"Parag Milk Foods Limited Q3 FY19 Earnings Conference Call"

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Moderator: Ladies and gentlemen, Good day and welcome to Parag Milk Foods Limited Q3 FY19 earnings conference call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions, and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. I now hand the conference over to Ms. Natasha Kedia – Head, Investor Relations from Parag Milk Foods Limited. Thank you and over to you.

Natasha Kedia: Welcome everyone to the Parag Milk Foods Q3 FY19 earnings call. Let me begin by introducing the management participants for today's call. We have with us Mr. Devendra Shah – Chairman; Mr. Vimal Agarwal, our CFO; Ms. Akshali Shah who is our senior VP, Strategy (Marketing & Sales); Mr. Poojan Shah from the promoter family and the Project Lead for Business Development; Mr. Amarendra Sathe - Chief Commercial Officer; Mr. Harshad Joshi – Chief Operating Officer; Mr. Shirish Upadhyay who is advising the company; Mr. Deepak Jain from the finance team; myself Natasha; and SGA, our investor relations advisors. I hope you have got a chance to look at our 'Financial Results' and 'Presentation' that is uploaded on the stock exchange as well as on Company website.

Let me start by giving some recent updates on the company –

- In the quarter gone by, we have launched Go Protein Power, a protein product which caters to the Protein Supplement Market in India. The category size is approximately Rs. 1,400 to 1,600 Crores and is growing upwards of 25% annually. We have launched the product in Mumbai and is available across 1,200 outlets in in packs of 200 grams & 400 grams. Our endeavour is to make the product available across all pharmacies, major nutrition supplement stores, modern retail stores and e-commerce portals.
- Further, we have expanded our Avvatar Portfolio and introduced a new variant 'Avvatar Advanced Mass Gainer', a product specially designed for weight gain. This launch is a strategic push for expanding the company's VAP category, specifically the health and nutrition portfolio that we have identified as a key growth driver. Besides this, we have also added new flavours and pack sizes. Currently, the brand Avvatar is available in 20+ states across India and is also available online.

Both these launches signify that we are focusing aggressively on the Health and Nutrition Category and we expect it to become a significant part of our product portfolio going ahead.

- Further, in January 2019, we have launched our premium milk - 'Pride of Cows' in Delhi NCR. The company will airlift the milk from our dairy farm, located in Manchar, near Pune. This expansion is a strategic move towards strengthening Parag Milk Food's offerings in the Northern region.

I will now give you some updates on certain media & marketing campaigns that we conducted during the quarter –

- As you all know, we recently introduced Gowardhan Cow Milk in Delhi NCR and surrounding regions. To make consumers more aware of the benefits of cow milk and to promote our brand we ran a Radio Campaign in Delhi on all leading radio channels and augmented that with hoardings, shelters, dealer boards, POS materials, etc.
- A full-fledged TV campaign was done for our products Gowardhan Ghee & Paneer on various popular news and regional channels. The campaign highlighted the importance of paneer as a daily source of protein or 'rozana ka protein' and Gowardhan cow ghee as the #1 choice in traditional homemade recipes.
- We also ran several campaigns for Pride of Cows across TV and digital platforms in our endeavour to start seeding Pride of Cows as a national brand.
- We continue to invest in building our whey protein brand Avvatar through initiatives such as partnering with Zee Maharashtra Kushti Dangal which was featured on Zee Talkies.

I will now hand over the call to Mr. Devendra Shah, Chairman of our Company to share his thoughts on the current business which will be followed by an update on Financials and then Q&A from our participants. Over to you sir.

Devendra Shah: Thank You Natasha.

Good Evening and a warm welcome to all the participants.

Our performance for the 1st nine months of this financial year has been as per our expectations, we grew by 20% as compared to the same period in the last financial year. Our efforts in strengthening our brands and increasing our distribution and retail reach across India is what has delivered higher growth in all categories as compared to the industry growth rates. Our brand strength in our key categories like cheese, ghee and paneer continues to be strong. With consumer acceptance and availability, along with increasing health consciousness and awareness regarding ghee made from cow milk, the ghee segment is growing rapidly for us. In the cheese category, through the various innovative products introduced, Go cheese has created a special place for itself and has attained a leadership position in the category.

Fresh category products like Milk, Curd, Buttermilk, etc continue to grow due to high quality and taste resulting in increasing consumer demand. We have already started the supply of these fresh category products from the Sonipat plant. This facility has not only allowed us to be closer to the consumers in the North and East regions, but has also helped increase our product offerings in the North and East regions as well as the freshness of products available on the shelves. We will be adding other product lines in this category which will contribute to footprint expansion in North and East.

We have also expanded our product portfolio in the Health and Nutrition category with the launch of Go Protein Power and a new variant under the brand Avvatar called 'Mass Gainer'. We believe that the future of this category is bright and by being the pioneer in India we can gain significantly from the same. We aim to have around 7% of our sales coming through the Health and Nutrition Category by FY20-21 from 2.5% in FY18. With this our overall Value Added Product Portfolio will increase to ~70-71% by FY20-21 from 66% in FY18.

We have also progressed well in the adoption of the 'New Way of Working'. We have developed a unique TOC model based on which we will be able to increase our retail presence and expand the range of our products across existing retail outlets. We have implemented this model in various parts of Mumbai and the results have been above our expectations. We plan to cover entire Mumbai by early 2019. We have also started our ground work in Delhi/NCR which we will target to cover post successful implementation in Mumbai.

Lastly, I would like to say that with this strong performance we are well on course to achieve our vision 2020 that we had guided last year. Our family has been in the dairy business since the last 25 years now, and while we initially started off in the commodity business of milk and SMP, we have transformed ourselves into a largely value added products business or an FMCG business. I feel immense pride on the journey of the company so far and I would like to thank the entire team of Parag and all employees for working hard and delivering a robust & historic nine months performance. We are very optimistic of Parag Milk Foods future in the dairy business in the years to come.

