"Hindustan Foods Limited Q4 FY22 Earnings Conference Call"

May 23, 2022

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Moderator: Ladies and gentlemen, good day and welcome to the Hindustan Foods Limited Q4 FY22 Earnings Conference Call.

This conference call may contain forward looking statements about the Company which are based on the beliefs, opinions and expectations of the Company as on date of this call. The statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sameer Kothari – Managing Director. Thank you and over to you, Sir.

Sameer Kothari: Thank you, Rutuja and good afternoon and welcome everyone for our Quarter 4 FY22 and financial year ending March 31st, 2022, earnings conference call. I hope each of you and your families continue to remain safe and healthy.

I am joined on the call by Ganesh Argekar, who is our Executive Director, Mayank Samdani, who is our Group CFO, Vicky Solanki, who is the Head - Emerging Businesses and Corporate Communications and Bankim who is our Company Secretary. I am also accompanied by SGA, our Investor Relations Advisors.

I hope everyone has had the chance to go through our updated investor presentation which was uploaded on the exchange and also on our Company website.

Coming to the performance of the Company, I have to say that I'm pleased with the performance in the last quarter and also for the entire financial year. What gives me confidence is that in spite of all the headwinds, including commodity inflation, slowing demand, stress in rural demand, etc. we've been able to achieve the target that we have set for ourselves, which was that of achieving a turnover of 2000 crores.

As I had mentioned in my earlier call, our business model not only shields us from the short-term vagaries of demand and inflationary pressures, but also provides us with a clear visibility of the medium term in terms of our performance, which brings me to our future target.

In my last call, I had laid down the path for reaching our next goal of 4,000 crores and I can confidently say that we are on track for most of those things that we discussed earlier. The M&A transactions have progressed, factories have been integrated into our systems and some of these factories have actually gone ahead and achieved their highest ever turnover in the last quarter and in this month of April as well. But more importantly we've been able to continue servicing our customers from all of these factories, without any disruption.

The deal pipeline looks strong and in spite of the general slowdown in the FMCG volumes, our strategy to diversify across product categories is beginning to pay off. To illustrate, while some of the categories are facing volume headwinds and down trading, some other categories like ice creams, beverages, color cosmetics are seeing a major spike due to the pent-up demand over the last couple of years.

We continue to invest in CAPEX across various geographies and are confident that things are beginning to sync in. We are successfully in the last few years, changed HFL from a single product, single location, single customer Company to one of the most diversified FMCG contract manufacturer in the country. This has been achieved by building new factories, identifying adjacencies and integrating acquisitions and developing new customers and product categories. I am confident that this experience will hold us in good stead as we start our journey from 2000 to 4,000.

I will now hand over the call to Ganesh, our Executive Director who will brief you on the operational highlights.

Ganesh Argekar: Good afternoon, everyone. I would like to highlight the operational performance of Quarter 4 and Financial Year 22. All the existing units of the Company were stable and performed as per the expectations. Our new color cosmetic acquisitions were completely integrated, and the factory achieved its highest ever turnover in the month of March '22 and again in the month of April 2022. The ice cream plant in Lucknow, UP commenced trial production and the first dispatch was made in April. We expect it to ramp up production to approximately 15,000 litons by the end of 2023. We need to invest an additional Rs. 75 crores at Lucknow for the expansion of ice cream plant. We expect the increased production to start from Quarter 4, 2023.

The merger of ATC Beverages is completed and the expansion at Mysore has been commercialized. The unit has started manufacturing for Tata Consumer Products Ltd. in addition to the existing customer Hector Beverages. We are hoping to invest to double the capacity on this site.

The Soaps and Bars project in Hyderabad continues to be delayed and we are cautiously optimistic to start project work in June. The new factories for the footwear division sports as well as knitted shoes have been commercialized and both units in Tindivanam, Tamil Nadu and Vasai have started production.

I will now hand over the call to Mayank Samdani – our Group CFO to take you through the financial results of the quarter and financial year 21-22 and explain to you the thought process of our decision to split the shares. Over to you Mayank

Mayank Samdani: Thank you. Good afternoon, everybody. I would like to Highlight Financial Performance for Q4 and FY22.

We are very happy to share that we have achieved our target of Rs. 2000 crores of revenue for FY22, which is 45% growth over last year. Our total revenue for the quarter increased by 15% on year-on-year basis to rupees Rs. 563 crores in Q4 FY22 as compared to Rs. 491 crores in Q4 FY21. EBITDA of FY22 stood at Rs. 120 crores which is higher by about 30% on year-on-year basis. While the PBT was higher by 41%, the PAT growth of year-to-year for the financial years was not strictly comparable to the last year as the last year PAT includes certain onetime tax adjustment and excluding that the PAT past growth was 41% as well.

As can be seen all the three parameters revenues, EBITDA and the profits are the highest in the history of the Company. As far as our ratios are concerned, as shares of the dedicated manufacturing increases, our margin profiles are tending to our normal rates of around 5.5% to 6.5% EBITDA and around 2% to 3% of PAT. This is in line with our expectation and guidance.

Our ROC and ROE have improved as most of the CAPEX are productive. While I am confident that we should be able to better this as some part of the CAPEX continues to be work in progress. Given our track record I can be confidently say that we will always have some CAPEX proposal as work in progress. It is this continued investment of CAPEX financed from our internal accruals and debt that has led to the significant gross block of around Rs. 550 crores on the consolidated basis including Capital WIP, leading to the scalable performance prompting a rating upgrade from India ratings.

