"Kwality Limited Q4 FY17 Post Results Conference Call"

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ANALYST:	**MS. SANGEETA TRIPATHI – EDELWEISS BROKING LIMITED**
MANAGEMENT:	**MR. NAWAL SHARMA - PRESIDENT AND HEAD (BUSINESS TRANSFORMATION) - KWALITY LIMITED** **MR. SATISH KUMAR GUPTA - CHIEF FINANCIAL OFFICER - KWALITY LIMITED** **MR. VARUN KAPOOR – INVESTOR RELATIONS & CORPORATE STRATEGY - KWALITY LIMITED** **MR. ANAND GOEL – GENERAL MANAGER (FINANCE) – KWALITY LIMITED**

Moderator: Ladies and gentlemen good day and welcome to the Edelweiss Broking Limited conference call on Kwality Limited to discuss on its Q4 FY17 and full year FY17 results. 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 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. Sangeeta Tripathi. Thank you and over to you Madam!

Sangeeta Tripathi: Thank you operator. Good afternoon everyone. On behalf of Edelweiss I extend a very warm welcome to all for this conference call on Kwality Limited. Today we have the management of Kwality Limited to discuss their Q4 FY17 and full year FY17 results. From the management we have Mr. Nawal Sharma who is the President and the Head Business Transformation, Mr. Satish Kumar Gupta, the Chief Financial Officer, Mr. Varun Kapoor the Investor Relations & Corporate Strategy Head and Mr. Anand Goel, the General Manager (Finance). We will start the call with a brief introduction of the quarter, how it went by and the entire full year and post this we can open the floor for question and answer. I would handover the floor to Mr. Nawal Sharma for his brief opening. Over to you Sir!

Nawal Sharma: Thank you so much Sangeeta. So first of all good afternoon everyone, it is really pleasure to have all of you on this call. So let us start with a brief introduction on the quarter. It has been a pretty good quarter and a fantastic financial year. So before I get into key enablement frameworks, which led to the delivery of these numbers let me first briefly touch upon the key data points and the key business numbers.

While the overall revenue for the quarter has gone up by around 8%, but the area of strategic focus that is consumer part of the business has grown by around 31% with contribution moving from 34% to 41% and as we talk about key profitability layers. The EBITDA has gone up by 35.5% from 78 Crores to 105 Crores, which is 5.5% to 6.9%. The EBIT part has gone up by 27.5% moving from 72 to 92 Crores, which is 5.1% to 6%.

There has been, what I should say a positive decline on PBT part moving from 55 Crores to 38 Crores and the reason is basically the interest part, which was earlier being capitalized due to CWIP, which is capex work in progress with unit III getting operational with effect from February 2017 is now being charged to P&L, so this is basically a positive investment, a positive development and this will lead to huge cash flows to be generated in the future years. So that is on PBT part.

Coming to the PAT part, again there has been a 42% increase moving from 24.5 Crores to 35 Crores, which is 1.7% to 2.3%, so again just would like to highlight there has been a 7.5% effective tax rate because as per income tax had got claim for around six months while calculating the tax, so that is the reason why tax component has been low in this quarter to the tune of around 7.3%. So having said that if you see the overall results on an annualized basis on the financial year the overall revenues grown by around 8.5%, but again the consumer part of the business has grown by 33% and similarly all the layers of profitability, which is EBITDA layer has grown by around 19%, EBIT layer has grown by around 21% and the PBT has grown by around 14% whereas PAT has grown by around 22% on a standalone basis. Now having said that while the delivery of this strong business and the layer is good and this has been due to a very meticulous 360-degree execution of a well thought out strategy, but let us briefly cover as to what have been the key enablement programs, which have helped us delivering the numbers over the last few quarters and which will continue to help us giving a good performance over the next three to four years' time.

So first of all touching briefly on the key programs, there has been a capacity augmentation to the tune of around 9 Lakh liters per day taking the overall capacity from 3.4 million to 4.3 million liters per day. Now this is further supported by a capex outlay of around 520 Crores out of which 410 Crores has already been invested and balance will be done in the next 12 to 15 months' time and this is further supported by KKR so from there we have already received around 300 Crores and further will be based on the business needs.

Now the next key area, which is procurement, the most complex and the most challenging part of the dairy business value chain there has been a very positive development. We are sure you would have heard that there has been a path breaking and a disruptive strategic alliance that we start with India's second largest public sector bank, which is Bank of Baroda where they have agreed to provide a loan of up to 4,000 Crores at a very concessional rate of 8.6% were initially identified One Lakh farmers. Now how the farmer is going to utilize these funds primarily into three buckets. First of all to buy additional animals up to four and second is to buy a smart phone to ensure the enablement and then the two or a four-wheeler, so these are the three key areas where the farmer will be utilizing these funds.

Now we are very sure that unless and until there is a complete win-win situation it is very difficult to have any strategic alliance continue for a very long time. So let see as to what each of the stakeholder gets. Now talking from quality standpoint, now this is going to be a huge booster to a direct sourcing channel that is one and then there are no legal liabilities on that because we act as a facilitator that is one part and if you do a quick maths, one lakh farmers, four animals, which is four lakh animals, 12 liters, which amounts to around 48 lakhs 4.8 milliliters per day even if we get 50% of this we are all sorted for the next three to four years time. So this is the capex like model. Now let us see as to what in from farmers' standpoint.

