Transcript

Conference Call of Heritage Food India Limited

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Presentation Session

Moderator: Good morning ladies and gentlemen. I am Leela, moderator for this conference. Welcome to the Quarter 4 FY07 conference call of Heritage Foods India Limited. We have with us today Mr. Anirudha Joshi of Anand Rathi Securities Limited and Mr. M. S. Rao, President of Heritage Foods India Limited. At this moment all participants are in listen only mode. Later, we will conduct a question and answer session, at that time if you have a question, please press * and 1 on your telephone key pad. Please note this conference is recorded. I would now like to hand over the conference to Mr. Anirudha Joshi.

Anirudha Joshi: Thanks Leela. On behalf of Anand Rathi Securities I welcome you all to the conference call of Heritage Food Quarter 4 FY07. We have Mr. M. S. Rao, President of Heritage Food with us and Mr. Shirish Pardesi, Senior Analyst from Anand Rathi Securities. Now I hand over to Mr. M. S. Rao for his comments on the results. Over to you sir.

M. S. Rao: Good morning to all of you. I do hope our friends at Mumbai have recovered from the rain. We have recently announced the results of the previous financial year. The overall revenue has reached Rs.347 crores compared to that of Rs.293 crores during the previous financial year. This includes the revenues from dairy division and the retail division. Our agri division activities are yet to start, most probably we will be starting in this quarter of the financial year to act as a backend supply chain for the retail business. All the three divisions are being presented separately for the reporting purposes, though all are part of the Heritage Foods India Limited as one legal entity.

During the last quarter of the financial year we have commenced retail stores, totally 15 stores have been opened in Bangalore and Hyderabad during the last quarter. All the 15 stores have different span of life, some of them have few days, some of them have few weeks, and very few are having three months full. The performance of the 15 stores ended up in a result of 628 lakhs sale during the last quarter, and in the dairy division, the entire division during the last quarter had given us 86 crores of the revenue. In terms of the profitability, the dairy division during the last quarter has achieved 628 lakhs of profits which is marginally higher than the previous year's 4th quarter. And overall, profit before the depreciation, interest tax recorded during this financial year was 12 crores, compared to that of 25 crores during the previous year. This effect was essentially because of the preoperative expenditure and professional charges we have incurred during the entire financial year in the retail division operation.

We are planning to go ahead with rolling out of more and more retail stores during this financial year. So far we have reached a number of 28, in all the three cities including Hyderabad, Bangalore, and Chennai. Hyderabad we have 20, Bangalore we have 3, Chennai we have 5. This is the breakup and we are continuing our efforts to improve the speed of opening the stores, because larger the number of stores, higher the revenue and greater the benefit. So this year is year of roll out of stores. We are hoping to reach the number of proposed 80 stores to 100 stores by the end of this financial year. This is hopefully going to help us in increasing our revenues from retail division, similarly our Agri backup activities are getting ready, already crops are sown and initial yields are coming, pack-houses are getting ready for operations by end of July, one in Chittoor District of Andhra Pradesh, and another is in Medak district of Andhra Pradesh. The pack-house in Chittoor District of Andhra Pradesh would get the fruit, vegetables from three districts, Krishnagiri District of Tamil Nadu, Kolar District of Karnataka, and Chittoor District of AP. These three districts contribute substantial volumes to our business in terms of Fresh@. Focus on Fresh@ has helped during the initial phases and we continue to increase our focus on Fresh@ so that maximum benefit is achieved in this operation of retail. Now I think I will conclude at this stage and open it for interaction.

Question and Answer Session

Moderator: Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone key pad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

First question comes from Mr. Balaji of Sundaram BNP.

Balaji: Good morning sir.

M. S. Rao: Good morning.

Balaji: Sir, thanks for giving this overall overview on the retail operation. Just to understand how the improvement in profitability will be…

M. S. Rao: Can I request you to speak louder, hold it closer to you; I am not able to hear you clearly.

Balaji: Yeah, sir if you look at some of the retail stores that you have opened, could you just give us some flavor of how the ramp up has been in terms of the revenues, because some have been existent for more than three months, or somewhere thereabouts. So how has been the experience in terms of daily sales growth and at what levels of daily sales do you see it kind of breaking even, and also could you just talk a bit about the overall infrastructure that you have in terms of the other IT infrastructure and the logistic etc, where are you in terms of the plans, and when do you see everything being, operating to full scale?

M. S. Rao: Sure. I would request my colleague Mr. Jagdish, Vice President looking after retail division to give you a full picture of the stores' performance.

