



# “Parag Milk Foods Limited Q2 FY20 Earnings Conference Call”

October 24, 2019



**MANAGEMENT:**

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**Moderator:** Ladies and gentlemen, good day and welcome to the Parag Milk Foods Limited Q2 FY2020 Earnings Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Natasha Kedia, Head of Investor Relations of Parag Milk Foods Limited. Thank you and over to you Madam!

**Natasha Kedia:** Thank you and good evening everyone. Welcome to Parag Milk Foods Limited’s Q2 FY20 earnings call. Before we begin, let me introduce the management participants for today’s call. We have with us our Chairman, Mr. Devendra Shah; our CEO, Mr. Venkat Shankar; Mr. Shashikant Dalmia, our CFO; Akshali Shah, VP Strategy for Marketing & Sales; Shirish Upadhyay, Senior VP Strategy; and myself, Natasha as well as our Investor Relations advisors, SGA. I hope all of you were able to go through the financial results as well as the Investor Presentation that is uploaded on the stock exchange as well as our company website. Let me now hand over the call to our Chairman, Mr. Devendra Shah to share his thoughts. Over to you Sir!

**Devendra Shah:** Good evening and a very warm welcome to everyone on the call. As you are all aware, our industry has its own unique set of characteristics and with milk being an agri-commodity, its availability and pricing depends on a lot of interlinked factors and is cyclical in nature. On a longer term basis, milk production as well as consumption has been growing by more than 4.5% and pricing is also aligned with overall inflation.

Rain gods have been quite benevolent to the country during this year and this abundant monsoon is still continuing as we speak. With excess rainfall, the milk production situation shall improve substantially leading to a continued flow of milk all year round.

During Q1, when milk prices were rising, we initially thought that demand will see us through, and it was more a question of protecting margins. While we did see demand sustaining, our ability to meet the demand because of the availability of milk, was a constraint in Q2 and will continue to be a constraint till Diwali. We witnessed delayed and prolonged monsoons and disruptions in milk availability due to marooning in some parts of Maharashtra which also hampered the flow of milk in different areas. The lengthy monsoon also led to delays in the feed reaching the market which resulted in stress on the availability of milk.



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As for our performance this quarter, we witnessed a revenue growth of 11.6% YoY to Rs.640 Crores in Q2 FY2020. Gross margin stood at 25.7% in Q2 FY2020 while EBITDA margin stood 8.7% during this quarter. While we were in a better position than the earlier years to combat milk prices due to our brand equity and brand power, were there more milk available, we could have seen a better revenue run as per our expectations.

We have already seen substantial improvement in the milk availability from Dussehra and slight moderation in the milk pricing has also started. Finally, we witnessed an improving trend at the starting of the flush season. With this above trend clearly visible now going forward, we see further improvement of the milk availability and some softening of the milk prices post completion of the Diwali festivities. However, on an annualized basis, pricing of milk for this year would be still higher as compared for the last year.

With the expectation that the milk availability situation will improve in the second half of this year and with festivals like Diwali and Christmas falling in the current quarter, for the full year we will try to meet lower-end of our stated guidance in terms of revenue, and are looking to achieve an EBITDA margins in the range of 9-9.5%. ROCE will be remain at similar levels to FY19.

As promoter of the company, post the IPO, we were keen to increase our shareholding in the company. Towards that endeavor, we had taken a loan to buy-back a small portion of shares from the market and in turn, pledged our shares as security. Over the last two months we have repaid 20% to 25% of the loans and are looking further reducing it in the coming months. Post the reduction we are looking releasing the pledge in a phased manner.

As you are aware, to bring in the higher level of professionalism and propel the company to greater heights we recently, got on board, Mr. Venkat Shankar as the CEO of the company, who we introduced to you on the last call. Venkat comes with a varied experience of working in various FMCG companies in senior roles and brings valuable insight that will help the organization recognize its objectives. Parag is entering the exciting phase of the growth and I am confident that we have built the right foundation for our future endeavors.

I would now request Mr. Venkat Shankar to share his thoughts and take us through the business performance.

**Venkat Shankar:**

Thanks Devenji and a very good afternoon to all of you. On the last call, which was about a month or so after I came on board, I had mentioned that I was spending time getting to know the various business verticals, traveling to our various markets and clients and meeting people. Having done that, I would like to share some of my observations and very



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broadly set out some initial direction that we want to drive towards over the next quarters. This could take a little bit of time before I get into the quarter numbers. So just do bear with me. Before I jump into that, though, one must acknowledge that the last 10 years have seen a period of accelerating growth for us, where our revenue grew from about Rs. 340 crore in FY09 to about Rs. 2,400 crore in FY19 over that particular decade. Clearly our early bets in certain product categories like cheese and ghee, the portfolio and brand proliferation across multiple categories, creation of a Pan-India distribution network, these have all contributed to building a solid platform and market position for Parag. I believe that was exactly the right approach that the company needed to take over the last 15 years.