So farmers will get "EEE" benefit. Now what is this "EEE" benefit. First is enabled financial assistance so where we act as facilitator and they do not have to slog in terms of getting this loan that is one. Second is they are empowered with additional animals, which is basically additional income for them and third part is e-enablement because through this smart phone and continuous engagement on digital platform by opening of these bank accounts the overall operational effectiveness will definitely increase. So that is the benefit from farmers' standpoint and thirdly from Bank of Baroda standpoint, it is a huge push to their priority sector lending and Kwality accesses a huge operational support partner because they can leverage a captive base of around 350,000 farmers out of which we have initially identified 100,000 farmers. So it is a direct access and how we will be making payment to the farmers on a transactional basis, so we will deposit the money in the Bank of Baroda account of farmers where they will deduct the EMI and pay the rest, which means their money is totally secured and the leverage on existing relationship.

So this clearly reflects that it is a complete win-win situation for all the three stakeholders. So that is a very key and a very deceptive model that we have stuck in this financial year. The procurement challenges are all sorted for the next three to four years' time that is two and thirdly from a brand standpoint it has been a very good year, we kick started a huge journey towards building a very strong consumer band, so with the help of key strategic partners with the leading partners in India that is one. Then we also stuck with ad for equity deals with Hindustan Times and Times of India, which will help us optimizing cash flows and thirdly from an implementation standpoint we have already initiated a very comprehensive marketing program comprising of ATL, DTL as well as customer engagement program, so this is in the direction of building a very strong consumer brand, which will be followed by a comprehensive brand health management system.

Secondly from a product standpoint, numbers clearly reflect that we are moving towards B2C space as 70:30 has moved to 60:40 as far as FY17 is concerned and in line with our B2C strategy you would have seen that already UHT tetra pack milk as the cream have been rolled out in Q4 FY17 as the first part of our value-added products. Next eight to ten variants in the categories of flavoured milk butter, cheese, yogurt, paneer will be rolled out over the next four to six quarters' time, so this will definitely help us in terms of re-engineering our bottomline and deliver an enhanced EBITDA level as well as cash flows and this unit III that we just mentioned has already become operational with effect from February onwards.

And from sales and distribution standpoint, the good news is we have been going very thorough on sales force automation, e-com has been a key focus area so where we have got very good response. Modern trade we are doing some pilot so we are again, initially we have got around 12% to 15% market share, which is a very good response from the customer side so that is the key focus area from a sales and distribution standpoint and also sometime back we had engaged Ernst & Young as a strategy growth partner, so what are we doing whatever the comprehensive strategy that we have worked out, so there has been a revalidation so what we did to get us along with E&Y so we did a detailed global plan as to how the consumer behaviour is changing, what has been the domestic response, how consumer attitude and usage and behaviour is evolving in the Indian market. So post that we did a very comprehensive and a detailed internal capability analysis as to what are our key strength areas and how we can leverage these strength areas and then there has been a very detailed CVP what we call as customer value proposition buildup program in which the key strategy is what you call as HPC before launching any product we consider what is the health benefit that is first dimension, second dimension is the pleasure part, what kind of indulgence we can afford and third is basically the convenience part. For any product there has to be two dimensions covered so that is how we are developing a very differentiated product in each of the category and then there is a engagement of a nutritionist who brings in the medical standpoint as to how it is going to help people at a large and then there is a R&D dimension would evaluate as to what is the technical possibility of launching this product so that is a three dimension validation ensure that we really rule out differentiated products in the market and the differentiation is at all the layers possible layers where it is at the product layer wherever possible or packaging layer as well as at the communication layer.

Now the next is where we did lot of development and lot of accomplishment was that IT layer. So as we said last time this is going to be a key enabler in a complete strategic shift from strong B2B players towards building a very strong B2C player. So again on this front we engaged Ernst & Young as a IT transformation partner and what they did they engaged with all our functional heads and created six teams, so where we are talking about connected business, where we are talking about things like how we can modify and create a comprehensive ERP framework to ensure that B2C becomes a seamless process. Then there is a business process automation piece, there is a IT for IT piece, there is integrated reporting piece and then there is innovative IT piece and under these six teams we have defined some 23 comprehensive programs over a period of three years broken by immediate term needs, mid term needs as well as the long term needs and currently we are in a process of executing these programs on the ground with the results being reflected after every six to nine months. So that is how IT is going to be a key enabler in helping people taking judicious as well as faster decisions.

And now coming to the last piece what we call as the people piece. Again there has been a great focus in this financial year to build a rock solid middle level management player so where we are hiring people from one of the best companies both within the industry as well as outside the industry and few people joined us bring a rich experience in the companies like Amul, Mother Dairy, Parle Group of Industries, Godfrey Phillips, Reliance, Taj Group of hotels, India Today good company and people are coming and joining us. ESOP has been again a differentiated framework. We became India's first private dairy company to issue ESOP, which has generated a huge positive response within the organization and there is a very update kind of environment within the company and people are very positive and very update and there has been a lot of partnership approach in this company. So that is briefly about the numbers and the rational as to why we have been able to deliver good numbers on the ground because this is based on a complete re-engineering approach on the organization front because if you have to deliver sustained good numbers you have to take a holistic approach and work on each and every function of the organization whether it is on people front, whether it is on sales and distribution front, whether it is on procurement product or brand standpoint, so that is how we as an organization are moving ahead in a very systematic, in a very structured manner taking support of leading partners whether it is in the marketing front, whether it is in the financial front or whether it is consultants like Ernst & Young. So that is how together we are moving ahead and we are confident that we will continue to deliver these numbers on a sustained basis. So that is briefly about numbers and what are the key enablement frameworks that we have implemented over the last one year's time and that is how what is going to give us these numbers in the future roles. So now we can get into discussion, feel free to ask any questions.

