"Kwality Limited Q2 FY17 Earnings Conference Call"

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Moderator: Good morning, Ladies and Gentlemen. Welcome to the Kwality Limited Q2 FY17 Earnings Conference Call, hosted by Edelweiss Broking Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. If you need assistance during the conference call, please signal the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Ms. Sangeeta Tripathi. Thank you and over to you, ma'am.

Sangeeta Tripathi: Thank you, operator. Good morning, everyone on the call. On behalf of Edelweiss Global Wealth, it gives us a great pleasure to host Kwality Limited for discussing its Q2 FY17 performance. From the management, we have Mr. Nawal Sharma – President & Head Business Transformation, Mr. Satish Kumar Gupta – Chief Financial Officer, Mr. Varun Kapoor – Investor Relations and Corporate Strategy, Mr. Anand Goel – General Manager, Finance. Without much ado, I would now hand over it to the management for their opening comments and from thereon we can take and open the floor for question-and-answer session. Over to you sir, Mr. Nawal.

Nawal Sharma: Good morning, everyone. And a very warm welcome to all of you. So, let me start with numbers first. So, as we talk about top-line, this quarter our top-line has grown from Rs. 1,416 crores to around Rs. 1,540 crores, which is about 8.8% increase same quarter last year, comparison is what I am sharing with all of you. But key thing to be noted is the strategic focus area, that is the consumer part of the business has grown from Rs. 446 crores to Rs. 606 crores which has clocked around 36% growth. And in terms of contribution it has gone up from 30% to 40%.

So, now coming to the profitability layer. So, as we talk about EBITDA part, this has gone up from Rs. 86 crores to Rs. 103 crores which is around 20% increase, which means 6.1% to 6.7%. Talking at the PBT level, this has gone from Rs. 49.5 crores to around Rs. 63.5 crores which is around 28% increase. In percentage terms, it has gone from 3.5% to 4.1%. And lastly, about the PAT layer which has gone up from Rs. 37.5 crores to Rs. 42 crores which is around 12% increase. And in percentage terms it has gone up from 2.6% to 2.7%. Now, this is just an output layer. So, as we always say, numbers have got no meaning unless and until it is discussed and interpreted in view of the business context. So, while the numbers are good so we are moving in the right strategic direction, now let's try to understand as to what are the various business layers which are helping us to deliver these numbers.

Now as we talk about business layer, we will break that from two standpoints. First, we will talk about the strategy perspective. So, as we discussed last time also that there was a strategic decision taken moving from B2B towards building of very strong consumer business. So, I am sure you would all agree that strategy layer is critical but where organizations generally falter is execution of the strategy on the ground. So, that is where in terms of the post various workshops and discussions with external consultants we have created a very massive and a robust transformation program, under which we are actually reengineering the complete organization and each of these components are helping us in clocking these positive growths in numbers at all the layers, whether we talk about top-line, whether we talk about the profitability there at different points. So, before I get into the execution part of this, also would like to mention that on an H1 basis also the numbers are very positive in line with the Q2 reports. So just a very high level data point sharing, top-line has grown by around 7% out of which consumer part of the business has grown by 33%. And in terms of the contribution, it has gone up from 32% to around 40%. And EBITDA there also has given a growth of around 12% whereas PBT layer has given a growth of around 31%, and PAT there is a growth of around 15%. So, H1 is also in sync with the Q2 part.

Now let's talk about a few execution frameworks which are working beautifully within the organization. So, the first part is the branding rollout is happening absolutely as per the plan. As we shared with you that we are in a process of rolling out various products under the brand name KDIL’s Kwality. Last quarter also there had been pretty good response and post doing various researches some very positive feedback has come and we have already rolled out which we discussed last time that we will be doing. So this quarter I am very pleased to share that we have already rolled out our brand campaign. So, when we talk about the brand campaign this comprises of three-four buckets, the first bucket is the ATL part. So where we have already kick started the print part as well as the radio part and television we will start soon once we achieve the said milestones and this will also be supported by a massive BTL where we are talking about hoardings as well as the bus shelter. And also, there is a very critical component on which we are focusing that is customer engagement programs where we are talking about stamping and various customer engaging programs to ensure the customer experiences the product before the switch. So, these are the various actions which have already been started as part of the brand track. So, as we discussed last time also that we are working with one of the best marketing partners whether it is PR part, creative part, digital part, so one of the India's best is where we are operating with. So, it is absolutely going very smooth.

Coming to the next layer where we are talking about what are we doing on the product part. So, few fresh product have already been rolled out and in the next quarter there is a plan to focus on tetra pack and then it will be a series of rollouts over the next 12 to 18 months' time primarily focusing in the area of flavored milk, tetra pack, butter, cheese, paneer and so on. Now, with the rollout of these high margin value added products this will have a good impact on the profitability which you will start experiences over the next 12 to 18 months’ time. So that is on the product part.

Now coming to the sales and distribution layer, so here also a lot of initiatives are being executed whether it is a very structured planning dividing Delhi NCR into nine zones, 46 territories, 160 distributors which I cannot recall any company has done so extensively at the time of launch and the response has been pretty good. So, already we are doing a productivity of around we can say 4,000 outlets on a daily basis and around 7,000 outlets on an alternate basis or maybe at different frequencies. So market response has been very, very good both at the channel level as well as at the customer level.