Considering the size and ambition of the Company the Board have considered split of the equity shares of the Company from the face value of Rs. 10 to the face value of Rs. 2 each. We reiterate our near term and long-term targets for revenues and profitability as we continue to focus on accelerating growth through exploring organic and inorganic opportunities. With this, we also remain focused on strengthening our balance sheet and cash flow through effective working capital management, which would facilitate us for further growth.

With this I would like to open floor for the questions. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Faisal Hawa from HG Hawa & Co. Please go ahead.

Faisal Hawa: From your investor presentation, I can see that the cash flow from operations has gone down quite a bit from the last time in spite of revenue will be much higher. Can you give me some reasons for that? Is there some steps that you have taken to improve it? Second is that with these inflationary pressures are we kind of facing some kind of requests, from top management of your main clients that, postpone the cost increase for this quarter or for this month, or just to make their balance sheets or profit and loss look good? Third since the new development person is also on the call can he guide us as to how he's approaching do business for HFL?

Sameer Kothari: This is Sameer. The first two questions are about the financial performance. I am going to ask Mayank to talk about it. As far as the new development is concerned, I'm going to ask Vicky to talk about it.

Mayank Samdani: This is Mayank here. As you are aware that we have invested in our subsidiaries, one is the HFL Consumer Product, which has ice cream plant, which is commercialized in April and Aero Care, which is LLP, which we have taken over in January. Both those investments, which we have done in tune of around Rs. 45 to 50 crores is being treated as current investment, not as the loans. As a result, that all these investments have gone in the operational cash flow and not in the financing activity, that is why these Rs. 45 to 50 crores is in the operational cash flow in the negative items

Sameer Kothari: Just to elaborate on that, the auditors have decided that since the investment has not been made into the fixed capital, in case of the LLP and not in the share capital in case of the subsidiary since they are being shown as loans, they have treated that as a current loan or a current advance which wecan recall at any point of time. As a result, they have classified it as part of our working capital and not as a part of our investing cashflow.

Faisal Hawa: So, these subsidiaries will be carrying that 15% income tax rate?

Sameer Kothari: One of them will, the HFL Consumer is the one which will be carrying the 15% income tax rate like you rightly identified Aero Care as you will recollect was an acquisition. It's an older Company which was in existence even before the new tax law of that 15% was announced. Unfortunately, in case of Aero Care, we will be continuing to be at the highest tax rate.

Faisal Hawa: Aero Care we have acquired at around Rs. 30 crores and you're expecting Rs. 100 crores sales. So, it's like a good acquisition and almost like .3 times sales, do you see such future acquisitions also coming up with a lot of such structures or contracting units on playback not wanting to continue the business on a standalone basis.

Sameer Kothari: So, Faisal thank you. We all are very confident about the Aero Care acquisition and yes, we all believe that it was a good acquisition. In terms of the future, I obviously can't give you any specifics, but given all that, that's happening in the market, and you talked about inflation, and you talked about the customers pushing back etc. We strongly believe that we will get more opportunities like this, because in case of a difficult environment to work, smaller and unorganized contract manufacturers will probably find it difficult. And we are hoping that we should be able to take their place and expand.

Faisal Hawa: What is our current ROCE and ROE ?22 ended?

Sameer Kothari: Current ROCE is around 20% and current ROE is 19%.

Faisal Hawa: You said 20%?

Mayank Samdani: Yes.

Vimal Solanki: Just to answer your last question on the new products on the emerging businesses, like you know where we worked with most MNCs operating out of the domestic market, as well as the domestic companies, there are a bunch of companies, which we hope to get them into our baskets sooner than later, we try to work with them for existing categories, new categories. And Of course, there are a bunch of startups retail chains which are growing. We continue to talk to them. We have a few and we try to get the rest into our portfolios. We continue talking about current categories with our clients. We talk about the new extensions of the current categories. We are sprucing up our R&D so that we are able to match up to their requirements of existing of new products and a few other things.

Faisal Hawa: How are your KRA is built in? How much of new revenue that you have to get in every year? Because what is happening is, the existing buyers are also growing, then you have to get a new business also. So how do you measure that?

Sameer Kothari: It's a good problem to have known the existing business is growing and we have to get to new businesses.

Faisal Hawa: I want to know how this particular assignment, the KRAs of this post are built in.

Sameer Kothari: I understand where your question is going. Let me just talk to you at a macro level. What we've done with the business development team is we have four verticals. We have one gentleman and one team who heads the key accounts. These guys basically look after our existing customers, large MNCs and we try and see how we can increase our wallet share with these guys. We've got another lady who heads the new accounts, as well as private label development for home and personal care. We have Vicky who's basically heading our food related new account as well as new product development. Then we have another sales and business development person who is basically looking after the health and pharma initiative that we've just started. All the four of them have very clear-cut targets in terms of which customers they're supposed to go after and what is expected from those customers.

Moderator: The next question is from Aakash Javeri from Perpetual Investment Advisors, please go ahead.

Aakash Javeri: My first question, just would like touch upon the ATC now that we still have a lot in ATC, it is about more than Rs. 80 lakhs and this will be I think, just onto this February 17th. Isn't that very steep even year-on-year if you see or the losses widened it's more than doubled if you could just throw some light on that?