As you are all aware, the dairy Industry possesses great opportunity for growth with many unexplored avenues and unfinished agendas that we are yet to accomplish. We believe that it is vital for a dairy player to have a strong milk procurement network and relationships with farmers, as well as a strong distribution and cold-chain network – both of which provides a competitive edge that determines the success of the dairy business. Parag is one of the unique companies with an integrated business model - with strength across the value chain right from Procurement to Distribution backed by latest technology. Thus, we are well placed to capture the growth and explore the opportunities in the dairy space. With continued focus, we are building the business for the next century and aim to create long term value for all our stakeholders

Now I would request Mr. Vimal Agarwal, our CFO to discuss our financial performance for Quarter and nine months ended 31st December 2018.

Vimal Agarwal: Good Evening ladies and gentlemen.

I will discuss the financial performance for nine months ended 31st December, 2018.

- Consolidated Revenue from Operations for 9M FY19 reported a growth of 20.0% YoY to Rs. 17,235.1 million as compared to Rs. 14,366.7 million in 9M FY18.
- Growth was driven by an increase in revenue from Milk Products by 23% YoY to Rs. 11,619.4 million.

- The share of Milk Products for 9M FY19 is 67.4% of total revenue, while that of liquid milk was 18.3% and the same for Skimmed Milk Powder was 12.3%.
- Gross Profit for 9M FY19 recorded a growth of 28.1% YoY to Rs. 5,392.7 million as compared to Rs. 4,210.7 million in 9M FY18. Gross Profit Margins improved by 200 bps YoY to 31.3% as compared to 29.3% in 9M FY18.
- EBITDA for 9M FY19 grew by 30.4% YoY to Rs. 1,797.7 million as compared to a Rs. 1,379.1 million in 9M FY18. EBITDA Margin increased by 80 bps YoY to 10.4% for 9M FY19.
- PAT for 9M FY19 recorded a robust growth of 46.8% to Rs. 894.3 million as compared to Rs. 609.0 million in 9M FY18. The PAT Margin increased by 100 bps YoY to 5.2% for 9M FY19.

Now, coming to the financial performance for quarter ended 31st December 2018.

- Consolidated Revenue from Operations for Q3 FY19 reported a growth of 15.7% YoY to Rs. 6,006.0 million as compared to Rs. 5,192.8 million in Q3 FY18.
- Growth was driven by an increase in revenue from Milk Products by 19% YoY to Rs. 4,054 million, continued focus on execution excellence and buoyancy in key categories.
- The share of Milk Products for Q3 FY19 is 67.5% of total revenue, while that of liquid milk was 17.1% and the same for Skimmed Milk Powder was 12.6%.
- Gross Profit for Q3FY19 recorded a growth of 22.6% YoY to Rs. 1,957.3 million as compared to Rs. 1,596.0 million in Q3 FY18.
- Gross Profit Margins improved by 190 bps YoY to 32.6% as compared to 30.7% in Q3 FY18.
- This was driven by improved product mix, favourable commodity prices and export benefits
- EBITDA for Q3 FY19 grew by 5.7% YoY to Rs. 620.4 million as compared to a Rs. 586.9 million in Q3 FY18.
- EBITDA Margins were at a healthy 10.3% which gave us the headroom to make investments in developing long term distribution infrastructure and new GTM as well as building our brands.
    - Building of a strong team, infrastructure, and modern GTM have also led to an increase in employee benefit expenses. More specifically, we have deployed manpower to leverage Sonipat plant which we had acquired earlier this year. We have further augmented our frontline for north and east regions and have hired new manpower for implementing the TOC model in addition to new hires in the leadership team which we had done beginning of this year.
    - Other expenses, which includes Logistics, Factory overheads, Sales Promotions, Selling & Distribution and Advertisement expenses have grown in sync with the expanding business, both in terms of depth and width. Advertisement and promotion expenses were higher due to festive seasons. However, Trade

incentives and Advertisement expenses put together continues to be in sync with trends in prior periods.

- PAT for Q3 FY19 recorded a robust growth of 20.6% to Rs. 307.4 million as compared to Rs. 254.8 million in Q3 FY18. The PAT Margin increased by 20 bps YoY to 5.1% for Q3 FY19.

During the last couple of years, we have made significant investments on the technology side encompassing Milk Procurement processes, Salesforce IT automation, DMS and SAP ERP. There are further enhancements being done on developing cold chain with state of the art modern technological interventions. We have been able to achieve positive outcomes by leveraging these tools on the revenue side as well as on the working capital side. Our net working capital cycle based on total revenue has improved to 60 days in Dec 18 versus 72 days in Mar18 and 61 days in Sep 18. We expect our net working capital to continue to improve in subsequent quarters as well.

That is all from our side and now we can open the floor for Q&A. Thank you.

Moderator: Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.

Nitin Gosar: A couple of questions; one is on the other expenditure which management highlighted that it was higher led by A&P channel development. Would you mind elaborating it further or breaking it down further between these two pieces, like what is the number with regard to advertisement spends YoY delta and what's the other meaningful piece in this other expenditure?

Vimal Agarwal: Thanks for asking this question and that's an important one. I will read out a few data points which I mentioned in my speech. The EBITDA margin YTD was 10.4% versus 9.6% earlier, and within that, other expenses component has gone up. Now, on the other expenses, there are two things. The variable part in other expenses which is largely logistics expenses and factory overheads which will grow in sync with the overall revenue growth. More specifically on advertisements and marketing, our last year's number was closer to 2.6% which is now closer to 3%. And that is the key driver where you are seeing the fixed part of other expenses really going up.

