"Britannia Industries Limited Q2 FY 2018 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Q2 FY 2017 - FY 2018 Earnings Conference Call of Britannia Industries Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Piyush Bhandari -- Investor Relations Team. Thank you and over to you, Mr. Bhandari!

Piyush Bhandari: Thanks, Karuna. Hello everyone. This is Piyush from the Investor Relations Team in Bengaluru (Bangalore). I welcome you all to the Britannia Earnings Call to discuss the Q2 Financial Results.

Joining us today on the earnings call is our Managing Director -- Mr. Varun Berry; CFO -- Mr. N. Venkataraman; Head of Sales -- Mr. Gunjan Shah; Head Marketing -- Mr. Ali Harris; VP and Business Head, Bread, Cake, Rusk and Adjacency - Mr. Jayant Kapre; and Head of Procurement -- Mr. Manoj Balgi.

We will start the call with Remarks on Performance by Mr. Varun Berry, subsequently; we will open up the call for Questions.

Before I pass it on to Mr. Varun Berry, I would like to remind you that anything which we say that refers to our outlook for the future is a forward-looking statement which must be read in conjunction with the risks and uncertainties that the company could face in the form of general economic conditions, commodities and currency fluctuations, competitive products and pricing pressures, industrial relations and regulatory developments.

I would now like to pass it on to Mr. Varun Berry for his comments.

Varun Berry: Good Afternoon, Everyone. So, I will start-off with the deck that we have uploaded. I am sorry, but we have not mentioned the page numbers there, but just getting to the first page after the disclaimer.

So, what we have seen in the last couple of years are some disruptions. But despite all those disruptions, we have maintained our momentum and delivered consistent and sustained business results.

Now, what have we seen? We have seen low category growths, we saw unprecedented inflation last year, we also saw demonetization and then the whole GST disruption which came through earlier this year. But despite that, I think, it is been a fairly good quarter and it is been a reasonable first-half of this year.

Going to the next page. In this year, smooth GST implementation was very-very critical to us. Moving to the next page which shows what were the steps in getting the GST migration done. So it was a fairly large task. So if you think about it, we have 3,800 customers, we have got 2,600 vendors, we have also got some hubs and spokes in the rural areas. So all those had to be registered, we have got software migration which was SAP related plus we have got a secondary sales system which had to be gotten to a stage where that could handle GST. There was a lot of training involved of employees, vendors, customers. And obviously, there were businesses, which were dependent on us. There were the wholesalers, huge number of wholesalers and they were hugely impacted. Now they are slowly stabilizing but that kind of disruption was fairly large scale. And we also placed distributor issue in Kerala which has been solved for but, it did give us a little bit of a setback as far as share was concerned in that state.

Moving onto the next page. However, having all of this happening, we kept our focus on basic execution, right. The underlying theme was just the same for us for all of us at Britannia and the areas that we were focusing on are well known by all of you. So driving premiumization, increasing the distribution footprint and attaining cost leadership in everything that we do.

So moving on to the innovation part. In this quarter we launched two very exciting products and the way we went about launching them was the important part. We clearly identified spaces where we were seeing some emergence of business and spaces where we were weak and we launched two products which were Good Day Wonderfulls and Treat which was chocolate biscuits with Vanilla Cream and Chocolate Cream. Both these products have done really well for ourselves.

We also dialed up our activation of the brands through alternate media like digital which is becoming fairly large as we speak.

The second part was on increased distribution and I am very pleased to report that this is one area where our momentum has continued despite all the disruptions that we have seen.

The chart shows you how we have grown our direct reach and it is about 2.3 times what it used to be three years back and now we are distributing to almost 1.7 million outlets directly, which I think is a great achievement and Gunjan is here and I would like to congratulate him and the team, the sales team, for having achieved that.

The second part was about our rural growths. We have been seeing a fairly large rural growths till about two years back obviously, double-digit has continued as far as rural is concerned. We did see a little bit of ebb although they still continued in the double-digit territory. And now, we are starting to see the rural growths also get back to the heady days of what we were seeing three years back. And then third thing was about our weak states. Again, I am very happy to report that we are continuing to see very good growths in our Hindi speaking states. So the numbers are there in front of you. So Rajasthan, we have seen a growth of 27.2%; M. P. similarly 16%; U. P. 15%; and even Gujarat which has been seeing above 20% growth for quite a few quarters has grown 14.3% which has given us approximately 170 basis points of shares in these states.