Sameer Kothari: Sure. So, ATC was the millstone around our neck for the last couple of years, as I've talked in a bunch of investor calls as well. I'm happy to say that and it's not just my information, but you reading it in all the pink dailies that beverage consumption and out-of-home consumption for beverages has increased tremendously in this year. So, I am happy to confirm that as a theme, exuberance in demand is reflecting in ATC performance as well. We've had the highest turnover in March and then again, in April, what we've done is we've also been able to successfully convert two of our customers there. One who was a new sign on which is Tata Consumer and the earlier one which is Hector Beverages, both of them have now signed up with us. If you're familiar with the business model of the Company, ATC is now not a shared facility, but it is an anchor tenant facility where both Hector and Tata Consumer have given us commitments in terms of their total off-take for the next financial year, which is FY23. In addition to that, we are cautiously optimistic about the performance of beverages going ahead and the Board has actually sanctioned that some money to expand the capacity at ATC. So yes, you're right that the performance of ATC has not been very good so far, but we are quite confident that it should turn around completely in the next few months.

Aakash Javeri: So, we can expect to see some profit from Q1 and would the profits from Q4 and Q1 kind of cover the costs for the rest of the year.

Sameer Kothari: You have to explain that to me. Will we start seeing profits from Q1, we certainly hope so. I didn't understand the second part of the question.

Aakash Javeri: The second part was generally for beverages in Q4 and Q1 would be the best quarters. Would the profits in these two quarters assuming that that Q2 and Q3 would see some softening in demand for beverages, would the profits in Q1 and Q4 be enough on a whole year basis? Would ATC be profitable? That's the kind of question I'm asking.

Sameer Kothari: My apology. I didn't understand the question. So, you're absolutely right. In case of beverage industry, that's generally the trend. In case of ATC, we've got two things which are in our favor. One is located in Mysuru in the South where the seasonality in the off seasonality of beverages is not as distinct as let's say the Northern territory. As a result, in case of South, since the weather does not really become cold in the winter beverages sale do not come to a complete halt in ATC, as opposed to let's say the unit was located in the North. The second thing, as I mentioned in the first part of my conversation on ATC, we've been able to successfully transition both Tata as well as Hector Beverages to an anchor tenant of that facility, which means they have given us commitments for the entire year. As a result, I think we've been able to remove the variability and the seasonality of that factory to a certain extent.

Aakash Javeri: My next question would be how much of the impact of power and fuel costs, and do we get to even pass on this with a lag?

Sameer Kothari: In case of the dedicated manufacturing and the anchor tenant model, we get to pass on the entire power and fuel cost increase to our customers. In case of shared manufacturing, there would be a lag and in case of private label, we would probably not be able to pass on that increased cost.

Aakash Javeri: My next question is with regards to the UP plant. How much the Rs. 125 crores investment in terms of top line and the additional Rs. 75 crores that you just announced, am I right of thinking that that this would double the capacity?

Sameer Kothari: Let me just step back to that one question on the power and I'm going to come back to this question as well. So, while I mentioned about, I know that you are familiar with our business models maybe a lot of the participants in the call may not be familiar with it. When I said dedicated manufacturing, you know that nearly 80%, 85% of the Company turnover comes from dedicated manufacturing and by definition all inflationary cost can be transferred to the customers in case of the dedicated manufacturing. Frankly, whether it's power, fuel, whether it is commodity prices etc. we can pass that on to the customers. Now coming to the second part since ethical consumer is a single product Company right now, I'm not at liberty to discuss the turnover. You'll obviously see it in a couple of quarters, but I can confidently confirm that the asset turnover ratio for this factory should be similar which is around 3.

Aakash Javeri: **Are** The payments for the Scholl acquisition completed?

Mayank Samdani: As you are aware that we have signed a share purchase agreement in Jan, there are some legal things to be done before and approvals to be taken, which is in process, we hope that we will be able to close in this quarter. By June we are hoping that we will close the transaction totally. Payment will happen only once the approvals from the government authorities come for this transfer.

Aakash Javeri: We expect that in Q1?

Mayank Samdani: Yes.

Aakash Javeri: Are there any price hikes which I expect you to be passed on in the rest of business which took a toll on margins or have the pricing pleases been completely passed on?

Sameer Kothari: Like I said earlier, the business model is such that price hikes are automatic. Every time there's a change in the commodity prices or if there is a change in the power costs or for that matter even if there is a wage, a minimum wage increase, it gets passed on automatically. Like we've mentioned in previous calls while there might be a lag that lag is more of an accounting phenomenon rather than a commercial phenomenon. What I mean by that is we will recover the money, but it could come in a quarter lag or something like that. But We do not foresee any situation where our margins should get affected because of inflationary pressure.

Aakash Javeri: I completely understand that question is more of like, has a lag happened or do we still that see that lag, I completely understand that. The next question would be how do we plan to fund the CAPEX of Rs 375 crores which you have announced and that remaining in terms of cash how you plan to fund it?

Sameer Kothari: I thought Mayank will take the question, but he deferred it to me. We do not have any intentions right now to look at equity. We continue to think that all the CAPEXs which have been announced, we should be able to fund it through debt and internal accruals.

Aakash Javeri: If you could just quantify what will be the total tax loss that we have at ATC?

Mayank Samdani: The total tax loss of ATC is around Rs. 19 crores which we'll be able to utilize in this year.

Aakash Javeri: Also, another question would be that the cumulative mat credit that we have, how long before we use those credits and go to the 25% tax regime?

Mayank Samdani: This is a chicken and egg situation because we continue to invest in new factories. The MAT will continuously increase. That is the only time when we get the utilized mat is after three, four years of the factory operations, when the depreciation of income tax is less and the corporate tax depreciation will be more, but at the same time if we invest in that year, a substantial sum of money, the mat will remain a problem in the near future.