However, when transitions happen, there is an opportunity to reassess where we stand and what course corrections will be necessary. In this process, there will be some areas of continuity and some areas of change. From a strategic standpoint, I think it is safe to say that largely there is going to be continuity. We will continue to bring the goodness of cow's milk to the Indian consumer. We will continue to be innovators. We will have a wide portfolio including our Health and Nutrition portfolio. The change at least in the initial stages is going to come more in the execution part and then in how we drive these strategies forward. As I look at our position, we have a wide portfolio, multiple brands, a Pan-India distribution footprint and a manufacturing footprint that spans three regions of India. In all, therefore, I am satisfied with the width of our business across all these dimensions. However, I believe the time is ripe to be driving more depth in our business, which essentially means that there will be a period of growth through consolidation and concentration in the categories that are core to us, in our brand architecture, in our distribution network, in the way we take our innovations to market, and then our productivity-driving efforts. All of this would require us to start tweaking some of the tools of how we do the business in order to prepare ourselves for the next phase of growth. So let me briefly touch upon some of these.

Firstly distribution. Distribution I think is one of the most enduring strengths of any FMCG company and this is one area where we will see a change in our approach. Over the past many years, we have expanded our distribution to about 3.5 lakh outlets currently. However, from here on, rather than driving width of distribution and further expanding our outlet coverage, we will now focus intensely on our depth and quality of distribution into the currently covered 3.5 lakh outlets. Dairy, especially in the value-added product side is a business where the Pareto principle is very real, which essentially means that you have a 20:80 rule in terms of contribution to business from outlets and therefore our quality and depth of presence in these weighted outlets, which contribute a significant portion of dairy revenues is going to be critically important. We now have a list of weighted outlets across our key markets that will see a higher intensity of focus on deeper and high quality selling



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by our team. This approach will also see us concentrate our efforts on the top metros and other key demand clusters based on our portfolio. While we clearly expect this to be a source of growth in the near and medium term, I feel this will also constitute growth with quality as we will be extracting more from the same base without really increasing our costs and this will also lead to us establishing stronger market share positions across geographies and especially in key geographies like the North and East.

Secondly, while we have focused a lot on expanding across into other categories, we will now put more efforts into our core categories like cheese and ghee in terms of distribution, pack-pricing and other tools to proactively drive our position in these categories. We also have a differentiated long shelf-life natural paneer product where we have stepped up our market activation and are already seeing good traction. Together, ghee, cheese and paneer will be three of our core categories that we have flagged for generating growth in the near and medium term.

Now while we focus on the core, we will continue to innovate - that is our strength and that is what Parag as a company is known for. However, we will do so with more rigor, more discipline, and certainly, with more checkpoints in place. Therefore, prior to investing time and product development and launches, it will be essential, going forward, to establish a business case to determine our right-to-win in these new categories and so on. All this could potentially mean fewer launches, fewer new products to market, but hopefully bigger and well-planned ones that will be significantly and sustainably accretive to the business.

The other element of our journey has been constant market segmentation and creation of differentiated brands across categories and this has helped us carve out unique identities for many of our new products. Going forward we will see consolidation here in the form of a very defined brand architecture wherein all our products will fall under two umbrella brands, Gowardhan and Go, with Avvatar as a functional brand oriented towards the specific growing niche. Traditional Indian products will continue to fall under the brand Gowardhan, whereas higher value-added, new and western format products will fall under brand Go. Avvatar will mainly serve as the vehicle brand for whey protein and related products while Pride of Cows will embody our premium niche products made from high-quality milk procured from our own Bhagyalaxmi Dairy Farm. Obviously, this kind of brand architecture is not trivial work, and we are working on it. We will continue to refine it and roll it out over the next few quarters in the market.

Work continues on the Health and Nutrition program, and we have accelerated our back-end work here. This is a space with immense potential. The Health and Nutrition portfolio in FY19 was at about 3.5% of revenue and is currently in H1 clocking about 4% of our



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revenues. Avvatar continues to grow at a scorching pace and will almost double revenues in FY20. In the past we have also piloted other functional products like Go Protein Power, Go Colo Power, and we have some clear learnings from these. Our team is working hard at assimilating these learnings into the marketing mix. At this stage we are reassessing our strategy and the resources that we need to support this very critical category with. So, while there is a lot of back-end work going on you will be able to see some of our moves towards the end of the fiscal year in this space.

Our fresh milk and Pride of Cows business' continue to have a strong foothold in the markets that we are present in. In our fresh milk business, we have been growing our presence across the country and of course north being a significant contributor, given the low base. Our niche brand, Pride of Cows, continues to exhibit good customer stickiness and is growing in healthy double digits on an organic basis. Our focus will be to scale up this business in the markets of Mumbai, Pune, Surat and Delhi before we expand into newer markets.

I also believe that the company has reached a stage today where we need to be cognizant of the cost, quality and sustainability of growth, and we have commenced work on improving productivity and bringing in efficiencies across the system. Of specific focus is our working capital structure and we are looking at tangible actions that will create a more sustainable cash flow to fund future growth. That said I do not want to jump the gun without specifics, and we expect to share our objective and roadmap on this very important initiative as part of our next guidance.

