Transcript

Conference Call of Parag Milk Foods

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Presentation Session

Moderator: Good evening, ladies and gentlemen. I'm Moumita, moderator for the conference call. Welcome to the Parag Milk Foods Ltd. conference call hosted by Antique Stock Broking. At this moment all participant lines are in listen-only mode. Later we will conduct a question and answer session. At that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to hand over the floor to Mr. Amish Shah. Thank you and over to you, sir.

Amish Shah: Thank you, Moumita. On behalf of Antique Stock Broking I welcome you all to the second quarter FY17 result conference call of Parag Milk Foods. I take this opportunity to thank the management. On the call we have Mr. Devendra Shah, Chairman, Mr. Bharat Kedia, CFO and Mr. Shirish Upadhyay, Consultant. I now hand over the call to the management. Over to you, sir.

Devendra Shah: Hi! I'm Devendra Shah. Good evening to everyone. On behalf of the board of directors and management I would like to extend a very warm welcome to all of you present here for the earning call of Parag Milk Foods Ltd to discuss result for the second quarter financial year 2016-17.

Before we discuss the financial performance of this quarter let me quickly share our business philosophy and provide a brief update on key business development, which took place during the quarter. Parag Milk Foods sells 100% cows milk products, which are healthy and nutritious. We follow an integrated business model, which gives help to the pioneer (not clear).

Coming to our performance during the quarter our focus was on a long-term sustainable growth and profitability. While we reported healthy growth in the milk and milk products we reduced our focus on SMP sales, this while our revenues remained stable, our growth margins significantly improved by 75 basis points year over year to 30.5. We also increased our ghee prices by 8% to the market, which helped improve our margins. Our export revenue also increased on the back of the reason of bulk order from the Philippine customer. We witnessed modest growth in the milk and milk products due to the rural demand and the delay ramped up in the sale side of the Diwali festival. We, however, witnessed a good transaction and sale improvement in important products category like cheese, whey, proteins, beverages, etc.

During this quarter we also launched our Spice Up, the new range of the cheese slice. It has a mix of the three slices with different flavors like Achari, Kacha Aam, Piri Piri & Schezwan and green chutney. It is packed into a single consumption pack with a tiffin box. We have also launched our new brand of dairy whitener, Milkrich, into the market with distinct packaging and consumer segment targeted. We are now further gearing up the launch the launch of the whey protein isolated for the consumer market and milk-based beverages with our natural food ingredients. With the above new product launches our focus core categories we are on the track on achievement of our medium term targets sales for overseas. We also launched an all-new 360-degree campaign of the Gowardhan Ghee during the festival season designed by our new agency, JWT, and we have observed very good response for the same from the market.

Now, I request Bharat Kedia our Chief financial performance during this quarter.

Bharat Kedia: Thank you, sir, for giving me the opportunity to present the financials for the second quarter. Good evening, ladies and gentlemen. The revenue from operations for Q2 of FY17 have remained stable at 0.7% growth to ` 472.8 crores in this quarter of financial year 2017 as compared to 469.6 crores in the second quarter of the similar quarter of the last year. During the quarter we saw increase in share of fresh milk by over 200 basis points and moving its share from 19% to 21% as compared to the last quarter to this quarter of financial year 2017. Also revenue from fresh milk has increased by 14% year-on-year from` 86.2 crores last year in the same quarter to 97.9 crores this year. This was on the back of a higher volume as well as price increase.

The share of skimmed milk powder has actually declined by about 400 basis points year on year along with the fall in its revenue by 31% year-on-year from `63.4 crores to 44 crores. This witnesses our commitment to our strategy of diving to reduce our dependence on a bulk product and increase our business towards the milk products business. It is in line, therefore, with our long-term strategy. The share of milk products, which is the core strategy of our organization, actually has increased by 270 basis points to 69% of the total business as compared to 66% of the total business a year ago. This is at the back of an increase of 5% in revenue year-on-year from 310 crores last quarter to 326 crores in this quarter. This has overall lead to an expansion of gross margin by 375 basis points for 76.8% gross margin to 30.5%. This brings our ambition of improving gross margin continuously and driving the launch of new products at a higher margin than current margin is witness to this improvement.

We have achieved an operating profit to 38.3 crores in quarter two of this financial year as compared to 41.4 crores in the quarter two of the last financial year. This subdued performance in the operating margin and going down from 8.8% to 8% is primarily laid by the fact that the company is emphasizing on future growth and driving its spend, which is an investment for future in advertising and marketing. The company’s net profit improved substantially by 47.6% to 14.3 crores in quarter two of financial year as compared to 9.7 crores in quarter two of the last financial year. That margin expansion by 97 basis points, that is from 2.1% to 3% YoY is actually driven by the savings in finance cost, which is almost half compared to the last year and this represents our commitment for reduction in borrowing, our commitment for improvement in credit rating and our commitment for effective utilization of R&D.

The company’s diluted EPS grew by 33% to ` 1.89 in quarter two of financial year 2017 as compared to ` 1.42 in the quarter two of financial year 2016. While this is an improvement of 33% in EPS we believe our journey has only begun. Our ambition for a higher EPS continues to grow. The financials of quarter two FY16 were from unaudited financial results of financial year 2016 and, therefore, ladies and gentlemen to be relied upon accordingly. Our comparison of this year's financials are based on limited review vis-à-vis unaudited and non-review of last year's financials.

To sum up the results of the quarter two financial year 2017 revenue remained stable. EBITDA de-grew by 7.4% at the back of an aggressive spend on advertising and marketing and the profit after tax margin has grown by 48.6% to bring a bad margin of 2.1% to 2.9%. With this I leave the forum for each of you, if you have any questions to ask so that we can clarify together. Thank you.

Moderator: Thank you, sir.

Question and Answer Session

Moderator: Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If you would like to withdraw your request, you may do so by pressing * and 1 again.

Sir, first question comes from Mr. Prakash Kapadia from Anived PMS. Please go ahead, sir.