Sameer Kothari: Let me tell you from an operational perspective, since we now have a couple of steps down subsidiaries and a large part of the new investment is happening in HFL consumer, we are hopeful that we will start seeing some amount of mat utilization in Hindustan foods,in the holding and the listed Company sooner rather than later.

Aakash Javeri: Also, you mentioned about the Rs. 10 crores investment for knitted shoes could just talk about the potential and would the top line be similar to the rest of the business the asset turns could you just throw some light on that?

Sameer Kothari: The asset turns in case of the leather business are higher, as you can imagine leather businesses is predominantly a labor-intensive business. Frankly, the CAPEX involved is very, very low. We are quite bullish about that sector though we've actually not invested too much money in it. The current actually I can't even say current, in the last few months the Government has taken certain steps, which makes manufacturing of shoes, especially leather shoes and sport shoes better in India, as opposed to importing them from China. As a result, we are confident that we should be able to grow that business. However, I don't think you can apply the same yardstick in terms of asset turns, margins, etc. to that business like you do for our other businesses.

Moderator: The next question is from the line of Anand Trivedi from Nepean Capital, please go ahead.

Anand Trivedi: A lot of my questions have been answered, but just for some more clarity, I'm looking at your presentation on page three, you have this Rs. 4,000 crores revenue target by 25. I just want to understand that,is your current gross block is Rs. 550 crores, this4,000 crores is an assumption of particulargross block?

Sameer Kothari: We have announced a bunch of things in fact we took in the previous call what we've done is we've taken through the analyst with our journey from Rs. 2000 crores to Rs. 3000 crores. In terms of the gross block additions, yet there will be some gross block additions. The Rs. 550 crores currently include the capital work in progress of ice cream, but then we announced a couple of more things we've announced the bar project, but actually we've been talking about the bar project for a few quarters now, but we are hoping that we'll be able to start work on it next month. We've also announced an increase of around Rs. 75 crores of CAPEX in the ice cream factory. We have also announced some small CAPEX in the Coimbatore factory relatively doubling of capacity at ATC beverages and a small CAPEX in the shoe factory. All of this, given the current visibility, we think will take us to our target of Rs. 4,000 crores.

Anand Trivedi: Going back to what you earlier clarified that, so there's no additional equity will be required to this Rs. 4,000 crores?

Sameer Kothari: So, let me rephrase what I said. What I said is that all the projects which have been announced and which are in the public domain will be funded through internal accruals and debt. However, we continue to have a very robust pipeline. I just take a minute to talk about this, given the stress in the FMCG market, etc. we believe that there'll be more opportunities coming our way primarily because as FMCG companies grappled with growth, as well as inflationary pressures, we think a lot more will start looking at contract manufacturing. We also believe that a lot of our principals will look at divestment where they want to get out of manufacturing, sell physical assets to somebody like us. We also are confident that we'll see some opportunities for consolidation where smaller contract manufacturers will probably not be able to cope with the volatility as far as the overall market is concerned. These things we believe will give us a growth momentum for the next few years. Now, obviously this pipeline and as you can imagine, any of these discussions, decisions have a gestation period of nearly a year. This pipeline is robust and continuing. Just to recap what I said for everything that we have announced, we do not need any more equity. We will be able to fund it through debt and internal accruals, however, whatever is in the pipeline as and when it is announced, we will obviously come back to you and let you know what's happening.

Anand Trivedi: Just to clarify everything you announced takes you to Rs. 4,000 crores?

Sameer Kothari: Everything that we announced will take us to Rs. 4,000 crores by FY25, the pipeline might ensure that it might take us a little earlier in which case the timelines will change.

Anand Trivedi: Will this Rs. 4,000 crores will private label be meaningful at all or it's a small business?

Sameer Kothari: I think it will continue to be a small business, as a percentage of turnover it will continue to be small business in absolute terms. It obviously will become far more meaningful than it is today.

Anand Trivedi: One last question from me which one of earlier participants had asked on your cash generation. Just to clarify this, based on the loans that you had given order said that actually should be part of working capital, if that was not the case, would that have been part of the net cash from investing?

Mayank Samdani: It would have gone if it is treated as long-term, it will have gone in the next cash flow from investing.

Anand Trivedi: So, it is reclassification over here.

Moderator: The next question is from the line of Vinod Malviya from Union Mutual Fund, please go ahead.

Vinod Malviya: I just had one question. Regarding your ROCE of your Company, wanted to know that if I annualize the 4th quarter EBIT numbers and even the net block or gross block and the working capital, the ROCE comes to around 15% to 16% from 18%, 19% what you been doing. Just wanted to get some understanding, where in one of in this particular quarter on the margin side which led to lower ROCE or project like some capitalization happened on the balance sheet, but there is no corresponding income was not reported in the P&L and that's why in this particular quarter, the ROCE has come down?

Sameer Kothari: As you can imagine, ROCE would be on the basis of the CAPEX, a large part of the CAPEX, which was made in Hindustan Consumer, subsidiary for ice cream, we started trial productions in the month of March and the commercial dispatches have happened only in the month of April. I think that asset will start generating revenues and profits from, let's say, the next quarter or this quarter. And as a result, our ROCE at any given point of time and I think Mayank referred to it in his opening remarks as well that our ROCE at any given point of time would not be what we would like it to because we will have a substantial amount of money invested as capital work in progress. And given that we have certain aggressive plans in terms of growth, I think at least for the next few years, we don't see a steady state CAPEX amount coming in to give you the ROCE that we expect. Does that answer your question, or you want some more specifics then Mayank can give you those?