And also, so far as the sales part is concerned, IT automation which we discussed last time, we are going full throttle on this and the automation that we discussed which is going for a cloud based platform which Field assist is under implementation. So what are we trying to do, what we intent is that as our field force visits retail outlets we intend to capture the competition data. That is one, we demand data, as well as various other data points so that proper data analytics can be done at the back end. And at the back end we have already established a very structured back office and this back office does dash boarding on a daily basis, weekly basis, monthly basis based on the need of different stakeholders. So, this is the action which is happening on the sales and distribution front.

Coming to the most critical and the most challenging component which is the procurement part, so here also a lot of initiatives are being taken. So currently our farmer contribution of the mill has increased to around 22% and also there is an increase of two milk chilling centers, so this part is also going absolutely smooth. And the focus which we are having on building a very strong direct sourcing channel is continuing with various farmer connect programs like we are talking about education support on this hygiene, we are talking about artificial insemination, we are talking about providing subsidies on the ancillary services, then we are also focusing on the loaning and all that stuff. So, various initiatives that we have taken are going full throttle and we are in the process of building a very strong procurement engine to create a differentiation in the market place. And luckily, we are in an area which is UP, Rajasthan and Haryana which contribute more than 34% of the all India production, that is we are very, very healthy. And what is our capacity, our capacity is just 3.4 million, not even 2%, which means there is a huge potential to build a further engine in this track. So, that is what is happening on the procurement part.

And coming to the quality part, so a lot of new processes and systems have been rolled out, so we are focusing very hard in customer complaint management system if any single complaint is analyzed through a proper root cause analysis what we call as RCA, RCS, action planning, because you see any complaint the action can be at the retail end where some training is needed, it could be at the training end of the plant and it could be at the procurement end. So, that is how our quality management team analyses each complaint and then converts the same into some concrete action plan with different stakeholders. And also, last time we shared with you that we have now integrated the organization reporting to head of quality. Now this is to ensure that quality becomes the strongest vertical within the organization.

Now coming to the next focus area, very critical enablement in this entire B2C play and that is the IT part. So as we discussed last time, Ernst & Young is our IT transformation partner, so they have already presented to us some 23 distinct programs with a three year road map broken into immediate term, medium-term and long-term framework. So currently we are in a process of executing this program on the ground with the help of various partners. So, with this IT is going to be a very huge enabler in this complete B2C strategy with specific focus on business intelligence as well as the data analytics.

Now coming to the last component which is the people part. So, lot of good initiatives are being take, for example, as last time we said that last year we were the first private dairy company to issue ESOPs across the board. Whereas in H1 now the time has come when there is a huge positivity within the organization because the resting has come, employees are extremely happy. We still recall when we go back that how people were finding difficult in dairy sector to connect with this ESOP framework. But now when they say that the price at which it was issued and what is the price as of today, employees are very, very upbeat and very excited working with absolutely full passion. So that is a very good initiative which is now being translated into employee benefits and a very positive environment within the organization. And another initiative that we had started some time back which is recruiting one of the best people both within the industry as well as outside the industry. In line with this there have been some good recruitment at senior level, marketing function is being supported by hiring of group brand manager who comes from Godrej, Phillips. And then we are also ramping up our investor relation function with Varun joining us, he comes with a similar I-Banking experience. So, this is to ensure that our investor interface becomes really, really strong which you would be seen with a annual report change and all that stuff. So, these are primarily the various initiatives that we are taking and which are under process of execution. And all these areas are being tracked by a very strong program management office setup at the corporate office. What we do is we do a daily review, a weekly review, a fortnightly review and a monthly review to ensure that all these tracks absolutely work as per the defined timeline and then we keep delivering as per the defined business schools. So, in essence what we are saying is, while the numbers are positive but the key thing to be happy is that these are positive on account of a very concrete strategy which is being implemented through a very robust execution framework that we shared with you on multiple front. And that is how the entire organization is being reengineered. So, that is in summary what are we trying to accomplish and what have been the numbers and what have been the underlying initiatives of execution framework which are resulting into these numbers.

So now we can get into Q&A and feel free to ask any questions.

Moderator: Thank you. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Dhruv Agarwal from Cresita Investment. Please go ahead.

Dhruv Agarwal: Sir, my question is regarding the CAPEX plan of Rs. 520 crores that you have already started. So, can you give me a breakup of how the Rs. 300 crores which has been spent till now, the division of that between the backend infra and the plant infrastructure?

Nawal Sharma: Sure. So the overall plan outlay is Rs. 520 company, primarily broken into two components, first is to ramp the procurement infrastructure in the back end and then there is a ramping up of plant infrastructure. So back end is around Rs. 120 crores and plant is around Rs. 400 crores. Out of which Rs. 330 crores has already been done. And if I see a breakup, Rs. 20 crores has gone into backend and Rs. 310 crores has gone into front end which is the plant infrastructure and balance will be done over the next 1.5 to 2 years' time. and this entire investment is going to help us augmenting our capacity by 9 lakh liters. So that is basically the CAPEX layer as to how CAPEX is supporting the product layer where we are planning to rollout various value added products over the period of time.