Prakash Kapadia Thanks for taking my question. If I look at two-third of the revenues, which is milk products, just wanted to understand, you know, why is there just a 5% growth in the first half and if you could add some color in term of reach and distribution of the milk products today versus last year. How much of it is rural, what is the target to increase the distribution in the near term for these milk products?

Shirish Upadhyay: Thanks, Prakash. I think it is to be addressed into two parts. So number one, based of last year all milk products contained a little bit of butter, which was nonexistent in terms of sales this year and, therefore, there is some tilt in terms of percentage sale; however, majority of our core focus categories are growing at a fast rate, so that is the first part. Secondly, as the chairman discussed in his address, there has been some subdued demand in rural areas particularly, which we discussed last time as well; so some of the product categories of ours, which has a significant rural proportion of sales has witnessed lower growth than anticipated. With good monsoon and festival season, which has gone by we hope those things will fall in line and we will see better performance going ahead.

Prakash Kapadia How much of these milk products would, you know, sales come from rural India, ballpark number?

Shirish Upadhyay: A smaller portion, so ballpark it would be somewhere around 25%-30% of milk products would be from rural areas.

Prakash Kapadia Okay. And something on the reach and how has that expanded and what are we looking at in terms of the milk product because here I would – the company is focusing on this higher margin and value-added products so how are we expanding distribution?

Shirish Upadhyay: Sir, we have been continuously expanding our distribution and if we compare to last year we have increased roughly around three depots, we have increased the number of distributors as well and number of touch points have also increased significantly as compared to last year, especially with our focus on beverages and those kind of products our reach in terms of absolute number of outlets has increased quite well in this particular year.

Prakash Kapadia: Okay. So as of date we would be, what, three, three and a half lakh outlets?

Shirish Upadhyay: Yeah, it would be somewhere around 300,000 outlets.

Prakash Kapadia: Okay. Okay. And one more question…

Moderator: Mr. Kapadia?

Prakash Kapadia: Yeah?

Moderator: I'm sorry to interrupt, sir. If you may come back in the queue again, we have…

Mr. Prakash Kapadia Sure. I'll do that. Tank you.

Moderator: Thank you so much, sir. Sir, our next question comes from Mr. Percy Panthaki IIFL. Please go ahead.

Percy Panthaki: Sir, just wanted to understand in your milk products, which constitutes about two-thirds of your sales how much of that would be the split between B2B and B2C?

Bharat Kedia: Our milk product business is primarily B2C; however, from an investor…while business we look at completely B2C, from an investor's perspective sometimes a portion of the sale of cheese, which goes through QSR is reflected as B2B, however, we continue to believe that our branding of cheese actually begins from the moment it reaches to the kids, whether they are in Dominos, whether they are in Pizza Hut or whether they are in McDonald's and, therefore, from our philosophy of thinking our total business of milk products is actually B2C.

Percy Panthaki: Right. And how much would be the portion, which goes to the institution like QSR, etc?

Bharat Kedia: About 4%-6% of the total product business that would go through QSR.

Percy Panthaki: Okay. So 4%-6% out of this 69% is sort of institutional sale, all of the others is direct retail sales.

Bharat Kedia: Right.

Percy Panthaki: Okay. And, again, this fresh milk would be completely retail and no institutional portion in it?

Bharat Kedia: Right.

Percy Panthaki: And the skimmed milk powder will be completely institutional. So if I look at your sort of entire mix would it be fair to say that less than about sort of 20% of the total sales is institutional and 80% plus is direct retail, is that a fair assessment?

Bharat Kedia: Before you go down that path of thinking let me just take one minute of your time to understand, primarily people distinguish between institutional and consumer sale is ability to drive, is ability not to remain dependent on someone and its ability to command premium. We believe on our institutional business, which relates to cheese, we have all the principles of consumer business, our pricing is under our control, we are able to take price increases, we are able to drive those businesses. Many of these QSRs are dependant on us rather than we being dependant on them, none of these exceeds any meaningful percentage of our revenue for us and, therefore, to be very honest we would only look at skimmed milk powder as an institutional realization from that perspective and this is the reason we are trying to defocus on that business because we are primarily a consumer company and moving away from being institutional in skimmed milk powder.

Percy Panthaki: Understood sir. And second question is this milk products, which constitutes two-thirds of your business, would you be able to give an idea of what are the main products in them and what is that split in terms of an approximate sort of revenue share?

Bharat Kedia: See, we will give you an overview understanding of it. We are at this stage looking at not going down into the further details. There will be a time where the organization would get into those details. As of now we can tell you cheese and ghee are our two flagship products within the consumer products. They each occupy a large space between the total products and then we come to the UHT milk, the fresh business, the beverages, these kind of business that they follow. The most important thereafter from a margin perspective for us is the whey proteins.

Percy Panthaki: Right. So cheese and ghee would be approximately the same size?

Bharat Kedia: Roughly about, yes.

Percy Panthaki: Okay, sir. Okay. That's it from me. Thanks a lot.

Moderator: Thank you, sir.

Bharat Kedia: Thank you, Percy.

Moderator: Thank you, sir. Sir, the next question comes from Mr. Shailesh Kumar from Sunidhi Securities. Please go ahead, sir.

Shailesh Kumar: Thank you for taking my question. This question is for Bharat. Can we have some sense of volume, I mean segment wise slides of fresh milk and milk products and SNP that we have seen during second quarter FY17 vis-à-vis second quarter of FY16?

Bharat Kedia: See, in the business in which we are explaining volume becomes a little bit challenging. The reason is that certain things are measured in lakh liters per day, certain things are measured in tons, certain things are measured in liters and kilograms and like that and their price realizations could be as low at 50 rupees to as high as 350 rupees and like that. So, therefore, overall to kind of mix all of them into one bag becomes very difficult when it comes to volume. So what we can I believe that we are probably looking from a volume versus realization perspective, so we can say this quarter we have taken a price increase in various products including ghee where we have taken the largest price increase of almost 8%? We were already a premium product in ghee. We have created further premiumisation because we are cow milk company, we can see the value we can generate to the consumers and these premiumisations in addition we have also taken price increase in other products including fresh milk and therefore the total realization growth that we have for the first-half year, which is revenue growth of about 1.5% that primarily comes from price increase.