So it is not like we are not doubling our share in the states every year because we do not want to do that. We want to do it in a sustained, slow and steady way. We do not want to have pricing come in to get share. We are doing it purely and clearly through our execution in the marketplace and hence, it is going to be a slow and steady progress and that is what we have seeing.

The third was on cost leadership and frankly, we have spoken a lot about that. So the themes are the same. It is about efficiency improvement, it is about distance to market, it is about wastage reduction, it is about market returns, write-offs, straight loads, etc. and the momentum there continues. The only place where we have really-really heightened our performance is in the area of cost efficiency program which are basically in the above areas only but there are certain areas like recipe changes, etc.

So overall, our cost efficiency programs from about Rs. 140 crores - Rs. 150 crores levels are this year looking at almost Rs. 250 crores. We might miss it by Rs. 10 crores here or there but we will be in the vicinity of Rs. 250 crores as far as our cost efficiency programs are concerned.

Now, with all this behind us and the disruptions behind us, now is the time to take a leap forward on some strategic initiatives. What are the strategic initiatives that we have in mind? So if you go to the next page, obviously, the first initiative is about making sure that we cater to smaller businesses in a way that they get the required focus, which is about creating business units and making sure that the smaller businesses which is Cake, Rusk, Bread, Dairy, etc. are catered to in the right way.

Second is about entering new territories in the international arena and what we have set ourselves out for is to enter one new geography every year.

And the third, which I think is extremely powerful is about entering new product categories to become a total foods company and this obviously the underlying factor for all of these is people because I am not going to deliver it nor are the people around this table. It is the entire team which is going to deliver it.

So moving on to the next page. We firmly believe that you do not build a business, you build people and then people build businesses and that is the theme that we work on in Britannia and we will continue to work on that.

The next page just gives an illustrative example on what I have just said. So if you were to think about it, as businesses expand and as we enter new categories, it is very important to have a separate and focused profit center for each one of these. So to give you an example, our people agenda clearly has been Britannia for Britannians.

Our strategic initiative now has been to get into filled long shelf life filled croissants and to get into one new geography which in this case, the example is Nepal. For the croissant business, we have identified a gentleman called Vinay Subramanyam, who is the Category Manager in the Biscuit area and is now doing a fantastic job setting up things in place for croissants to be launched next year.

Similarly, for Nepal, the Country Manager Nepal role, we have Anil Sharma, who was the Head of Sales for Dairy and he is going to move as the Country Manager. So, these are great experiences for these young managers that we have. At the same time, what it brings to the table is a new kind of thinking and a focus on these businesses which will take us to a very different level.

But that is not all. We are also wherever needed we are looking at talents from outside. So, for this entire area of Bread, Cake, Rusk and Adjacencies we have splitted into a separate business unit and we have got Mr. Jayant Kapre, who is here with me right now. Jayant was the CEO of IFF and before that, the CEO of McVitie's in India and Asia and he has joined us, and he has been with us now Jayant, how many months?

Jayant Kapre: Four months**.**

Varun Berry: Four months. He has been with us for four months and he is doing a great job in setting out the agenda for this business unit.

Last but not least, as I said earlier, our simple dream of being a total foods company is genuinely very-very powerful, right. It is very simple when you state it but frankly, I think with the kind of brand power that we have in our stable, I think, this is a dream which can become a very large part for our business as we move forward and we cannot share all of what we are doing in this area but things that you know of obviously, we are working on the croissant business which is now taking shape. We have ordered the equipment which is going to come into India and we will start to set up the factory, etc.

Dairy, we are working on. We have put up some experiments to make sure that we do the milk collection part the right way and we learn on what are the right practices as far as milk collection is concerned.

Similarly, we have launched some dairy drinkable products which are doing reasonably well in the market. But currently, they are still being in a contract pack mode. So, if we have to become competitive, we will have to look at how we bring them in-house.

And finally, we are working on other macro snacking categories. So differentiated products within Cake and Rusk and some new formats within Cheese and some other dairy products and besides this, we are working on quite a few other territories, quite a few other categories within macro snacks. And as we are ready and as we realize where our right to succeed exists, we will share those with you.