Dhruv Agarwal: So sir, of the remaining Rs. 200 crores how much more would we spend on the plant?

Nawal Sharma: So as we said, so Rs. 310 crores has already been spent, so balance Rs. 90 crores is pending.

Dhruv Agarwal: Rs. 90 crores is pending on the plant side?

Nawal Sharma: Yes, absolutely. And accordingly around Rs. 100 crores is there at the back end side with respect to…..

Dhruv Agarwal: And sir, what is the present capacity utilization of your new 9 lakh liters plant because you are rolling out?

Nawal Sharma: See, this capacity we will be building so far as 9 lakh liters is concerned. However, general capacity you are talking about, we have around 3.4 million capacity at around 86%, so current sourcing is hovering around 3 million.

Dhruv Agarwal: So right now production has not started from the new plant, the 9 lakh liters?

Nawal Sharma: Yes, it will be done starting this quarter onwards.

Dhruv Agarwal: So that is how you will be starting the whey products from Q4 2017, right?

Nawal Sharma: Absolutely, you are right.

Dhruv Agarwal: So these are the products that will be out in Q4 will be flavored milk, tetra pack as you said in the con-call?

Nawal Sharma: Exactly, so starting tetra pack and then there will be a series of rollout. Because what we have done is we have integrated product rollout with market research as well as brand campaigns. So with this rollouts we will keep doing market research and based on the feedback we will keep taking decision as to when the new rollout should happen, and at the backend also we are in touch with the top four which is KPMG, and very soon we will be finalizing one of these to help us building a very strong go to market game plan. So the intent is how to work with one of the best partners whether it is marketing or whether it is strategy field or whether it is in the finance space. Because once you work with one of the best partners and having one of the best guys within the organization, I think that is what assures success, because success is not because of one person, there has to be a integrated piece both within the organization as well as outside the organization. And that has been our strategy as to how to collaborate and get help from one of the best domain experts to deliver against the business.

Dhruv Agarwal: And sir, the interest payment that you have to make to KKR on the debt investment, so that will be done on an annual basis or quarterly basis?

Nawal Sharma: That is on a quarterly basis. And also see, as you raised this point of KKR, let's also understand as to what is the context. People generally ask this question and maybe somebody would be interested why KKR, so I will tell you it is not about Rs. 520 crores, generally they have agreed to invest around Rs. 520 crores. So it is not about Rs. 520 crores and as a coincidence CAPEX and these two numbers are same. So, we could have easily got this money from any other banking institution, I will tell you what was the intent. Intent is to have a company of the status of KKR onboard. And why is it so, and how is it going to help us? A couple of things, first, it is a reinforcement of strategic direction that we are moving in the right direction, between the kind of intense discussions KKR team had with all our senior level people, it was of great help I tell you. And secondly, it is a huge reinforcement of execution excellence. And thirdly and the most important part, this creates a huge positive pressure within the organization on corporate governance. So that is the reason now we are further putting a lot of pressure in hiring one of the best consultants and focus on building a very strong systems and processes. And how we intend to utilize these funds? Primarily into two, three buckets. First, we will get into CAPEX, second we will get into debt consolidation and third we will get into branding as well as building IT infrastructure. So this will be done over a period of next six years' time and out of this Rs. 520 crores already we have got Rs. 300 crores, and rest will depend on the business needs and appropriate strategic calls will be taken. But I will tell you, as of today experience with KKR over the last three to four months is very, very good. So really both of consider each other as extended family only whether it is formally or informally, the way we are in touch with each other, the way they are sharing their inputs, I think it is a great journey that we are travelling together. And this relationship may evolve over a period of time, so that is how we are hopeful and it is a wonderful experience I will tell you. And the intent that we had, it is really giving lot of result.

Moderator: Thank you. Our next question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: My question first on the update on the product rollout. So we are supposed to rollout the new products in the retail segment, so what we have launched during this quarter?

Nawal Sharma: You see, fresh milk, curd, and chhach is being rolled out. And as I shared, response has been very, very good. I will tell you, because of few reasons. The kind of intense resource that we have got into product development, because see I will share with you a very transaction but it gives the insights as to how we generally operate. See, from a customer standpoint what is it that a customer sees in milk, so first is basically the whiteness, I am talking from the north perspective. So when you say whiteness this is a result of cow - buffalo milk mix, now buffalo milk is generally whiter than cow's milk, cow's milk is towards yellowish side. And second one is how much malai it is giving. And third one is, how good is the tea. The way we actually integrated our procurement engine, identified those areas from where we should be sourcing this milk which is basically from a buffalo dominated belt, I think that is what is really helping us in making customer experience the difference, I think that is what has been the channel feedback also that the customers are really appreciating on all these parameters. Because these are the parameters what can be verified physically. Technical part, obviously none of the customers can make out, but these are the physical attributes. So that is what is helping us, the way we do research, get into FGDs which is focused group discussions, do other kind of research with the help of one of the best partners. Though the process is slow but it is a long drawn process, we do not do things in a hurry, it is a well-structured program, we go very step by step, do something, take research feedback, again change the things and then again move in the market. So that is how we are approaching this entire thing.