Jagdish: Yeah, just to respond to your question. If you look at the retail stores in terms of their typical growth journey, every retailing store typically starts off between 50% to 60% of its ideal occupancy or ideal throughput. If you notice the various stores that we have put up, some of them been about a week old, a few a month old, etc. So on a basic basis; they have delivered about Rs.840 per square feet per month. Now, we expect the retail stores to contribute around Rs.1,200 per square feet per month in terms of the their throughput from each of the stores and typically the stores start between 600 to 700 and then keep on increasing. For instance, now, most of the stores which are more than six months old, are at Rs.1000 plus square feet per turnover. If you look at the Hyderabad stores, almost all the stores, which we have put up about six months back, are between 1,000 to Rs.1,100 per square feet per month turnover now as against about three months back when they doing 650 to 700. Our Bangalore stores are performing much better and their returns per square feet is between 1,400 to Rs.2,300 per square feet per month. See typically it takes between six to eight months for a store to achieve its desired level of sales per square feet and that is also the period when we expect a typical store to breakeven. So to answer your question, the store which is on the desired growth graph will take about between six to eight months to breakeven and it takes even roughly about between, depending on the fixed cost structure between 900 to Rs.1,000 per square feet a month.

Balaji: How much of fixed cost you said?

Jagdish: Can you repeat your question please?

Balaji: How much was the fixed cost per square feet per month you said?

Jagdish: This translates into, when you look at the way they were opened, for example, we had one store which was operational as a pilot in the month of November, three more got added, later nine more got added, which was operational in January and on the last day it was there. It is roughly about Rs.840 per square feet.

Balaji: And in terms of the product mix at this point in time, this 100% fruits and vegetables, or have you also started to stock the general other provisions, and FMCG products, so how is this mix of products…

Jagdish: When we put up this format, we actually wanted to create a format where consumers not only shop for fruits and vegetables, but also for a monthly grocery. Now, in a typical supermarket right now, fruits and vegetables contribute to between say around 10% to the entire mix. When we did the research, we had the insight that consumers spend about 22% of their monthly consumption on fruits and vegetables. We expected our mix to be closer to 25%. Currently, I can say the mix is between 25% to 30%. Close to 30% of our revenues comes from fruits and vegetables, and the rest 70% comes from categories other than fruits and vegetables. So this is exactly the kind of format that we wanted to put up, where people not only come to buy fruits and vegetables, they also come and shop for their monthly grocery and other home needs.

Balaji: And across Chennai, Hyderabad, and Bangalore, how has been the experience in terms of, city to city, how has been the acceptance by the consumer and how has been competitive scenario in these three cities that you have been there?

Jagdish: Yeah, see I think we are quite satisfied with the way our stores have been accepted by the consumer and with the reaction of the consumers. As I mentioned, different cities have reacted, all of them positively, some it has been extremely encouraging, others have been quite satisfactory, but the greatest amount of satisfaction comes from twofold, first is in terms of acceptability of the format and the kind of mix that we wanted. Second is the number of transactions, which we wanted to clock. These ranged between say 700 to 800 transactions on an average, and the third has been in terms of growth rate. All the stores in all the three cities are on a double-digit growth rate. There is a recruitment of acquisition of consumers happening at this stage. Typically, stores grow between 10% to 15% per month on the number of transaction, which basically means people who have been coming to the stores, there is a word of mouth publicity which is also happening, there is a critical margins expanding in the area where the store is there, and more and more consumers are coming and trying out our store, which is a sign of the store getting more entrenched in the locality where it has been launched. So in short, the stores have been able to make a presence in the localities, we are fine by the kind of transactions that we expected, and the stores are, even though it is very early period, the stores are on a growth path with the number of transactions growing at double-digit month on month.

Balaji: So, of the stores that you have opened, could you tell us the size of each store, which will be the largest, which will be your smallest, and overall what is the total square feet of retail space that you are operating in currently.

Jagdish: Yeah, if you look at it, the largest store that we have in terms of the size is the D D colony store, it is about, in term of super built-up area about 5,060 sq. ft. The tradable area is about 4,330. Overall if you look at it, the store size comes to roughly about 2,800 sq. ft on an average. The smallest store that we have is the Padmarao Nagar store in Hyderabad; it is about 1,700 sq. ft as a tradable area and 2,029 as the carpet area. Overall about 2,750 sq. ft is the overall average of the store. And in terms of the average rental, it is about Rs.60. The total tradable area that we have for all these 15 stores, on a built-up area is 56,000 sq. ft, on a carpet area it is about 41,000 sq. ft.

Balaji: Okay, and city to city how is the lease rental different from one city to another and you said you had plans of about 80 stores for this financial year, so have you already tied up for the space for all these new stores?