Nitin Gosar: Okay, so that's been the meaningful delta.

Vimal Agarwal: Yes.

Nitin Gosar: Okay. Sir, my second question is with regard to the gross margins. We have seen a good enhancement in the gross margin. Is it with regard to the raw material cost or is it coming in from the sales mix? And how much of it do you want to keep on deploying in advertisement spends and channel development going forward?

Vimal Agarwal: On the gross margin, what more relevant is to really look at possibly a longer term trend of say 9 months trend where the margin is closer to 31%. Quite a few factors contributing to it. For example, the value-added mix per se is going up, and within value-added products also, there are categories like protein which is picking up momentum and next year will hopefully be a game changer for us. Now, outside of that, as I mentioned in the previous part of the conversation, our marketing spends are going up. If you look at trade incentives or say channel leverage along with advertisement promotions, we usually operate at around 8 to 9%. We have managed that, while the advertisements have gone up which means that the trade incentives have dipped for the quarter. So, these two three things are the key factors which are contributing for the improvement in gross margins.

Nitin Gosar: Okay. My question also was extended to how much of your gross margin improvement you want to deploy in advertisement as well as channel development going forward? Like we have seen almost 40 bps delta in advertisement spend, i.e., 2.6% going to 3%. So, what's the upper limit going forward to this number?

Vimal Agarwal: The key point is our advertisement and sale promotions will continue to operate in the range of 2.5-3.0%. Having said that, within quarters, you will see upsides or downsides. For example, the Sonipat plant which in a way went live in the later part of Q2 was up and running for full year and we did make investments in Quarter-3 on the Delhi NCR distribution as well. So, to that extent, you are seeing the ups here which hopefully will drop in Quarter-4, but as a stated principle, as we have maintained in the previous calls, our advertisement budget would be around 2.5-3.0%.

Moderator: The next question is from the line of Bhargav Buddhadev from Kotak Mutual Fund. Please go ahead.

Bhargav Buddhadev: Sir, I missed the figure of net working capital for 3Q18. You said for 3Q19, it is 60 days. What was it for 3Q18?

Vimal Agarwal: I would not have shared that number in my conversation earlier this time. I remember March 2018 exit, overall was about 72 days.

Bhargav Buddhadev: And is it fair to say that in March 2019, we will be closer to 60 days or whether it will increase from here on?

Vimal Agarwal: In the last investors' calls, we had talked about this aspect in much detail. Our stated approach or drive is to ensure that we improve on working capital. December we were at about 60 days. We intend to improve on it if we can but we definitely are not going to deteriorate.

Bhargav Buddhadev: Secondly Sir, there has been sort of a significant increase in the employee cost in 2019. Just wanted to know your thoughts in terms of how will FY20 look at as far as the employee cost is concerned?

Vimal Agarwal: Bhargav, on this one, FY19 is a year of investment so far as talent buildup is concerned. If you look at it, we have hired people at the key leadership positions and that's the communication we had sent out in Quarter-4 of FY18 and Quarter-1 of FY19. And now that significant leadership hiring is done with. Our North plant acquisition which was largely executed in Quarter-1 of FY19. We have hired people for the plant as well as for frontline distribution and we are very hopeful that that decision of hiring very talented bunch of people will really payback. And the third reason is North and East right now are growing at a pace which we have not seen in the last many years, and that's on the back of the leadership team which we have built up across North & East which includes northeastern states as well. Fourth is, and I am sure lot of people on the call are aware of the Theory-of-constraints (TOC) led GTM which we had implemented post November 2017. We are right now scaling that model in Bombay as well as have started the investments for Delhi. That is leading to manpower hiring and to that extent, you will see the employee cost to be higher so far as this year is concerned. On a percentage basis, I am sure that we are not going to go up versus what you have seen as of now.

Moderator: The next question is from the line of Jasdeep Walia from Infina Finance. Please go ahead.

Jasdeep Walia: Sir, the trend in your SMP sales is pretty subdued on a YoY basis. I had thought that because of the government incentives, there will be significant increase in SMP sales this quarter which would also reduce your inventory significantly. Could you comment on that, Sir? Why is the trend so subdued in SMP sales?

Vimal Agarwal: I think, the trend is not that subdued. It is in line with we have been telling and doing over all these years. Till date also, around 12.5% of our total sales consists of SMP as a commodity and 12% to 13% is the range in which we have been doing and trying to reduce it a little bit as far as possible. Secondly, the price realization increase in terms of commodity has started only few days back. So, it may take time for the market to stabilize in terms of pricing and also the inventory levels. Accordingly, we will take a call how much to sell and how much to take it forward.

Jasdeep Walia: Sir, but the in government incentives on exports of SMP was significant, right? So, even at subdued prices, you could have sold a lot of SMP.

Vimal Agarwal: The government incentive is quite good and we thank the government for all that support, but however even after all those incentives, we were somehow not able to match the international pricing and therefore the kind of business that we could generate from export was limited.

Jasdeep Walia: So, in that case, I should also assume that the inventories of SMP continue to be high in your company?

Vimal Agarwal: No, it is not that high as of now.

Jasdeep Walia: Could you quantify, could you give some color on level of inventories of SMP?

Vimal Agarwal: It would be very difficult as of now to comment on that.

Jasdeep Walia: And Sir, now you are saying that since possibly the exports have started, so should we expect significant reduction of SMP inventory in the next 2 quarters?

Vimal Agarwal: It is very difficult to comment on the commodity market because it fluctuates on a daily basis, but as we discussed, currently there has been some price increase both in the domestic as well as international market. We are watching the market, discussing with market players. So, hopefully there will be increased sales and liquidation of some inventory going forward.