Moving on to the next page, we are also investing in capacities for the future. So Ranjangaon you have seen an announcement. It is going to be a fully integrated food park which we have bought the land and we are now looking at the layouts and starting to get clearances from the Government and Guwahati, where we are putting up a factory which should be ready within the next six months or so.

We are also investing in capacities for the international business. While the international business today is a little slow because of the geographies that we operate in. But we are not stopping at that because we know that these kinds of issues keep happening in different markets. So, we are making sure that we set ourselves not for the next quarter or for the next year but for the next three years to five years. And in that area, we are looking at putting up a factory in Mundra which is a SEZ and also a factory in Nepal which should be in play in the next year or so.

Now getting to the Q2 results.

So we have delivered a high single-digit value growth in Q2 on a standalone basis and if you were to look at adjacent businesses, I am quite proud to say that all of our adjacent businesses have been accretive in this quarter. So Bread, the growths as well as the profitability has moved up substantially.

International, while there is turmoil in the markets that we operate in, however, we have seen positive growths in our business at least and the profitability is accretive to what Britannia does.

And finally, on dairy. Our focus is on driving products with high profitability. In that area, specifically talking Cheese we have seen double-digit growth and we are de-prioritizing some of the categories which are not profitable as a result of which we are starting to see much better profitability even in our dairy portfolio.

Moving to the next slide, which shows the bars of revenue as we have gone through the last 3.5 years so one thing to notice is that we were almost for a very long time at about Rs. 2,200 crores revenue number for the last four quarters - five quarters. And this quarter, at least we have bucked that trend and we are on Rs. 2,537 crores revenue number which is good and which sets us up for the coming quarters as well. And while this was happening as far as growths were concerned we were moving up, inflation has also been in check.

So moving onto the next page, except Sugar and Milk prices, other commodity prices are stable. So Flour, there is actually the prices are lower than what they were last year; Sugar there is an inflation of 7%; RPO, again the prices are lower; Milk, while this looks like a large inflation, the fact is that the milk prices have been coming down over the last few months and while versus last year we are still showing an inflation. The trends are looking reasonably positive as far as Milk is concerned.

Moving on to the next page, in line with our top-line, our bottom-line performance has also been consistent. As I have already said, we have accelerated our cost efficiency programs and we have also leveraged our fixed costs. As a result of which, we have also seen an improved profitability.

So again, quite like what I was talking about from a revenue standpoint, our profits have also been in the Rs. 260 crores to Rs. 300 crores kind of a range for the last six quarters - seven quarters. And this quarter we have moved up to Rs. 344 crores and our profitability has also gone up to 13.6%. So, happy with that progress and we hope to continue that.

Now moving to the final slide which gives the consolidated numbers.

So consolidated net sales have grown 7%; profit from operations 11%; profit before tax 13%, almost at Rs. 400 crores; and profit after tax 12% to Rs. 261 crores.

And below that, it shows you the trends as far as profit from operation is concerned which has gone up from 4.6% in 2011 - 2012 to 13.4% in the first-half and similarly, the trends on PBT and PAT.

So feel good about the trends, feel good about the results, and happy to answer any question that you may have.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin with the Question-and-Answer Session. First question is from the line of Sameer Gupta from India Infoline. Please go ahead.

Percy Panthaki: This is Percy Panthaki here. Sir, last quarter in our results concall you had mentioned that there are some signs of market share gains from small unorganized players. And in that quarter, I think, your sales growth was around 6% to 7%. This quarter also your sales growth is very similar at around 7% to 8%. I think, the consensus expectation was that this quarter your sales growth will go into double-digits. So just wanted to know, I mean, is there something that we sort of overestimated or this is the kind of sales growth that is a sustainable number?

Varun Berry: Percy, you got to remember that this was a quarter, the first month of this quarter was the implementation of GST. So that was almost a flat month for us, right? And not just for us, for everyone in the industry. So, the start to the quarter was with a month which was not the greatest month and then thereafter, it has moved up and things are sort of coming back to normal. But I do not think that a double-digit growth, obviously, this quarter there will be a double-digit growth because this is the quarter that we are settling the demonetization phase but a sustained sequential last year basis double-digit growth. I think, it will take a few quarters before we get to that. But we are hoping that it is going to be sooner rather than later.