Jagdish: Yeah, if you look at, I would put, at each of the cities there are the real estate market behaves differently. Hyderabad and Chennai, probably you can say the subset is largely similar. If you look at the average rental for Hyderabad is about Rs.58, the least being Rs.33 and the highest being Rs.84 on a super built-up basis. In Bangalore, our average rental is about Rs.74, the least being Rs.50 and the highest being Rs.90. Similarly in Chennai the rental ranges from about Rs.35 sq. ft, currently what we have tied up about Rs.50 a sq. ft. Now, overall I would say Bangalore, Hyderabad, and Chennai, the average rentals are expected to be between 50 to Rs.55 a sq. ft as we go forward and Bangalore would be closer to about Rs.60 a sq. ft.

Balaji: And you have already tied up for the location?

Jagdish: If you look at currently, we have tied up for the next quarter, now as we are going forward in each of the three cities, we are now confident that on an average between 8 to 10 properties is what we should be definitely be able to launch every month now. The next quarter's requirement, till August end we expect, there are currently about 24 sites, where we have signed, or where the work is going on, or the design phase is in implementation. We are confident that on an average we will able to open between 8 to 10 stores per month in all the three cities put together.

Balaji: Okay, sir we will get back to you if there are further questions.

Moderator: Next question comes from Mr. Girish Pai of ICICI Securities.

Girish Pai: Yeah, hi sir. I wanted some data on your dairy business. If you could give the volume output you have had in '06 and '07 and what you are expecting in '08?

M. S. Rao: Yeah sure. We have a chilling capacity of 12 lakh liters per day as of now, including the expansions we have done last year. And we have capacity utilization at 50%; it comes to around 6 lakh liters per day, 1 lakh liters of additional capacity per day. And packing capacity of milk, per day is around 7 lakh liters in the company, and utilization is 100%. That is the volume.

Girish Pai: And what was it in '06 and what do you see happening in '08?

M. S. Rao: ’06 to ’08?

Girish Pai: No, ’06 what was it, you were mentioning these numbers for ’07, what was it in ’06 and what will it be in ’08?

M. S. Rao: You mean ’07-’08, current financial year?

Girish Pai: That’s right.

M. S. Rao: We are hoping to achieve 7 lakh liters per day in terms of procurement and in terms of sales. And ’08-’09 we may have to target around 8 lakh liters per day. Basically the growth is limited by the scarcity in the market in terms of procurement of milk, not by the sale or by the capacity for profit sense. Last financial year, there was a severe drought in several parts of India, there was a drop in procurement, coupled with increased export of the skimmed milk powder by five to six times more, which lead to the imposition of ban on export of skimmed milk powder by Government of India. So these two, increased exports, and decreased supplies have led to some kind of restrictions on the growth of the business.

Girish Pai: Okay, so your packing capacity has to increase if you have to sell something like 7 lakh liters in ’08…

M. S. Rao: We have acquired one sick industry last year from Indiana Dairy in Hyderabad outskirts, this has a possibility of 1 lakh liters, and we have expanded only up to 50,000 liters during the last financial year. So we will be now going ahead with the remaining 50,000 in Hyderabad definitely, and we are now planning to create another 50,000 liters packing capacity most probably in North Andhra Pradesh, near Vizag, where our growth potential is quite high, as per the recent estimation. This financial year we have to add the packing capacity so that we can reach the 8 lakhs during ’08-’09.

Girish Pai: Okay, just a few more details on your dairy business, what was the price per liter that you got in ’07 and what was it in ’06 and what is your expectation in ’08?

M. S. Rao: Is it the sales?

Girish Pai: Sales realization per unit or realization per liter?

M. S. Rao: I think it was around Rs.13 during ’06-’07.

Girish Pai: ’05-’06 was…

M. S. Rao: '05-'06 it was around Rs.13.

Girish Pai: Okay, and do you expect any movement upwards?

M. S. Rao: It was around Rs.17.

Girish Pai: I am sorry?

M. S. Rao: Okay, I will repeat. '05-'06 it was around Rs.13, '06-'07 it was around 15 plus. There are different prices in different cities. So this year we are expecting another one rupee hike in prices, maybe next couple of months.

Girish Pai: Okay, so which city gives you better realization?

M. S. Rao: Hyderabad.

Girish Pai: Okay, and you supply Hyderabad, Chennai, and Bangalore is it?

M. S. Rao: Yeah, main cities are these three, but we do have sales in Vizag, Vijayawada, Tirupati, partly in Trivandrum, and some places around Trivandrum, Pondicherry, and Madurai, these are the markets.

Girish Pai: Okay, and then in terms of procurement cost per liter, how has it shaped up over the last two years, and what do you foresee?