Just one final point before we get into the quarter that has gone by and this relates to our engagement with Vector and the Mumbai TOC experiment in specific. As a seasoned marketing professional, I think that the present project based on the Theory of Constraints that we have undertaken in Mumbai is a truly transformative exercise and to that extent we need to acknowledge the enormity of this whole task and the fact that while this could have been 2 years in the making the execution has actually been completed only a few months ago in Mumbai. As with any such mammoth project, we will need to make a few tweaks to optimize the model, which we are doing currently. However, we have a good preliminary read on the whole situation and clearly our feeling on the revenue and selling indicators part has been very positive. Mumbai is clearly growing over control geographies and the sales KPIs are visibly ahead. Simultaneously we want to get clear validation on the cost side. We believe that the increased costs will be leveraged down through scale and will lead to a cost model, which is similar to the cost structure prior to rollout of the new model. Now we will need to observe a few months of optimization and sustained growth and validate our hypothesis completely. So I do want everyone to understand that this is a pretty complex



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transformation and we do want to see sustainable results before we move into the next market and I believe that we will be in a position to make our final determination on timelines and next steps by Q4 of this year.

As mentioned by Devenji earlier, given the moderating milk prices and improving availability of milk we expect to improve our revenue run-rate and margin performance thereby expecting to close this fiscal at the lower end of the guidance in terms of revenue and clocking an EBITDA margin in the range of about 9% to 9.5%.

I do want to also mention here that the last two quarters, that is Q1 and Q2 of this particular fiscal, have been actually quite brutal in terms of the whole milk situation. We have had a double whammy of both high milk prices and a shortage of availability of milk even at those high prices, which has, obviously, had an impact on some of our metrics like our gross margins, etc., but as we had mentioned we do see enough indicators about moderation on this front as Devenji mentioned and Shashikant will expand a little more on this part.

So in all, I think, we have a robust platform to build from. You would have noticed that the emphasis through my talk has been more on execution rather than on changing much of the strategy and execution I think is that one critical quality that we will be focusing on in the short and medium term to enable us to scale from here on.

I would now request Shashikant, our CFO, to take you through the financial performance for the quarter.

**Shashikant Dalmia:**

Thank you. Good evening everyone and thank you very much for joining us today to discuss the operating and financial performance of our company for the second quarter and half year ended September 30, 2019.

Consolidated revenue from operations for Q2 FY20 stood at Rs.6,400 million a growth of 11.6% year-on-year from Rs.5,735 million in Q2 FY19, driven by a 11% increase in revenue from Milk Products of Rs.4,360 million. The share of Milk Products for Q2 FY20 was 68% of our total revenue, while that of Fresh Milk was 19% and the same for Skimmed Milk Powder was 11%.

EBITDA for Q2 FY20 stood at Rs.555 million while EBITDA margin stood at 8.7% for Q2 FY20. Other expenses saw a reduction this quarter compared to the same quarter last year, which had a one-off item of reversal of PSI of Rs.6 crores. Furthermore, the provision this quarter has been lower and has reached normalized levels. Also, the marketing and advertisement expenses are aligned with the festive season with a major portion being



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utilized in the present quarter. PAT for Q2 FY2020 was Rs.285 million with a PAT margin of 4.5%.

In terms of the half yearly financials, revenue from operations grew 13.1% year-on-year to Rs.12,698 million in H1 FY2020. EBITDA stood at Rs.1,123 million while EBITDA margin stood at 8.8%; PAT was Rs.560 million with a PAT margin of 4.4%.

Moving to the balance sheet, our working capital cycle changed from 68 days in March 2019 to 71 days in September 2019. Debtor days increased from 42 days in March 2019 to 43 days in September 2019, while creditor' days were decreased from 45 days in March 2019 to 39 days in September 2019. Due to constraints in the availability of milk, working capital increased due to an increase in the inventory and extended credit as a result of the festive season.

In terms of the government incentives such as the PSI incentive and milk subsidy, Rs.74.3 crore is still pending from the government against claims submitted. We have received PSI incentive of Rs.5.6 crore and milk subsidy of Rs.11.89 crore in Q2.

We generated an operating cash flow of Rs. 50.9 crore in the first half of the year with a free cash flow amount of Rs.33.7 crore.

Our current debt stands at Rs.211.1 crore; however, with a substantial increase in the price of milk and higher volume of milk to be procured for further growth, we have higher cash requirements. Further there is a substantial amount of money blocked with the government in the form of subsidy receivables. We may therefore look at avenues to adjust this gap.

On that note, we come to an end to opening remarks and will like to now ask to the moderator to open the lines for the question and answers. Thank you.

**Moderator:** Thank you very much. The first question is from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.

**Nitin Gosar:** Thanks, Venkat, for the articulation of what you intend to do. Two questions, one is on the gross margins. The cost of procurement has gone up Q-o-Q, Y-o-Y. It would be advantageous if you could spell out more in terms of numbers, how the cost has gone up, what has been the percentage change or the absolute number change in milk procurement cost and where is it setting off today?





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**Venkat Shankar:** Yes, thanks, Nitin, for that question. First of all, if you all recall, in the last call, the previous quarter call, Shirish had flagged about a 12% increase in the price of milk Q1 over last year Q1. We thought that was pretty much where things would largely hold. However, when we look at the weighted average milk price of Q2 over Q1, it had gone up by a further 11%, which was quite unexpected.

So in all, Q2 over last year's Q2 actually had something like a 23% inflation on milk price. Now we had covered, as we exited Q1, for a milk price, which was an escalation of the first 12% of the first quarter. However, while we continued to keep covering our pricing, even as the milk escalated in Q2, we obviously, could not do all of it, and the milk escalation was fairly rapid and steep. So in all, our pricing, for example in Q1 over last Q1, moved up by an average of about 5% given that we took it somewhere around the second month, etc. So the effective pricing increase we took in Q1 was about 5% and the effective pricing we took in Q2 over Q1 was overall about 7% and as you can see these are full quarter averages there is a bit of a lag, but that is essentially what is leading to the gross margin dilution of 3% odd in the first quarter and a further 1% in Q2 over Q1.