Moderator: Thank you very much. Ladies and gentlemen we will now begin with the question and answer session. We have the first question from the line of Dhruv Agarwal from Cresita Investments. Please go ahead.

Dhruv Agarwal: Sir my question is regarding the capacity utilization at the new plant, which is producing the B2C product so what was your utilization for the full year FY17 and for the Q4 FY17?

Nawal Sharma: See as we mentioned that this capacity augmentation has been done in February only so again earlier the capacity utilization with a tune of 86% to 88%, but now it is dip to around 70% because of the addition of this new capacity, 9 Lakh liters per day, but this will gradually improve as we will continue to roll out new products out of which two products we have rolled out in Q4, which is UHT tetra pack milk as well as the cream, so we will continue to roll out these products over next four to six quarters' time and that is how this already existing new capacity will help us in seamless execution of the product and roll out of the product on the ground.

Participant: Sir what was your total capex spend for FY17 and what will it be for FY18?

Nawal Sharma: Yes, as far as capex part is concerned there is a plan outlay of around 520 Crores into two buckets. First is the back-in bucket what we call as procurement bucket, so where the plan is to the tune of 120 Crores and then there is a plant infrastructure upgrade, which is to the tune of 400 Crores and out of this 520 Crores 410 Crores has already been invested and balance 110 Crores will be done over the next 12 to 15 months' time. So with this we are all set to get into this high margin value added products and which will give a huge boost to our overall profitability.

Participant: Last question if I may ask what are the like apart from the two value added products, which you have launched what are the different type of products that you will be rolling out in the next six to twelve months particularly in FY18?

Satish Gupta: See the next level of products that we have lined are in the categories of let us say flavoured milk that is one. We are talking about paneer as a category we are talking about lassi and chaas in tetra packs. We are talking about butter and cheese, but the points to be noted is it will not be a me too kind of product approach it will be a differentiated product approach with validation from three perspective, so that is the process that we follow within the organization. The first perspective is our structured marketing function with the help of external consultant they bring customer inside based on the resources. So this is the dimension one. Second dimension is then these insights are further validated with nutritionist who brings in the professional medical angle and then the third part is our internal very sophisticated and structured R&D function who evaluate the technical feasibility of this formulation or recipe. After the validation from three dimensions, we decide on development of the overall product, which is further passes through ICP as well as ECP, which is internal testing as well as external testing. And once the testing is done then only the product will roll out in the market with key focus on differentiation at the product layer, at the packaging layer as well as communication layer. So that is the approach of a rolling out of product in the market, so that whatever we roll out we get very good response from the customer and it is let us say real and good offering to our end customers.

Participant: Thank you for the detailed explanation Sir! All the best for FY18. Thank you.

Moderator: Thank you. We have the next question from the line of Vetri Raju from Equity Analyst Private Limited. Please go ahead.

Vetri Raju: Thanks for taking my question. Congratulations for the good set of numbers and my question is on this trade receivables from the consolidated number you have given looks like from FY16 from about 95 days it will come down to something like 85, 84 days am I right?

Satish Gupta: Yes. If you talk about let us say debtors 90 to 82 days standalone.

Vetri Raju: So can you explain what has contributed to this improvement and can you also explain the cash conversion cycle number corresponding to this?

Satish Gupta: Yes, so let us first talk about the receivables. See as the mix is changing as the business model is changing from B2B towards B2C we will see continuous improvement on this debtor numbers right and so as far as the overall cash conversion cycle is concerned that is also get positively impacted with B2C focus because of the very obvious reasons right and then there has been a mix change of various products, there has been a slight increase in the inventory also because of the tetra pack and various B2C products as well as, as we initiated and rolled out unit III so that is the reason there is a slight impact on the inventory part. So overall perspective both cash conversion cycle as well as on the receivable part there will be a positive impact only and what is the reason, the reason is basically, the continuous change in the business model that we are doing where numbers are very clearly reflective of this. If you see current year it is around 60:40 where 60% is B2B and 40% we have already said in the case of B2C and by 2020 we want to hit at least 70% B2C space. Now just imagine once we hit that particular thing those numbers, so obviously it is going to be a huge increase in the cash flows and within five to six years' time it also become a kind of debt free organization. So that is what the numbers reflect and that is what the strategy we are pursuing for the next five to six year's time.

Vetri Raju: What is your internal target in terms of bringing down debtor days in the next one-two years FY18, FY19?

Satish Gupta: So far as immediately next one year is concerned as an organization we generally avoid quoting numbers short term numbers because we are governed by certain guidelines in turn so that is it, it may not be advisable to share these numbers, but long term horizon as I shared with you over the next five to six years' time we intend to become a debt free organization and the strategy front I have shared with you why this will happen because of this value added products that we are rolling out and the implementation has already been initiated from Q4 FY17 onwards. The two products have been rolled out.

Vetri Raju: Great to hear that you have put the plant in operation from February onwards and you have just now talked for the previous question that you are going to roll out flavoured milk, paneer, lassi, butter and curd can you, how all these value added products is going to take the company in the coming years in terms of revenues margin?

Satish Gupta: You see so far as let us talk on two perspectives, so first is revenue and second one is margins. So far as revenue part is concerned strategically speaking we have been growing at around CAGR of around 25% to 30% for the next three to four years' time that is not going to grow this. We would be hardly growing at around 8% to 10% so far as topline is concerned, but within the topline the area of strategic focus, which is B2C will be growing big time, so that is the one from a revenue standpoint as to where exactly the focus is. Now coming on the margin profile as to why the margin profile will change because B2C layer offers anywhere between 10% to 20% EBITDA margin. Now out of these value added products the margin profile will automatically change over the next three to four years' time.

