



“Prabhat Dairy Ltd Q2 FY-16 Earnings Conference Call”

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MODERATORS: MS. POOJA LATH – EDELWEISS SECURITIES

Moderator: Ladies and gentlemen, good day and welcome to the Prabhat Dairy Ltd. Q2 FY16 Earnings Conference Call hosted by Edelweiss Securities Limited. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Pooja Lath from Edelweiss Securities Ltd. Thank you and over to you Madam.

Pooja Lath: Thanks Aman. On behalf of Edelweiss Securities, I welcome you all to the Q2 FY16 Earnings call of Prabhat Dairy. From the management, we have with us today Mr. Vivek Nirmal- Joint Managing Director and Mr. Ravi - AVP Corporate Finance. I will now handover the call to Mr. Vivek for his opening comments, post which we will take the question and answer session. Thank you and over to you sir.

Vivek Nirmal: Good afternoon everyone. It is a great experience to have this analyst call, I think we are having it for the first time and we just got listed before one and half month. Journey of Prabhat since last 16 years; I think we have reached an important milestone. We basically will be focusing on, since this is the first call after listing, our major emphasis is on the H1 numbers for this year and H1 numbers for the last year. In overall dairy industry, we are witnessing a healthy growth with the consumption increasing, the per capita consumption increasing, at the same time the overall unorganized sector shifting to organized, which is mainly fueling the growth. I think there are two major things what is really changing the industry dynamics and dairy sector. Talking about Prabhat especially, our major strength remains our procurement excellence, manufacturing excellence and the consumer brand excellence I think is right now which is the under construction or we are building it up. So, these remain the major strength of Prabhat. In last 6 months, we have basically seen 2-3 important milestones we have seen; our cheese plant got operational by end of June. We are the 3rd largest cheese capacity in the country, capable to manufacture cheddar cheese, mozzarella cheese, processed cheese and cream cheese, paneer; that has got operational. We have been able to start our food service division which is quite an ambitious plan to develop the food service products, in terms of the processed cheese. We have specifically identified that out of home consumption of products like cheese is growing very rapidly along with other products, so food service is specifically we have started; that is an important milestone and we have launched up couple of new products including paneer, shrikhand in the domestic markets. I think this is basically in our direction to emerge as a stronger regional player in Central and Western India, I think that is where we are doing. On the procurement front especially because that also remains a major part of the dairy industry, I think we are witnessing some deficit in the rainfall in monsoons in our region. It is not the first time we are obviously witnessing it as a dairy industry, as like any agricultural industry has its own cycles and its own seasons and I think we are witnessing out some deficit in monsoon but at the same where any areas are highly irrigated, we are also experiencing a good increase in milk production that is what we are seeing on the milk

procurement side. On the sales, EBITDA and PAT, in terms of sales in H1, this year we have been able to achieve a sale of INR5584.2mn against the sale of INR4633.9mn last year for H1, so this is around 20.51% increase. In terms of EBITDA, we have been able to achieve an EBITDA of INR633.6mn against the last year EBITDA of INR487.5mn which is again a very healthy, 30% increase in the EBITDA. In terms of PAT against the PAT of INR166.9mn last year H1, we have been able to achieve a PAT of INR88.3mn PAT, and PAT is lower basically on account of interest capitalizations since our new cheese project has gone operational which is an investment of more than INR1.4bn, so since the interest has been capitalized last year, this year part of it has been capitalized in H1 and part of it has been booked to expenditure; that is the reason for Rs. 8.83 crores of PAT and I think so, those are the key numbers, I am happy to participate in this call and please over to you Pooja and if we have any questions and answers, happy to answer them.

Moderator: Thank you very much. We will now begin the question and answer session. First question is from the line of Bhavin Chheda from Enam Holdings. Please go ahead.

Bhavin Chheda: Just a few questions, if you can give your current daily procurement run rate, what it had been in first half and quarter 2; first. Second, if you can give the sales of new products; what has been the sales in ghee, shrikhand, if you can share that number and third is how much CAPEX you did in H1 and how much you intend to do in FY16?