Percy Panthaki: Right, sir. Sir, my next question is on the croissant product. Can you give any details at all in terms of the price and the shelf life, etc.?

Varun Berry: So at this point in time, all I can tell you is that the shelf life will be more than four months, right? As far as price is concerned, it is going to be under Rs. 20 a piece, so it will probably be in the Rs. 15 kind of a space. And the brand at this point in time, we are not clear about, but it is going to be one of our existing brands.

Percy Panthaki: Okay. Because in the presentation on the pack it says seven days, so what exactly is that?

Varun Berry: No, no that is just to show you what they do in Greece and what they do in Egypt, etc. That is their brand that is Chipita's brand.

Varun Berry: Yes, it is their brand name. What we will be doing in India will be one of our existing brands.

Percy Panthaki: Okay. And lastly, sir, there is some kind of one-off in the employee cost, if you could just quantify that rupees crores, please?

N. Venkataraman: This is Venkat, Venkat here. So, under employ benefit expenses we have provided for about Rs. 17 crores in this quarter. So if you are aware of the pension matter which has been going on, so very happy to report to all of you that that has been closed now. It is absolutely coming to a close and we should be disbursing the amount as we speak. We have actually started to disburse the amount. So I feel very happy about it because it is a long pending matter which has been there and it is not getting to a closure so now that is happening. So there is about Rs. 17 crores which has been budgeted in the employee line.

Percy Panthaki: And that is not going to repeat I mean, no part of that will repeat in the future?

N. Venkataraman: No it should not. No.

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

Abneesh Roy: Sir, in the Breads category your growth is double-digit and improved profitability. Is it because of favorable base last year? There was a Potassium bromate issue, margin is that the reason why double-digit growth and is the better profits because of the Wheat prices coming down?

Varun Berry: So let me answer this in two parts. So, obviously, the first question is about the growth. So, I would say part of the reason is the Potassium bromate. But I do not think we are cycling exactly the same period. But, yes, there was a slowdown for quite some time and we are now cycling the base which is the slower pace of growth for Breads. The profitability, I think there are two or three reasons. One is our cost efficiency program. We have gone very tight on our cost efficiency programs on Bread as well. All the learnings of Biscuits we are applying to our Bread business as well and second is that we have also been able to get some pricing. And the third which is not immediately applicable but for the longer-term is that this industry which used to be a completely small player industry now seems to be moving towards some kind of consolidation because modern is now funded by private equity and they are looking at doing business differently. There is a Mexican player who is looking at buying one of the existing players in Delhi and they are also looking at consolidation and they will be looking at value added products. So hopefully, we should see some movement towards better products at the right price and the right kind of competition which is in the area of innovation rather than reducing product quality and reducing prices.

Abneesh Roy: So, sir, will it be fair to say that in breads your strategic thinking on that segment, is it changing? Because till now you have been saying that margins are also very important for you in this business. But now, if the entire industry is shifting towards a different business practice and more focus on premium etc., will your growth expectation also change from a sales perspective in this?

Varun Berry: Very early to say Abneesh, so cannot say right now. But our current thinking remains what it was that what is most important for Bread is to get the margins in. It is not so important to get top-line, if we get top-line, it is icing on the cake. But that still remains our stated goal. But let us see how it pans out, let us see how the organized players start to play and we can take a call thereafter.

Abneesh Roy: Sir, my second question is on the dairy and the drinkables which you have launched. So in drinkables Britannia has tried earlier also and there is a lot of players who are trying this out. Obviously, there is Amul also which is there with a very aggressive pricing. So what is different this time for drinkables to succeed in this case? And second, sir, in dairy now plans are more crystallized. So is it all about shifting from a contract to in-house? Is that also, you get more control on pricing or will you be able to play in more segments within there because see now new players like Kraft are also coming in this and the existing private players are also struggling and then Amul again is present in every segment. So, what is the right to win if you could elaborate on the dairy?