Now I do want to say that as we sit at the exit of Q2, first part is that the milk price has just started somewhat moderating and as we sit today it is about 3% to 4% below the average of Q2 and post-Diwali, as we see the milk availability improve, we expect a further Rs.1 to Rs.2 per liter moderation in prices, which essentially leads us to expect that over H2, we will have about 6% to 7% of moderation on milk prices compared to Q2 so that is point number one. Point number two that we need to keep in mind is that we had obviously taken our price increases in line with the prices of Q2 and therefore now the price reductions in line with the milk price reducing is something that we are obviously also going to do with as much of a lag effect as possible leading us to believe that our gross margin for H2 will be significantly better than Q2.

**Nitin Gosar:** One small follow-up over here. So you said effective price milk payment cost has been up by 23% in the first half right?

**Venkat Shankar:** There are 3 figures that I gave so let's get this right. Q1 of this year over Q1 of last year was an inflation of 12%, Q2 of this year over Q1 of this year was a further 11%, and Q2 of this year over Q2 of last year was about 23%.

**Nitin Gosar:** So the answer lies between the averages. It is 12% plus 23%, so average of these 2 sort of roughly around 18% is what the inflation has been for first half?

**Venkat Shankar:** You could say, yes about 17%, 18% would have been the weighted average inflation. Yes.



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- Nitin Gosar:** And for that, we have taken price hike to the tune of 12%, 5% plus 7%?
- Venkat Shankar:** So we have taken a total price increase of 5% in Q1 and a further 7% in Q2 so that is 12% in Q2 so you can look at a weighted average there, which would be about between 5% and 12%, so about 7-7.5% in the first half of the year.
- Nitin Gosar:** Okay. So that is what you are saying is the current scenario. So, coming in third quarter if the procurement cost remains where it is and if your price increase that you have taken has to culminate then the current gross margin may not look like and it will improve from here on?
- Venkat Shankar:** So Nitin, what I am saying essentially is that obviously now the pricing at an exit standpoint is at the highest because we have been ramping up our pricing to the consumers, right? Now obviously we would like to hold that as far as possible. On the procurement side we expect that the milk prices will moderate through H2 on an average by about 7% over Q2, based on the fact that already there has been a moderation of about 3-4%, and we expect further moderation post-Diwali.
- Nitin Gosar:** Okay. I think you will need some kind of price hike or moderation to happen for gross margin to improve from here on. The second question is now on the cost levers since you got some time to spend in last 3-4 months, what are the cost levers you are looking at or which are those cost levers, are they largely in the back-end procurement front or on the front end, if you can help us understand this because in last 5 years this company has done phenomenal in terms of gross margin expansion, going from 25% to 31%, now it is coming down to 25%, but in that journey of 25% to 31%, the EBITDA margin never went that way. So there is some kind of cost which is sitting in the system have you been able to understand or target those costs?
- Venkat Shankar:** So, Nitin, like I mentioned in my opening address, I do feel that for a growth-oriented company that there potentially could be areas of efficiency and that is why I had even mentioned that point on productivity. However, like I said there, I do not want to jump the gun without specifics. We are looking at a complete end-to-end scan of the entire cost structure of the company and I am looking at not necessarily just the cost, I am also looking at aspects which tend to sit on the balance sheet. So everything from, say, packaging material to our inventories is under the scanner for opportunities. I would only request you all to just hold for probably another quarter or so when we come out with next guidance when I plan to give out a target and kind of a roadmap towards what kind of productivity we are going to be targeting.



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- Nitin Gosar:** Got it.
- Moderator:** Thank you very much. The next question is from the line of Shailesh Kumar from Sunidhi Securities. Please go ahead.
- Shailesh Kumar:** I have a couple of questions. First thing is what has been the dynamics in Liquid Milk space that our Liquid Milk sales has gone down sequentially from Rs.113 crore to Rs.98 crore. Secondly, I do appreciate your payables problem that has gone down because of tight supply, but why has the receivables further deteriorated, what is there in this, these two things I want to understand?
- Shirish Upadhyay:** Yes. So in terms of Liquid Milk, our overall business has gone up and as a percentage of the total pie also it has improved to 19% as of now and that is because of addition of the Delhi market in Liquid Milk, which was started in the later part of last year so that is showing up in terms of growth. So Liquid Milk has definitely improved in terms of overall performance.
- Shailesh Kumar:** If I look at your quarterly numbers in Q1 FY2020 your Liquid Milk sales was around Rs.114 crore and if I do the calculation Q2 FY2020 is at Rs.98 crore so I was at loss to reconcile these two numbers.
- Shirish Upadhyay:** No, it is not Rs.98 crore. We have given in terms of percentages in the presentation and there it says 19% of the total business of Rs. 640 crore, so it is around Rs.120 crore in terms of numbers.
- Shailesh Kumar:** And then this receivable thing?
- Shashikant Dalmia:** On the payable side, I covered in my speech also that there is a constraint on the milk side so we have made some fast payment to the suppliers to maintain continued supply irrespective of the increase of other purchase, but our creditors reduced by Rs.10 crore. For the debtor side, due to the festival season, we have allowed some additional credit days, mainly in general trade business segment so the debtors in absolute number has increased, but if you see in the days-wise then it is in the same line of 42-43 days.
- Shailesh Kumar:** So Shashi, by the end of the year where do you see these receivable days to stabilize?
- Shashikant Dalmia:** We are expecting somewhere in the same range, 40 to 42 days.