Vinod Malviya: Just slightly more specific on the, the aggressive CAPEX which you are planning to do, what kind of a ROCE one should blend in?

Sameer Kothari: It's difficult to give you an exact number. We will give you a range in terms of ROE, our expectation is between 18% to 22%. That's our expectation for return on equity. Sorry, I am getting too many prompts here. Just one second. Hang on. Let Mayank answer this.

Mayank Samdani: As Sameer told you the ROE expectation is 18% to 22% and ROCE expectation is between 16% to 20% on a steady state.

Vinod Malviya: Just one more clarification. In this Hindustan Consumer initially which you talked about which has gone in the fourth quarter, how much was the capitalization done on that front for the expansion?

Sameer Kothari: Capitalization will actually be done in this quarter. We just did trial production in the previous quarter and the first dispatch happened in the middle of April.

Ganesh Argekar: The entire investment was in capital work in progress, Vinod.

Vinod Malviya: How much is that number?

Sameer Kothari: It was around Rs. 70 odd crores

Moderator: The next question is from the line of Ashay Jain from Jain Capital. Please go ahead.

Ashay Jain: Just wanted to understand a bit more on the CAPEX in the health and wellness segment, that's about Rs. 100 crores. So, what would be the products that would be manufactured in the particular segment? And is the CAPEX limited to only one pharma client.

Sameer Kothari: We have discussed this earlier. What we are doing with that Rs. 100 crores is we are actually acquiring a facility from Reckitt Benckiser Scholl. We have actually entered into a share purchase agreement already. This particular factory, which is located in Sriperumbudur, Chennai, manufacturers medical bandages and other footcare products. These medical bandages are also used for corns, blisters, etc., which happen on your feet. This facility is a MHRA approved facility supplying to close to 20 countries in Europe. And we expect to continue that business in that facility with the existing team as soon as we take it over, which like Mayank mentioned should happen in the next quarter. Having said that, that's not the only pharma business that we are looking at. Like I discussed with Anand earlier, we continue to have a robust pipeline in terms of acquisition opportunities, as well as Greenfield and brownfield expansion. As and when things happen, we will definitely come back to you and let you know what is happening.

Moderator: The next question is from the line of Amit Shah from ACE Securities. Please go ahead.

Amit Shah: I just wanted to understand what are the risks that we see, or we face in terms of not achieving our target of Rs. 4,000 crores revenue in next three years.

Sameer Kothari: Amit, that's a difficult question. If I say something like we don't expect any risk, it is going to be hubris and I am sure it's going to get jinxed. So, let me tell you this way, in case of our business, the basic risk is that about execution. If we are not able to execute a project in time or properly, or if we are not able to manufacture a product in the right quality at the right time, etc., our entire businesses at risk because that's what we do, we only manufacture products for customers and we don't do anything else. In terms of risks, we don't see macro-economic conditions as a risk. We believe that in spite of the slowdown in FMCG, we think contract manufacturing will continue to grow disproportionately. And within the contract manufacturing space given the diversification we have in terms of product categories, as well as customers, we don't see demand evaporating as a risk. We believe that demand for our services will continue to be strong between the Rs. 2,000 crores to Rs. 4,000 crores journey that we have mapped out. We believe execution given the current team and given the additions to the current team that we are continually making, we think we should be able to address that risk as well. But then of course, I can't talk about any external shocks that can come in.

Moderator: The next question is from the line of Harsh Shah from Incred Capital. Please go ahead.

Harsh Shah: Given the nature of our business which is more capital intensive and having thin margins, at what size or at what level of sale do you expect to generate free cash flow on a sustainable basis?

Sameer Kothari: Harsh, a couple of comments first and then I'll answer your question. One is, yes, we are a high CAPEX intensive business with no margin, but I have to point out that's by design and not by default. Given the nature of our business, we are guaranteed of those margins, we are guaranteed of that profit or EBITDA and as a result, we invest into CAPEX. So, the correct metric for us is not to look at the margins. They will continue to be, I mean, all contract manufacturers by definition have to work at lower margins. However, the difference is in case of a Company like HFL, we have the added comfort of the fact that we have long-term contracts which guarantee our EBITDA for the next 5, 7, 10 years. And as a result, we are quite comfortable taking on the risk of investing in CAPEX in spite of the fact that the margins as a percentage of sales are low. So, that's part one. As far as free cash flow is concerned, like I have taken pains to explain, we have an appetite to grow. We believe that contract manufacturing as an industry will grow substantially in the next few years. I don't see us resting on our laurels anytime soon. So, we will continue to invest very-very aggressively in new projects, new categories, new factories, etc., at least for the next three to four years.

Harsh Shah: I was not planning to argue on the low margin side, I get that point Sameer. But I was just trying to understand that let's say, the Rs. 4,000 crores which we have a target of FY25. Going ahead assuming that the margins keep on increasing steadily, after that do we see a point where we are generating free cash flow? And despite investing, I completely agree with your point that there are tailwinds of this industry but despite investing higher, can we expect free cash flow on a sustainable basis from FY25-26 onwards once we achieved a particular level of sales?