Shailesh Kumar: Okay. On like-to-like basis do we have any idea or company would like to guide about volume growth for FY17 full year over FY16 full year?

Bharat Kedia: See, in the business in which we are we have always been looking at and we will continue to look at the longer-term horizon than two quarters or one quarter. So as a management we had given a guidance to the community in the past suggesting that for the next three years that is from FY16 to FY19 we will have a CAGR growth of 14% at top line and our PAT margins would increase from 2.9% to 5% plus. We continue to believe looking at the past performance of last two quarters we continue to believe these indicators are still valid and remains valid because we have got of new products in the pipeline, which will kick in the top-line growth as they come in and we have already been very focused on driving the bottom line growth and the results are in front of us with 48.6% growth in the PAT margin for the second quarter. So we would a little bit at this stage try to kind of not get into a very short term forecast because that drives little bit us away from the long-term thinking of the organization.

Shailesh Kumar: No, but the thing is this PAT margin and PAT improvement is mainly due to financing, which is your IPO money, which you have received, it's not about the operating performance and…

Bharat Kedia: If I can add to that – sorry, go ahead.

Shailesh Kumar: Yeah. This cheese thing, how much of it is from rural India?

Bharat Kedia: Cheese if primarily urban.

Shailesh Kumar: So basically your ghee sales have suffered a jolt in rural market?

Bharat Kedia: Yeah. I'll come to the ghee sales; just give me one minute. To your comment on that the PAT margin expansion has come from a finance cost, let me take you down to the P&L three lines. Our gross margin has improved by over 375 basis points, that is not driven by the finance cost, but it is driven by we trying to sell more business of higher gross margin and trying to decrease our dependence on a lower gross margin business such as skimmed milk powder. So rebalancing our portfolio has driven our gross margin. Then our EBITDA margin has declined, however, we have increased significantly our spend in advertising and marketing this quarter. We have hired a new agency called JWT to run us through our marketing campaigns. They have come up with a lot of differentiated initiatives for which the fruits are yet to come in the quarters to come, but the cost has already sunk in because things are all prepared to launch. A lot of these advertisements have already been launched pre-Diwali. Most of you would have seen hoarding and TVC on ghee that we have worked up on. So some of these performance has taken EBITDA down and therefore it looks that it is the finance cost that is driving the PAT margin, however, that's probably far away from the way the business has moved along.

Now, coming to ghee you are very right, we have taken two or three initiatives on ghee. 1) We have taken a price increase of 8% plus in second quarter while the competition has not taken that kind of a price increase. It definitely has impacted us in short run, but we believe that it is important for us in the long run. With the size of business of ghee that we have we couldn't afford not to take a reasonable price increase.

2) as Suresh was explaining us in the previous discussion that we have had some subdued demand from the rural markets of India. Ghee is one of those products, which has quite a substantial portion of it's sales that comes from also rural and therefore it has got impacted partially and these are certain reasons, but we believe the demands have already started to pick up, so rural demand issues seems like going to get over with the good monsoon that we have already witnessed in quarter two. The effect of that good monsoon may come slightly later and, therefore, we are yet to see and, therefore, we don't see these are systemic challenges, but we see these as opportunities for us for future.

Shailesh Kumar: Basically these villages – in which part of the country these are situated, I mean northern, southern, eastern or western, I mean because normally rural India is supplier of milk, so it is a bit strange that they would be procuring milk products, so just for my understanding.

Shirish Upadhyay: They are spread all across and it is not the case that rural India is always the supplier and not a consumer. Rural India is equally large consumer as well and particularly as far as our company is concerned we are more of an urban focus company because of the kind of portfolios that we carry, like cheese and beverages and those kinds of products, but some of the categories like ghee, you see those are much higher tilted towards rural areas as well and in those areas everyone in this space has been some dampening of demand over last two quarters.

Bharat Kedia: To add further we have actually come up with a small cachet of ghee, actually trying to tap a smaller affordable community there and we have also run advertisements programs around that cachet for some time for people to consume and test. So we are working through this. It is not something that we are just accepting as it is (not clear).

Shailesh Kumar: Thanks. I will get back in queue for further questions.

Bharat Kedia: Thank you, Shailesh.

Moderator: Thank you, sir. Sir, the next question comes from Mr. Jubil Jain from PhillipCapital. Please go ahead, sir.

Jubil Jain: Thank you for the opportunity. Sir, Parag Milk Foods has a very robust new product launch strategy and I like the Spice Up variant of Go Cheese. I wanted to understand how much of incremental revenue came from innovations in H1 versus the previous year? Secondly, what are innovations in the last two years, which have become significant contributors for the revenue?

Shirish Upadhyay: Jubil, we don't bracket that way in terms of incremental revenue generated because those are normally improvements over our normal SQ, so a normal cheese slice converted into a flavored cheese slice and then adding further flavors into it, so we normally look and attract in terms of the overall category growth that we are able to generate in a particular category by different innovations. That is number one and number two in terms of the product innovations that we have done over last two years, which have contributed significantly some of them are products like variants of cheese, particularly cheese spreads and chutney cheese slide and those have done quite well in the market. Some of the categories, again, being niche they will take time in terms of ramping up of consumer base and therefore sales of those kinds of products.

Jubil Jain: So what would be the size of the cheese spreads, cheese spreads chutney and other variants?

Shirish Upadhyay: We normally don't divulge details into that level as of now. So may be we can…

Bharat Kedia: May be after six months.

Jubil Jain: Sure, sir. The second question is on the growth rates, which you have observed in H1 for cheese and ghee, could you at least give some range as to, what has been the growth rate for cheese and ghee, some ballpark range?

Bharat Kedia: Jubil, we can have this discussion offline, but just to give an overall update. Our cheese growth is higher than our expected growth and our ghee growth is lower than our expected growth and we have explained the reason why the ghee growth has been slightly subdued.