Vivek Nirmal: So, going by question by question Bhavin, we are right now, if we compare with last year, our average milk handling was around 8,50,000 liters per day in the H1 for the entire 6 month and this 6 months it has been 9,75,000 liters on a per day basis for the last 6 months, so that has been the run rate. On the product specific actually, we would be disclosing the revenue on basis of the segments which is B2C and B2B, we do not really give numbers which are product wise, so I will not be able to respond to the specific product wise sales numbers of shrikhand and ghee, but I think shrikhand numbers; just to give a broader sense, shrikhand numbers are very low because it is a newly launched product which has been just launched before 2 months. Ghee numbers are seeing very good growth because with average additional milk handling, obviously your ghee production becomes higher because you are handling more milk and then we basically, as you know, we would be having two segments; B2B and B2C, so B2C is definitely witnessing a larger growth in terms of ghee, especially since the company has launched a lot of new packs, company has also partnered with current some of the regional movies to promote their own product. So, we are running lot of campaigns, so in terms of B2C; Prabhat ghee is witnessing a very good growth rate. And coming to the third; on the CAPEX front, we have as an utilization of funds, around INR350mn out of the IPO expenditure is expected to be going in CAPEX but that is a CAPEX which we will be incurring in our next 12-18 months, so there is a significant CAPEX which has been incurred in the last 6 months. For the past 6 months CAPEX of the H1 particularly CAPEX incurred, I think you can just give me your mail ID; I will be sharing the CAPEX numbers for the H1 last year, concurrent to this year.

Moderator: Thank you. The next question is from the line of Rajiv Berlia from Edelweiss. Please go ahead.

Tanmay Sharma: Sir my first question is on competitive intensity, I have seen since the Nestle fiasco, Nestle has cut off prices of its tetra pack and other things as well. So, can you just throw some light, how is the competitive intensity panning out in the B2C segment for you, which is a focus area for you guys?

Vivek Nirmal: I will just explain you the background in a minute, see basically we place Prabhat in the middle of the pyramid segment, so we do not really operate in the top of the pyramid segment where you see players like Nestle or Britannia operating, so that is number 1. Number 2, in the products or the segments specifically which we call as a middle of the pyramid segment which is targeted towards the middle income group consumers, major actually competition happens from the unorganized sector because 70% of the products there are from the unorganized sectors and so normally we are not facing too much of competitive pressure over there, except whatever the regular pressure or regular competition profile is, especially in smaller towns where we have the first mover advantage. We do not really see competition from lot of organized players and in bigger towns like Mumbai where we definitely have all the players available like Nestle and all, there definitely some impact is there but our product profiles remain different, for e.g. Nestle has such cut down the prices in tetra pack, they have cut down the prices in some products like Dahi and yoghurts and all, but obviously their pricing were very premium. Just for an example, a Prabhat Dahi for 400 g sells at Rs. 45 for a cup at MRP, which has been there since last 6 months or which is even there today, Nestle, the MRP itself was Rs. 65, which they have brought down to Rs. 55. So, I think they are still there in that space compete with the lines of Danone and Britannia, we normally are in the space of mid segment players, so we really are not seeing too much of competitive pressure.

Tanmay Sharma: Sir talking about competition and means lot of FMCG companies have shown their results as well, so there is a lot of pressure being shown in the rural areas, so sir I want to know are you witnessing the same as of now? What is your on the ground feel as far as the demand is concerned and since monsoon has been little bit scarce in Maharashtra, so can you throw some light on the same as well?

Vivek Nirmal: See in smaller towns where we are present, we are present in smaller towns of Gujarat, Madhya Pradesh and Maharashtra. So, Maharashtra is not the only state where we have presence; however, yes Maharashtra is definitely major state where we have our presence, in terms in relation to all the 3 states but to answer to your question, we really have not yet reached that level in the smaller towns where we can really feel the hit because we still have a very small market share, in terms of smaller towns it might be our paneer or dahi or even ghee and the market is quite large including the organized and unorganized, so I still see no slowdown in the growth what we are expecting. We are still seeing good numbers as per our expectations going there for you know the sales normally we track the sales per particular market or particular town and this necessarily are, if you see the essential items like dahi or

paneer and ghee and all are the essential items so it is form of part of the households rather due to the festival season and all, but definitely we are seeing good growth, in specially products like ghee which are in good demand during the festival seasons Tanmay.

Tanmay Sharma: Okay sir that was on basically B2C segment, but if you see demand from overall perspective, B2B which remains large part of your portfolio still, are you not seeing slowdown from the company who supplies to because though the company to which you supply, caters to the consumer as a whole and are you witnessing slowdown in the B2B segment due to the overall slowdown?

Vivek Nirmal: Partly yes, but what happens is, we are in a growing phase, we have lot of capacities. So as a strategy, we keep on adding new clients always, not only new clients but also new product lines, for example we have just started cheese or added paneer and all, so as a strategy we want to increase our product basket and number of clients as well. So, what happens is; while maybe there has been a slight, I am not really seeing too much of slowdown in that segment but because normally due to festival season all the demands go up, usually in this area and we are expecting the same but in terms of milk powder and all, we are having a good growth and especially due to new addition of clients and all, we are expecting a moderate growth or whatever we had expected, we are going as per that.