Manish Ostwal: Great sir. Second question, with the increase in retail business contribution in the total business, now it is 40% but why it is not reflecting in the gross profit margin, gross profit margin is improving very slow pace.

Nawal Sharma: Yes, you see I will tell you, there are a couple of reasons, couple of dimensions that you have to consider. So one is basically when you talk about B2C bucket, it has got multiple sub-buckets, for example, first bucket is the fresh product bucket, second bucket is the value added bucket. Now, as we will be rolling out the real value added piece this margin will undergo a change, that is one. And also as we compare numbers with the same quarter last year, so if you go a step deeper into this and eliminate that income from other sources which is basically this exchange fluctuation, these numbers will become further better. For example, there could be an increase of 1% point at PBT layer, there could be a 0.5% point at PAT layer, if you eliminate the impact of exchange fluctuation. So this differential with respect to the same quarter last year will further widen in a positive direction. So, these are the two data points that I would like to share that yes there is a definite impact but this impact will further intensify as we get into the second bucket from Q4 onwards, while the first bucket is already on, second bucket onwards. And gradually step by step you will start experiencing these changes in numbers.

Manish Ostwal: And last question, this demonetization impact because we also procure significant amount of milk through milk contractors, they are basically doing a case payment to the smaller farmer from their end. So how that chain is impacted because of demonetization?

Nawal Sharma: When you see this demonetization people, I think this is a very hot topic these days. Now let me share with you from two dimensions, first dimension we will talk about the demand side which is on the distribution side. So here obviously being in staples category the impact will not be much, while there could be an impact on the luxury segment or discretionary product segment. So on the demand side we have managed the things through the temporary logistics problems through credit leverage framework, whereas on the supply side which is on the farmer side there is a multi-pronged strategy that we have taken. A couple of things, first, we are in a process of identifying where all farmers have got bank accounts we are trying to transfer the money straight to their bank accounts, that is one. Secondly, our procurement team is in touch with all the VSPs, VSPs are nothing but they are the Village Service Providers, the local representative who are in touch with the farmers. So they are trying to do NEFT payment to the farmers wherever it is possible. And lastly, whatever little bit is left out, so there cash support is being taken where our team is liasoning with banks to ensure that our farmers do not face any problem in lieu of this demonetization. I think how we look at this, we are taking this as a huge opportunity to further the grand vision of the honorable PM with respect to digital India as to how to promote and motivate farmers to have their bank accounts so that we go towards digitization and away from this manual part. And I am sure he will take this opportunity and leverage this opportunity to the fullest, and very soon over the next two to three quarters we will ensure that all these direct payments to farmers account becomes a sizable portion. So this how we are trying to manage the supply side which is the farmer side. And the team is very upbeat and farmers are also very positive and that is how we are trying to convert the so called and perceived challenges into an opportunity from a business standpoint.

Manish Ostwal: And sir one small data point, what is the outstanding gross debt number as on 30th September?

Management: See, so far as debtor part is concerned it is around Rs. 1,357 crores.

Nawal Sharma: Manish, just to correct, so our total debt stands at Rs. 1,505 crores and our debtors are close to Rs. 1,357 crores.

Moderator: Thank you. Our next question is from the line of Venkat Subramanian from Organic Capital. Please go ahead.

Venkat Subramanian: We heard detailed report presentation on qualitative aspects that are being done, when do you think this will translate into quantifiable returns either in the form of lower debtor days or higher margins, etc. You a couple of minutes ago talked about how during this quarter itself gross margins are close to about 0.5% higher, is this a trend that we can see almost on a quarterly basis?

Nawal Sharma: See, you are absolutely right. So these numbers, as we always maintain, are the outcome of the business model. So last year the business model was tilted towards B2B to the tune of 70%, but over the next three to four years' time we want to reverse this in favor of B2C. Now in this journey the directionally fresh product rollout is already on, soon in the Q4 FY17 we are getting into high margin value added product also. So as we are moving in these direction so obviously we will start noticing continuous improvement in the margins. And similar thing will happen on the other financial metrics also like debtor days and working capital and all that stuff. Because as you tilt towards B2C your debtor days will also come down because as I hear a number right now, so it has already come down from 90 to 81 debtors over the next let's say a quarter. So these numbers will continue, because see numbers is nothing, numbers is just an outcome of a business direction that you have taken and moving in the right business direction numbers are bound to come. Because in the B2B we are talking about 90 to 180 days' creditors, whereas in the B2B they are 35 to 40 days. So it is nothing, there is no rocket science in this, the only thing is we have to move in a very methodical manner and that is how we are doing a complete reengineering of the complete organization because this also true that just by chasing one number you will not get the output, it is the complete organization that has to change. So, I agree with you and I am fully firm we will continue to move in this direction only and you will continue to see the positive direction so far as the numbers part is concerned and quantification part is concerned.

Venkat Subramanian: I missed your number sir, you said debtors' days have come from 90 to 81, is that what you said?

Nawal Sharma: Yes, that is right.

Venkat Subramanian: That is just in one quarter?

Nawal Sharma: Yes. So it is just a data point that I am sharing with you.

