Hindustan Foods Limited
Q3 FY21
Earnings Conference Call
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Management:

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Mr. Ganesh Argekar, Executive Director, Hindustan Foods Limited
Mr. Mayank Samdani, Group CFO, Hindustan Foods Limited
Mr. Vimal Solanki, Head Emerging Businesses & Corporate Communications, Hindustan Foods Limited
Mr. Bankim Purohit, Company Secretary, Hindustan Foods Limited

Moderator: Ladies and gentlemen, good day and welcome to Hindustan Foods Limited Q3 FY21 Earnings Conference Call. This conference call may contain forward-looking statements about the company which are based on believes, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involves risks and uncertainties that are difficult to predict.

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

I now hand the conference over to Mr. Sameer Kothari, Managing Director, Hindustan Foods Limited. Thank you and over to you, sir.

Sameer Kothari: Thank you so much. Good afternoon and welcome everyone for our Q3 FY21 earnings Conference Call. I am joined today by Ganesh Argekar, who is the Executive Director on the Board of Hindustan Foods; Mayank Samdani, who is the Group CFO; Vimal Solanki, who is the Head of Corporate Communications and Bankim Purohit, who is our Company Secretary. In addition to that, we are being mentored by SGA, our Investor Relations Advisors.

I hope everyone had a chance to go through our updated investor presentation which has been uploaded on the Exchange and also on our company's website. Coming to the performance of this quarter we had a good quarter. On the back of the continuing expansion and the ramping up of the new facilities, we have been able to post the highest turnover and the profitability numbers in the history of Hindustan Foods. While we did improve our operational performances, I think it is important to clarify that a certain part of our turnover was actually boosted due to reasons completely out of our control.

A key raw material saw an unrealistic increase in price and since our business model necessitates passing on the increase in the cost to our principles, this has boosted our turnover as well. However in addition to the increase in the turnover this has also led to some margin erosion, which will be explained by our CFO, Mayank in his speech. This margin erosion is temporary in nature and we hope to recover this in the coming quarters.

I am pleased to inform you that the company now has a gross block of nearly Rs. 350 crores and is planning to invest another Rs. 250 crores in the coming few months. Timely and within budget, execution of the projects have resulted in to this large gross block, which is a testament of the hard work our team has put in. This team is headed by Ganesh, Executive Director; Prasad, Head of Projects, and the operations team at Hyderabad and Silvassa headed by Govind and Manish respectively.

I am really proud of the work that these guys have done in the last year or so. Coming to the immediate future we are very excited about the upcoming project in UP which will witness the company investing close to Rs. 125 crores in the new product category within food space. However, I am not at liberty to discuss what specific product category we are going to start manufacturing in that location. I am personally very bullish about this category and believe that as contract manufacturers we could see some great opportunities in this category in the future as well.

In addition to these investments, we have also announced and started work in this quarter on the brownfield expansion in Hyderabad and we have also announced a new smaller CAPEX investment in our associate company ATC Beverages in Mysore. I am confident that all of this put together with the current factories should help us in achieving our turnover target of Rs. 2,000 crores by next year.

Now just before I handover the call to Mayank who will take you through the financial numbers, I just want to say that we at HFL are very excited about the future and are chalking out our plans for the next financial year and beyond. While this is work in progress, I can just tell you that the plans are quite aggressive and the opportunities are unlimited. So we are very excited about the future.

I will now handover the call to Mayank, our Group CFO who will take you through the financial numbers for the quarter and for the nine months ended December 31st, 2020.

Mayank Samdani: Good afternoon everybody. . I will go through the financial performance of the company for the quarter and 9 months ending December 2020. So first when we talk about the quarterly performance, we are very happy to share that the growth momentum in the business has sustained. Our total revenue for the quarter grew by 85% year-on-year basis to Rs. 384 crores. Our strong year-on-year revenue growth has further reinforced our strategy for decentralized manufacturing and proven the benefits of contract manufacturing.

Our EBITDA for the quarter has seen a growth of 49% year-on-year, which stood at Rs. 22.4 crores as against Rs. 15.1 crores in Q3 FY20. As Sameer indicated earlier, EBITDA margins for the quarter was impacted due to increase in the raw material prices but due to inherent strength of our business model this increase is a pass through but there is always a time lag in this process. So, we will be able to recover this erosion in margins in the coming quarters.

There are some other factors as well that has affected the margins. One of the reason was, the shoe business which was affected due to the lockdown in Europe and within the shoe business logistic cost has increased by 25% to 30% in the quarter. For the quarter, PAT has registered a growth of 97% year-on-year which stood at Rs. 12.6 crores against Rs. 6.4 crores in Q3 FY20.

PAT for the quarter includes benefit from the reversal of excess provision of tax for last year to the tune of Rs. 3.86 crores. The same has been adjusted in the quarter after filing of IT returns, Even without considering this adjustment the company has achieved the highest quarterly PAT ever. Coming to the nine month performance, our revenue has registered a 73% year-on-year growth and stood at Rs. 904 crores as against Rs. 524 crores in 9 month FY20.