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- Moderator:** Thank you very much. The next question is from the line of Bhargav Buddhadev from Kotak Mutual Fund. Please go ahead.
- Bhargav Buddhadev:** Is it possible to know what is the outstanding balance of PSI, milk subsidy and advances as on September 19, 2019?
- Shashikant Dalmia:** PSI subsidy balance is somewhere Rs.52 crore for the PSI subsidy. In March 2019, the PSI subsidy was Rs.47crore and for this H1 we have accrued another Rs.11 crore, so the total outstanding is Rs.58 crore, out of which we have received Rs.5.6 crore. The net receivable is Rs. 52 crores is pending with the government. For the milk subsidy, which is Rs. 37 crore for the March 2019 and for the April we have accrued another Rs.6 crore. Overall, Rs. 43 crore is outstanding for the milk subsidy out of that we have received Rs.22 crore. Now Rs. 21 crore is pending with the government for the milk subsidy. Advances, we had around Rs.73 crore advances in March, and we are in the same line in H1, balance advance is around Rs.75 crore.
- Bhargav Buddhadev:** What has been the marketing and ad spend in this quarter and what was it same quarter last year?
- Akshali Shah:** So for the H1 we have spent around Rs.10 Crore and last year it was around Rs.15 crore.
- Bhargav Buddhadev:** And this quarter?
- Akshali Shah:** It will be half and half, Rs.5 crore for this quarter.
- Bhargav Buddhadev:** Okay and same is the trend the last year also, half and half?
- Akshali Shah:** Last year, it was Rs 3 crore.
- Bhargav Buddhadev:** Okay and in terms of the ESOP policy any update on that?
- Shirish Upadhyay:** No. ESOP policy, as we have discussed, that has been approved by the AGM so now it would be taken up by the NRC in this next meeting and further granting, and those things would be decided by the NRC, so when that happens we will update you.
- Bhargav Buddhadev:** And lastly, Mr. Shah mentioned on the reduction on the share pledge, any timelines by when are you targeting to do that?
- Devendra Shah:** In the next 3 months we would like to reduce another 20% of the outstanding loan amount.



**Moderator:** Thank you very much. Next question is from the line of Aniruddha Joshi from ICICI Securities.

**Aniruddha Joshi:** So Sir can you indicate the indicative loss due to the excess rains in Maharashtra or probably the floods in Maharashtra if it is possible to quantify? Also, how do you see the consumer sentiments playing, many FMCG companies have indicated that due to the weaker consumer sentiments or there has been a relatively lower sales growth so do you see any such issue over there and what was the volume growth? Assuming 7-7.5% as annualized price hike, can we say the volume growth was somewhere around 4-5%.?

**Venkat Shankar:** Yes. So, let me first take the demand part of your question, Aniruddha. So, first thing is that you know when we discussed in Q1 I said that we had not quite seen any real slowdown. Now, if you look at a lot of the signals that are being put out on the slowdown you would see that a bulk of it is skewed towards commentary on the situation in rural markets. Now the fact is that our business has far lower reliance on rural markets compared to many of the very widely distributed FMCGs – that’s perhaps one reason. The second, of course, could be more to do with dairy as an industry being a lot more in terms of essentials and so on and therefore not suffering so we really did not see much of that. In fact, in Q2, unfortunately, I do not think we were able to test the demand fully because we were not quite able to supply what we wanted to supply - there with availability issues of raw milk and therefore I would actually say we probably fell short in catering to the demand that our products had in the market in Q2. Very tough to quantify what could have been the loss you know when there is a shortage, there is obviously a very exaggerated sense of what the shortage could be, but my very rough guess would be somewhere between 3% to 5% on the full quarter numbers could have been the shortage, but that is a very, very rough estimate.

**Aniruddha Joshi:** Okay and volume growth for the quarter?

**Venkat Shankar:** So volume growth for this particular quarter was around 2%; however, we had pricing growth close to about 10% and as we have said we have taken a fair amount of price increases so that is really how we had about 12% overall revenue for the quarter.

**Aniruddha Joshi:** Okay. So one last question. So you indicated that you had around 3.5 lakh retail outlets right now so can you indicate the same number exactly one year ago and where do you look at the number maybe one year or two years down the line?

**Venkat Shankar:** You know what I recall is that I think we were at about a 2.5 lakh number somewhere around first quarter of FY2019, and we have been somewhere around the 3.5-3.7 lakh mark



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for some time now and like you said we will probably stay there for a bit of time before we consolidate.

**Aniruddha Joshi:** Okay sure. Thank you.

**Moderator:** Thank you very much. The next question is from the line of Raj Koradia from Edelweiss Broking Limited.

**Shradha Sheth:** This is Shradha from Edelweiss. Three questions, as you said working capital has gone up by 3 days mainly because of the extended credit due to the festive season so how are we looking at the year end, how are we looking at consolidating the working capital as you also said in your commentary we will be consolidating this? Secondly, I wanted to understand, you said because of the higher cash requirement, the debt, which is around Rs.211 crore can go up. If you could just spell out what will be your capex plan for the year and maybe the next year and hence what could be the indicative debt position and just lastly, the subsidy received, both PSI and milk subsidy, if you can just, again, please repeat the numbers, both orders received and what is outstanding?