Jubil Jain: Thanks a lot, sir.

Bharat Kedia: Thank you.

Moderator: Thank you. Sir, our next question comes from Mr. VP Rajesh from Banyan Capitals. Please go ahead, sir.

VP Rajesh: Thanks for the opportunity. Could you tell me what is the percentage of revenue you are getting from the HORECA segment?

Bharat Kedia: HORECA segment actually is a mix of various products that we have. Cheese that we sell in HORECA segment is the primary product that is there. Cheese in HORECA segment, if I take into overall milk products would be about six odd percent.

VP Rajesh: So total products to HORECA segment is around 6-10 percent roughly, right?

Bharat Kedia: Less. It would be may be six to seven percent.

VP Rajesh: Okay. And the next question is in predominantly in cheese, are you doing co-branding with, you know Dominos, etc, that you were earlier saying is the cheese, which is, you know, being consumed by the ultimate consumer.

Bharat Kedia: No. This is not from a branding perspective. Let me explain to you some of the cheese that we manufacture. They are specialized to the special needs of our QSRs, so the cheese that we sell to one QSR is different than what we sell to the QSR. This is our speciality. This is because we have enzymes. This is because we have the capability, technical know-how to differentiate cheese into various forms and factors and that is why we specialize in those products. What it does is the people when they have these products at the QSRs and they particularly like the taste of these products they come back and our cheese. So we are actually driving our sales through the consumption in occasions in QSR, not through the branding.

VP Rajesh: I see. But how does a consumer know that it is Parag's product and not something else, I mean they have to just ask the guy or is there a branding thing going on by you in conjunction with these QSR players?

Shirish Upadhyay: We have tried it some times, but it is something, which is done one-off in a year or so depending on the particular campaign that we run jointly with this kind of player, but that is not our focus in terms of the branding efforts that we do.

VP Rajesh: I see. So unless and until I ask them, like, who you got these cheese from I wouldn't really know as a consumer that it is coming from Parag?

Shirish Upadhyay: Yeah. For those kind of large players, as I was telling you, once in a year or so we try to conduct this kind of joint branding campaign, but those are one off. For small-time players, HORECA and all those things we do have joint branding in terms of our brand mentioned as a part of menu or our brand mentioned as a part of the establishment or something somewhere and those kind of things are common.

VP Rajesh: I see. Okay. Thank you very much.

Bharat Kedia: Thank you.

Moderator: Thank you, sir. Sir, our next question comes from Mr. Hemang Kapasi from Canara Robeco Asset Management. Please go ahead, sir.

Hemang Kapasi: Hello?

Bharat Kedia: Hi, Hemang.

Hemang Kapasi: Yeah. Good evening. Can you share the advertisement and promotion figure of the quarter?

Bharat Kedia: Advertisement and promotion expense for the year in this company runs around between 7%-7.5%. These are the expenditure, that is for the full year; however, the percentages tend to differ between quarter to quarter depending upon the time at which these investments are made into the market. In this particular quarter we have an advertisement and promotion expense that is up by about 1.1% as compared to the average of the company for the full year. We believe that would get converted back into the system, because we have two more quarters to go. Overall we are not looking for the full year if the expenditure exceeds our budget.

Hemang Kapasi: And promotions are netted in the revenue line item?

Bharat Kedia: Yes, promotions are netted off in revenue line item, but not the advertisements.

Hemang Kapasi: And year-on-year it would be the same, right, reporting would be same?

Bharat Kedia: As I said the advertisement expense is actually about more than – a little over 100 basis points higher compared to the last year. In this particular quarter, having said so for the full year we are still likely to be in the budget.

Hemang Kapasi: No, I am referring to 2Q FY16; the number would be adjusted with promotion, right, like-to-like number it would be…

Bharat Kedia: Like-to-like number are presented. The revenue for FY16 as well as FY17 are adjusted for promotional expenses.

Hemang Kapasi: Okay. Thank you.

Moderator: Thank you, sir. Sir, our next question comes from Mr. Amnish Agarwal from Prabhudas Lilladher. Please go ahead, sir.

Amnish Agarwal: Yeah. Hi, sir, I have a couple of questions. My first question is can you share with us what was the total volume of milk procurement during the quarter and the previous quarter and what is the price per liter, which we have paid?

Bharat Kedia: As we have stated in the previous quarter as well and the question keeps coming. The price for milk actually varies from state-to-state, district-to-district, month-to-month, period-to-period and, therefore, it is very difficult for us to actually come up with a price for milk to be given. Number two, price for milk depends on the solid content of the milk and the solid contents of the milk varies from day-to-day and, therefore, this is a little bit more complex to get into a price for milk. In terms of the volume growth, we, last year, if you recollect, we have actually stated as part of the IPO discussion that we had purchased more products, semi-finished processed products and had done production of our products through semi-finished processed products. This year our purchase of semi-finished processed product has come down and we have actually increased the purchase of milk. In terms of volume our milk purchase is almost 25% higher than the same quarter of last year.

Amnish Agarwal: So how much it would be if we have to look at, say, lakh liter or a million liter?

Bharat Kedia: Amnish, we can come back to you on this, if you can just drop your communication back with us.

Amnish Agarwal: Okay. Sir, my second question is regarding the revenue guidance of 14%, which you had given. Now, if you look at say the first half and second half. Last year first half turnover was 843 crores and second half was 801 crores. So second half turnover is less. So, if you grow by this yardstick and apply 14% sales growth, which you had indicated that in second half you need around 27% odd sales growth. So, the way the first half has gone, do you think that we need to scale down the 14% growth expectation at least for the current year?

Bharat Kedia: Actually speaking we haven't given a 14% growth rate for year; we actually have given a guidance of a 14% growth rate as a CAGR for three years. We were already scaling in our mind that the growth rates will kick in at a higher speed once we have a launch of new products under the beverages and protein and therefore while the first quarter and second quarter are slightly below our expectation, it is not that far in terms of achieving the growth rate that we had been looking for, and it is certainly within the line for the growth for the three years of CAGR of 14%.