Varun Berry: So the stage one is about making sure that we have end-to-end dairy supply chain because that is what is going to give us our destiny in our own hands in the long-term. And obviously, that is going to be the first foundation for us to diversify and look at getting into truly value-added categories within dairy. So as I have said in the past as well, some things we can do ourselves. There will be some things which we think that other players can do better than us. And if they are looking at coming into India and if there is opportunity of getting some kind of an alliance going, we will be happy to do that. So that is where we are at. But having said that, we are still in an experimental stage right now, it is not a slam dunk even today. What we have done, we have put some experiments in place so that we can read the market so that we can understand how milk collection will happen? How milk processing will happen? And then from there on we will start to look at how we can get to a much larger collection system and a processing plant which is going to be owned by us. So I would say we are still about three months to four months away from concluding our experiments and moving forward.

Abneesh Roy: Last question, sir, weak states, this is the third year of strong performance. So when do these weak states start getting classified as strong? I understand, when you started you were a fraction of Parle. So where is the situation currently? And similarly, just the way you have done well in the strong markets of Parle in your own strong market has there been any issue because competition now would be doing that? Anything you want to highlight from the strong states?

Varun Berry: No, the strong states we guard like with our lives. The weak states are still very far away from being classified as strong states because our shares are still in the early teens in these states. So till the time the share of a state reaches the average share that we have across the country, we will continue to classify it as a weak state.

Moderator: Thank you. We take the next question from the line of Ankit Singhal from Motilal Oswal Asset Management. Please go ahead.

Pulkit Singhal: Your commentary has been I mean, fairly strong in the opening remarks and also in the previous interactions in terms of with rural growth coming back and back to three years back how it was and also with GST behind us. And if one were to just do the math, it seems that August and September would have been double-digit revenue growth for you to have shown 7% kind of consol revenue growth. So why is it that you are not seeming very confident of double-digit revenue growth going ahead irrespective of the base?

Varun Berry: Well, as I told you, double-digit revenue growth in this quarter is something that is given for most companies because of demonetization. I am talking about a sustained double-digit growth and I am not confident because I have not seen it for a sustained period. There has been one quarter where we have seen a double-digit growth and then something happens, and we start to move in the other direction. So till the time, I do not see it for a couple of quarters and I see the momentum building, I will not be able to sort of show my confidence towards that. But having said that, I think, everything seems to be moving in the right direction. And frankly, what I would be happy with is not just double-digit revenue growth but a double-digit volume growth. That is what I would aspire to have in a country like India over a period of time.

Pulkit Singhal: Sure, sir. My second question is on margins. As you are saying everything seems to be moving in the right direction. I mean, after a long-time commodity prices are coming off and premiumization continues its trend and with this kind of growth. I mean, how do you internally look at margins? Do you keep some kind of cap in your mind that okay this is what you would want to limit it to or would you let it just expand till it expands?

Varun Berry: No, how can we keep a cap in our mind. No, we do not do that. Obviously, our endeavor is always to keep the margins going but without losing the competitiveness in the marketplace. We do not want to be at a very high premium to the market and we start to lose share. You have got to remember that we have got to grow not just revenue, profit but we also got to grow market share. So that is what constrains us from going completely off the track on one and not sort of balancing the other two.

Moderator: Thank you. Next question is from the line of Latika Chopra from J.P. Morgan. Please go ahead.

Latika Chopra: My first question was on Biscuits. If you could comment on your pricing strategy going forward and also if you could let us know how the mix behaved over the last few months for you?

Varun Berry: So pricing at this point in time does not seem to be necessary because as I told you the commodity prices are fairly benign. The mix has not changed Latika. So what is happened post demonetization is that actually if you look at pre-demonetization there was a trend in the market where the value segment was falling through the roof and the premium segment was growing very strongly. What we have seen post-demonetization is that both segments have started to grow. I guess the value segment reached such a low that there was no way to go but up from there. So the value segment is also starting to grow and so is the premium segment. So the mix is fairly stable, I would say, for the last three quarters or four quarters.

Latika Chopra: Okay. And in that context, given that commodity inflation is coming down and you have a strong cost savings agenda for FY 2018 and you intend to double the savings. As you look into FY 2019, do you see a similar scope at least in absolute terms of cost saving potential? I am asking this in the context that you probably will also need to spend more on your dairy initiatives or on your Bread, Cake and Rusk initiatives. So on an overall context, how should one look at the company margin progression?