Moderator: Thank you. We have the next question from the line of Samir Kapadia from Rockstud Capital. Please go ahead.

Samir Kapadia: Just in your opening remarks you said you are going to transfer from B2B to B2C so just wanted to ask would it lead to cannibalization of its institutional sales or like your retail portion consumer facing business is expected to grow at a much faster ratio so that eventually it would lead to 30:70 kind of a ratio?

Nawal Sharma: See these two are very different tracks and there is no cannibalization. It is that our deliberate effort to slow down on B2B part is concerned. Otherwise these are totally distinct tracks targeting different set of customers.

Samir Kapadia: Yes, that is right. So like if you are going to slow down on your institutional sales so that would impact right because your focus area would now move towards your consumer facing business so do you expect any fall in the institutional sales or like will it remain at the stagnant level?

Nawal Sharma: This is what I was saying, our B2B part will either be flat or there could be degrowth also that is also being deliberated so there could be a degrowth and that will be deliberated.

Satish Gupta: In fact if you talk about our FY17 numbers so there has been a significant decline in our trading business, so I think there has been a decline of close to 40% so we deliberately take out the calls and the idea is to focus more on the B2C aspect rather than on the B2B aspect so that is why we always maintain a stand either going to be at the same level or it is going to de-grow over the next couple of years.

Samir Kapadia: Just I missed out, what would be your percentage of your value added products accordingly?

Satish Gupta: See currently if you see we have just initiated the roll out in Q4, so it is hardly any, so there is not statistically significant number, so currently it is a very small component of complete B2C, which is to the tune of 40%, but just over the next three to four years' time it will definitely increase and by 2020 it should be contributing some 20% of the overall sales.

Samir Kapadia: Value added product would contribute 20% by 2020?

Nawal Sharma: Yes.

Samir Kapadia: And lastly in regards with your networking capital cycle can you throw some guidance in regards how would it span out?

Nawal Sharma: So basically in a typical retail businesses. Right now our receivables are close to 82 days, which change in the sales mix, our target is to bring it down to close to 50, 55 days that is a combination of our B2B and B2C; however, if you talk about our retail business there the receivable cycle ranges from 35 to 40 days in an ideal state and this is what we intend to reach at. However if you talk about inventory, inventory when we enter into the consumer business, yes, there are certain levels of inventory that need to be maintained because the number of SKUs are higher so what we can say right now is that over the next three four years we can bring down this receivable cycle through 35 to 40 days, our inventory can be in the range of 15 to 20 days and the creditors will remain at the same level may be three to five days.

Samir Kapadia: Thanks a lot. That is it from my side.

Moderator: Thank you. We have the next question from the line of Devansh Lakhani from NVS Brokerage. Please go ahead.

Devansh Lakhani: Good afternoon Sir and congratulations on good set of numbers. First of all Sir I think you just mentioned and you were giving an example of that that one lakh farmers into four animals so can you just repeat that I think I just missed that one?

Satish Gupta: So the mathematics is like this that each farmer can buy up to four milching animals. So let us say if you take an average yield of 12 liters per day so that gives us an access to 4.8 million liters per day so one lakh farmers up to four milching animals makes it four lakh milching animals and each animal giving us an yield of 12 liters per day so that gives us an access to 4.8 million liters per day and let us say if we go by the phenomena that 50% of the milk is consumed domestically by the producer so even if we get 50% that is 2.4 million liters per day I think we are well sorted as far as procurement from the farmers is concerned over the next three four years.

Devansh Lakhani: Right and Sir broadly also can you just throw some light on how is GST going to impact us, is it going to be, I think from what we understand is that is going to be more or less the same thing what was there on the taxation front, but anything that we will be able to pass on to the consumer some benefit or some add on pricing or something?

Satish Gupta: Yes. As far as GST part is concerned I think we appreciate the government's step, which is very path breaking and strategic and this is definitely going to give a huge impetus on the overall economic growth of the country. Now let us talk from two perspectives, one is at the generic players this industry agnostic as to what, how it is going to impact us. Now again there are three standpoints in this, first of all from a corporate standpoint so there what we can leverage is supply chain management, so which has got two buckets, one is warehousing and second one is the transportation. Now as we talk about the warehousing piece you see what companies are update about is they will be rationalizing the overall warehousing so there will be a lesser inventory, they have to maintain optimization on inventory, this is also due to better forecasting and demand planning, which means basically an overall optimization and then one would be able to deploy better technology enablement and then there will be better people focus as well as the process focus. So that is on the warehousing part and on the transportation part obviously there will be a no long queues and there would not be any worries of pass through different states and all that stuff. So overall if you see from an opex standpoint if I have to summarize there will be a huge technology efficient process efficient as well as cost effectiveness that we will be experiencing. Along with that a superior customer experience will be delivered. So there is a huge opportunity how we can leverage this for better-cost effectiveness and to deliver superior customer experience. Now talking from a customer standpoint, which is primarily an enterprise customer one can expect a superior experience as well as the cost effectiveness and time efficiency. And thirdly from a government standpoint obviously there will be enhanced revenues and more compliance, so that is from an industry agonistic at a generic layer level impact of GST. Now let us talk from a dairy perspective. When we talk from dairy perspective now it was in line with the expectation the government has shown extreme sensitivity towards poor in masses that is one and majority of the dairy products are falling in the buckets of let us say 0% to 12%, so that is another thing and overall impact if you see I will break the overall impact in two buckets, on a short term horizon it will be a neutral impact, but on a long term horizon we will expect a gain on account of operational efficiency and operational effectiveness. So that is how we look at GST as an enabler on a long-term horizon.