M. S. Rao: Procurement prices are growing up slowly, our cost per liter has gone to Rs.11.22 paisa during '06-'07. It is continuously increasing during the last seven, eight months. But now in this season, couple of months, May and June, the rainfall was there in our milk shed areas, so the further price increase is not seen for the next three, four months, but there is a bit of improvement in the production and supply of milk from the farmers. So we don't anticipate any big rise immediately, but certainly there will be rise at least by Re.1 during this financial year at some point of time.

Girish Pai: Okay, and this 11.22 compares with what in FY06?

M. S. Rao: FY06 could be 9.75.

Girish Pai: Okay, so on your dairy business, your outlook on margins will still be under pressure, is that what you are saying?

M. S. Rao: Yes, the situation was difficult last year, but this year it is improving, except for prices of skimmed milk powder have not yet come down, the coming flush season, October onwards, we should see how the prices of skimmed milk powder and milk behave. Past financial year, two years I would say, the pressure was due to increased prices of raw materials, both milk and milk powder. This year situation is looking different from the beginning of the year itself, because production has gone up and export ban on SMP continues to be in place. If these two are there for another six months, the procurement prices should be a bit lower, and sale prices, we are now thinking of revising sale prices in Hyderabad quickly, so this might help us in increasing our margins slightly more.

Girish Pai: Okay, in terms of mix of products, is there any view that you are going to sell more of value-added dairy products, compared to pure milk, is that the strategy you are planning?

M. S. Rao: In this financial year itself, a decision was taken, to improve the sale of value-added products as a share with reference to the fresh milk we are selling in the market, so normally 85% is the breakup, between the milk and the milk product. We are trying to go every year at least 5 to 6% more towards the milk product. We are introducing, within two weeks time, the ice creams in Hyderabad, we just got the production facility up, and we are also going for tetra packing of fresh milk and flavored milk in the month of August, including the cream. We are also looking at increasing capacity of the flavored milk and curd production within the company. In this financial year we will be increasing our share of products from the second quarter onwards. And our ambition is to add at least 5% this year, 5% next year, from the product, so that the profitability will be better.

Girish Pai: Just to come back to your retail venture, I just wanted to know, in a steady state situation, what kind of operating margins and net margins can one expect?

Jagdish: First let me say about the gross margins, gross margins I am referring to sales minus cost of goods sold. Now typically in the industry, the gross margins operates, the band is between 16% to 18%, but because we are focused on Fresh@ and Fresh@ is about 30%, and as we had explained last time the idea is to fully deploy a private label strategy where 50% of the products in the store will be either own sourced, or through private label. We expect this strategy to contribute in 5% to 7% more than the standard industry gross margin. A combination of higher Fresh@, the opportunity for margin will be higher and the private label margins. As far as EBITDA, let me explain once our stores stabilize and we are able to deploy private label strategy, the EBITDA levels should be between 5% to 7%.

Girish Pai: Okay, you mentioned that fixed cost was something like Rs.840 per sq. ft, and you mentioned rental to be something like Rs.60 per sq. ft.

Jagdish: Fixed cost is not 840, I said on an average when you look at the realization per sq. ft., different stores have been opened at different points of time, and this 6.69 crores, roughly is about Rs.840 per sq. ft per month throughput. And if you look at the rental currently, it's around 7% to 8% to the turnover and once the stores are able to achieve the critical mass in six to eight months time, we expect the rent to sales contribution to be less than 5%.

Girish Pai: And what is your CAPEX per store?

Jagdish: CAPEX per store currently is about Rs.1,800, Rs.2,000 per sq. ft.

Girish Pai: Okay, and what would be a rough working capital per store like?

Jagdish: Working capital, the average credit that you get from the marketers of FMCG product is about 15 days, therefore, the entire pipeline, since we are currently at the stage of opening new stores, therefore, we are gearing both at the distribution center, in terms of loading of stocks, because we are planning around three, four stores. But the net working stock in the pipeline, once we have stabilized should be between 7 to 10 days.

Girish Pai: So you are saying the net working capital should be like 7 to 10 days of…

Jagdish: Typically we are talking about 20 to 25 days of the total stock, out of that average credit that you get is about 15 days, and therefore, own paid capital should be about 10 days.

Girish Pai: So you are saying that we should take 10 days of sales, or 10 days of your cost of goods sold…

Jagdish: This is 10 days of cost of goods sold.

Girish Pai: Okay and this is going to be largely inventory?

Jagdish: Yeah, inventory.

Girish Pai: Yeah, and one more thing is regarding competition, I believe Reliance Fresh is there, and whole lot of others, Subhiksha and all are there, so how would you stand out vis-à-vis other players.