Sameer Kothari: If you are looking at free cash flows from an operational perspective, we achieve free cash flows from operational perspective within three to four months of our factory ramping up. If you are looking at free cash flows from a Company's perspective where you are looking at declaring dividends or something like that, given that we think we have an opportunity to invest this free cash flow continuously at an ROE of between 18% to 22%, we believe that as a shareholder, any shareholder would be happier if we continue to invest that free cash flow into productive assets rather than return the money in a tat ineffective way back to the shareholders. Till we continue to see investment opportunities and the growth, we will keep investing. The day we see that drying up, we will come back and write a cheque to all the shareholders.

Harsh Shah: One more thing, Sameer, in a previous conversation you did talk about, since we have a lot of dedicated manufacturing facilities, you did talk about that the cap value of the factory at the end of the contract period is the joker in the pack, means where we can fetch the higher value for that. So, has there been an instance actually, basically where we have really seen that pan out for us where we have been able to fetch a higher price for that factory. Because I remember that you shared that you were on a particular ROE formula with your partners wherein you decide on a particular scrap value at the beginning of the contract, and whatever gains you accrue towards the end is something which belongs to HFS. So, I just wanted to understand has there been an instance of that occurring for us?

Sameer Kothari: Harsh, in terms of paper profits, absolutely. One of the largest factories that we have where we have acquired some 20 odd acres of land, when we started acquiring the land cost was around Rs. 16 lakhs an acre and the latest rate there is around Rs. 3 crores an acre. So, paper profits, on that aspect of our business and there. Have we actually converted them into free cash or converted them into profits, the answer is no, because we have not had an opportunity yet where a customer has actually walked away from a factory or shut down the factory. But on the paper, absolutely. We see that across all our factories where land prices have gone up substantially, where the cost, I mean, just pure inflation, a building which cost X amount of Rupees to be built five years ago, just by sheer inflation, the cost of steel, cement, etc., the salvage value or the replacement value of the building is much higher now. But all of this is in the paper, Harsh. So, nothing to talk about.

Moderator: The next question is from the line of Nikhil from Perpetual Investment Advisors. Please go ahead.

Nikhil: When you announce a CAPEX does it include the working capital investment or is it only the fixed part?

Sameer Kothari: Nikhil, we generally do not announce the working capital investment. But in most of the cases our working capital investment is minimal because that's the way the business model is. Having said that as the size of the Company grows, even that minimal amount is becoming large. But to answer your question, no, when we announce a CAPEX, it is only the project CAPEX, we don't look at working capital that time.

Nikhil: Noted. And I think it was Q1 or Q2 press release of last year where you had mentioned about pet foods and confectionary, savories, and deodorants as new categories. Probably you are exploring them, any progress on them? I hear pet food is completely imported, or majority is imported, so any progress on that?

Sameer Kothari: Nikhil, yes, I had taken pet food as an example. And while we are in discussion with a few people as far as pet food is concerned, I am not at a liberty to discuss any specifics. But let me tell you that the industry dynamics that we talked about nearly six months ago, some of the pet food continues to be imported into the country and a lot of awareness about pet food has increased. So, we are now in touch not only with the established players as far as pet food is concerned, but we are also working with a lot of B2C companies who are launching pet food. So, pet food as a category is seeing a lot of action, but I don't have anything tangible to report to you.

Nikhil: And any progress on the outsourced R&D business that you, I mean, of course you didn't say you wanted to start it, but you wanted to get into it eventually. Any progress on that?

Sameer Kothari: We have actually added to our team of R&D. We have set up a small lab. We have recruited some people. We have started doing some work. We have actually also, not that I'm proud of, but we have actually also developed a Wasabi Hummus which we have launched in the market for one of our customers. So yes, we continue to do some amount of R&D and our efforts along that are increasing.

Nikhil: I'll try to find a Wasabi Hummus in the market. One last question is, do you see demand for exports? Currently we are probably majority catering to the domestic market via your clients. Do you see a big export opportunity or let's say, how is the flow of queries around exports?

Sameer Kothari: Nikhil, actually exports is a very interesting part. There's a lot of inquiries coming in and I have talked about this separately in some forum that we do not, FMCG does not have the infrastructure to be able to cater to all the demand which is coming out of China. Just yesterday, Sanjay my colleague and I were at a meeting with an American Company who was just making a brief stopover in India, and I was shocked to know that just make up brushes is a $75 million business for that Company. All of it being sourced from China and they are looking at plans of getting some part of that business into India. So, I think the potential is huge. I think it's still going to take some time. You know we have acquired Aero Care which is a color cosmetics makeup Company. We are trying to build capabilities across these product categories, but for exports to become significant for us, I think it's still going to take some time.

Moderator: The next question is from the line of Sumit Poddar from Tikona Capital. Please go ahead.

Sumit Poddar: I was referring to your presentation, Slide #24 regarding different business models that we have. So, could you throw some more light on how the bucket, or the revenues may be divided between 8 business models? And going forward, a guidance on this Rs. 2,000 crores, how do we look for that concept, Rs. 2000 crores within these three buckets.

Sameer Kothari: Sumit, first of all, thank you. You are the first person who has actually congratulated us on the numbers. We all are very proud of the fact that we hit Rs. 2000 crores and nobody seemed to have noticed it. So, thank you for that.

Sumit Poddar: That's the bad part of markets that once you have already shared something and it always gets priced in. So, that's the bad part of market.