Jasdeep Walia: Could you comment on how Avvatar has performed in 9 months of this year?

Vimal Agarwal: There are a couple of points on Avvatar. One is for this year and how do we see this going forward. We launched the Avvatar brand about 4-5 quarters back with one key driver which is whey protein. As standing today, we have been able to increase our product offerings under Avvatar and we have recently launched Avvatar Advanced Mass Gainer. , You will see a couple of more variants like Isorich which is 90% protein and Avvatar Rapid, which is for runners or people who are into lighter activities, getting launched as we speak right now. With these launches, we would be completing the entire product basket. Our distribution across 20-22 states is largely done with. We believe that whatever it takes in terms of providing the inputs to the business, we are largely done, which will mean that next year we should see significant contribution coming in. Our stated number for the contribution of the health and nutrition segment to the overall topline for FY21 is about 6-7% which is around 2.5-3.0% currently. That's the journey that we want to cover in the Health and Nutrition space where Avvatar is going to play a critical role. Apart from this, we have Go Protein Power under this basket, which right now is getting test marketed in Mumbai. Additionally, there are few institutional supplies which we do to key or niche clients. So these three things we are hopeful that they will start trending the way we had said in the investors' conference earlier this year.

Jasdeep Walia: Sir, I think your target for Avvatar sales was Rs. 25 crores, if I am not wrong, for this year FY19. Are you on course to achieve that?

Vimal Agarwal: We are ahead of that.

Moderator: The next question is from the line of Anil Sarin from Edelweiss. Please go ahead.

Anil Sarin: I just wanted to know what are the figures for creditors during the first 9 months, what is the figure for loans and advances during the same period, and what is the figure for inventory and debtors?

Vimal Agarwal: I will not be able to share the exact numbers with you. However, a couple of points which I can share with you which you can possibly layer on the September numbers and get a good sense. So far as creditors are concerned, we are largely in sync with the numbers which we had seen in March 2018 or September 2018, there is not much change. Similarly, loans and advances there is not significant change. We are seeing some recoveries as per schedule for the loans which we had given to the farmers. The related part which is critical here is the PSI incentive which Parag gets from Maharashtra government, export subsidies for all the exports which we have done in the last 3 months or 6 months, and Maharashtra state led subsidy of Rs. 5 to the farmers. These three put together as of now makes a significant contribution to the entire balance sheet. Now our expectation is that in the next 45 days or so, we should see this number coming to back to normal. When I say normal, it means that the Rs. 5 milk subsidy which has got built up, we should be getting all that money; and similarly, PSI incentive usually we get a large chunk in Quarter-4. If all that comes in, our loans and advances will be much better versus where we were last year.

Anil Sarin: This is the dues from the government but in terms of the loans that you give out to aggregators to support them, how is the movement on that account?

Vimal Agarwal: Actually, I mentioned that part as well, the outstanding in March you will see that dipping because as we buy milk or procure milk, that amount starts getting adjusted. So, that number should be better versus our March number.

Moderator: The next question is from the line of Bhavin Chheda from Enam Holdings. Please go ahead.

Bhavin Chheda: Sir, what was the milk procurement number in the Quarter? One is that, and your presentation slides show that for the Sonipat also, you will be soon targeting 4 states for milk procurement. So, what are the plans there? When would the sourcing start and what would be the strategy on the milk procurement number over next 2 years?

Vimal Agarwal: Milk procurement for the quarter is somewhere in the range of around 13 to 15 lakh liters on an average. As far as the Sonipat plant is concerned, we have started laying the procurement network in that area but it is too premature to give any figures or facts in that regard. As of now, it is work in progress. As and when there is some development, we will update you.

Bhavin Chheda: But will it take time or you have a strategy where you can get 3-4 lakh liters by next year or 2021?

Devendra Shah: We have started work in that regard but procurement is always a time consuming thing. So, it will take time in terms of achieving full scales.

Bhavin Chheda: And what was the debt number as on December 31st?

Vimal Agarwal: Broadly the same as on 30th September 2018.

Bhavin Chheda: Roughly, that was around 200 odd crores?

Vimal Agarwal: Yeah, it was about ~Rs. 260 odd crores including long term debt.

Moderator: The next question is from the line of Sameer Gupta from IIFL. Please go ahead.

Percy Panthaki: Sir, I just wanted to get your views on how do you see milk procurement prices trending over the next few quarters. There is an opinion that after 3-4 years of very benign and declining milk price, now we should see some gradual inflation and some part of it is already visible in terms of SMP prices and now it will flow over to liquid milk prices also. So, just wanted your view on that.

Vimal Agarwal: I think corrective actions that were required in terms of bringing milk procurement prices in line have been taken in respective regions, be it Maharashtra where there were some concerns and government intervened with subsidy and started to stabilize the market. Similar was the situation in Gujarat. Same was also in few other states. So, all those corrections have been done. Going forward, we would see normal inflationary increase in terms of milk procurement prices which would be roughly around 5% to 7%. Other than that, we don't see any major changes.

Percy Panthaki: Okay. And this normal inflation that you expect going forward; when that happens, could there be a temporary dip in your margins on account of that?

Vimal Agarwal: Two things. Normally, the increase in terms of procurement prices happens with the onset of summer season. So, typically by end of March or beginning of April is the time when the increase in procurement prices happens, and it happens gradually over the summer period depending on availability and carry forward inventories. In terms of hit on our margins is concerned, as we discussed this is a normal inflation and we have to take care in terms of managing that increase either by cutting down the different offers that we provide into the market, or secondly by passing it onto the market. So, that is a part of normal business and we will take care of that.