Varun Berry: So I am not going to comment on how the margins are going to move because we do not do that. But every business has to be looked at separately. It is not that one business subsidizes the other. So every business has to perform. It is not like let the Cake margins drop by 5% this year, but we will make it through Biscuit margins, no. And that is why, what we have done is we have made these business units profit centers whereby each person in charge is in charge of making sure that the margins move in the right direction. And that helps us keep a balance. Now, yes, there will be certain categories where we will have to invest. So like, Chipita we will have to invest but that is a separate company. There might be some other areas where you might have to invest but that is fine, those are small segments. But from a business standpoint, every business is on its own.

Latika Chopra: All right. And just lastly, what kind of initiatives are we looking particularly in these segments, Cakes, Rusk and how sizable these could become for Britannia over a period of time, any thoughts there?

Varun Berry: So I have spoken about this, previously as well. So I do think, that while Cake and Rusk is about Rs. 1,100 crores - Rs. 1,200 crores today I do think that the potential there is much larger. It is just that it requires thinking, it requires differential treatment, it requires a business manager which is now Jayant and it also requires some investment in technology. So we are looking at all of that. And with that, I think we will be able to take it on to a very different path and I would say that the differential growth between the base business and Cake and Rusk would be as much as 2% or 3%.

Moderator: Thank you. Next question is from the line of Amnish Aggarwal from Prabhudas Lilladher. Please go ahead.

Amnish Aggarwal: A couple of questions here. One being that if you look at the numbers of this quarter, the other operating income has declined by 44% from Rs. 21 crores to Rs. 12 crores, any particular reasons for that?

N. Venkataraman: Yes, Venkat here. Company was eligible for fiscal incentives in a few states in the country under the VAT regime. With GST implementation, there is no clarity on the fiscal incentives part. So these have therefore not been recognized in this quarter.

Amnish Aggarwal: Okay. Now we cannot recognize that but once there is clarity, so will we be able to then take it subsequently from 1st July of year 2017 itself?

N. Venkataraman: No, we should see what kind of policies are being announced. But mostly, it should be possible.

Varun Berry: Certainly, will be possible. It is just that we are waiting for clarity in terms of how much for the state GST, how much the Central Government has made it very clear on the excise benefits. But the State Governments have not yet announced their treatment of the VAT incentive. So as soon as that is done, it will certainly be taken into account.

Amnish Aggarwal: Okay. Sir, my second question is on the Kerala impact where we had seen you can say, prolonged sort of strike by the dealers and all. So can you throw a little bit more light on how it has been solved? Have we given them some additional incentive and what sort of impact it had on the performance in 2Q?

Gunjan Shah: Hi, this is Gunjan here. So this issue as Varun touched upon in the brief at the start, it is something that may impacted us partially in the quarter. We are well on our way in terms of recovery. The network, in terms of distribution is I would say almost 95% stabilized. And I would guess that this quarter we should be absolutely back to normal in Kerala. There has not been anything differential that we have done. It was just trying our best to amicably resolve it without doing any differential treatment.

Varun Berry: So the reason it took us time versus other companies was that we dug our heels in and I am being absolutely categoric about it. We dug our heels in and we said that we are not going to succumb to any kind of blackmail in the face of a changing tax regime and Gunjan and the team did a fantastic job. So we did not budge while most other companies they gave in and they started to give higher margins, we dug our heels and we said, no, we will do it the way we have been doing because we think this is fair and that led to a lot of disruption. But in the end, I would think that we would have benefited most out of all the FMCG companies.

Amnish Aggarwal: Okay. Sir, my final question is on the dairy business, where we want to be an integrated end-to-end player with our own procurement branding and marketing. If I compare Britannia Dairy with some of the other listed players in the universe, the general guidance is that the dairy industry cannot have say, high double-digit margins. Most of the people are looking at say, high single-digit sort of margins which are actually in line or even lower than what we are making in our dairy business. So do you think that from the current margins or the kind of operations we are running which is like a very you can say tight cost operations operating in a very limited territories and all going into fully integrated your operations, will it be more like your top-line driven or will it be margin driven in the long-term?