Jagdish: Yeah, there are three components operating, first is, if you look at it, our stores format itself. The mix that we are able to achieve today it is 30:70, which is a store which not only caters to fresh fruit, vegetables as well as grocery, in the industry today, it is a unique format. We are neither too much sharply focused on fresh, nor we are a supermarket, which is a grocery supermarket with fresh shelves as another product line. Therefore, today what we are able to see is, consumers who normally shop for their fruits and vegetables, either through the hawkers and go to a supermarket for their grocery, we are able to recruit many, many more such consumers to the store because of the size of the store. Second is of course our orientation in terms of our quality, our backend direct procurals from farmers and the private labels. We said that once we deploy our private labels we almost keep a check of what we have, will be our own source of private labels. The third which we believe is our focus on home delivery. As stores get ensured we would aggressively, like for example in Hyderabad we already started to market our home deliveries, as very aggressive and not merely as a service, so we have already put in the required infrastructure. Once consumers establish trust and are able to see the consistency in terms of supply and quality in the stores, we believe more and more consumers will opt for home delivery and this is also another way in which we are able to differentiate ourselves from competition by the kind of home delivery infrastructure and service that we offer. We have set up a call centre, which is dedicated, you can call up the call centre, there are convenient delivery windows that we have morning, afternoon and evening so what value is very, very low at Rs.200 and we also offer the convenience of paying through credit card to home deliveries. Then the other thing is that since Heritage is quite popular as a dairy brand in these three cities, roughly about five lakh households wake up to Heritage milk, we will be using and promoting our milk delivery agents who currently distribute milk to the households as a means for even further penetrating the home delivery business. So, that is the unique distribution strength that we have and we intend to do these things.

Girish Pai: Okay, thank you, I will come back with further questions later.

Moderator: We have a followup question from Mr. Balaji of Sundaram BNP.

Balaji: Yeah sir, you had also intended to start the sales through the Internet, so how is that viable and have you already started that for your old stores, sir?

Jagdish: We have not yet started our sales through the E-portal at the moment, so that is another channel through which we expect future home delivery revenues to come in. The means which is quite new to this country and probably in terms of fruits and vegetables, the prices vary from city to city and therefore one must have enough intelligence here as a business model, the intended model before we can start it. We are in the process of developing and testing that, it maybe still about a month or two away. In terms of our priority, we are first promoting the call center as a home delivery channel, followed which we will penetrate the home delivery through the milk distribution agents and this segment of E-portal would be a niche segment, the developing segment, that we want to be there for people who are highly savvy, especially people who are young, both husband and wife working, IT kind of, all the three cities if you look at it have fairly young population, lot of IT population, people working in IT organizations, who work late and probably want to enjoy their weekends, so it is an avenue for such people, who are IT savvy, who would like to probably make an order through the portal, where we would like to service that. But our understanding is this portal is still about a couple of months away.

Balaji: Okay and that segmental breakup, if you could just give it for the fourth quarter alone?

Jagdish: Yeah, one second.

Prabhakar: Good morning sir, I am Prabhakar, GM Finance. For the fourth quarter actually we have achieved 86 crore, 31 lakhs as far as dairy sales, segmental revenue is concerned is 72.11 crores when compared to the last previous quarter. As far as the retail is concerned, 6.28 crores we have achieved, so there is no corresponding previous quarter figure. In total, revenue including interest segment revenues, interest segment revenue in the sense we are buying dairy products from dairy, for the fourth quarter figure it is coming to around 18 lakh worth of material we have purchased from dairy. So, total revenue that is income from operations, 92 crores as against 72 crores. Then as far as the operating profit is concerned segment results, dairy has achieved 6.38 crores as against 5.28 crores and retail incurred loss of 11.67 crores, this is because of start up expenses like consultancy charges and all these things, the employee training for the past one year. Then in agri, even though we have not started the agri business, but because of this AS26, so whatever the expenses we are incurring, that we are adjusting to the profit and loss account, that comes to around 16 lakhs. So, total segment results, operating profit is 5.45 minus as against 5.28 plus last year. As far as capital employed is concerned, we have actually as far as dairy is concerned, capital employed as on 31st March 2007 comes to 114 crores as against 84 crores. As far as retail is concerned, capital employed is 25 crores, as against, there is no actually corresponding figures and agri business where we are constructing a pack-house in Chittoor district, the total capital employed in that business is coming to around 16 crores.

Balaji: So, if all your plants go as per your schedule of eighty stores, then could you just give the guidance for operating profit from 11.67 crore loss in FY07, what kind of number are we looking at in FY08? Yeah, actually I was asking in FY08 if everything goes as per your schedule of eighty stores, then if you could guide us for some operating profit number that you are looking at from a loss of 11.67 crores, how will this number move to?

M. S. Rao: May be we can give you later, because we have not projected the numbers, so the original plan is different, we can give you later.