Sameer Kothari: That is exactly what Sameer bhai is saying that once you have made the announcement, we are seeing they have forgotten us. But thank you Sumit. Now, to answer your question, yes, and for the benefit of everybody else on the call, I'll just quickly go through that three business models. The three business models that we have, are dedicated manufacturing. In this case, we set up factories for a customer which basically is built to suit, which means it's a specific requirement of a customer, we build a factory around that requirement. The customer actually gives us a take-or-pay contract which is for a long period of time, could be five years, seven years or 10 years. In this take-or-pay all the cost, the operational costs are a pass through and what is guaranteed to us is a return on investment. 80% to 85% of our business is currently this arrangement, which is the dedicated manufacturing. The second part of that business, or the second model that we have is shared manufacturing. In case of shared manufacturing, we are able to manufacturer for competing brands or for competing companies and none of these companies give us any kind of commitments. And if I can take a second, I'll just very quickly tell you how the transition works for us. As a Company, what we like to do is we like to reduce the risk as much as possible. And as a result, we prefer a dedicated manufacturing. While we are happy to take on shared manufacturing, we constantly nudge or push our customers to move towards a dedicated manufacturing. And like we discussed about ATC Beverages; we have been able to successfully do that. ATC Beverages was, when we acquired, a shared manufacturing facility. It actually ended up making losses for us for two years because of the fact that there were no commitments from any customers. We have now in these two years successfully converted that into an anchor tenant, a dedicated manufacturing where Hector as well as other consumers have committed to certain dedicated volumes. So that's the natural evolution as far as business for us is concerned. I would say around 10% to 15% of our business is shared manufacturing. And a very-very small part of the business is private label which is our third business model where we basically develop products for B2C companies. We develop products for retail chains, etc. This business, I believe will see some interesting times in the next few years, few months. And we will see how that grows. Like I was telling Anand, while the amount will become interesting, as a percentage of the turnover it will continue to remain small.

Sumit Poddar: How are the ROEs or maybe ROCEs in this business as such? I mean which would be the best one as such.

Sameer Kothari: It is it's got to do with risk. So, return would completely be commensurate with the risk. In case of the first one, which is dedicated manufacturing, we don't take on too much risk. We don't take on the risk of inflation. We don't take the risk of slowdowns. We don't take the risk of wars. So, as a result, we are happy to do business between ROE expectation of 18 to 20. In case of the shared manufacturing, we take on a lot more risk and as a result our ROE expectations are higher. And in case of private label, we take on even higher risk and as a result our ROE expectations are even further higher there.

Sumit Poddar: What kind of investments then we are putting on the private label manufacturing side? And as you mentioned, it will continue to be a very low or a similar proportion of revenues. I mean, the question I ask is primarily because how will you then add value or incremental differentiation to your business, is more of my question?

Sameer Kothari: In case of private label, actually you don't require investment in plant and machinery, because the private labels actually will piggyback on our shared facilities. And as far as the capital allocation policy that the board has set up for the Company, in case of our shared manufacturing facilities, we have been given the levy to invest up to Rs. 30 crores. And if it's anything beyond that, we necessarily require some kind of an arrangement with our customer either by way of buyback or a long-term commitment. In case of private label, I think the investment is more about R&D, the investment is more about vendor development, the investment is more about our network of using larger vendors which we are working with for our multinational companies, etc., and trying to get them to service smaller brands. I think that's the value addition we bring in for private labels. So, for example, if it is a small Company which is manufacturing, let's say, a toilet cleaner, they would not be able to get access to the same kind of resources that the market leading multinational Company manufacturing toilet cleaner does. We are able to bridge that gap and bring them to an even keel, at least as far as operations and vendor development and quality is concerned.

Sumit Poddar: Of course, my question was more on the R&D or talent side as you shared already. But with current B2C kind of boom that is going on within the FMCG space, how did this concept fit in as such, is what my question was?

Sameer Kothari: It's very interesting and we are actually also watching it with a lot of interest. I think the B2C boom is definitely there in terms of funding. I think the B2C boom is definitely there in terms of the media coverage. I think we are yet to see the B2C boom actually reflect on the retail shelf. It's early days. I think all of these guys are doing some great job. Some of the larger companies are doing a fantastic job in terms of new ways of attracting customers, etc. I think the next couple of years will actually show what will happen in terms of these B2C brands. It's very interesting and that's one of the reasons why we have actually developed this particular division in our Company. That's the reason why we are investing in R&D, etc. As you can imagine, you don't expect a Reckitt Benckiser or a Unilever to approach us for R&D. The R&D set up that we are doing, or the smaller facilities that we are setting up is essentially for these kinds of companies.

Sumit Poddar: So, the revenues would largely be D2C guys, or it is a mix? How much percentage would be the new age guys in your revenues?

Sameer Kothari: It's very-very small. Sumit, I keep referring to this and then at some point of time, Mr. Sanjeev Mehta is going to be very unhappy about it, but he said it in one of the interviews and I keep repeating the same dialogue. He said that Unilever is a Rs. 50,000 crore Company and it grows at 10% every year, so which means they add around Rs. 5,000 crores of turnover every year, whether it's by volume or whether it's by value. All the D2C companies put together, do not have that kind of a turnover. So, as a percent, I mean I am talking about just the incremental turnover, that's Rs. 5,000 crores. So, as a result from a turnover perspective, I think D2C companies will continue to be very-very small, but strategically I think you are seeing a shift in FMCG consumption, and you will see this shaping up in the next few years.

Sumit Poddar: Got it. Just referring to the questions regarding FCS that was being asked earlier. While I understand that growing business will always need CAPEX and it is always prudent to invest in CAPEX first, because that's business growing at 60%-70% kind of CAGR would need continuous CAPEX per se. But then what of the areas which can really help you to generate much higher FCS which actually takes care of your CAPEX as well as much more value added. Because this actual CAPEX slows down, which ultimately means that you are not seeing much of a growth of the rate of growth that was being seen earlier. And particularly given the opportunity that you have, you will have to have continuous CAPEX. So, how do you really solve this mystery as such?