Nawal Sharma: I think just to add to that it would also lead to formulization of the unorganized segment and I think it is going to change the entire landscape of dairy industry and it is going to create significant opportunities for the organized segment.

Devansh Lakhani: Got it and Sir another thing on your new commercial front how is the new commercial with Mr. Akshay Kumar has gained traction for our B2C business?

Nawal Sharma: That is a good question. I will tell you there is a huge positive response. See what we have decided as an organization and in terms of our very structured marketing processes we intend to do a customer dipstick after every three to six months' time and we are just done with our first dipstick as to how the customer is perceiving our brand campaign and the results are very, very encouraging. Our positioning platform was active performance, which means a lot of energy about zindagi nonstop and all that stuff. In research what we found was customer is actually perceiving the brand in the similar way so there is lot of connect with the youth segment to whom we are targeting. So initial research outcome clearly indicates that we are moving in the right direction and we just have to keep reinforcing the current positioning in a structured way, so that is the reason we are doing a very detailed media planning when it comes to, that is print, television and radio. So as far as detailed part is concerned there also there is a very good customer response in terms of creating visibility and then third it is from a customer engagement front also there is a very positive response. Last quarter what we did we announced a scratch and win offer, so where we got a very good customer response there is very good trials also. So overall our brand campaign is getting very good traction and this is being corroborated with the research that we have recently concluded and we will continue to do this kind of brand effectiveness research after every three to six months' time as a part of brand health monitor system.

Devansh Lakhani: And Sir just a last thing it is just from investor and shareholders point of view, what we understand is the dividend that has been declared I think 10 paise so that is approximately in fact 10% so what we understand is that is I think it is very sort of less or not investor friendly so just a suggestion, I do not know there might be I might be wrong also, but if you can increase that dividend outlet or something it would be much more investor friendly?

Nawal Sharma: I think we really appreciate your thought. See just to clarify, so right now we are more into an expansion mode so I think this dividend yield will start increasing over the next couple of years. See the thing is what we need to understand at which cycle we are right now. We are in the expansion cycle and we would like to keep our retained earnings and start investing into the capex and expansion of the overall business; however, once we reach a steady state, which we target to reach by 2019-2020 so you would see that there is a significant increase in the dividend yields in the coming years. So I think once the investors and the shareholders should appreciate the fact that right now the company is committed to create significant value for the shareholders and for which we are just investing as of now. So we are just taking a head start and probably in the next couple of years we would see significant value being created for all our shareholders and this is what Kwality stand for today.

Devansh Lakhani: Thank you Sir!

Moderator: Thank you. We have the next question from the line of Manoj Doshi from Budhrani Finance. Please go ahead.

Manoj Doshi: Could you just explain what is the debt situation and why the interest is so high and what is the next year's debt projection and interest cost if you could help?

Nawal Sharma: See as we mentioned the current debt position is around 1508 Crores and if you see the divide between long term and short term around 38% is long term and this includes KKR's 300 Crores, but this part of the debt is definitely going to help because there has been investments in the capex front that we just shared so this investment in the capex part specifically in the unit III, which is dedicated to value added products is going to be a future cash generator. So I think may be we have almost hit the highest level and may be FY18 there could be a slight increase in the debt and after that we start generating cash flows and as we mentioned over the next five to six year's time we intend to be totally debt free and that is what the internal business plan that we have worked out along with the Ernst & Young clearly reflects in some of the future outlook. Because if we are able to deliver these revised mix, which is in favour of B2C so we can easily become a debt free organization.

Satish Gupta: See the way to look at it is Manoj, majority of the debt is short term, increase in the long term debt that is accruing to the infusion of funds by KKR. The thing is that right now the business or the sales mix is shifting towards B2C and this is going to reduce our debtor days as well as we will try to improve the overall working capital cycle, so that has significantly reduced our short term debt, this will be further supported by the increased margins from value added product. So I think we would try to finance our working capital requirements to internal accruals in the coming years that is what we target. Apart from that we expect certain level of increase in debt in the next one year because there is certain level of working capital support that a new unit need at the start of the operation so we have just commenced our new operations in February, so I think there will be certain level of working capital support that will be required for the unit, but I think that will be partially offset by the increased margins from value added products and reduction in the debtor days owing to the shift towards B2C sales.

Manoj Doshi: Just to understand, how does our interest cost of 52 Crores, the debt is 1500 Crores I mean it is does not add up right?

Satish Gupta: Right. So I think if you look at our interest cost it is close to...

Nawal Sharma: Now the increase in the interest cost is on account of KKR is 300 Crores. Getting into a very specific details right. So as we said earlier that interest cost was getting capitalized due to capital work in progress, which is now being charged to P&L after unit III of that has become operational in February so that is the reason you see a certain increase in the interest cost in the P&L.

Manoj Doshi: Normally annual interest expense should be 160 Crores or something like that?

Nawal Sharma: Yes, 170 Crores.

Manoj Doshi: So next quarter onwards there will not be any capitalization right I assume that?

Nawal Sharma: No, so now everything will be charged to P&L only. So that has led to the bump.

Manoj Doshi: Fair to assume will go to 40 Crores or something right?

Nawal Sharma: Yes.

Manoj Doshi: And last thing on the taxation part, what happens on the taxation?