Percy Panthaki: Okay Sir. Next question is you mentioned that you are seeing a very good growth in North, East and Northeast. All put together, this is giving you a growth of about 15-16%. Just wanted to understand the growth in your main core business that is the western region, is that really something which is not up to the mark? Would you be able to give some color on how much growth is there in the western region?

Vimal Agarwal: Region-wise, we don't give out numbers but rest assured there is no issue or any slowdown in terms of growth in the established markets like West. Just to correct your figures, we have grown by 20% in the last 9 months, and within that, our consumer product growth is much higher than that. So, we have been growing consistently in our consumer products across geographies. While we are discussing East and North as a major focus market, our base in those markets was much smaller and therefore the percentage increases that we are getting in those markets looks higher, but overall established markets like West are also growing significantly.

Percy Panthaki: Right Sir. And finally, just a clarification on the other expenses line, you mentioned that 40 basis points as account of higher ad spend, but if I see YoY, your other expenses and percentage of sales have gone from 15.9 last year to 18% this year. So, that's a 210 basis points increase out of 40 basis points explained by ad spends. Sir, what would the other increase be on account of?

Vimal Agarwal: See I would suggest that you stay with absolute numbers because that is easier to understand. We had other expenses in first 9 months last year of about Rs. 230 crores which has gone up to about Rs. 290 crores. So, overall first 9 months revenue growth was about 20% and we have got at least 50% of other expenses which are variable which means that inherently Rs. 230 crores would have gone up anyways 20% because your base or the revenue is going up.

Percy Panthaki: Sir, makes sense on 9 months basis. My question was on the third quarter itself.

Vimal Agarwal: I am requesting you to stay with 9 months because you can appreciate the numbers much better.

Percy Panthaki: Okay, then it makes sense.

Moderator: The next question is from the line of Manoj Baheti from Omniscient Capital Advisors. Please go ahead.

Manoj Baheti: My first question is in respect of working capital. As we keep on growing our consumer centric business, if you can give us some guidance or color that what will be the additional requirement of working capital. Also it would be great if you can share some numbers on the composition of working capital; especially inventory, credit, or receivables?

Vimal Agarwal: Overall working capital cycle as I mentioned in my earlier discussion, it was about 72 days in March 2018 which is down to 60 days in December 2018, which basically means an improvement of about 15% on a revenue growth of 20%. And if you do the numbers backward, it means that the absolute working capital need has more or less stayed where it was in March 2018. The endeavor will be to ensure that we are not going up in absolute working capital so far as this financial year is concerned. Now having said that, the point which we had mentioned in our previous calls as well, as you grow and distribute deeper, it will always be important to watch out the receivables part because you tend to extend receivables. Our intent here is to ensure that our number of days of receivables also improves. And similarly, the inventory should come down as our base goes up. But the related part really is on the capacity utilization. We should exit anywhere between say Rs. 2,300 to 2,400 crores in this financial year as far as revenues are concerned which means that we would have grown for about 5-6 quarters without any substantial capacity led CAPEX. These are the two critical points which I thought I will just clarify.

Manoj Baheti: Vimal, on the working capital side like as you mentioned that the absolute level of working capital has been maintained as compared to March 2018. Just wanted to understand that you also mentioned that the debt level is more or less similar, right? Or has it come down vis a vis March 2018?

Vimal Agarwal: It has come down a bit, Manoj.

Manoj Baheti: Okay, and how much it has come down? Because we have generated over 9 months a good amount of EBITDA and what is the CAPEX number during these 9 months? Just wanted to understand the cash flow equation during these 9 months.

Vimal Agarwal: If you go back to the initial guidance, we had said that we will try and do CAPEX of about 2.5%of revenue. So, our CAPEX for first 9 months is about 59 crores. And I don't see any substantial CAPEX coming in, in the next 3 months or so. So, largely we should be closer to this number itself or maybe 5-10 crores higher.

Moderator: The next question is from the line of Sangeeta Tripathi from Edelweiss. Please go ahead.

Sangeeta Tripathi: My first question is on the distribution footprint. What would be our distribution footprint right now?

Akshali Shah: Currently our distribution is around 3 lakh retail outlets pan India. And we are also expanding, so we are adding outlets every day.

Sangeeta Tripathi: Okay. And if I were to understand it on the northern front because it has been around let us say 9 to 10 months since we have been very focused on the northern part of the region, if a broad split across the regions that would be really helpful of these 3 lakh outlets that we have?

Akshali Shah: It will be very difficult to share region per se because we are looking at cities where it is more populated where outlets per population is much lesser wherein the rural area it is much higher. But yes, we are also expanding very much in the northern region. Especially with the liquid milk and curd coming in, we are also reaching out to the daily outlets in the North.

Sangeeta Tripathi: My second and the last question is on the growth in the value-added product mix what we have achieved for the 9 months and 3rd quarter, quite decent one 19% for this 3rd quarter. Within this value-added product mix basket if you can just give some indication as to which is the category which is growing much faster. I understand we don't share the numbers category-wise but still some subjective analysis on that would be helpful.

Devendra Shah: Cheese and ghee basically these 2 products and our whey business on a lower base, but these 2 categories are very fast-moving.

Sangeeta Tripathi: Cheese and ghee these 2 products would have grown at the higher level of 19%?

Devendra Shah: Higher level, yes.

Moderator: The next question is from the line of Mehul Desai from IDFC Securities. Please go ahead.

Harit Kapoor: Just 2 questions. Firstly, looking forward to next year, this year we had a tailwind of very strong mix as well as milk product prices which were in our favor, next year as Deven bhai also said that you will see a normal inflation. I just wanted to understand what will be your EBITDA margin driver for next year? Will it be largely only overhead operating leverage or would there be a positive effect on gross margin also?