Balaji: Okay, and your plans for roll out of ice creams, how is that progressing and which brand are you planning to launch the ice cream and whether it will be in all the three cities?

M. S. Rao: Yeah, ice cream will be initially in Hyderabad, in the name of Heritage only, milk is also in the brand name of Heritage, there is no sub-branding given yet. Within a month or so, once we stabilize our products, then we will plan to move to Chennai and Bangalore.

Balaji: And you mentioned CAPEX of about Rs.2,000 per sq. ft, so for the 80 stores, how is the funding going to be in FY08?

M. S. Rao: It is basically through the consortium of banks, we have already tied up 120 crores of loans for entire retailing projects, partly it has been spent in the '06-'07 and balance will be spent during this financial year to achieve both backend support systems as well as stores and the DCs, distribution centers.

Balaji: And in terms of equity dilution you are looking at?

M. S. Rao: Equity dilution, at the moment there is no plan, but we have to discuss internally about the expansion. We are planning to go beyond these three cities and the present numbers and then we may have to go for it, may be in another three months' time, we will be making up our mind on what should be the direction.

Balaji: Okay, thank you.

Moderator: We have a followup question from Mr. Girish Pai of ICICI Securities.

Girish Pai: Yes sir, the margins between your milk and the value-added milk products, what would be the differential like?

M. S. Rao: Margins are quite high in value-added products. I would say it is double as a general way of understanding. It is even more than double in certain specific niche products. But certainly in all the products it is double compared to milk margins. That is why we are thinking of adding the value-added products quickly so that our margins can be improved while the turnovers are growing.

Girish Pai: Okay, so will you be just for your value-added products, is it going to be still, I mean, you mentioned about launch of ice cream in Hyderabad and flavored milk, would you think of a much larger launch, say a national launch or something like that, a year down the road?

M. S. Rao: It is possible only if we get into tetra packing because the present packing material we are using has certain limitations of transport and shelf life, so we would be confining to South Indian markets till we get our own UHT packing facility and our expansion into other geographies.

Girish Pai: Okay, and as of FY07, what was the cash balance in your books?

Prabhakar: Actually it is coming to around 24 crores, sir. 24 crores because of the nature of the business, before 31st March actually we have to transfer these funds to the various banks for making milk payments.

Girish Pai: For milk payments.

Prabhakar: Bank accounts are there, remote areas we have opened actually for serving these farmers for making bank payments as per the milk procurement. If I have to transfer funds from here to the respective locations, on 1st or 2nd we make the payments.

Girish Pai: Okay, so I mean, if you net that off and if you were to look at a more steady state kind of a cash balance, what would it be like, I mean, I just want an approximate number, where would that stand?

Prabhakar: The net cash balance?

Girish Pai: Yeah, I am not talking about the official accounting figure, but if you were to take into account these payments which you have made to the banks, if obviously you are going to have sales coming through, adjusted would be how much, because 24 will not suffice for the CAPEX that you are looking to do?

Prabhakar: It would be around 78 crores.

Girish Pai: 70, okay, couple of questions on impact of your work on farmers, the agri produce that you are purchasing from them, what would be the percentage of final price that you are selling at that goes to the farmer at this point in time? Say, suppose you are selling some vegetable for Rs.20 a kg, what would be the extent of the final price it is sold at that goes to the farmer?

Jagdish: I would say that currently our overall gross margin is about 24% for fruits or vegetables. Now, typically when you look at it in terms of the distribution cost between when you procure from the farmer and sell it through, there are two components, one is the entire purchase cost, second is the distribution cost to the stores. Roughly say that almost about 50% of the entire, on an average I am just giving you, it depends, varies from product to product, 50% of the front end, the overall pricing is the rough procurement cost.

Girish Pai: Okay, so compared to what they were getting previously, is this a substantial jump versus what they were getting previously when they were selling in the local markets there?