**Shashikant Dalmia:** Shradha, about the working capital, I have just mentioned in my earlier answer due to the festive season our working capital cycle has increased by 3 days. If you see, the creditor has decreased by Rs.10 crore. Due to the festival season we are keeping more inventory in form of butter and ghee. For the debtors, we have given some additional credit mainly in general trade business, so we are working on the same, and we are looking some improvement in terms of the working capital days.

**Shradha Sheth:** Sir will it be at similar levels or what is the kind of improvement we are looking at?

**Shashikant Dalmia:** If you see for the full year number, then it will be in the same range of 65 to 68 days for the full year basis.

**Shradha Sheth:** Okay and hence what is the kind of cash flow we will be looking at for the full year because first half we did see deterioration in the operating cash flow so in case you can give some color?

**Shashikant Dalmia:** If you see the cash flow for the H1, we have operating cash flow of Rs.50 crore after paying the tax and the free cash flow is Rs.33 crore and we are expecting the cash flow will be in the same range. Operating cash flow, somewhere Rs.130-140 crore and the free cash flow somewhere Rs.60-65 crore.



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- Shradha Sheth:** Okay, fair enough and just on the debt you have said there could be some increased debt because of the higher cash requirement so if you can give some color what will be the increased requirement?
- Shirish Upadhyay:** As he mentioned in his speech, that is a temporary requirement because of some receivables pending with the government as well as increased milk prices and therefore some requirements. That is more a temporary cash flow situation where we are looking at enhancing our sensor limits and growing as and when required. On the second part, capex we had earlier discussed that with the current capacities we are good to go till a topline of roughly Rs. 3,200 - 3,300 crore and beyond that whatever further capacity requirement we are working on that. Maybe over the next 4-5 months, we will have a much clearer picture in that regard.
- Shradha Sheth:** Yes, that is helpful and just lastly if you can please repeat the PSI and the milk subsidy, what is received and what is outstanding?
- Shashikant Dalmia:** In March, PSI subsidy was outstanding of Rs.47 crore and for this H1 we have accrued another Rs.11 crore. Out of that we have received Rs. 5.6 crore in H1 FY20 and for the milk subsidy in March outstanding was Rs.37 crore and we have accrued another Rs.6 crore for April. Out of that we have received Rs.22 crore. Now outstanding is Rs.21 crore for the milk subsidy.
- Shradha Sheth:** And outstanding for PSI is?
- Shashikant Dalmia:** Rs.52 crore.
- Moderator:** Thank you very much. The next question is from the line of Ashwini Agarwal from Ashmore.
- Ashwini Agarwal:** Thanks for the opening comments Venkat and obviously a very challenging time, but just looking a little bit into the details. We have seen some deterioration in the profitability of Bhagyalaxmi Farms as well that is what I can sort of make out between the consolidated and the standalone. What happened there any comments?
- Shirish Upadhyay:** Yes. So that, obviously, was related to unavailability of feed and therefore a subsequent increase in prices of fodder, which has led to some depression there. So what farmers have suffered we have also suffered equally.



- Ashwini Agarwal:** Okay. And for Shashikant, even if I look at your other expense line, which has gone down from Rs.95 crore to Rs.83 crore, is it all on account of provisions, which you had made against PSI receivables last year or is that on account of some other savings, what is driving that decline in other expenses?
- Shashikant Dalmia:** Mainly, it is led by the PSI, which was in last H1. The other one is the provision for doubtful debts. In last H1 we have provided Rs.10 crore and for this H1 it is Rs.4 crore, a reduction of Rs.6 crore provision amount.
- Ashwini Agarwal:** Okay and when you look at your PSI and your milk subsidy numbers, how are you sort of testing them for veracity in the sense that, is there a possibility that some of these numbers may need to be provided for as we go along?
- Shashikant Dalmia:** No. Our PSI subsidy, if I am giving the bifurcation. For FY2010-11 to FY2016-17, our outstanding amount with the government is Rs.8.72 crore, for which we have received the provisional sanction from the government, and we are expecting to get this amount before the end of this month. For FY2017-18, outstanding with the government is Rs.11.83 crore and for FY2018-19 it is Rs. 21 crore. We have already filed these claims with the government and we are expecting to get the filled amount from the government.
- Ashwini Agarwal:** And Maharashtra milk subsidy that should get paid off this quarter. Correct?
- Shashikant Dalmia:** Yes. We are expecting to receive the same before December end.
- Shirish Upadhyay:** It basically got delayed because of elections and other things. So now it should be regularized.
- Ashwini Agarwal:** So circling back to that comment that Shashikant made in his opening remarks that the debt might go up. If I think about it, second half, your cash flows will be strong. You do not have much capex, you will see some receivable coming down on account of this milk subsidy as well. PSI should remain stable. Then debt should come down. Why should it go up I am not able to understand the arithmetic?
- Shirish Upadhyay:** Yes, that you rightly said that may come down by end of Q4 also, but this is a requirement, which is for today and today as Shashikant has mentioned we have roughly Rs.70 crore outstanding with the government and with the increased milk price as well as the quantum of milk that we are looking to increase there is roughly Rs.70-80 crore kind of further cash flow that is required to flow back to the farmers to get that quantity of milk and therefore to meet this immediate requirement we may look at a few avenues.