Amnish Agarwal: Okay. So, you mean to say that while this year it might not be 14%, but once you look at the three year CAGR.

Bharat Kedia: That's right.

Amnish Agarwal: Okay. And sir my second question is that while you are indicating approximately say 7% to 8% as advertising and selling…your A&P expenses, so if we go by what is there in the balance sheet of the company under the heads of advertising and marketing and sales promotions, if you add both, it actually amounts to around 2.4% only.

Bharat Kedia: You are absolutely right. So, there are promotional expenses, which are meted off against revenue and those are not visible from the financials that you see. What you see from the financials are the pure advertising expenses and they are in two different lines called branding and called promotional, but they are both pure advertising expanses that is what you see in the P&L. And therefore you only see a part of the total picture.

Moderator: Mr. Agarwal, I am sorry to interrupt sir, if you may come back in the queue again, we have other people waiting as well.

Amnish Agarwal: Okay.

Moderator: Thank you so much sir. Sir, our next question comes from Mr. Harith Kapoor from IDFC.

Harith Kapoor: Yeah, hi sir. Sir, just from the price increase front, if you could just give us a sense of how much has happened in milk as well, liquid milk, how much…out of this 13% how much would be price increase?

Bharat Kedia: The price increase in milk was taken in quarter 2, that was about 6% to 7%.

Harith Kapoor: I am sorry sir, I didn't get you.

Bharat Kedia: The price increase was about 6% to 7% taken in quarter 2 of this year.

Harith Kapoor: Okay. And just a followup on that is that how are you seeing the inflation in terms of milk and milk products now and do you think you would require any more pricing action to take care of deflation.

Bharat Kedia: Harith, there is a proverb in our company called "Aap ke munh mein ghee shakkar". We would always love to take price increase; however, we have to remain cognizant of the fact that we are playing into a field where there are competition available. We have already taken price increase in ghee as I stated ahead of the competition, which is important for us in terms of driving profitability of the organization. We are growing towards more profitability. However, we remain always conscious of the fact that the price increase is not necessarily taken only to meet inflation, but also to ensure that we remain competitive in the market. We will see how the market behaves and wherever we have the opportunity, we would definitely take the price increase.

Harith Kapoor: Sure. The next question was on the SMP, for the first half we had said 11% of sales, so is that a sustainable number, given that it is part of our production process also, and so is 11% a number that can be sustained at this low number or what's your thought on that.

Bharat Kedia: Yeah, this is in line with what we are expecting actually. So, it has to be (not sure).

Harith Kapoor: Okay. So you can probably maintain, this would probably be what it is even going forward, right, in this rate?

Bharat Kedia: Yeah. We probably can maintain at this rate, right.

Harith Kapoor: Okay. And the last thing was on the working capital part, so you have seen a higher number on the inventory side for the half year, so would that be just before the festive season when the inventory number goes up, is there seasonality to it? How does it work?

Bharat Kedia: So there are two things to the inventory number, a) as you rightly pointed out, we have to build inventory before the festive season comes in, b) the valuation of inventory has also gone up. As the inflation has kicked in, as the milk prices have gone up, we have a (not clear) method of valuation and therefore the price at which the inventory is valued has also gone up. So for both these reasons inventories are up at this stage.

Harith Kapoor: Okay. And if you could just give an update on your CAPEX, you know, how is it going along, when is it going to kick in, etc.?

Bharat Kedia: So, lot of initiatives are on, we have…in terms of procurement we have already made some partial payments for investment, in terms of whey, we have already made some partial payments, have made some commitments for machineries to come in, that is in pipeline. We have done some work already in terms of storage and expansion. So there are various projects, which has already started. So far we have invested about 14 odd crores out of the 150 crores that we had taken from our IPO money into the CAPEX. However, that is partial because lot of these things are in pipeline. We believe that we would have a fairly good view of the investments in the fourth quarter of this year, by that time we would have some of the understanding and clarity on the new products that we are working on.

Harith Kapoor: Okay, that's it from me. I will come back for more. Thanks.

Bharat Kedia: Thank you Harith.

Moderator: Sir, our next question comes from Mr. Pritesh Chheda from Lucky Investment Managers. Please go ahead sir.

Pritesh Chheda: Sir, sorry for, you know, maybe I would be repeating the question since I joined late. I just wanted to know two parts, one on the milk product side, the growth rate is around 5% and what were your comments there, and on the other, expenses side, it is a disproportionately higher growth number, so what were your comments?

Bharat Kedia: Pritesh, you are right. Very important, both of them you have summarized into one question, very interesting. So, in terms of the expenses that have gone up, we have explained that the pricing and other expenses have gone up at the back of two reasons, a) we have handled about 25% roughly more milk compared to the last year. Last year we had purchased quite a bit of semi-finished processed products, this year we have gone into more milk purchase, and as we handle more milk, the expenses go up, but the gross margin improves because obviously it is not processed, so it comes at a lower cost. At the same time we have also done an aggressive spend on advertising and marketing for this quarter ahead of the festive season to start building up the momentum. And this is disproportionately high in that quarter; however, we are very clear in our minds that for the full year we have still continued to follow the budgeting process. So we don't see a danger for the full year, but we have spent more. So these are two reasons why our expenses have actually gone up in this quarter compared to what you would have expected. Coming to the revenue side, our product business has grown…

Pritesh Chheda: Sir, just before that, so the gross margin number if you take the cost of milk handled, and the milk itself vis-à-vis purchase of semi-finished products, would the gross margin would have expanded even then? Because there is an expense, which is there in other expense line, on account of more milk handled?

Bharat Kedia: So, Pritesh, the way it works is that at a gross margin level we take revenue minus cost of milk or cost of semi-finished processed products that we have purchased. When we buy milk, the cost of converting that milk into semi-finished processed products goes under the other expense line. So actually as you move from one to the other, there is a slight impact of movement.