Varun Berry: First you have got to start from the top. If you look at it, the dairy business is the largest business in the FMCG space in India. Yes, I understand that the gross margins in dairy, not just in India but across the world are not the highest but they are in line with our Biscuit margins. If you were to look at some of the dairy companies across the world, their margins are in-line with what we make in biscuits in India, right? So can we deal with those margins? Of course, we can deal with those margins because we deal with our Biscuits margins and we make sure that we make enough net profit out of that. The important thing is going to be that like Britannia does in every business that we operate in, we have to run a very tight operation. We have to make sure that wastages, efficiencies, etc., we have got a complete hold on, right? Our fixed costs are low. We have a product range which is innovation driven, which is premium and obviously, we have the network to take our product to the customers and the consumers which is our backbone really our distribution system. So thinking of it this way, if you were to run a tight dairy operation, can we build a large enough operation which can give us margins which are better than what they are today in the dairy business? I certainly think, yes. How do we do it? How do we make sure that we get everything under control and are able to run this tight operation is something that we are working towards. And not just working towards on a piece of paper but also working towards practically, understanding what are the levers, hat are the drivers of collection, what are the drivers of processing, what are the drivers of innovation, what are the strategic alliances that we might need in the future, etc., etc. So that is the homework that we are doing before we launch into this business.

Moderator: Thank you. Next question is from the line of Aman Jain from AJN Associates. Please go ahead.

Aman Jain: We can see the constant focus on cost efficiency and reduction of fixed cost over the years. Would you like to dwell a bit more upon what are the measures taken in detail? And some observation that while our revenues have grown by around 5%, material costs have also increased by 7% same quarter last year. So whether any recipe change or any material usage impact has been out of the cost saving actions? So if you may please share a bit more details on the program that you have done?

N. Venkataraman: Venkat here. On the cost efficiency program like Varun mentioned at the beginning, the themes continue to be something very similar. It is about efficiencies in operations of the new lines which are commissioned. We had eight lines commissioned in the last year and we are planning to commission six lines this year. So there are going to be efficiencies coming out of these new lines which are getting commissioned. The focus will continue to be on distance reduction. We are in the vicinity of about 400 kilometers currently. We still see a scope of reducing this by another 25% in the next two year to three years' time. So wastage reduction will be the third theme that we will be working on whether it is material wastage, it is market returns, etc. So wastage reduction therefore, is the third theme. Couple of themes which are emerging currently are to do with network optimization in the GST scenario. With state boundaries going away under GST, we are looking at optimizing the distribution network. That should give us some benefit. We are not entirely getting the benefit this year but then it should be over by sometime next year. We are also negotiating with the vendors who have got a benefit of low rate of GST in terms of structurally getting a reduction in the prices. So broadly these are the themes on which we are working if that answers your question. What is the second part of the question that you asked?

Aman Jain: Sir, what I wanted to ask was while some of the cost efficiency program also deal with reduction in usage of raw material and packing details but if you look at the financials of the quarter versus Q2 last year, we see that while the gross sales have gone up by 5%. So material has still got up by more than 5% at 7%. So generally, when we tend to see some sort of usage reduction, so generally the ratio tends to grow smaller than the sales ratio.

N. Venkataraman: This is Ram here, if you look at the top-line growth, the reported number is basically around 3% lower because you have to adjust the excise of the last quarter then the effective comparable growth is 7%, right? Against that the material cost has grown only 5% so there is a delta that is happening so it is growing lower than the top-line growth.

Varun Berry: Do you understand? Basically, the accounting treatment is different and that is why while our actual growth is 7.8% what it is showing in the top-line is 4%.

N Venkataraman: You will need to adjust about Rs. 76 crores of excise duty which is shown for making it comparable.

Moderator: Thank you. Next question is from the line of Nandan Vartak from Wealth Managers India Private Limited. Please go ahead.

Nandan Vartak: Sir, I wanted to know about volume growth in Biscuit, Dairy and Cake and Rusk segment?

Varun Berry: The domestic volume growth is just under 6% which is a fairly good number as I look at it.

Nandan Vartak: And about dairy business and Cake and Rusk business?

Varun Berry: The Cake and Rusk business is slightly more than the average. Dairy would be negative because as far as dairy is concerned, we have de-prioritized the lower margin products. But if you were to look at the high-margin products like Cheese, it will be a 10% growth.

Moderator: Thank you. Next question is from the line of Amit Sachdeva from HSBC. Please go ahead.

