to Mr. Shailesh Kumar for closing comments.

Shailesh Kumar: Before we give the closing comments, couple of questions from my side as well. I waited patiently for a long hours. Dr. Rao in your assessment, we have already reached our milk procurement price hike or you expect further hardening of the procurement price during this financial year?

M. Sambasiva Rao: It is almost reached the peak. I do not see any big change in the procurement prices from now. May be in certain market, it might certain procurement area it might happen but not at the national level or state level some localized competition issues and there is some procurement price goes on in some areas but otherwise it is more or less at the peak and procurement will start in the month of June, South India receives the monsoons and then weather changes and yields on cows will start increasing so the milk cycle, the improvement procurement starts from Karnataka, Tamil Nadu, Rayalaseema of Andhra from mid June so our situation gets eased out as monsoon progresses into west and north, then all over India changes that is two to three months.

Shailesh Kumar: Great and for our value added product almost 75% is curd, so next two products and what is your revenue contribution combined?

M. Sambasiva Rao: Each will be contributing 5%, 4%, 3% like that. Like flavored milk, butter milk, ice cream, paneer, each one will be contributing 3% to 5% kind of range. They keep changing seasonably. Some items will move up in some season, some items will go down.

N Brahmani: This is Brahmani here. These products also are quite natural that the amount of organized sector penetration is higher of course, and it is lower in other products. So the same trend reflects in our revenue contribution as well, some curd versus other products.

Shailesh Kumar: Thanks. That was all from my side Sir. I will take this opportunity to thank the management of the company to share their time generously. I will also like to thank all the participants who have taking their valuable time out to attend the call. Now we may disconnect the call, Thank you very much.

M Sambasiva Rao: Thank you all. Thank you very much from Heritage team.

N Brahmani: Thank you so much.

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