Tanmay Sharma: Sir, just wanted to get your sense on the raw material front; how is the milk prices panning out, what is the current pricing trend and the overall demand environment and do you see margins improvement going forward as well, as I have a bit, just if we look at the results, I see there is a margin improvement, which might be towards due to mix improvement also. So, apart from raw material, can you also show the split of the B2B and the B2C segment in the current quarters for your company?

Vivek Nirmal: Taking your second question first on the split, I think if you see in last year, our B2C, in H1 it was around INR1,141.6mn which was around 24.65% of the total sales and this year it is around INR1,569.1mn, which is around 28.15% of the total sales, so we have grown as a proportion for B2C; number 1, so obviously that is also helping us to improve the EBITDA but secondly, yes I think milk prices have definitely helped. Milk prices have been on a lower side for last 6 months and there are lot of factors which have been affecting it, including the global milk prices, the larger inventories in the country and all. So that has helped milk prices to be on a lower but as you understand it is an agri-commodity and it has cycles. If you ask me particularly about that how do we see these prices panning up and the trend, I think it was already quite low in last 6 months. We see now the milk prices are improving and we expect that this milk price will continue to improve especially with the kind of monsoons and some monsoons deficits and all, but it will not impact hugely. It is not going to change the entire thing but yes, we have seen increase in trend in milk prices and we expect the milk prices to go up in next coming days.

Tanmay Sharma: Last question from my side is on the Mega project – can you just highlight us what is the current status of the same.

Vivek Nirmal: Mega project normally is an incentive provided to us by the State Government, we are awarded a Mega project and against which we have the incentives of the VAT refund. So since our CAPEX and all are mostly completed under the Mega project scheme, right now the appraisal reports and all have been filed with the State government, and soon we are expecting to get the eligibility certificate and the VAT refunds will be kicking in after we get the eligibility certificate.

Moderator: Thank you. We have the next question from the line of Pooja Lath from Edelweiss. Please go ahead.

Pooja Lath: Vivek Sir, just 2 questions; one we have seen that our gross margins have expanded handsomely and that has flowed down to the EBITDA also, which is where we are seeing such a good growth. The only thing is that interest costs if we compare it year-on-year, that looks a little higher. So if you could dwell a little bit on that?

Vivek Nirmal: The interest is higher compared to last year's for 2, 3 reasons; one is I think now we will see a lot of interest cost coming down in 6 months, just to give a brief background of that because we have reduced around INR1,850mn of debt out of the IPO proceeds. So it will be substantially reduced in the next 6 months, but obviously since it has been repaid at the end of September, we do not see the impact here; so that is number 1. Number 2; our working capital and all have increased in the H2 last year or in the H1 this year as well. So our overall borrowing compared to the H1 was higher in terms of '15-16 that it was a higher borrowing compared to 14-15, number 1. And number 2, we also saw a lot of expenditure being capitalized last year out of the total interest cost, which has not been the case this year because since cheese plant has been operational on June 20th, around 1st quarter has been capitalized but the second quarter, this H1 has not been capitalized. So you see an increase in overall interest cost this year compared to the last year.

Pooja Lath: And Sir in the previous question, you had hinted that milk prices may likely go up or procurement cost, so in the B2C segment also, we will be able to take up our prices in a similar fashion or how do you see pricing action going forward?

Vivek Nirmal: See in B2C, if we see particularly; we expect a margin improvement because in overall the gross margin level itself are high compared to the B2B segment but we are not too much into the pouch milk segment wherein it is very closely linked to the milk procurement price. The rise and the reduction in prices of, sales prices of pouch milk is very closely linked to this but in terms of products like Dahi or ghee and all, it is really not linked, rather it is more linked to the market. For example, in summer seasons, you get better realizations of cold chain products like, dahi, lassi and paneer and all, while in the seasons like, especially winter seasons and

Deepavali, where the demand of ghee is like products is high. You see higher realization over there, so I would attribute them more towards the market factors, so these prices are not really linked to the procurement prices; except if there is a very exceptional increase in the prices suddenly. So I think that is how my take on this is.

Pooja Lath: Sir, because of the Maggi issue, has our relationship with trade partners in terms of the tests that they require or the quality that they want from you; has that increased or has that changed our relationship with any of our partners because we are engaged with all the big names in the industry and the FSSAI issue has made a big dent in the whole F&B space, so has that impacted us also in anyway?