Nawal Sharma: You see, so far as tax part is concerned obviously as we mentioned that the effective tax rate is 7.3% this quarter and this is you see as per income tax act, we have got depreciation claim for around six months in the tax calculation so that has led to a low tax structure. However if you talk about the outlook on the next financial year I think what we are expecting is with this new unit III getting operational so effective rate should be and we are hovering between 21% to 25%.

Manoj Doshi: Thank you so much.

Moderator: Thank you. We have the next question from the line of Lokesh Manik from BAO Financial. Please go ahead.

Lokesh Manik: Good afternoon Sir! Congratulations on a good set of numbers. I have a couple of questions regarding the procurement strategy. I was going through the previous past annual reports and conference call, so as I understand in your 2011 annual report projections given was you mentioned that it takes approximately three years for an MCC to reach peak operations and if we look at the numbers it is reaching peak operation in FY16 assuming 20% direct procurement of three million LPD and also the number of MCCs has remained flat during this period 2011-2016 any particular reason for that?

Satish Gupta: Now let us talk about the procurement strategy as to what has been the intend so before getting into procurement strategy little fundamental on our areas of operation, which is UP, Rajasthan and Haryana right, so luckily we are in an area where overall let say production is around 146 million liters per day, which contributes some 34% of all India production so first one we are luckily present in a very good state that is one and so far as the procurement part is concerned there is a direct sourcing and then there is a contractor based routing so that is two and our focus has been under asset like model and in line with that strategy is what we mentioned sometime back that we got into a strategic alliance with Bank of Baroda, so which means that we will be able to leverage our current framework, current MCC with support from Bank of Baroda and that is how we will be able to source enhanced let us say quantity of milk to ensure that we have sufficient milk for value added product roll out is concerned. So as you mentioned it is around 22%, which is 6.6 lakh liter plus there is a little hybrid model so totaling to around 7.5 to 8 Lakh liters, but with this Bank of Baroda strategic alliance in place we are all set, so far as procurement need for next three to four years is concerned rather it is much more than what exactly we need so it is now at our discussion. So in terms of the overall procurement strategy this Bank of Baroda kind of strategic alliance is the key disruptor and the differentiator in the market place and we really intend to leverage this to the fullest extent and that to the strategic part and then on the operational implementation part, so there is a plan to enhance stickiness with the farmer that is on the other front. Now how to increase the stickiness with the farmer, so there are multiple programs that we have initiated whether it is basically providing education support on basic hygiene, we are talking about artificial insemination, we are talking about providing subsidies on ancillary based services, we are talking about last year we brought in Dr. Kuldeep Sharma ex-director of Indian Council of Agricultural Research more than 35 to 40 years of experience in farmer connect program, who is helping us in terms of creating this farmer connect program so these are implementation frameworks and programs that we are implementing on the ground so with mix of this strategic alliance in Bank of Baroda and then this farmer stickiness creating program is what is going to help us in terms of building a very strong procurement network, which is a key enabler in any dairy business. So that is what has been the strategy.

Lokesh Manik: Sir with reference to your Bank of Baroda tie-up I wanted to know if there is any exclusivity you have with the farmers in terms of depositing and sell that in the market?

Satish Gupta: See while you do not need a technical or a legal exclusivity because how it happens on the ground so there is a very natural stickiness with your current service provider right, so let us say the farmers with whom we are dealing and we have let say engagements framework so their first preference is basically to give milk to us so then post after that we take a call as to whether we need this kind of milk or not, so only after that it can go to somewhere else, so with this one lakh farmers in place we already have enough finance with us right, so the finance is more than enough for the next three to four years' time, rather now we become the chooser as to how much milk we really need from the farmer. Positive decision as of today.

Nawal Sharma: See I think the situation on the ground is that you know there is an enhanced focus on farmers stickiness, so when we say, there is a lot of emphasis because this is one stakeholder with whom you cannot sign legal contracts with. The thing is that is why it is a relationship driven kind of a vendor so that is why there is an enhanced focus to ensure the stickiness of the farmer towards the company and that is why we conduct all these farmer connect programs, which basically comprise of artificial insemination, providing them call center support. So these are ensuring the stickiness of the farmers.

Lokesh Manik: Right. Sir the reason I am asking is because if I just go through your numbers year-on-year the FY16 numbers you have been sourcing 0.6 million LPD from three lakh farmers, which translates to two LPD per farmer and as per our projections we were expecting around 5 LPD per farmer?

Nawal Sharma: Actually can you just repeat that because we could not hear your voice properly?

Lokesh Manik: Sure, so where I am coming from is actually just going through your past numbers we have been sourcing 0.6 million LPD approximately direct sourcing from 3 lakh farmers, this is FY16 number, which translates to 2 liters per day per farmer and our projection in 2011 was translating to 5 LPD per farmer so what makes you so up going forward we will be able to do 12 LPD per farmer?

Nawal Sharma: See, as we mentioned that already it has been taken to 4.3 million liters per day and the plan is to take 22% contribution to 50% overall contribution so as we mentioned what are the key enablers for this and how and why we are confident this is because of the two tracks. First track we talk about Bank of Baroda, right, so we talked about this in detail as to why we think we are so confident that we have more milk than what exactly we need as of today that is one and second source of confidence is the various farmer connect programs that we are running so with the help of these two tracks, which are running parallel and with the help of domain specialist, so that is the reason why we are so confident and we will be able to deliver seamless numbers. So we are much more than what we actually need as of today.

Lokesh Manik: Sir on an average what would be your cost for these farmer stickiness programs, even running since 2011 if I am not mistaken?