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**Ashwini Agarwal:** Okay, okay. So that is good. So one sort of a bigger question is that second half of the financial year usually is somewhat softer because that is the time when you have surplus milk and you end up with a lot of raw milk surplus, which gets converted into powder and so on and so forth. So looking at those complications ahead of you while milk prices will soften, is there a risk that the revised guidance that we have put out might still be at risk because the second half usually or especially the fourth quarter is a weaker quarter?

**Shirish Upadhyay:** No. So typically, Ashwini, what has happened in our case was that Q4, for us, for last year was quite big, much heavier than the normal pattern, and that was led by export subsidies, and we exported to get benefit out of that. So based on that, this quarter would be more normalized in nature, and that is how we have revised our guidance and are looking at roughly 10-12% growth in H2 as well.

**Moderator:** Thank you very much. The next question is from the line of Sunil Kothari from Unique Investments. Please go ahead.

**Sunil Kothari:** My congratulations and thanks to Mr. Shankar for explaining so well about the thought process and strategic change he is thinking about. Sir my question to you is, we are also having some products, which is maybe of a very small size, like rasgulla and gulab jamun, and we are also selling milk in Singapore what is your thought process, is this a strategy to follow and expand on these terms or should we focus more on this cheese, ghee and butter in domestic market?

**Venkat Shankar:** So yes, thanks for allowing me to expand a little more on what I said in my opening address. I think we need to see some of these initiatives for what they are. Some of these things that we do, at times, are driven by certain opportunistic kind of situations that we see, and we do not necessarily need to read much of a strategy into it. So, Singapore Pride of Cows was something, which was an opportunistic kind of a thing that came up and we obviously seized that opportunity. However, there is no massive strategy to go outside India or even go too wide within India and increasingly as I said we will be focusing on our core categories and while we will continue to drive categories that we are present in, we have made some investments, our salesmen carry these products in certain outlets. Some of these niche products allow us entry, etc., but I can very safely say that most of our efforts and resources will be in driving our core, which will be cheese, ghee and paneer.

**Sunil Kothari:** Sir, one more thing is, since long, we were requesting for the clarification which you have given in this call by CFO, Mr. Shirish and Mr. Venkat. I think this was what expected from the management and really we thank you for doing this, and hope will continue to explain all the numbers, whether it is the government receivables and PSI and all these things. Just



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last one thing I wanted to know is last year, we have written off roughly Rs.53 crore, totally bad debt, provisions and everything. What type of provisioning or some numbers if you can say with us whatever of write-offs will require during this year?

**Shashikant Dalmia:** In last year, there was a new method for the calculating provision amount, which is called ECL, Expected Cash Loss method, in that method we are bifurcating our debtors in different buckets and if there is a delay by one party in one bucket, it will lead to additional provisions within all the buckets. That is why our provision amount was increased, but if you see the H1 number for this year, there is a provision amount is Rs.4.4 crore, and we are expecting within the same line will remain for the full year.

**Moderator:** Thank you very much. The next question is from the line of Manoj Bahety from Carnelian Capital Advisors.

**Manoj Bahety:** A couple of questions. First one is, just wanted to understand like if we have to improve ROC's from here, I think one of the things which is required to bring down the elevated working capital, particularly inventories, trade receivables as well as other current assets, which we have like milk advances. So just wanted to understand what is the thought process behind that, like whether in this business, can you bring down the working capital cycle from these levels or we have to live with the current level of working capital?

**Venkat Shankar:** Manoj, thanks for the question. See, at this point, it is pretty obvious that we have been somewhere around the 65 to 70 number of days working capital over a period of time, roughly, plus/minus. So the business has been obviously growing, and we have been moving things forward, but like I said during my address we are taking kind of an end-to-end look across the board in terms of our different elements of our working capital and we will definitely have a roadmap, which will make it very clear that this is the kind of number we should be targeting in the medium term and what are the milestones towards that. I would request all of you to just wait for our next briefing on the guidance for the next few years along with our working capital roadmap and the capex roadmap that Shirish also alluded to. So I think we should be in a position to put that out in probably Q4.

**Manoj Bahety:** Right. But this 65 days it includes like elevated level of trade payables also and I think in Milk business can we have a sustainable number of these kind of trade payables just wanted to understand what is the nature of these trade payables, which is almost Rs.300 crore and if I see as a percentage of milk procured, it is almost, I think 50 to 60 days kind of trade payables are there right?



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**Shashikant Dalmia:** If you see the creditor days, it is somewhere around 39 days, but if you see the absolute number, it is Rs.287 crore, which is including packing material, transportation, advertisement and the provision amount, which is not for the milk creditors only. If you see for the milk creditors, creditor days in the range of 20 to 25 days.

**Manoj Bahety:** And finally, last question. Just wanted to understand, like, it is almost 1.5-2 years since we have launched Avvatar and then we have like added various variants of Avvatar and Venkat you mentioned like your focus will be mainly on cheese, ghee and paneer and Avvatar was missing in that. So is there any like push back which we are getting on Avvatar scaling up vis-à-vis the global brands?