Management: Just to clear that out, we had our debtor days at 90 if we talk about FY16 end, and if we talk about H1 FY17, it has come down to 81. The other point I wanted to make is the increase in the gross margins will happen once the value-added product start rolling out because as of now our B2C contribution is increasing and it primarily comprises of fresh dairy products where the prices are very competitive as against the cooperatives. Now as we start rolling out distinct value added products, there the gross margins vary from 25% to even 70%. So then the significant movement in the gross margin will start taking place once we start rolling out our first set of value added products starting Q4, and it is going to be a continued momentum over the next 12 to 18 months, and that is how we can say that the full-fledged and the cascading impact of all this will start coming in let's say second half of FY18.

Venkat Subramanian: Just to put the numbers in perspective, over the last two to three years we would have had a cash flow generation of close to about $500 crores - $600 crores odd, as against that I could be off our numbers a little bit here and there. While you are either working capital and as a result actually all your borrowings was up by close to about Rs. 600 crores - Rs. 700 crores. So therefore net negative cash flow would have been of something like about Rs. 1,100 crores -

Rs. 1,200 crores. Now, directionally what will be the rate of change going forward? And secondly, when do you think you actually will be cash flow positive, after of course taking into account the new Rs. 520 crores that you pumped in?

Nawal Sharma: See, fundamentally you see already we are cash positive at operating level at Rs. 130 crores, but as you are aware that…

Venkat Subramanian: I am talking about net of working capital.

Nawal Sharma: But as going forward in favor of B2C so there will be a lot of cash being generated over the next three to four years' time and the plan is to become debt free over the next three to four year's time. So that is how you will see huge cash flows coming on account of this B2C play happening. So you are right absolutely, moving in that direction definitely there will be a drastic improvement in this direction.

Moderator: Thank you. Our next question is from the line of Alok Rawat from Karma Capital. Please go ahead.

Alok Rawat: Sir, most of the questions have been answered. One question, curiosity rather which I had was, the farmer numbers, farmers from whom you procure milk is up by about 8% -8.5% versus March, while the number of villages from where you collect milk is lesser. Does it mean that you are trying to penetrate deeper in your current area, I mean is it going to be both geographical expansion as well as deeper penetration?

Nawal Sharma: Yes, you see so far as procurement play is concerned there is a multi-pronged strategy focusing both width as well as depth. So that is the reason you have seen farmer number going up from 300,000 to 325,000 whereas villages are 4,500 only. So, this will keep varying from quarter-to-quarter as the simultaneous focus is there on both width as well as depth. So that is where we are. And the various farmers' stickiness programs that we have initiated, so it is not that only we need to focus on one dimension because you cannot take a unilateral decision with respect to that, we have to take a holistic view. And that is what we are doing. So as a coincidence, in this quarter the number has been from the existing area only, but next quarter it could be different, there could be number of villages also being added, so this could be another this thing. These are all operational transactions data points, but directionally the focus is on both, width as well as depth.

Alok Rawat: And sir, if I may ask a second question, you talked about the execution part in very detail and how you are putting up a strong team to ensure that at every step the execution goes in the correct direction. In this regard have you tried using the TOC approach for the company as a whole for the individual SPUs or functions, just as a curiosity?

Nawal Sharma: Sorry, I missed that word, you said what approach?

Alok Rawat: Theory of constraint.

Nawal Sharma: Absolutely. See, now not only this but there are multiple frameworks that we are using where theory of constraints is one where each and every function…. See I will take you in the background, see when we do our functional reviews so there is a section on identification of constraints where function heads share with us what kind of constraints they are having and then they present a game plan as to how they intend to overcome these constraints, both within the organization as well as the market driven constraints. And then there is a well structured program that we create, the function head creates which is discussed at FLT level, what we call as Function Leadership Team, and in case there is a need then it is escalated to the CLT level, what we call as Corporate Leadership Team. So where in case some special budgets need to be approved or some operational authorization need to be given, these are managed. So that is how through this structured framework the constraints are managed at all the levels. And then another thing is, we have a framework called as DOA, Delegation of Authority where from time to time we keep evaluating as to with the passage of growing business what kind of authorities need to be given at what level. So there is a half yearly revisit of DOA framework in case there is a need of further delegating or enhancing the powers of our existing layers at different levels. I think that way HR is doing a tremendous job. And also we are taking help of external consultants also who keep doing process audits from time to time, for example let's say recently last quarter only we got one process audit done by one of the external consultants who identified certain area and that is how on a proactive basis we are trying to fix some of the process in our systems issue. I think it is going to be an ongoing process where such frameworks need to be implemented at the process layer, at the systems layer and to ensure effective management of all the constraints both within the organization as well as at the industry or the market level.

Alok Rawat: Sir one last question if I may ask, the product launches, fresh products till now, and value added which will come in the second half, is it fair to say that initially it will be focused in NCR itself and later you will be moving to…?

Nawal Sharma: Yes, because see NCR is a huge market I tell you and it can also throw lot of customer insights. If I just share one data point, Delhi alone is around 12 million liters milk market, so it is a very good place to test your hypothesis how customer is reacting to your branding and marketing initiative and what kind of customer insights come from different segments. For example, here you can have let's say a South Delhi kind of framework and maybe let's say low end kind of framework. So based on these customer insights maybe then we can take a decision of taking it further to the other regions in the north. But primarily all the targets that we are talking about can easily be achieved through north focus only. But yes, initial focus will be there on Delhi and NCR because it is a huge market. So let's leverage, I think a couple of days back only we were going through this AC Nielsen report who have projected some 80,000 outlets. So this itself will take a lot of time optimizing on Delhi and NCR.