Nawal Sharma: So while we can dig this transaction detail for you overall it depends on let us say program to program and what is the let us say scale of this program, whether you want to run this program let us say ‘X’ number of villages or ‘Y’ number of villages that we can definitely let us say cull out this transaction detail if you want as to what has been the overall spend in terms of procurement program. So it is right now not handy with us, but definitely we can take out this detail that is not a problem.

Lokesh Manik: So we should expect a slow growth in these expenses given that we are already tieing up with Bank of Baroda?

Nawal Sharma: Yes, absolutely so that is the reason we are so confident that as far as the procurement piece is concerned.

Lokesh Manik: Thank you Sir! That is it from my side.

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

Alok Rawat: Good afternoon Sir! Let me add my congratulations. Sir few questions, some of them housekeeping what is the diluted number of shares as of March 31,2017?

Nawal Sharma: 23.7 Crores.

Alok Rawat: You talked about gain for organized sector market share after implementation of GST, so I just wanted to delve a big move on this so for example the institution customer if they were to buy from unorganized sector post GST how does the unorganized vendor get impacted if you could just throw some light on that?

Nawal Sharma: So basically when we say it would lead to formalization of the unorganized see what happens is that, they are very local players who are considered to be part of the unorganized segment, now what happens is that they used to gain that competitive advantage by tax evasion so that had actually make the organized base I would not say uncompetitive, but relatively there is certain level of impact on the organized segment as far as the price is concerned. So this is what we are trying to say that yes there will be efficient inventory management when we talk about big institution so they will be able to keep a task on the inventory and the inventory holding cost will reduce significantly and obviously there will be certain level of operational efficiency in terms of a logistic cost and the transportation cost and at the same time there has to be certain level of strategic call that we have to take or the management has to take when it comes to keeping the warehouses. So rather than small warehouses there will be a significant demand for regional distribution centers.

Alok Rawat: Actually my question was so for example if an ice cream factory from an organized sector today if they are buying today from unorganized vendors let us say without a proper bill, etc., tomorrow an unorganized vendor who is supplying their milk will he be forced to actually give them a proper bill after GST is that?

Nawal Sharma: See obviously the overall direction in which government is moving so there is a huge focus and crack them on these kind of stuff so we are very confident and hopeful that these people who try to evade taxes will find it very difficult year after year so that is one reason that why we think that gradually it will benefit to the organized sector. Besides the routine operational effectiveness, which will be happening and which we will be leveraging due to various reasons.

Alok Rawat: Where I am coming from is, if I am understanding correctly the GST on liquid milk will be 0%?

Nawal Sharma: Yes absolutely.

Alok Rawat: So then it does not really make any change to...

Nawal Sharma: So there will be certain level of, let us say when we talk about skim milk powder, so it is not that we expect to, let us say zero tax products like fresh milk, curd, chaas, I think this reference was with respect to the other products where we have GST.

Alok Rawat: Understood. If you could give us the volume of milk procured, average volume of milk procured in FY17 in terms of liters per day?

Nawal Sharma: Close to 3 million.

Alok Rawat: And what is the progress of BOB tie-up in terms of how many farmers have already received the loans or sanctions?

Satish Gupta: I think so recently we organized the colossal event at Lunkaransar as well as Sardarshahar in Rajasthan and that event was graced by the presence of Mr. Arjun Meghwal as well who is the Ministry of Finance of the State so this was the second disbursement that has happened so there have been two events that we have organized till now. And you know the event was, I think there were close to 2500 farmers who participated into that event, but the sanction letters have been issued to close to 400 during that event and during our first disbursement there were sanctioned letters issued to over 150 farmers, so in total 550 farmers have already got the sanction letters from Bank of Baroda.

Alok Rawat: And second question related to that would be for example if a farmer gets a loan today and buys anyone let us say within the next week or two when do the animals start lactating?

Satish Gupta: So what we are targeting is the way we are trying to provide money to the farmers that see, the age group of the milching animals will be close to two years so at that age they start lactating, so I think the focus is to get the right milching animals of the right age who start lactating immediately. So the shortlisting of milching animals is on the age group as well as the breed per se.

Alok Rawat: Sure and farmer obviously would like to buy a lactating animal or closer to lactating.

Satish Gupta: Obviously there will be certain level of **(inaudible) 57:18** and then gestation period will be longer so rather than we are promoting the idea to purchase the milching animal who starts lactating immediately so that is what the age group and the breed factor comes in.

Alok Rawat: Sure. Again on the procurement side, if you could talk about the milk procurement cost range in terms of has it gone up, down or stable over the last three to six months?

Satish Gupta: I think this was the first time Alok as far as our little experience is concerned that during the flush season when the supply is more I am talking about the winter season let us say second half of FY17 there was an increase in the milk procurement prices because of increase in the input cost, because of the increase in the cattle feed cost and various other input cost, which the farmer incurs, so the overall procurement prices had increased and there was a I think it was an increase of close to 15% to 20% that we experienced and which was eventually passed on to the consumers so the blessing that we have in dairy industry is that whenever we feel that you know the price rise is sustainable we pass it on to the consumer, so that is how we recently increase the milk prices or the realization on the milk prices by Rs.2. So just to pass on the burden to the consumer, but what I would like to comment is that yes whenever the prices had shot up during the flush season and this was I think one of the prime phenomena that has happened in the last four, five years that we have been part of the business.

Alok Rawat: Sir sorry for if I can ask one more question, which was if I heard correctly 170 Crores was the total interest in FY17 including the capitalized component?