M. S. Rao: There are I would say the comprehensive approach if you see, the benefit should be understood in a different context instead of only price factor, but it is one of the important factors. One is the productivity levels, the quality of the product. Because of our intervention in the cultivation practices, we had a number of agronomics working (inaudible) application of management practices and supply of better seeds from the established brands and arrangement of credit for timely operations, timely implementations. We expect substantial increase in the production and productivity of the farmer and mix of A grade products, which are table varieties or saleable through the retail also is increasing substantially, based on A, B, C classification of the product they get, so that achievement of 90% of the price in the A category is the main benefit for him, which could be around 75% otherwise as this share of the product is going into high category plus the price is definitely better. And the other benefits are, we pick up from the farm, instead of farmer carrying it to the market. The damages are minimized in handling physically and the weight losses, which he incurs while going to market due to the weather, the time to wait for the marketing, then the weighment problems and related issues, the payment problems and related issues, all these are taken away from him, his time is saved, his efforts are minimized and jointly for farmer and the company, the wastages are controlled because within few hours, one or two hours of the harvest, the product reaches the pack-house, which has a pre-cool facility. During this operation we minimize the wastages substantially instead of product going in a dry store vehicle to long distance markets and getting spoilt. Then the disintermediation is also there, we are directly picking up from farmers, so the agent, aggregator, and wholesaler all those issues are also not there. So, there is definitely a set of benefits for the farmers, some are monetary, some are not monetary and some are price oriented, some are not price oriented, but net income of the family per acre should go up, that is what our ambition is. Same units of land he is cultivating, he would definitely get the higher income and secondly we are also giving him annual cropping plan. These areas we have chosen have at least 300, 320 days of the cycle, so they grow three crops, all the three crops we have assured pickup from him. So the per acre income at the end of the year would be much, much higher than what he is getting otherwise. We explain to farmers how his income is going to go up from the same units of land.

Girish Pai: Okay, sir you mentioned about net income for farmer per unit of land through various interventions that Heritage is doing, if you were to compare with say, two years back and where the farmer is right now in his relationship with Heritage, what increase in income would he be getting now, it will be 100% or 50% or what would it be like?

M. S. Rao: Of course we are yet to show the results, we have just started our crops. We aspire to achieve 100% increase over the last year's income. That is the direction in which all efforts are being made, may be three months later we would really show the numbers.

Girish Pai: Okay, one last question, this is regarding your pack-house, what is the kind of investment that you would be making in this pack-house?

M. S. Rao: We have two pack-houses, one is near Hyderabad and the other is near Bangalore. The pack-house near Bangalore would be close to 20 crores and the pack-house near Hyderabad would be close to 9 crores.

Girish Pai: Okay, so this is cold storage equipment that you are buying?

M. S. Rao: Basically they have four functions, one is cleaning, washing, polishing wherever possible and grading, sorting, packing, this is one line, and it is a comprehensive treatment line. Second is pre-cool, as the vegetables come from the farm, they are at the high temperature, and it will be brought down to 18 to 20 degrees through a pre-cool hall, all the material that reached straight away, that is increasing the shelf life. Third is the cold store, for long-term or transit storage. If there is a surplus deficit management there will be a temporary cold store for one day, two days and the long term cold store for items like carrots, oranges, potatoes or apples, which have to wait for six months or three months to go to market. Other facilities, ripening chambers for bananas, mangoes type of fruits, where there is a process of ripening without using chemicals. These are the basic facilities available in all the pack-houses.

Girish Pai: Okay and you do the logistics yourself?

M. S. Rao: Yes.

Girish Pai: Okay, thank you sir.

Shirish: Good morning sir.

M. S. Rao: Good morning.

Shirish: I am Shirish from Anand Rathi. Yeah, I have two questions on your milk products, what kind of competitive scenario you are facing in these three states, I mean, your average price is about 13 plus what is the competition selling and what's the kind of volume the competition is selling?

M. S. Rao: In each of these three major cities where we have sales, we have 10% to 15% of the market share with us. Cooperative milk unions, like Aavin in Chennai, Nandini in Bangalore, and Vijaya in Hyderabad take close to 60% to

65% of the market share. The cooperatives are the market leaders in all the three cities and the remaining 20% to 25% is with other competitors like Hatsun's, Arokya, Tirumala, Jersey, there are many, many names in the market. Mother Dairy has entered recently in Hyderabad also. The market share is more or less growing in favor of private companies, vis-à-vis cooperative union over the last 10 years. Cooperatives are significantly losing out on their market share. In terms of prices, cooperatives are the trend setters because of the leadership position they have. They fix the price with the intervention of the state governments concerned. Both the procurement prices and the sale prices are determined by the government for the cooperative union. Though there is no legal restriction on private companies to have their own prices, these leadership positions put us in a particular bracket. We cannot be very different from the cooperative union. More or less all the private sellers are slightly higher than the cooperative milk. Heritage is maintaining normally Rs.1 higher price compared to the cooperatives. Some times on par with some private players, some times higher than some private players. It is okay or you need more?

Shirish: Yeah, my next question is that when government procurement process is in place, then who would buy the milk, is that the quality, which is driving or is that the availability for the longer time drives the sale for the private players?

M. S. Rao: In favor of private suppliers or in favor of a particular company, there are certain factors, which will drive the sale or purchase. In terms of sale by farmers, they look for certain assurances like accuracy in measurement of quantity and quality because milk payments are based on quality also. Then the punctuality of the payment, other services extended for animal health care, immunization, or vaccinations, or artificial insemination, supply of fodder, feeder and tying up of credit etc. The farmers prefer a company, which is offering all the facilities throughout the year and assures buying of entire milk they deliver without any rejections on one pretext or other. So, we try to achieve all these factors, particularly the accuracy in measurement and punctuality in payment coupled with the services required for the farmers on the (inaudible).