**Venkat Shankar:** So Manoj, I must thank you for giving me the chance to kind of just layer that on. So obviously I was trying to signal that when we look at our entire portfolio towards the consumer in terms of general dairy, it will all be very Go and Gowardhan specific. I did mention that the Health and Nutrition portfolio is a space that we have tremendous amount of belief in terms of potential and our right to succeed. Avvatar is one leg of that. We have launched products, like Go Protein Power, etc., and I think this is a space where we are going to constantly keep tweaking our next steps and our strategy. I also think that this is a space that will be reasonably resource-intensive in the first few years to build these brands, and that is the kind of commitment that we are already bringing into Avvatar. It is just that it is a different business model. It is neither FMCG nor is it dairy, it has a different go-to-market and therefore we treat it like a different business, pretty much like a Pride of Cows, etc., but Avvatar is an area where we are putting a lot of resources and efforts on and like I mentioned, I think we are seeing validation in the kind of growths, where Avvatar business is almost kind of expected to double in FY2020. So very much in focus, very much being resourced. It is just that in terms of relative size, it is smaller than the rest of it, but this is a space where we think that there is a lot more headroom to grow.

**Manoj Bahety:** Thanks for giving the detailed explanation. Just one follow-up on payables. Shirish mentioned that 37 days is the payable to us on milk, but whether farmers will wait that long for getting their milk payment I understand like you might have to make payment next day or next to next day for direct milk procurement, right?

**Shirish Upadhyay:** No. So Manoj, let me, again, clarify what Shashikant was trying to explain. It was that 37 days is the total payable cycle and the quantum of payable involves a lot of things apart from milk. So as far as milk is concerned, there the cycle is roughly around 20 days. Apart from milk suppliers or farmers, we also have other suppliers, be it suppliers in terms of services, or packaging material, ingredients and other things and for those kind of suppliers,



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the payment terms are bit higher and it ranges anywhere up to around 90 days and so on a total consolidated basis, it comes to roughly around 37 days.

**Manoj Bahety:**

Thanks for taking my questions.

**Moderator:**

Thank you very much. The next question is from the line of Percy Panthaki from India Infoline. Please go ahead.

**Percy Panthaki:**

Sir, my first question is on the capex. Since the last 2 years, we have been saying that there is enough capacity, and we do not need to do much of capex and you today also mentioned Rs. 3,200 crore, which probably will take 1 or 2 years more to achieve so if I look last 2 years, plus next 2 years, and each year, you have been doing about Rs.80 crore of capex so over that 4-5-year period, we will do in excess of Rs.300 crore capex so just some rough idea as to where that Rs.300 crore is going?

**Shirish Upadhyay:**

Yes. So Percy, whatever capex that we are doing, we have clarified earlier that roughly 2% to 2.5% of the business is our requirement in terms of maintenance capex. That is more maintenance in nature, it is not new capex, expansions of capacities on newer lines that we are talking about. We need to appreciate the fact that we are in food business, milk business, and therefore, upkeep of the equipment, their life and their regular maintenance, change-over parts, all those things are much higher and therefore, maintenance capex looks a bit higher if you may be comparing with any other traditional industry.

**Percy Panthaki:**

Okay, understood. Secondly, this price hike that we have taken in Q2, the price hike is like almost 12% so just wanted to understand. Two parts to this question, one is the underlying input cost inflation of 23% that itself seems to be quite high. Is this only a Maharashtra phenomenon or do you see this in many other parts of the country and secondly, this 12% increase, how has it been spread I am assuming that this is MRP increases, and also, withdrawal of trade promos, etc., both put together would come to 12%. So if you can give me any idea of how this is split across this 12%, one is across different product categories, and second is between what is the split between MRP increase and trade promotion withdrawal?

**Venkat Shankar:**

So you are right, Percy. It is a combination of MRP and spends before the NR level. It is a little tough, but my estimate would be about 80%, 85% of this would have been largely from MRP increases and probably about 10% to 15% would have come from trade spend reductions. Coming to your first question on the pricing, yes, Maharashtra saw this 23% increase, but this year specifically milk prices have been fairly challenged across the country, whether it is North where it spiked up in Q1 and early parts of Q2 where there is



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some moderation, but even markets like South where players, cooperatives like Aavin took a one-shot Rs.5 price increase overnight after 5 years that is the kind of price shocks that this industry has seen, which is really a little unprecedented. Therefore, I would clearly say the last 2 quarters have been a little not-so-normal from that sense. In short, yes, I think this is a price fluctuation and volatility, which we have experienced throughout the country, not just Maharashtra.

**Percy Panthaki:** Okay. And lastly, so on promoter pledges, can you give some clarity on what will be the source of funds for reducing these pledges and payment of debt?

**Devendra Shah:** It is my own funds and I am managing from my own funds only.

**Percy Panthaki:** That is it from me. Thanks and all the best.

**Moderator:** Thank you very much. Ladies and gentlemen, due to time constraints that was the last question. I will now hand the conference over to the management for closing comments.

**Natasha Kedia:** Thank you everyone for being on the call. If there are any followup questions, please feel free to reach out to me or our Investor Relation advisors, SGA. You can also refer to our company website and the stock exchanges for our investor presentation. Thank you again.

**Moderator:** Thank you very much. On behalf of Parag Milk Foods Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.