Vimal Agarwal: There will be 2 things which will be happening here. One is the value-added mix will continue to improve led by categories which are growing at a substantially higher rate which is paneer, cheese, and whey protein. The second part is also the operating productivity or efficiencies where there are a few projects which we are working. That should start giving us some upside. So, a combination of both these will mean that gross margin should improve a bit and EBITDA margin as we said our guidance continues to be between 11% and 12% for next year.

Harit Kapoor: Okay, fine. And the second thing was on the tax rate. I think you had guided for 26-28%. First 9 months, it has been far lower. Would the assumption be that the 4th quarter will be much higher and hence we will be in that same band?

Vimal Agarwal: On a full year basis, for next year you can assume the tax rates to be sub 24%.

Harit Kapoor: Okay, this year and next year would be 24%?

Vimal Agarwal: Lower than that, yes.

Moderator: The next question is from the line of Sagarika Mukherjee from Elara Securities. Please go ahead.

Sagarika Mukherjee: Just wanted to check with you what has been the PSI benefits/export incentives, etc., and duty-drawback for the quarter?

Vimal Agarwal: Overall, our export mix in revenue is about 3.5% to 4%. Earlier in the conversation, we were talking about SMP. SMP is one part. The value-added product is largely where we get the maximum upside., The subsidy that the government announced which was 10% in the beginning and after that it improved to 20%. The important point here one should note is that the subsidy fully will never get into the P&L because all other players are getting similar subsidies and to that extent, the competitive bidding tends to indirectly take away some portion of subsidy benefit.

Sagarika Mukherjee: PSI benefits like other operating income for the quarter?

Vimal Agarwal: PSI benefits we should be getting at about Rs. 20 to 25 crores this year.

Sagarika Mukherjee: Average milk procurement price for the quarter?

Vimal Agarwal: Our average milk procurement price will vary depending on which district or geography we are talking about. In South, it is high. In West, it is low. The range is anywhere between Rs.23 to Rs.27.

Moderator: The next question is from the line of Vishal Punmiya from Motilal Oswal. Please go ahead.

Vishal Punmiya: What was the overall volume growth for the quarter?

Vimal Agarwal: It's about 3.5% to 4% better than the revenue growth.

Vishal Punmiya: And what was the contribution from the Sonipat plant in terms of revenues?

Vimal Agarwal: Overall, for the full year FY19, we should be closer to about 3% to 5% percentage points of revenues.

Moderator: The next question is from the line of Anirudh Joshi from ICICI Securities. Please go ahead.

Anirudh Joshi: Just one request regarding IRIS Business Solutions. Earlier, it was part of promoter and then we have seen it as part of non-promoter and now it doesn't appear in the shareholding pattern. Can you just clarify on it? And second question is the Bhagyalaxmi Dairy revenues and PAT in this quarter as well as YoY, i.e., Q3 FY18.

Vimal Agarwal: So far as the IRIS Business Solutions is concerned, the reason it was getting classified as promoters group entity was because one of the director was a shareholder. After that shareholding reduced below the threshold limit, it was classified in the non-promoter group.. The second point is so far as Bhagyalaxmi is related, we are about Rs.40 to 42 crores of revenue with a PAT of about Rs.5 to 6 crores.

Anirudh Joshi: And same numbers last year Q3?

Vimal Agarwal: I do not have the numbers readily available right now.

Moderator: The next question is from the line of Nitin Raheja from AQF Advisors. Please go ahead.

Jai Tejwani: One question from my end. As we go to 7% in health and nutrition by 2021, how will our gross margins look?

Vimal Agarwal: Health and nutrition gross margins, once the category is matured and we are more stable in that segment, it is upwards of 40%. The key part is that in year-1, it will not be 40% but the potential say for example Avvatar once we are stabilized on distribution, it should be upwards of 40%. That is how we are looking at this category.

Moderator: The next question is from the line of Amarjeet Maurya from Angel Broking. Please go ahead.

Amarjeet Maurya: A couple of questions, first on tax rate. Currently, for 9 months we have a 22% tax rate and compared to last year it was 27%. So, why it is low, and you said in the conversation you were expecting 24% tax rate in FY20. What is the reason behind that?

Vimal Agarwal: The direct tax rate for the quarter is low driven by incremental deductions allowed for revenues and profits generated through new CAPEX investments which we have done. These investments include cheese and whey CAPEX. Other CAPEX like compliance CAPEX is concerned, tax department allows you higher rate of deduction. That's the key driver why the tax rates are lower and I do expect it to stabilize at above 24% for this year.

Amarjeet Maurya: I know it will have a number for working capital. Just give me a rough sense like for the 9 months number, inventory, receivable, and payable. Just give me a sense in terms of numbers if you don't have exact numbers.

Vimal Agarwal: Overall working capital cycle is what I had mentioned in my speech it is about 60 days. Now, if you look at the March 2018 numbers of inventory, debtors, and creditors. We expect inventory to drop versus March 2018, debtors to remain flat or slightly higher, and creditors to be similar to March 2018 numbers.

Amarjeet Maurya: Okay. Sir, I just wanted to understand one thing on a business front like as of now you are selling Go Protein in 1200 outlets. What is the response from customers like and what is the competitive scenario in that segment?

Natasha Kedia: We have only launched Go Protein Power in Mumbai and right now it is a pilot and we are doing all our marketing activities also around that. We are doing several in-shop activities and we are explaining why protein is required as a supplement in our diets. So far, the response has been really good. We are getting repeat purchase from the same outlet. So, this is a good sign, plus we are the only ones who are talking about milk-based protein or 100% milk protein, so, that's an added advantage.