Vivek Nirmal: See I think this issue has definitely made a lot of companies to think twice about their sourcing strategy, we now as a company are known to be a premium dairy ingredient supplier in this space and I think we have definitely identified this as a challenge before 5, 6 years and we have been extensively working on developing our own procurement systems. We have the best in class infrastructures and best in class quality assurance team and I think that is also predominantly a reason why companies which are the leaders in terms of infant food or confectionery or bakery are working with us. I think this recent Maggi issue only underlines the requirement and I think now more companies, not only the leaders but also the I would say; a 2-tier or companies who were not really so serious about the food security issue, will now also start thinking that way. I think, that is a good thing for us because now I see Prabhat as a company will be valued more or will be more sought after companies to source their products. That is how I see this, so in another way, I see this is an opportunity for companies like who are already operating in the quality space that now more and more final product companies like who are selling their final branded products will seek the sourcing of quality ingredients.

Pooja Lath: Sir, on the B2B side, if you could give us some sense on how our developments with new partners have been or who are the big partners we are associated with and how is the demand panning on the B2B side?

Vivek Nirmal: Pooja, there is a policy; we do not disclose name of the clients but yes, I think we are also acquiring new clients as a part of our continuous strategy. Now, obviously the milk powder movement relatively is slow because globally you know the prices are low and even in India, lot of inventory is piling up, so it is slow I would say, but yes on the cheese front, I think now there is a lot of movement happening because cheese is a new plant and we have developed couple of products; including like mozzarella, blended mozzarella and cheddar cheese, sliced cheese, paneer, paneer cubes and all and I think these are, some of them are very new offerings for the market which there are no products at all. For example, in the cheese; especially in the food service, there is no player who is operating in all the geographies. There are a very few players like Amul or Parag or Britannia and all but I think that gives us a very large room for the food service segment in terms of cheese to grow. Second in terms of paneer, and especially when we talk about the smaller cubes of paneer, we again see a lot of scope over there because

there is no organized player really catering this market and there are lot of these hotels, restaurants catering and Fine dine restaurants wanting to have sourcing from a quality supplier, now it gives a lot of comfort to them that a company who is already associated with likes of Mondelez or Abbott and Britannia, is a company who is also supplying to us. I think that gives a lot of comfort to them in terms of quality, service and all. That is working to our advantage and I think that is a major area where we are growing now.

Pooja Lath: And do we plan to take our cheese or the paneer units in the B2C segment as well, in the near term?

Vivek Nirmal: Yes, paneer obviously is a major product in the B2C segment and paneer is growing as well. We are right now into the 'fresh paneer' which has a 15-day shelf life, we are also; our R&D is working to increase the shelf life to 30 days and but I think we are keeping it to that only because our whole motto is to deliver fresh products but at the same time, we are also focusing on other products like dahi and all. Now about the cheese, we do not really expect this product to be launched in the B2C segment because as the strategy we do not operate in the top of the pyramid segment and cheese is particularly top of the pyramid product, when it really comes to B2C, but cheese is the middle of the pyramid product when it comes to the food service because in the food service, lot of eating out and all is happening, lot of sales in terms of restaurants and out of home dining is increasing and there we see a lot of cheese consumption happening. Today you have cheese in most of the even in Indian and Western products, so our basic focus is the food service. You can see food service which is in middle of B2B and B2C you can categorize it over there if you want to position it, but yes I think that is where we are expecting increased sales of cheese.

Pooja Lath: And sir one last question from my side would be on the A&P expenditure, do we plan to significantly step up on that front, given that we want to make a big mark on the B2C side?

Vivek Nirmal: Yes, I think in coming days we will see a lot of action over there, in terms of spends; yes I think H2 will see some spend, next year also we will see spend now going up because consumer segment is a segment now which we are focusing on.

Pooja Lath: But, our spends will mostly be on the local advertising, right?

Vivek Nirmal: Yes, it is more on the BTL activities, especially which now includes the sampling, which includes promotions, which includes reaching more and more consumers; it would be slightly less on the ATL activities, but yes more on the BTL activities.

Moderator: Thank you. Ladies and gentlemen as there are no further questions, I would now like to hand the floor over to the management for closing comments. Thank you and over to you sir.



*Prabhat Dairy Ltd.
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Management:

I, first of all thank you all of the analysts and all to get on the call, I thank Edelweiss to organize the call for us as well. I think we as a company, have lot of good aspirations and ambitions to, our slogan is being 'Partners in Progress', earlier we were only "Partners in Progress" to our family of farmers our employees, our clients and associates, I think now we are also partners for enormous shareholders who are part of the Prabhat family now. I wish everyone a very happy Diwali and I again thank you very much for participating on the call.

Moderator:

Ladies and gentlemen, on behalf of Edelweiss Securities that concludes this conference call. Thank you for joining us and you may now disconnect your lines.