Sameer Kothari: I think that's an excellent question, Sumit. So, here's how it's going to pan out. I think in our dedicated manufacturing, we do not get any operating leverage on our CAPEX. So, whatever money we invest is directly proportional or rather whatever money we make will be directly proportional to the investment and as a result, the more we invest the more money we will make. However, there are two aspects or two windfall gains or alphas coming from a couple of things. So, in case of dedicated manufacturing, we only play on the financial leverage. We do not play on operating leverage. In case of shared manufacturing on the other hand, there is a lot of operating leverage. We believe that in the next four to five years, as a larger percentage of our business moves out of the dedicated manufacturing and converts into shared manufacturing, we will see some amount of operating leverage coming into it. And that operating leverage will hopefully give a lift to the ROE that we can drive from that particular investment. And I think that's going to be a very important part. And then the third part of course, is the private label. The private label, assuming that they grow, we are very confident that we don't see private label companies or D2C companies, or for that matter retail companies investing in manufacturing assets, which means they will continue to come to contract manufacturers like us and we believe that we will be able to sweat our assets much better with those guys as compared to the larger multinationals. And the last thing which I briefly talked about, and Kamal talked about it as well, which is exports. We currently are not considering exports as a part of our portfolio because of certain infrastructural gaps. But I think in the next three to four years, we will definitely see that happening and I think that should unlock some amount of alpha as well.

Moderator: The next question is from the line of Akhil Parekh from Centrum Broking. Please go ahead.

Akhil Parekh: Congratulations on achieving the target of Rs. 2000 crores. My first question is on the beverages part of ice cream units. Given that this product are seasonal and the capacities are not utilized for the entire year, do the ROCEs differ uniquely as compared to the other product? And will we see a dilution in ROCEs with the incremental capacity utilization for the beverages and the ice cream plant?

Sameer Kothari: Thank you Akhil. The short answer is no. Our ROCEs are guaranteed for the year and as a result, they take care of any seasonality which might come in within the year. To answer that question very simply we look at it at a yearly basis. As you will see some amount of difference from quarter-to-quarter on a year-end basis, it evens out.

Akhil Parekh: And the assets turn also is broadly similar basically for these units?

Sameer Kothari: The asset turns actually depends on the product category. And you have talked about ice creams one hand, and you have talked about beverages, both of them completely different product categories. Even within the product category it depends on what kind of SKUs we make. For example, if we are making the lower MRP products, the Rs. 5, Rs. 10 products in that factory, our asset turns would probably be lower. So, as a result, it's very difficult to give you a specific comment on whether ice creams will have better asset turns or not. What we do is general indication is in our experience we believe that we should be able to get a three times asset turn on most of our product categories. Some will be more; some will be less.

Akhil Parekh: Second thing is regarding what's shown in the investment, we have mentioned that we will see Rs. 100 crores of topline in FY23 but the legalities or the formalities will only be done by end of 1Q 2023. So, the contribution from this business will only be for the nine months? So, it will not be completely Rs. 100 crores in FY23. Is the interpretation correct?

Sameer Kothari: Absolutely correct. In fact, the legal implementation of that deal is already delayed. We were hoping that we would have been able to get a full year in as far as that facility is concerned. Unfortunately, that's not happened. So, you are absolutely right. Every day that we are not able to close the deal, we lose turnover as well as profitability.

Akhil Parekh: Last question, on the dedicated units, we have a model where we get assured volumes for the particular product, if you are manufacturing from that units. But say, for example, tomorrow if the macro situation turns bad for xyz reasons, will this still continue to see those kinds of assured volumes? If I were to give an example, say edible oil prices have doubled over the last one year and all of a sudden if we see a reduced off-take by the consumer, does that hurt our volume assumption as well as the dedicated units?

Sameer Kothari: Akhil, the short answer is no. The arrangements are that we are agnostic as far as volumes are concerned. Of course, this does not envisage a complete shock basis, but let me just give you an example of, even in the case of COVID, if you look at our results during the peak of COVID, most of our customers stood by us and were okay with the underutilization of the factories. So, the short answer is that no, the changes in the volumes is not a risk that we carry on our books. It's a risk that is carried by our principal.

Akhil Parekh: Last from my side, the bar project has been delayed. So, it is from the client's side or is it from our end?

Sameer Kothari: The client's side for sure.

Moderator: Thank you, Ladies and gentlemen, this was the last question for today. I would now like to hand the conference over to Mr. Vimal Solanki – Head, Emerging Businesses and Corporate Communications, for closing comments.

Vimal Solanki: Thank you Rutuja. Overall operational and financial performance for this year has been in line with the Company's targets and we are on track to meet our medium term and our long-term goals. We continue to believe that there is enormous untapped opportunity in FMCG contract manufacturing space and will remain focused on accelerating growth through our strong CAPEX plans and capturing the large pie of this opportunity. With the new acquisitions and organic growth from our existing factories, we are confident of achieving the target of Rs. 4,000 crores of turnover by FY25. I take this opportunity to thank everyone for joining on this call. I hope we have been able to address all your queries. For any further information kindly get in touch with us, or SGA, that is Strategic Growth Advisors, our Investor Relations advisors. Stay healthy. Stay safe. Thank you so much.

Moderator: Thank you. On behalf of Hindustan Foods Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.