Amarjeet Maurya: Just wanted to understand one thing like for the Avvatar front, this is a whey protein. Actually, even I am using whey protein. I am using multinational brands, US brands like Optimum Nutrition Protein or Ultimate Nutrition Whey Protein. How are you facing competition with these guys and in domestic front like MuscleBlaze. Overall and with respect to Avvatar whey protein, how is the competition scenario for you?

Devendra Shah: Many of the international brands are re-packers mostly. Avvatar is India's first brand made from 100% cow milk based protein which is freshly manufactured at our plant. The consumers have accepted this product well as the solubility and taste is better than that of the international brands. That's why this has been a very fast moving product for us.

Amarjeet Maurya: Just wanted to understand where you are selling this product? Are you selling in the chemist shops or you have a unique distribution network for this particular whey protein?

Akshali Shah: For our health and nutrition, we have a different sales team working on it and we are supplying it to specialized sports nutrition shops. We are also going to chemists. A large portion of it is also coming from online portals like Amazon and Healthkart.

Amarjeet Maurya: What is the mix between the distribution off and online?

Akshali Shah: 20% or so would be coming from online.

Moderator: The next question is from the line of Sunil Kothari from Unique Investment Consultancy. Please go ahead.

Sunil Kothari: Sir, at the end of Quarter-2 presentation, we have mentioned we had 2.8 to 3 lakh outlets and in the Quarter-3 we have mentioned that we have 3 lakh outlets. Has there been a change in strategy because between Quarter-2 and Quarter-3, our number of retail outlets remains almost the same versus our earlier run rate of 10,000 outlets a month?

Vimal Agarwal: One thing which I am sure we all appreciate is the fact that in the first 25 years we opened about 2.5 lakh outlets and then went on and said that we will expand it disproportionately because that's the single biggest bet which we are putting as an organization. Now, we have added approximately 50,000 outlets in the last 9 months, and I think that's a commendable job that the frontline has done and we will continue to build on the distribution network.

Sunil Kothari: So, should we assume that it will be 6000 to 7000 outlets a month addition over a longer period?

Vimal Agarwal: You will not be able to measure it on a month-on-month basis. I will say that take it as yearly basis. There are 2 things happening. One is the GTM which we are changing right now will give us disproportionate increase in outlets. Apart from this, we will have the normal increase in outlet base. So I think we should start hitting anywhere between 7000 to 8,000 outlets as we go along.

Sunil Kothari: Okay. Sir, my second question is regarding this interest expense quarter-on-quarter. We have improved on our working capital too. Why other interest expense gone up from 7.5 crores to 10 crores this quarter?

Vimal Agarwal: Interest for first 9 months is about Rs. 27-28 crores which is for the short-term and long-term debt put together. The number for the quarter includes few processing charges which we have paid and a small component of forex fluctuation. For the next quarter, you can assume it to be in sync with what you are seeing for 9 months at a consolidated level.

Sunil Kothari: So, we have some forex loans as part of our debt?

Vimal Agarwal: Yes.

Sunil Kothari: Can you quantify that number please.

Vimal Agarwal: Yeah. It is there in the balance sheet. We had taken a loan around 4-5 years back from IFC World Bank of about Rs.110 crores out of which we are left with about Rs.50-55 crores right now.

Moderator: The next question is from the line of Shaan from Edelweiss. Please go ahead.

Shraddha: Wanted to understand when we give this guidance of 11% to 12% of EBITDA margin for 2020, what is the milk price assumption and inflation that we are assuming?

Vimal Agarwal: It's a normal inflation of around 5% to 6% which we have calculated and it applies both in terms of input as well as output.

Shraddha: Okay, so we are assuming a growth as compared to a decline in the last 2 years? We are assuming this should start picking up and after that we will be able to grow our margins because of the improvement in product mix, right?

Vimal Agarwal: Yeah, it is mainly improvement in product mix which we are targeting, moving up the ladder in terms of whatever categories that we are in, and that is what is going to drive the improved margin expansion.

Shraddha: Sure. And just lastly, wanted to understand how are we progressing with Vector Consultants if you can give some color how many outlets we have covered and what has the progress been there?

Vimal Agarwal: Shraddha, we will not be able to share the exact outlet count at the moment due to business confidentiality.

Shraddha: Probably some qualitative aspect how are we progressing with them, any improvement?

Vimal Agarwal: We believe that we are doing exceptionally well and therefore we will continue to be on this Vector scale up journey.

Moderator: The next question is from the line of Jayant Mamania from Care Portfolio Managers. Please go ahead.

Jayant Mamania: I was just comparing the inventory and debtors with our industry peers like Hatsun Agro and Heritage Foods. Hatsun Agro has debtors of Rs.10 crores only on the sales of Rs.5000 crores and inventory of only 278 crores. Heritage Foods has debtors only Rs.13 crores and inventory of Rs.56 crores on sales of Rs.2500 crores. Whereas we have debtors of Rs.262 crores on sales of Rs.2200 crores and inventory of Rs.383 crores which is substantially higher. Can you explain this?

Vimal Agarwal: Yeah, that's right. That's a valid point and observation you had. The only difference is that Heritage and Hatsun are in a different business segment versus Parag Milk Foods. The conversation and the discussion that we had till now you would have heard is that value-added product is about 67-68% and out of that curd for us is not very big. It means that if you just compare at a product level, the equation is extremely different, you will never be able to compare it. Just to quote one example, some of these companies operate in a specific sort of radius versus Parag which has got about 20 depots, 3000 distributors spread across all 29 states. This makes it very different from the other companies and the fact that your value-added products are more compatible with FMCG because the shelf life is higher. So, I will request not to compare because the models are very different and the products are extremely different.