Pritesh Chheda: Yeah, but if you take sum total of two…

Bharat Kedia: Yeah. So if you take sum total of two then you come down to the EBITDA margin. As EBITDA margin is slightly subdued, that is primarily from an advertising and marketing spend, so we were just saying on this call before that we have spent on advertising and marketing little bit over 100 basis points more than last year, which is overall it is in line with the budget, however, it is more, and therefore our EBITDA margin looks little bit subdued.

Pritesh Chheda: Had that not happened…

Moderator: Mr. Chheda?

Pritesh Chheda: Yes.

Moderator: I am very sorry to interrupt sir, if you may come back in the queue again, please?

Pritesh Chheda: Ma'am I haven't asked my…I am still waiting for the second question's answer; I am just taking clarification on the first question.

Bharat Kedia: Yeah, so Moumita, just give me one more second, I will give you on the first point that we have clarified on the revenue, while the milk products revenue looks like growing at 5% speed, it is primarily at the back of two this things that has happened, one that the rural demand had been little bit sluggish for us in this quarter, and part of our products such as ghee and such as UHT milk has quite a reasonable amount of presence in the rural market. So both of them got little bit hurt by this fact, and #2, we have taken an aggressive price increase in ghee of 8% plus in this quarter, which we also believe had some impact on our volume for this quarter. We believe both of…we believe the increase in the price is right in the right direction for the business, and we should have the neutralization of this impact coming up in the quarters to come, and we hope with the rural demand will pick up with the good monsoon that we have seen in the quarter 2. So we don't see any of these as a systemic challenge or a concern for the company in the quarters to come.

Pritesh Chheda: How about cheese and other products?

Bharat Kedia: They have all exceeded the expectation of the management.

Pritesh Chheda: What was the profits?

Bharat Kedia: So, as you know, cheese is growing at the speed of 16 to 18% in the market and we are growing ahead of the market growth.

Pritesh Chheda: And value-added products?

Bharat Kedia: The other value-added products, whey protein has grown reasonably well, fresh products are growing, so our primary point of bringing it down to a single digit is coming from ghee and UHT.

Pritesh Chheda: Okay. Thank you very much sir. All the best sir. Thank you very much.

Bharat Kedia: Thank you sir.

Moderator: Thank you sir. Sir, we have the next question from Mr. Kaustav Bubna from SKS Capital and Research. Please go ahead sir.

Kaustav Bubna: Yeah hi, I wanted to know, so this lack of rural demand you were talking about, is it state-specific? So, in certain states you saw lack in rural demand, so could you mention the states?

Shirish Upadhyay: Yeah, so this is specific to different regions. There may be different reasons. So, for example, there have been some impact of drought last year in parts of Maharashtra, Andhra Pradesh, Karnataka, Tamil Nadu, those regions, and then we also have seen problems due to heavy rains in North Eastern parts of the country during this particular quarter where we were not able to send our products and cater to the consumers. And there are also some other factors, which were involved, so every area had their own issues, but overall in most of the areas that we are operating, we have seen some subdued demand particularly from rural areas.

Kaustav Bubna: Okay. So you seem very bullish on this whey initiative of yours, I see it as a point of differentiation between at least other domestic competitors you do have, SO could you tell me, I mean, can you give us some color on this whey initiative, how much revenues you have made right now, I know it is very less, but how much revenues you make right now out of it, what are the actual margins compared to other value-added products, what is your international competition like, and what is your vision for this initiative?

Bharat Kedia: This is an extremely interesting question and I must say this is, looks like you are in the management committee of the company, these are the kind of questions that we are deliberating internally as we are looking for going into a whey consumer product business. It is a large market as of now in India. It is growing very rapidly. However, the product that we are manufacturing right now, it is suitable for institutional sale only, that is as an ingredient to some other products. We still don’t have a product that is suitable to consumer. We are in the process of manufacturing a product that we can sell in consumer. We have ordered certain equipments as we have gathered some funds through the IPO and once these equipments are in place, commercial production starts, then we would get into the product and it will be launched in the market. We believe the margin in this product would depend on how we price this product. Today these products are priced very high for reasons because they are primarily imported by us, it comes with a heavy customs duty levied upon them, and therefore the market price of these products are reasonably very high. If we are going to position ourselves at a similar price range, which is not likely, the margins can be phenomenally exceptional. However, until the price is not firmly decided in the management of the committee, it is difficult for us to conclude what kind of margins we can drive from this business. All I can say that this would be one of the highest margin products for the company.

Kaustav Bubna: Yeah, but, I mean, if you could give like a broad range, because in terms of how much more value creative is it compared to other value-added products like cheese and if you could talk little bit about your CAPEX for whey and one more thing is when it comes to whey proteins, a lot of clients in the consumer sector would be more worried about is this actually more beneficial to me in terms of, like, protein consumption and building muscles, than other international company, so what are you doing in terms of branding for that to market out that your products are as good as international compared to those and all of that like some, because you guys seem pretty bullish on this initiative, and you all are claiming that this will be one of your growth factors to that 5% margin that you want and to this 14% CAGR. So, I mean, I think of this as an important initiative, so if you can give a little more color on what exactly your margins would be, it is important I feel.

Bharat Kedia: To be very honest we love your question because this is exactly what we would like to get all that clarity upon. Only thing I would say is we are probably little bit orally to have that discussion. We would be able to answer each of your question once the product is more closer to its launch and we are still in a phase where we are getting equipments installed, production to get through, and then branding discussions, and then launch discussion. So, maybe if you hold on to this question for few months or for few quarters, I think we should be able to get you a better clarity on it.

Kaustav Bubna: But, right now, in your institutional sales, how much are you making and how much margin are you making on that?

Bharat Kedia: You know, our institutional sale, it is the second largest margin making product for us.

Kaustav Bubna: And how much revenue are you getting right now?

Bharat Kedia: Whey is about 3-1/2 to 4% of our revenue.

Kaustav Bubna: Already?

Bharat Kedia: Already.