Moderator: Thank you. We have the next question from the line of Rahul Jha from Bay Capital. Please go ahead.

Rahul Jha: Can you please give us the trend in milk procurement prices over the last few quarters?

Nawal Sharma: See, milk procurement prices over the last few quarters, it touched as high as Rs. 42 and gone as low as Rs. 24, whereas currently it is hovering around Rs. 36.

Rahul Jha: So where do you see them going on or stabilizing, sir?

Nawal Sharma: See, again I tell you, so far as milk prices are concerned luckily we are in an industry where it will not impact our margins, it is all market driven. And in case there is a increase in the milk prices it is all basically passed on to the customer. So that way we are totally agnostic towards this milk prices change because it does not hit our bottom-line. So that is how the industry has been operating. So based on the market forces while the price may swing towards positive or negative side, but without having any impact on the business bottom-line or the demand, because demand is huge I tell you. So as we shared, this time we did not share because why we say demand is huge, just couple of data points, Rs 6 lakh crores industry is only 20% organized, industry is growing at a rate of around 15% and organized sector growing at a rate of 19% and value added segment going upwards of 25%. So there is a huge market so that is the reason we say, people generally sometimes talk about competition, so we say even very big, 10 15 players come into this industry and still all of them will flourish, I am not saying they will survive, they will flourish. So that is the kind of potential which is there, enough room for everyone to do good in this particular space.

Rahul Jha: Can you also give us the B2C share of pouch milk?

Nawal Sharma: You see, so far as B2C part is concerned, B2C pouch milk contributes 50% share.

Moderator: Thank you. Our next question is from the line of Devang Patel from Crest Wealth. Please go ahead.

Devang Patel: Sir, on the inventory side it seems to have gone up to Rs. 320 crores from Rs. 160 crores a year back, is there anything to do with the change in accounting policies?

Nawal Sharma: See, there has been a slight variation in inventory, see I will tell you the reason. Recently you would have seen because of this global crises and a lot of price pressures were there, so what we did the race came down from $5,000 per ton to around $1,300 per ton, so we deliberately took some decision to let's say not to liquidate powders and that transaction lead to certain kind of inventory variation, but that is only temporary. Now again it has gone up to around $3,000 plus dollars per ton, so market is picking up and we will see this all gets fixed.

Devang Patel: Sir, for our perspective what is our cost per ton and at what price therefore it will become remunerative to export again?

Nawal Sharma: See, I will tell you, so far as export part is concerned, again, see it is all opportunity based business, I am telling you strategically speaking. Here company is focusing, we are focusing very hard on building consumer business, so that is where we are moving so far as the strategy part is concerned. And so far as $3,000 is concerned, I think that is a good price where we make good money and already market is picking up and attacking this particular point.

Devang Patel: So there is another Rs. 100 crores to Rs. 150 crores of inventory which we could liquidate very quickly in a couple of quarters?

Nawal Sharma: Yes, so I think that should not be a problem. So it is only a temporary problem when it touched very low price, it is just 15 days of inventory, that is it.

Devang Patel: So have you started re-exporting liquidating this inventory already?

Nawal Sharma: See, already they started and it will only pickup over a period of time.

Devang Patel: And this international price, how does it compare to the local prices?

Nawal Sharma: See, local is much better in today's time. As we are talking today local is much better, $2,400 is internationally and here it is $3,000 or so.

Devang Patel: And the skimmed milk that we sell domestically B2B, how much that is as a percentage of sales?

Nawal Sharma: So far as SMP piece is concerned, that should be 6.5% of total.

Devang Patel: This is last year's figure?

Nawal Sharma: Yes.

Devang Patel: And this is exports and domestic put together?

Nawal Sharma: Yes, this is basically domestic.

Devang Patel: And how much was exports last year?

Nawal Sharma: SMP was nill last year because of the price differential.

Devang Patel: The other thing I wanted to ask was on what the fully diluted equity will be post the HP deal and the Times of India deal that we have?

Nawal Sharma: It is very negligible, 1% - 1.5%, not more than that.

Devang Patel: 1.5% equity increase over the base that we have currently?

Nawal Sharma: Yes.

Devang Patel: And this is primarily the Times of India deal and KKR is already built in?

Nawal Sharma: HP and Times of India.

Moderator: Thank you. We have the next question from the line of Swati Iru from Ratnabali Capital Market. Please go ahead.

Swati Iru: What would be the product wise breakup of the revenue of the company?

Nawal Sharma: You see, as we said if we take B2C which is a key focus area, around 50% would be pouch milk, 22% would be curd, chhah would be around 4%, ghee will be 22% and 1% will be rest. So that is how B2C piece stands.

Swati Iru: And what is the reason for the de-growth in the other income this quarter?

Nawal Sharma: See, it is all exchange fluctuation. I think same quarter last year was Rs. 9 crores and this time it is Rs. 1.8 crores, exchange fluctuation.