Our EBITDA for nine month FY21 has seen a growth of 52% year-on-year which stood at Rs. 60 crores as against Rs. 39 crores in nine month FY20. Our PBT has registered a growth of 33% year-on-year which stood at Rs. 33 crores. Our PAT has registered the growth of 62% Year-on-Year which stood at Rs. 25.2 crores as against Rs. 15.6 crores in 9 months FY20, but PAT for nine month FY21 includes the onetime adjustment of reversal of tax.

Our net worth for the nine month FY21 stood at Rs. 213 crores. As Sameer mentioned in his speech, we are constantly investing in CAPEX. Company has invested nearly Rs. 190 crores - Rs. 200 crores in last two years. Additionally, we will be investing Rs. 250 crores in next one year for manufacturing of personal and home care products and food and beverage products. Despite investing consistently in CAPEX, our debt to equity ratio stood at Rs. 0.91x for 31st December 2020.

Further, as a result of our prudent financial practices, India Rating has recently upgraded our long term credit rating to INDA with a positive outlook. This upgrade will result in reduction of borrowing cost for the company in coming future. Nonetheless, the interest rate has already been reduced by approximately 40 to 50 basis points based on our negotiations with the banks.

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

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Anand Trivedi from Nepean Capital. Please go ahead.

Anand Trivedi: As you mentioned that the margins have come off partly because of the raw material prices going up which you passed on but not entirely, within couple of quarters that will be passed on. And then second comment which I heard was increase in logistics cost for the shoe business, if I heard that correctly.

I just want to get little more granular on that. The margins on the gross profit have gone down from 12.5% to 9% so how much of this is a function of the raw material prices which will come back in the coming quarters? It is 90% or 70% or what?

Sameer Kothari: So Anand, we will be unable to give you exact details on the cost of the raw material which gets transferred because frankly this is a specific raw material which has to do with a specific customer of ours but if you are familiar with our business model you can be rest assured that

the entire cost of any increase in the raw materials gets passed on to our principle if not in the same quarter definitely within the next quarter.

Anand Trivedi: Okay so then going forward would gross profit margin of 12%-12.5% would be a sustainable number?

Sameer Kothari: Sorry Anand, let me just address your other question. And I think that should give you some idea. So while in the dedicated manufacturing business the raw material prices are passed on with a lag effect but they are definitely passed on. In case of the shoe business that is a permanent loss that we have faced in this quarter.

However, the shoe business now accounts for a very small portion of the business. So from that perspective I can just tell you that we are quite confident that more or less whatever margin erosion you see should get recovered within a short time frame.

Anand Trivedi: The next question I have is in terms of your CAPEX, you have posted Rs. 300 crores of CAPEX which should be done by in the coming year, correct, over the next 12 months?

Sameer Kothari: Yes, around Rs. 250 crores, Anand.

Anand Trivedi: And so is that all completely funded or you need to raise any money for that?

Sameer Kothari: I think Mayank can answer that. We do not need to raise any funds but Mayank can give some more details on that.

Mayank Samdani: So Anand, we are fully funded as far as the equity is concerned. We need to raise debt, which we will do in the coming future. We are confident that internal with accruals and the equity which we raised earlier, we will be able to fund these upcoming projects.

Anand Trivedi: How much of this Rs. 250 crores will be from equity?

Sameer Kothari: The normal debt-to-equity ratio for our projects is around 75:25. So, if I have to give you as a thumb rule, we will need 25% of Rs. 250 crores as equity. It will be completely from internal accruals. So we would not be raising any equity for this.

Anand Trivedi: And I am assuming the 18% ROE model remains for this CAPEX as well?

Sameer Kothari: Yes Anand, the ROE model remains. I do not want to get into the discussion about whether it is 18% or not but yes, the model remains the same.

Moderator: Thank you. We will move on to the next question that is from the line of Himanshu Nayyar from Yes Securities. Please go ahead.

Himanshu Nayyar: So firstly, as you said that the opportunities in this business are endless, so just wanted to understand your thoughts on the client concentration. , So are we looking to get more and more business from our current top one or are two clients or are we looking to diversify our client base a little bit? And if you can share what would be our contribution to top line from the top two or three clients as well?

Sameer Kothari: Let me first address the macro question on the opportunities that we are seeing. We are seeing opportunities across the customers, across product categories and across geographies. As you are aware, Hindustan Foods has always tried to hedge by diversifying across product categories, geographies as well as customers. So today we manufacture in close to eleven locations across the country.

We manufacture products from pesticides to baby food and we work with practically all the FMCG companies in the country. So going as far as the client concentration is concerned, that for us is a moving target. What ends up happening is when a particular project or a couple of projects come online for one particular customer, obviously the concentration of that customer in the business increases.

However, the pipeline includes projects for other customers which come online over a period of time. So let us say a couple of years ago, there was a customer and who was our largest customer then and today he is our third largest customer. Similarly, a customer who was our second largest customer has become the largest customer in the last year or so.