Naval Sharma: No excluding, see initially till the time the plant was operational it was being capitalized and this was part of the capex. Now since the plant is now operational from February now the interest component is now being charged to the P&L account that has increased the interest cost for this year.

Alok Rawat: Sir what was the amount of interest capitalized before February?

Naval Sharma: I think we will check on the number we will get back to you Alok. You can just separately write an e-mail to the number.

Alok Rawat: I will do that. Thank you so much and best of luck.

Moderator: Thank you. We have the followup question from the line of Vetri Raju from Equity Analyst Private Limited. Please go ahead.

Vetri Raju: I just wanted to understand the difference between this direct procurement and this hybrid procurement and so on government **(inaudible) 1:00:24** contractors it is actually asset like, can you just throw how the company benefits, throw some information on how company benefits there and what is the strategy going forward there?

Satish Gupta: So the thing is that there are two routes. One is procurement directly from the farmers and the second is from the milk aggregators, so what happens is that milk as an entity needs to be chilled within three to four hours after milching, otherwise the microbiological count increases and that milk is not suitable to manufacture consumer products or any of the product, which is directly consumed by the consumer. So this is the difference between the milk, which is procured directly from farmer as against the contractor, which is a multilayered architecture where the milk exchanges hands multiple times still it reaches the largest contractor and who in turn supplies the milk directly to a plant. However if we talk about procurement directly from the farmers, so it is a three tier model where farmer deposit milk at the VLCC, which is the village level collection center and in that village level collection center it is run by VSP, which is a village service provider. We provide them AMCU, which is known as automatic milk collection unit, which basically takes the milk sample from the farmers milk and ascertain the fat and SNF content in the milk and based on the market price and the fat and SNF content in the milk sample the price is paid to the farmer he gets a slip from that automated milk collection unit. See this is the amount of milk that you have deposited and this is the fat content and this is the SNF content and based on the market rate he made the payment. Now after that milk is collected there is a third party man who collects the milk cans from all these village collection centers and directly transfer it to the milk chilling center, there the milk is chilled and then it is transported through an insulated van directly to our plants. So it is a three tier model where the milk is chilled within three to four hours after milching where the contractor, which is a multilayered architecture that the milk is not chilled within three to four hours so that milk is not suitable to make consumer products rather it is suitable to make those ingredient products or the commodity products and that is why the cost of farmer milk against that of the contractor milk on a per liter basis there is a differential of Rs.2 to Rs.3 in favour of the farmers, so that is the difference between that is why we say that the product profile or the product portfolio is nothing but a function of your procurement mix.

Vetri Raju: What is the strategy of the company going forward you want to increase the direct procurement directly from farmers?

Satish Gupta: This is what Nawal had mentioned earlier that this is a path breaking strategic alliance that we have done with Bank of Baroda to empower direct procurement from farmer. See what we are trying to achieve is that we had examined the trend over the last three years that how the direct procurement has increased over a period of time. So there was incremental increase; however, the increase was very modest; however, being a growth oriented company we wanted to expertise this entire direct procurement route and that is how we came up with these strategic alliances the Bank of Baroda the idea is reach the throughput of our existing farmer network. So one way is to increase the farmer network, which has already increased from 325,000 in FY16, now it is close to 3,50,000 farmers so as we increase the farmer base, but the overall incremental direct sourcing happens in a very modest way. So what we did is that we shortlisted one lakh farmers in the initial phase out of our existing network of 3,50,000 farmers and we are trying to increase the throughput. Throughput of this existing farmers rather than setting up our own dairy farm we had adopted an asset like model, which is a win-win proposition for all the three stakeholders, which is Kwality, Bank of Baroda as well as the farmers because for Bank of Baroda is a private sector lending we get direct procurement from farmers we do not incur any liability and…

Vetri Raju: I heard that, I was part of that explanation just in interest of time, just one quick question. Just 500 farmers have actually got the loan what are the internal targets to actually disburse from the 100,000 farmers?

Satish Gupta: Yes, so we got into the strategic alliance in January. We have started doing the processing of the farmers the paperwork that we have to do for farmer so we have set up a dedicated office in Delhi NCR, so who is basically taking care of the entire processing of the loans for these farmers and we have over the next three, four months this number is going to increase significantly; however, within a very short span of time I think within a couple of months we have issued sanction letters to over 500 farmers and I think in the next subsequent event this number is going to shoot up very significantly.

Nawal Sharma: In the initial phase of any program roll out you have to do intensive planning where you have to create some execution frameworks, various stakeholders, so once you cross that initial planning phase your phase of your execution definitely will increase at a later stage.

Vetri Raju: Thank you and all the best.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now hand the conference over to the management for their closing comments. Thank you and over to you.

Nawal Sharma: So it was really a pleasure to have all the stakeholders and on behalf of Kwality we assure you the kind of focus, which has been there in the last financial year with the same vigor, with the same perseverance we can continue and ensure that strategic framework that we have set in front of ourselves will go full blast in terms of huge focus on execution part. So that is what will be the focus because strategy is already very, very clear and that focus has to be on great execution and overall the intent is obviously how we can create value for all the stakeholders so whether it is investor community, whether it is employees, whether it is partner, so unless and until you take a holistic view where all the stakeholders are benefited it is very difficult for any organization to go a long way. So that has been our approach that ensure that all the stakeholders are aligned so they are benefited so that we as an organization grows and create wealth and value for all the stakeholders. So I am sure that, that wishes are there with us from all the stakeholders and together we will achieve great heights over the next few years. Thank you so much for your time and from all of us thank you once again.

Moderator: Thank you very much. Ladies and gentlemen on behalf of Edelweiss Broking limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.