Moderator: Thank you. Our next question is from the line of Kaustav Bhubna from SKS Capital & Research. Please go ahead.

Kaustav Bhubna: Sir, just wanted to get some light on your plan for margin expansion from your 6.5% to 9% and comparing it to, I know you cannot really directly compare your margins to other milk and dairy players, but I would like to know what are your plans in terms of procuring milk directly from farmers currently to let's say one to two years down, because that also has an effect on your gross margins, right. So how do you plan to move on that? And also, when it comes to advertising expenses in terms of sales when you are moving into your B2C segment your advertising expense and SG&A expenses are usually higher in the beginning to get your reach out. So how will all of that play out? And also, I mean I know there is nothing you can do about demonetization but what have you seen up till now and I am guessing that would probably put negative pressure on your margins for the upcoming quarters, so do you expect to see a bump up in quarter four to maintain or achieve your margin targets for just second half of FY18?

Nawal Sharma: So first thing you talked about is how this margins will increase from 6.5% to 9%. See, again as we say margin is nothing but an outcome of the product mix, so as we will be getting into this high margin categories which is basically flavored milk, tetra pack, butter, cheese, paneer, so automatically the overall EBITDA margin is going to increase, so that is one. Now to support this, while this is mathematics at the product layer, now this product layer margin enhancement program is being supported by the CAPEX layer where we are investing to the team of let's say Rs. 520 crores to ensure that we augment our good milk capacity by 9 lakh liters, that is one dimension. Now second dimension is also we are working simultaneously on ramping up of procurement, procurement infrastructure. Now as we talk about procurement infrastructure the entire focus is on width and the depth of the reach, so there we are working on various programs, as I shared with you, how to support farmers to enhance their productivity and create stickiness with the farmer through multi-pronged strategy whether it is basically subsidies on ancillary services, helping them in getting loans or maybe call center based support, connecting let's say some magazines as to how they can enhance their income, their lifestyle and all that stuff. So there are various stickiness programs and also we are hiring one of the best domain experts. Last year Dr. Kuldeep Sharma who is ex-Director of Indian Council of Agriculture Research, he also came onboard helping us in terms of creating this program so that when all these domain experts are working and creating a massive procurement engine then definitely this 9-lakh capacity augmentation that we are talking about is not a very difficult task. And I tell you, one also has to see this, see procurement is the most challenging building block in the entire dairy industry value chain. But it is the first mile which is the most painful. But since we have already crossed that first mile with 4,500 villages and 325,000 farmers, journey for us from here onwards will not be that difficult, that is one. And also, luckily, we are in an area which contributes 34% of the total milk production, so we are in a very safe area. So here challenge for us will not be that. So with this as procurement track and product track will work in sync with each other, taking the margin from 6.5% to 9% will not be that difficult, and this is also being supported by a very intense brand building exercise.

Kaustav Bhubna: Sir, talking about this brand building exercise, there is a cost involved in it and I have seen in many dairy companies they give margin expansion estimate but then cover that up with high SG&A expenses in B2C markets.

Nawal Sharma: Yes, one has to understand also, see let me also give you a perspective. While we are seeing we will be building strong brand but if we see dairy as an industry so there only 20% is organized and rest is all unorganized, and there is huge potential, massive growth rate. Actually if you see, practically speaking, you do not get to invest much. See, last year we closed at around 1,800 crores worth of B2C revenue, how many customers or people even know about Kwality limited. To take FMCG example Rs. 200 crores brand, entire world would be knowing about that. So, this is an industry where having a massive procurement engine and a sound sales and distribution play you will be able to push. But since there is a strategic shift in the overall organization in terms of strategy, so that is the reason we are investing in brand building to position ourselves very uniquely in the market place. But you do not really intent to invest much, maybe 1% or so, the turnover will be more than enough. So it is not that situation where there is a cut throat competition and we have to really counter competition campaigns and all that stuff, there is enough room. Maybe even 10 more players can get into this space and still there would not be any problem, rather everyone will grow. So, from a brand standpoint you do not need to really invest much, but yes we are making it as our focus are because there is a strategic shift happening in terms of the overall image of the organization in the market. We are primarily seeing as a B2B play but now we really want to reposition ourselves as a very strong consumer brand.

Kaustav Bhubna: And when did you get Akshay Kumar as your brand ambassador for B2B?

Nawal Sharma: Yes, B2B brand ambassador is Akshay Kumar, yes.

Kaustav Bhubna: So when did you get him?

Nawal Sharma: It is basically one year, it has been one year. So already we are ready with various campaigns, as I mentioned that print has already started, radio has already started, very soon in line with the milestone that we have set in front of ourselves we will be starting our television part also. So, marketing program is being implemented as a very structured play linked to the overall rollout of the products. So that is how we are going in a very systematic manner.

Management: And just to add to that, so basically see Kwality as a brand has a strong brand recall and salience in the market. So we are going to ride on that as well, so that plant is now registered with us. Apart from that, so we want to create a distinct identity for ourselves in the market. So if you talk about the off take, off take is not a very big problem since the favorable demographics are actually making the consumers shift towards the high quality branded products, now they are looking for more distinct products. So there can be one conventional way of rolling out value added products and there can be another way of adding some distinctiveness in terms of product, packaging or communication. So that is what we intend to do going forward.