Jayant Mamania: But Vimal what happens if Hatsun Agro with a sales of Rs.5000 crores if it has 20% of its sales in value-added milk products which comes to Rs.1000 crores. So, if you take 15% of that, then also it comes to around Rs.150 crores, but their debtors is only Rs.10 crores?

Vimal Agarwal: That may be the right data point, but I will not be able to comment on their business model.

Jayant Mamania: Because our interest burden is high with most of the amount lying in the working capital

Vimal Agarwal: Moving away from value-added products and coming into the fresh milk business is not the strategy which Parag Milk Foods has taken from long-term perspective.

Moderator: The next question is from the line of Nisarg Vakharia from Lucky Investment Managers. Please go ahead.

Nisarg Vakharia: Gentlemen, there is a B2B business segment also in the whey market in India. Do we have any contribution in our sales as of now by selling whey into the B2B market?

Vimal Agarwal: Yes, we do have.

Nisarg Vakharia: Sir, can you please quantify that number for the first 9 months out of the 1700 crore sales?

Vimal Agarwal: I will not be able to quantify specifically for B2B and B2C whey protein, but overall health and nutrition segment does have this number inbuilt. When I said that 3.0% of sales is coming from the health and nutrition segment, I am including the institutional part of it which is not a substantial portion of this.

Nisarg Vakharia: Sir, how large is the institutional market in India?

Vimal Agarwal: You are saying whey market?

Nisarg Vakharia: Yes.

Vimal Agarwal: About Rs. 1000 crores is our estimate.

Nisarg Vakharia: And all of that is completely imported right now, right?

Devendra Shah: No, the B2Cis around Rs.1500 to Rs. 1800 crores, and for the B2B, it's around rs.1000 crores.

Nisarg Vakharia: So, B2B 1000 crores is completely imported right now, right?

Devendra Shah: Around 1/3rd is local and the rest is imported.

Nisarg Vakharia: So then why are we not able to capture a large part of the market share of the 66% market which is available? Because it would make a logical sense for the customer to buy from you rather than importing that product.

Devendra Shah: That is right, but there are two things. As a company, our focus is consumer value-added products and especially with the kind of investments and efforts that we have put in the protein business over the last 4 to 5 years, it does not make any sense to get into commodities and sell it against current players who are selling it at dirt cheap prices. Ultimately please understand that the current Indian whey protein market, especially in the lower end constitutes around 80%, was a waste stream 2 years back and now people have tried converting into some dried form and selling it into the market. And therefore, it is a highly competitive B2B market and does not make any sense to get into that as of now.

Nisarg Vakharia: But Sir, for you it is just an incremental sale, right?

Devendra Shah: We are already selling it into the market but we are not targeting the lowest end of the market and we don't want to get there.

Nisarg Vakharia: Okay. Sir, my second question is that you have done as Rs.60 crore CAPEX in the first 9 months. What is the maintenance CAPEX that we have to incur on our gross block annually?

Vimal Agarwal: This Rs. 60 crores includes the Sonipat plant as well. However, on an ongoing basis, last time I had said that the compliance capex would be 2.5% percentage points of sales. However, my sense is that it will drop because the revenue base will go up and the number of plants or manufacturing units will not increase.

Nisarg Vakharia: So Sir, out of the EBITDA that we do for the 9 months, what percentage of that EBITDA is direct cash flow to us post working capital?

Vimal Agarwal: My sense is it should be closer to 65% post adjusting for milk subsidy receivables, but I don't have the exact number right now.

Moderator: Ladies and gentlemen, we will take the last question from the line of Akshay Bhor from Premji Invests. Please go ahead.

Akshay Bhor: Gentlemen, is it possible to share the cash flow from operations for the first 9 months and how much was this for last year 9 months?

Vimal Agarwal: Our operating cash flow should be about Rs.100 crores this year. I don't have the last year number rightly available with me.

Akshay Bhor: Okay. As we understand, the next 2 years are going to be good in terms of free cash flow generation because you don't have a lot of CAPEX. How are you going to deploy this free cash flow because you still see a good chunk of interest expenses coming through? Any plans of paying out the debt from here on or what is going to be the strategy?

Vimal Agarwal: Actually that's a valid point. There are 2-3 options we have and still we are evaluating as to what all we can achieve or do out of this cash flow. One is obviously to evaluate part of the debt which we can retire and our sense is that we will continue to invest part of this cash in building up the infrastructure from long-term point of view.

Akshay Bhor: Okay, but then you also mentioned that you don't need much of CAPEX, right? And infrastructure building would be part of that.

Vimal Agarwal: No, when I say infrastructure, I don't want to increase say the number of plants but within the plants we do compliance CAPEX. We have made investments in cold chain in the last 1 year and we have made significant progress. Further, the write-offs or the inventory ageing which used to happen has significantly dropped for us. So, by infrastructure, I am also referring to indirect investments which we made in transportation or cold chain development.

Akshay Bhor: Understood. In terms of 2 product categories paneer and curd, could you give us a ballpark how much you have done in the first 9 months and generally what is the business traction there, specifically paneer and curd?

Vimal Agarwal: Like any other category which is nascent and not matured like ghee, we are seeing growth which is upwards of our average growth rates for the company. To that extent, we are experiencing good growth in cheese, curd, and paneer.

Akshay Bhor: Any ballpark numbers in terms of the overall sales, what percentage would contribute paneer and curd?

Vimal Agarwal: I will not be able to give you the specific numbers at a category level.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to Ms. Natasha Kedia for closing comments.

Natasha Kedia: I would like to thank all participants for taking the time out to join us. Please feel free to get in touch with me or SGA for any further questions. Our coordinates are provided at the end of the Quarter-3 presentation which is uploaded on the Stock Exchange and our company website. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Parag Milk Foods Limited, we conclude this conference. Thank you for joining us, and you may now disconnect your lines.