Kaustav Bubna: And it is the second largest margin?

Bharat Kedia: Yeah.

Kaustav Bubna: And what is, if you could, okay, I will ask you this question later. I understand that your margins can improve if you directly do the milk procurement process from farmers rather than getting it from vendors, so how much percentage of your milk is got from farmers and how much from vendors?

Bharat Kedia: See, primarily our milk is being procured through farmers, but given the supply and demand stability in terms of procurement of milk and demand for product is not always equal. We do go out at times and purchase milk from aggregators. I would say that our ratio between procurement and purchase of milk from aggregators would be in the ratio of about 80:20.

Kaustav Bubna: It is about 80:20. And what's your overall capacity utilization like?

Bharat Kedia: See, different lines have a different capacity utilization like…and if you are looking for some global understanding of it, I would say that our Manchar production facilities are pretty well utilized as of now, very close to its optimum utilization. Whereas our Palamner production facilities are not fully utilized as of now, that is, when I say as of now, as of quarter 2. While we have increased utilization significantly in Palamner production facilities, we have slowly actually defocused on the job work that we used to do to fill up the capacity needs and therefore the utilization today in Palamner plant is about 50% to 60%.

Kaustav Bubna: In the what plant?

Bharat Kedia: In our southern plant.

Kaustav Bubna: And So what, southern plant is about 60%, and what products are manufactured there?

Bharat Kedia: Our production facilities are mirrored to each other. So both of our production plants actually produce anything and everything, except for two things, cheese is only manufactured in our western plant and UHT products are only manufactured in our southern plant.

Kaustav Bubna: Okay. And do you have, like a target for capacity utilization in the southern plant?

Bharat Kedia: Oh yes.

Kaustav Bubna: What is that, and in how many years?

Management: So we are looking from three years from now we should have a full utilization of the Palamner plant.

Kaustav Bubna: Okay, thank you for your time.

Bharat Kedia: You are welcome sir.

Moderator: Thank you sir. Ladies and gentlemen, we request you to restrict to two questions per person during the initial round. Thank you. Sir, the next question comes from Mr. Samrat Das from Tamohara Investments. Please go ahead sir.

Samrat Das: Hi sir. Sir, my question is on the strategy front. So, going forward into the future, so in line with your given projection and the competitor sales also, so what if Amul, according to my research Amul, when Amul enter into the market, the procurement price goes up. So how are you going to counter that measure, like, in future if it happened sir?

Shirish Upadhyay: Sir, there is nothing like that, #1, #2, we operate in terms of procurement in areas where Amul does not have much of a say in terms of procurement, so particularly in areas like Maharashtra and Tamil Nadu, Andhra Pradesh, and Karnataka, where we operate through procurement of milk, they don't have much of a presence, but obviously there are local cooperatives who like Amul who are there in each and every state with whom we are competing. So, maybe there is KMF or Aavin or Vijaya who are present in South or there are Mahanand and Gokul and other cooperatives who are present in Maharashtra whom we are competing with in terms of procurement and we don't see much of a problem in terms of procurement.

Samrat Das: Sir, so basically I was asking because the prices, normally, normally when Amul enters into a market, the prices normally increase by around 10% to 20%, so if that happens, so how much of a price increase can you take on the product side?

Shirish Upadhyay: No, I think Samrat, #1, this is a very hypothetical question and #2, this is based on a myth rather than a fact, it is not an established fact that Amul enters any place and procurement prices increase by x or y percentage. It all depends on local situation in a particular territory. If it is a territory where the organized players are not that active or share of organized is not that high, entry of a large organized player makes a difference in terms of procurement price. In markets like Maharashtra or southern part of India, these are already quite well organized markets in terms of procurement and as I stated we are competing with other large private players as well as large cooperatives in these regions and therefore Amul or anyone else from any part of the world is not going to make any difference in terms of procurement pricing in these regions.

Bharat Kedia: Moreover to add to increased prices by 10 to 20% in the business in which we are, does not look like feasible, because we don't have that kind of a margin.

Samrat Das: Okay, okay. Thank you.

Bharat Kedia: Thank you Samrat.

Moderator: Sir, we have the next question from Mr. Amnish Agarwal from Prabhudas Lilladher. Please go ahead sir.

Amnish Agarwal: Yeah, hi sir. My question is that recently we have seen increase happening globally also in SMP and butter prices. So will we be trying to sell more of SMP and how will this price increase be in Parag Milk Foods?

Shirish Upadhyay: SMP basically is a commodity and commodity prices do fluctuate a lot, both globally and also it has some impact in India as well. But as we have been pursuing a strategy of defocusing from commodities as far as possible, so we have been declining our reliance on SMP or other commodities and have been focusing on branded consumer products, and that is how our results are visible over last two, two-and-a-half years, that is what we are trying to pursue further as well. So, whatever excess milk that we have during a particular season, if the realizations of commodities are good, we may sell it off or we may carry forward that inventory, depends on situation at that point of time. But it does not change our strategy in terms of focusing only on consumer products.

Amnish Agarwal: Okay. And sir the butter prices are also moving up in Parag?

Shirish Upadhyay: As we discussed earlier, there has been some increase in raw milk prices because of increase in commodity prices, and accordingly we have taken increase in terms of our ghee prices over Q1 as well as Q2, so that is what we have been moving ahead of the market in terms of raising the prices.

Amnish Agarwal: Okay sir. Can you share just how much has been increased in the prices of liquid milk?

Shirish Upadhyay: We just discussed on our call earlier that increase in liquid milk prices that we took over Q2 was roughly around 6%.

Amnish Agarwal: Okay sir, thanks a lot.

Management: Thank you.

Moderator: Thank you sir. Sir, we have the next question from Mr. Harith Kapoor from IDFC. Please go ahead sir.

Harith Kapoor: Yeah hi. Just a couple of follow ups. Firstly on the price increase, the full benefit of this will be from the third quarter onwards? Would you have taken this mid-quarter in the second quarter?