Kaustav Bhubna: Yes, I understand that, it is good. But talking about the quantitative effect of demonetization that you have seen up till now, because I would presume that it would somewhat negatively pressurize your margins for the upcoming quarter. So, post this quarter if you could quantify, somehow quantify the negativity that demonetization would cause this quarter and would it be a bump up, do you expect a bump up in the beginning of FY18?

Nawal Sharma: There could be a very miniscule impact, to be very honest. While we have done some kind of change, for example let's say credit days may be reduced by one day, earlier it was around 2.5 days to 1.5 days, so we are helping the farmer to the extent possible. But we being in a staples category we do not see basically any major impact, it will be very miniscule. And little bit whatever operational issues that were there are being managed through various frameworks, as I shared with your current leverage framework on the demand side and how we are intending to connect and give a better service to our farmer, so that is on the other hand. It is being managed, so there would not be any impact. Yes, on discretionary item in those kind of industries, yes there will be an impact but not in our kind of case.

Moderator: Thank you. Our next question is from the line of Shailesh Kumar from Sunidhi Securities. Please go ahead.

Shailesh Kumar: I will request you to pardon my ignorance as if I do not know anything. Just wanted to get a sense, though we are a dominant B2B player our gross margin is in higher single-digit. While a comparable B2B players who claim to be B2B and in listed space, they are commanding gross margin of say mid-20s and sort of thing. So how do we justify that?

Nawal Sharma: Again, it depends on the product mix. So depending on the product mix what kind of product you are selling is what drives your overall margins. For example, as we shared, somebody I think raised this question that till at EBITDA level or at various levels are margins are less because as we shared with you again, even B2C has got multiple buckets. For example, we have so far leveraged fresh layer bucket within B2C, the value-added leverage still has to happen which will be starting from Q4 onwards. So this is nothing but an outcome of the million of the products, you cannot **(Inaudible) 56:01.8** it and all the products will have same margins, one product could be 15%, another product could be as high as 60% or 70%. So it is difficult to comment with respect to other peers because we have to see and analyze as to what kind of product mix do they have and what kind of stage in the lifecycle or stabilization. So this is all market driven, as well as the product mix driven.

Shailesh Kumar: If I may ask point blank, what is the proportion of skimmed milk powder in consolidated revenue for Kwality?

Nawal Sharma: So, as I said, this would be around 6.5% to 7%.

Shailesh Kumar: Which segment is a loss-making segment for Kwality, is it fat segment?

Nawal Sharma: See, as we shared that, let's understand fundamentally why are we taking a B2C shift. Obviously B2B is a segment which has got pressures as far as margins are concerned, and that is the reason the first part of our lifecycle we focused very hard on building scale with focus on institutional play. But having achieved scale with this massive 4,500 villages and 325,000 farmers, now the intent is to move towards and to focus on the margin enhancement. And that is a reason why we have implemented or we are in a process of implementing this B2C play or B2C strategy. So obviously when you compare at a macro level, B2C is a much better play, and within B2C value added is the best play. Because had EBITDA level if you see, value added has got upwards of 20% EBITDA margins, fresh would be at 9.5% to 10%. So that is how we are pursuing this entire game in a systematic manner. Phase One of the organization is to build scale, which we have done. Phase Two, focus on fresh products, which we are doing.

Phase Three, start getting into value added segment and build really a good bottom-line. So that is how we are building scale and going in a very structured manner.

Shailesh Kumar: How much of our revenue is export dependent?

Nawal Sharma: See, again as we said, percentage we just shared with you, export around 10% would be there but export is really opportunity based, so focus is not there. In case there is a good opportunity we will leverage that, but there is no strategic focus on exports, strategic focus is there on only single minded focus on the consumer part. Half yearly it is around 6% to 7%.

Shailesh Kumar: Last question, in next couple of years do we expect to become cash flow positive?

Nawal Sharma: See, we are already a cash flow positive at operating level, but over next maybe two to three years' time I think we will continue to improve our cash flows with this B2C play ramping up. So you are absolutely right, directionally we should move in that direction and maybe another two to three years' time you should be cash positive even at the CAPEX level. Because majority of the investments have been made, some of the investments are yet to be done. However, the major part of the entire CAPEX then has already been incurred. So going forward we can expect positive cash flows.

Shailesh Kumar: So by FY18 what is the CAPEX that is left behind, that we still need to do?

Nawal Sharma: See, as we discussed with you, Rs. 520 crores is the plan out of which Rs. 330 crores is already done and balance will be done over the next two to three years' time.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I would now like to hand the conference over to Ms. Sangeeta Tripathi for a closing comment.

Sangeeta Tripathi: Thank you. On behalf of Edelweiss Global Wealth, I thank the entire management team of Kwality for sharing their strategic intent and execution plan with the company. Thank you, team. And all the best for your future endeavors. Thanks.

Nawal Sharma: Thank you very much from Kwality team also, both Edelweiss as well as all the investor friends. Thank you very much for your patience.

Moderator: Thank you. Ladies and Gentlemen, we that we conclude today's conference. Thank you for joining us and you may now disconnect your lines.