Amit Sachdeva: Just a question on the cost saving program. Sir, you mentioned about Rs. 250 crores cost savings that you want to achieve for FY 2018. Can you just remind us that what part of this has already been achieved in H2 and what part of this has been, if at all, reinvested back? And how should we think about its impact on earnings as a driver of the continuous cost savings, if you could guide us a little bit more around how we should think about that?

Varun Berry: Yes. So we have achieved almost 40% of this in the first-half of this year and as you know that these sort of build up, so obviously we will be looking at ramping it up as we get into the next quarter and the final quarter of the year. Now, it is very difficult to say how this is going to impact the margins because when we look at the P&L, we look at all the moving parts in the P&L. We look at what is the inflation, what is the growth, what is the cost saving. How are we leveraging our fixed cost, etc., and basis that we build our competitiveness in the market? So I do not think, you can directly correlate this with what margins you are going to get as far as the company is concerned. The best way to look at it is what we have delivered in the first two quarters.

Amit Sachdeva: And what I mean to say is that, obviously, when you talk about sustainable growth barring the subsequent quarter which obviously has a lower base but then you are obviously saying that it will take some time for double-digit sort of growth to sort of return back. In that case perhaps, given this cost efficiency program, perhaps cost management becomes a key driver for earnings growth. That is the reason of my sort of asking this and how we should think about your quest for earning growth in this construct over the next few quarters.

Varun Berry: No, of course, this is a very important part of our agenda. It is very important clarity for us. And we will continue to drive cost saving initiatives as we get into not just the next quarter, but the next financial year as well.

Amit Sachdeva: Sure, that is very helpful, Varun. Varun, in terms of pricing, I think somebody asked already as well. In terms of pricing from your commentary so far, I can sort of infer that you do not see any reason to perhaps take price increases in the subsequent quarter perhaps whatever we have, we have and incremental price increases are unlikely, is that a fair understanding?

Varun Berry: Yes, it is a fair understanding.

Moderator: Thank you. We take the next question from the line of Aditya Gupta from Goldman Sachs. Please go ahead.

Aditya Soman: First question is regarding your investing in new capacities, you have talked about Ranjangaon and Guwahati. Will this be replacing existing capacity that you outsource or this is just targeting new products and new demand? And the reason I ask this is I think, you also alluded those state borders going away to an extent because of GST. So would that mean that you can just replace some of these older facilities by having more modern facilities in these new places?

Varun Berry: No, largely it is going to be new capacity. But yes, there might be a few small contract packers who are inefficient who might have to give way but, you know most of it is going to be new capacity. Think about it this way we almost do 1 million tonnes of product and if we are growing let us say 6% or 7% or 8% in terms of volumes, it necessitates us to get that capacity on the ground otherwise we will be running out of capacity. So every year we will be requiring capacity. Now, whether we go through our own factories or we go through a CP route is something that we are going to balance as we go forward, and we are going to keep the balance between the 65 in house and the 35 outsourced capacity, it is not going to be that we are going to go 100% in-house. It will be distributed in the same ratio which is 65-35.

Aditya Soman: Understand. Fair enough. And just a follow-up on this, you talked about efficiency improvement, especially in the sort distance to market reduction. What is driving this, what could be the primary driver of this efficiency improvement?

Varun Berry: There is a program that we run, it is basically an operation research program. So you have got plans, you have got demand centers, you got to make sure that you optimize which product you make in which plant so that you have long enough runs in the plant. At the same time, you are not very far away from your demand center. So that is how we optimize it and obviously, some of the new plants help us in reducing the distance. But it is a very-very scientific way of optimizing it. It is completely analytics that we run through this software that we have which points us towards what we should be doing and then we override it with human intelligence and decide what our way forward is going to be.

Aditya Soman: Understand. Thank you. And just one last question following up on this, so this you have said there is a 33% reduction, was this over the last year ?

Varun Berry: Over the last three years.

Aditya Soman: Over the last three years and you said about 25% over the next two year or three years, right?

Varun Berry: Yes.

Moderator: Thank you. Ladies and gentlemen, this was the last question for today. I would now like to hand over the floor to Mr. Piyush Bhandari for his closing comments.

Piyush Bhandari: Thanks, everyone for spending time with us on the call. We look forward to interacting with you again. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Britannia Industries Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.