Bharat Kedia: The price increase for fresh milk was taken early second quarter. The price increase for ghee was taken mid second quarter.

Harith Kapoor: Okay. And next question is really on the new launches. So, is it fair to assume that the pace of new launches in the second half will be at a higher pace or you would see more of that only in FY18 as the CAPEX starts to come through?

Bharat Kedia: Actually we see the pace of new launches to start from the quarter 4 of this year.

Harith Kapoor: Okay, within your key product categories at the top end of the value-added?

Bharat Kedia: Right.

Harith Kapoor: Thanks. That's it from my side.

Bharat Kedia: Thank you Harith.

Moderator: We have the next question from Mr. Prakash Kapadia from Ambit PMS. Please go ahead sir.

Prakash Kapadia: Sir, currently as I understand there is no procurement of, you know, milk from farmers. How will this change under GST? Would it be fair to assume there will be a 10% increase in milk prices and similarly on some of the value-added products? Would this GST lead to inflationary measure, where this could increase from a 6% to around 12% under the proposed regimen, is that right?

Bharat Kedia: Okay. So, let me just, first let's understand that milk is the largest commodity of India. India is the largest producer and consumer of milk. Actually the value of milk that is produced in India is higher than wheat and higher than rice, including, and therefore an assumption in our mind that the raw milk that we procure, which today comes with a 0 tax would get into a GST at a tax rate other than 0, could be very difficult to absorb. In our thought process, given what we have understood so far from the GST, though the categorization has not been final, the essential commodities for the lifeline of poor would continue to remain in to the 0 category and that is what has been understand as at least 50% of the consumer lifeline products would be in the 0 category. However, if the rates do change, I think the market will actually try and absorb and pass to the best of its ability. To speculate that today may be difficult because we don't know how this categorization will take place.

Prakash Kapadia: Right sir. And on the value-added products, is it right to think it will be from 6% to 12% or there is no clarity there also? With regard to ghee, tetra pack, butter…

Bharat Kedia: Currently our value-added products range on a tax range of 5% to 14%. We don't know at this stage which product would get categorized into various categories that has been defined already. We assume an estimate that we may come back to the average, which is similar. But to be very honest again we would only know once the clarity is thrown into the categorization of products.

Prakash Kapadia: Understood sir. Thank you.

Moderator: Thank you sir. Sir, we have our next question from Ms. Sangeeta Tripati from Edelweiss.

Sangeeta Tripati: Good evening sir. Thanks for taking my question. Just three data questions, other questions have been answered. I wanted to understand the cheese facility utilization at our level. What is it currently?

Bharat Kedia: We are very close to its full utilization on cheese already and that is the reason we had sought for an expansion, for which we have garnered funds through IPO. We are in the process of expanding the cheese capacity as we speak. Before the need for cheese increases on the 40 metric ton plant that we have, we would have the new capacity in place.

Sangeeta Tripati: Right now it would be around 90% plus utilization level?

Bharat Kedia: Generally in a dairy, utilization levels are close to about 85% at an optimum because of the seasonality and fluctuation of milk purchase, it is harder to get beyond that, and we are in close loop of that percentage.

Sangeeta Tripati: Okay, thanks. Secondly on the whey protein side, you talked about that the market is pretty big. Just wanted to understand what is the market size and how is it growing. I am sure it is growing in double digit high, double digit 20%, 30%, but just some sense on how big the market is?

Bharat Kedia: Sangeeta, if you allow us for this quarter to hold on to some of these discussions, because they are a little bit premature, we are working on a full blown plant for our protein products launch. As this product launch comes in place, we will definitely come out and explain to the investors about the market and the product and its advantages and competitive advantages.

Sangeeta Tripati: Sure, sure. We will get the more nuances, more understanding, as it comes closer to the launch date, but just to get a sense, how big is the market, is there a 300, 400 crore market already, which is totally served by the import?

Bharat Kedia: It is bigger than that.

Sangeeta Tripati: Okay fine. And lastly on the tax rate, why there has been a decline in the tax rate for this quarter and what is total effective tax rate for the year going ahead?

Bharat Kedia: The effective tax rate for the full year is expected to be between 31% to 32%. Please do not look at some of these quarter tax rates. And it has not been so different, but they are slightly different on a quarter-to-quarter because the way, we have something called PSI incentive, that is the sales tax benefit, and the way this benefits works slightly move around in terms of the tax costs. So we are actually in our organization looking at the effective tax rate annually and not really quarter by quarter. So we continue to have in the same range of 31 to 32%.

Sangeeta Tripati: Okay, thank you. Thanks.

Bharat Kedia: Welcome.

Moderator: Thank you. And sir we have the last question from Vishal Purohit from Prabhudas Lilladher. Please go ahead sir.

Vishal Purohit: Sir, thank you for taking my question. I must congratulate the entire team of Parag Foods for the way they are transforming the entire milk industry from unorganized to the organized and also the way the brands of Gowardhan and Go Cheese have been built. Sir, looking at the opportunity, at any stage did you look at the option of going the inorganic route to expand your footprints?

Shirish Upadhyay: We have, we did look at that, but somehow we don't find that lucrative.

Vishal Purohit: So, if I can ask you, was at any point Heritage Foods considered?

Shirish Upadhyay: It is a big fish for us.

Bharat Kedia: Vishal, we are a product company and therefore if at all we look for M&A opportunities, we will look for where we can implement and enhance our product visibility and branding. So it may not synergize with us…in that sense.

Vishal Purohit: Sure. Right, right. But would you be okay in terms of a product, if you get regional well-doing product company, which you can acquire and build it up and scale it up at the national level?

Shirish Upadhyay: We can evaluate and then see whether it fits our strategy or not.

Vishal Purohit: Okay, alright. Thank you so much sir.

Shirish Upadhyay: Thank you.

Moderator: Thank you sir. Ladies and gentlemen, with this we conclude our conference call for today. Thank you for your participation and for using Door Sabha's conference call service. You may all disconnect your lines now. Thank you and have a good evening everyone.

Note: 1. This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.