Shirish: Okay, my last question on dairy business is that, what is the current demand and supply mismatch within these three states?

M. S. Rao: Demand supply is a seasonal function again. It depends on the rainfall and the disease out break, etc. Presently

Andhra Pradesh is facing 15% to 20% shortfall in the demand and most of the companies are procuring milk from Maharashtra, including Heritage, we are also picking up some milk from Maharashtra on a bulk purchase basis. Even the cooperative unions are buying milk from Maharashtra. Tamil Nadu has picked up, last year it had a 20% short fall, but from April, May, Tamil Nadu has come to normalcy. Karnataka is still having deficiency; they are also buying from Maharashtra, about 10% deficiency. I think AP has the highest mismatch.

Shirish: Okay, my next question is on our retail business, by and large would you be able to share, what is the consumer profile who is visiting our shops?

Jagdish: If you look at both in terms of our location strategy, which typically defines the true format and positioning, we appeal to consumers in terms of I think B, B+ and A are consumers who visit our retail stores are people who seek hygiene, convenience and most importantly people who seek quality. Now, we are able to extend the consumer profile and get people from the middle and even lower middle class because of focus on fresh. The unique format, our core segment is definitely as you see B, B+ and A; our localities where we open the store and the store positioning is for this kind of a consumer profile.

Shirish: Okay, what kind of foot fall we are having on the minimum scale and the higher scale that is the first part of my question and the second part is that, what kind of foot fall we expect as Heritage after six months of the opening of our store?

Jagdish: In fact if you look at foot falls, there are on an average, on a day, it will be between 700 to 750 foot falls and it typically doubles on a weekend in the stores. Now, the foot falls typically are growing at the transaction of the last two months that we have seen, number of transactions growing at about 10% to 12%. We expect this to stabilize at close to about 900 to 1000 foot falls a week going by the current trend if I have to extrapolate, it will be around 2,000 odd foot falls or so.

Shirish: Okay, now when you say that there is a repeat purchase which is happening, would you have any kind of data that we have some loyalty customers, about 10% of total foot fall, which is there coming up with Heritage or is there any other data, which is available to measure that, who are the people who are spending this?

Jagdish: Actually recently I have currently accurate data to share as we have recently launched stores at various places, but we have just launched a loyalty card, we have launched it in both Bangalore and Hyderabad. This loyalty card will help us track consumer repeat purchase, their consumption patterns and their average frequency of visits to the store, so probably in the next one or two months we should be able to issue the loyalty cards to most of the people who opt for it and we should be in a position to share this data then.

Shirish: Okay, in fact my last question on this business, you mentioned that we have 30% coming up from the fruits and fresh vegetables, is that right?

Jagdish: Yes.

Shirish: And 70% coming from the FMCG business?

Jagdish: All the other categories, the other categories comprises of various things like beverage, dairy, personal care, health and beauty, general merchandise, oils, there are quite a few other categories, which are there. All the other categories make up for grocery, for example make up for the rest 70%.

Shirish: Yeah, my question is that, if you are comfortable, could you just share the percentage, which business coming that 70% further break down between the grocery and the packaged personal care or the other products?

Jagdish: If you look at typically, I can give you the rough, when consumers, if you could just appreciate our business model, our recruitment engine in the store are fruits and vegetables. So, what happens is typically when consumers come and try us out for the first couple of visits or the first few times to buy fruits and vegetables and then they are drawn to other categories. In a high growth scenario we would typically have, as I mentioned this is currently at 30%, people who are with us for about a month or so, they get drawn to other categories much more strongly. Typically on an average our grocery contribution, this will be roughly about 10%, it varies from store to store, just to give you a rough idea.

Shirish: Okay, further question which is last, what kind of margins we get from the balance 70%?

Jagdish: FMCG contributes the biggest chunk and FMCG branded organization, depending upon the category, the margins range from as low as about 6% to 8% going up to about

22% in some categories. On an average FMCG products margin is about 15 odd percent, 15% to 16%.

Shirish: Okay, thank you.

Moderator: There are no further questions. Now I hand over the floor to Mr. Anirudha Joshi for closing comments.

Anirudha Joshi: I thank Mr. M. S. Rao and all the participants for being on the con-call. On behalf of Anand Rathi Securities, I thank you all for your time and asking questions. Thank you very much.

M. S. Rao: Thank you.

Moderator: Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant day.

Note:
1.This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.