I think this will continue for another year, where again we hope that the top line of clients will change for us. As a company and as a sales team, we frankly are, very aware and well versed with the fact that we need to manage client concentration and our sales team has the target to go out and get as much new business from new customers as they can.

Does that answer your question? I cannot give you granularity or percentages about the customer because frankly it will then get into our business models with the customer. The top 5 customers would probably account for around 70% to 80% of the business.

Himanshu Nayyar: And then secondly a related question, Sameer. So just wanted to understand your thoughts on this. On the category mix as well, so do you think in your kind of a business there is any benefit of increasing scale in the same category or the same product segments say personal care or package food etc and cater to more and more clients may be look at export opportunities as well?

Or you think there is not too much of a benefit and you can do equally good even if you are doing multiple products for the same client rather than expanding scale and getting some economies of scale on a same product like? So how does that work for you?

Sameer Kothari: So frankly that is a very interesting question, Himanshu, and as a management team we spend a lot of time trying to understand that. The way we are looking at it, for the next couple of years we have enough runway to keep growing just the way we are which means we are agnostic in terms of product categories, geographies and customer itself.

I think post that once we have achieved a reasonable size of let us say around Rs. 5,00 crores to Rs. 6,000 crores, that is when we will start looking at getting specialized within a domain and start offering contract research in addition to contract manufacturing.

So you are absolutely right that we will eventually move in to that model of offering domain expertise, contract research and specialized place within our product category but I do not see that happening for the next couple of years because frankly the industry is so nascent right now that I do not think we need to get in to that kind of a situation to be able to post further growth in terms of our numbers.

Moderator: Thank you. We will move on to the next question that is from the line of Faisal Hawa from HG Hawa & Co. Please go ahead.

Faisal Hawa: My question to you is would we be looking at acquisitions of contract manufacturers who are already supplying to these large corporates because you may get a lot of these assets at much less than book value and with the market cap at almost two times sales there is always that much more value you can create even by buying these assets at less than book value. So that is one. And secondly how do you see this entire space of this food playing out, I mean do you feel that this will dominate our revenues going forward?

Sameer Kothari: I got your first question, the second question I am going to ask you to repeat in just second but let me just talk about acquisitions. So if you have looked at us we have actually been quite open to acquisitions all through our history. In fact we have acquired a division from Hindustan Unilever, one of our largest customers and that is how we got into the shoe business.

We acquired another shoe business from a company called G Shoes and then we acquired a stake in ATC Beverages which is located in Mysore which has become our associate company and our team is now planning to do the merger for that company.

So acquisition is something that we very actively look at. You are absolutely right that we look at acquisitions in a way which will add value to the equity shareholders and to the company. I do have a difference of opinion with respect to the fact that we are quoting at two times our sales because that gives right to an arbitrage in terms of the equity value but I take your point in terms of the fact that it will be just an acquisition opportunity at book values or stressed values of our competition. We are definitely looking at such kind of opportunity. Now your second question was?

Faisal Hawa: I will just rephrase my second question. I think I did not even phrase it properly. My question is that food is a much larger opportunity and large companies like Britannia, Parle are already having a very developed contract manufacturing ecosystem. And I believe in foods because of regulatory concerns, overall there could be an opportunity to make a little better margin and the contract manufacturing ecosystem of these companies is very segmented in the sense it is like single owner or one owner owns two factories. A lot of consolidation could happen there, from which a player like us could really benefit there?

Sameer Kothari: Absolutely. So two things. You are absolutely bang on in terms of being able to identify that especially in case of segments like biscuits etc the contract manufacturing as a concept is definitely far more acceptable than in case of certain other food categories. So yes, there is huge potential there.

You are also right about huge potential for consolidation in that category because most of the competition that we have in terms of the contract manufacturing in those categories are promoters, entrepreneurs who have been able to set up one factory or two but have not been able to scale up and that is something that we bring to the table and that is something which we can definitely leverage upon.

So absolutely I agree with you. Having said that, let me also add that as a company and at least for the next couple of years we continue to be agnostic in terms of the category of the product itself because the way our model is, the margins especially in case of the dedicated manufacturing model is same irrespective of the product category. So whether we manufacture pesticides or whether we manufacture foods the amount of money that we stand to make from our factory would technically remain the same. So we are open to manufacturing anything, Faisal.

Faisal Hawa: So this gross block of Rs. 250 crores which we are planning in the next one or two years this would result in a sale of potentially another Rs. 1,000 crores?

Sameer Kothari: Okay so I cannot give you the exact numbers. I can just tell you that for first Rs. 250 crores the timeline is not one or two years, it is actually just about a year. And in terms of our asset turnsI can just give you a thumb rule that we should be able to do between 3x and 4x of assets.

Faisal Hawa: So is it Rs. 250 crores or Rs. 450 crores?

Sameer Kothari: Once the factory has ramped up to its peak we should be able to do an asset turn of 3x to 4x.

Faisal Hawa: So the gross block that you are planning it is Rs. 250 crores or Rs. 450 crores?

Sameer Kothari: Rs. 350 crores is our current gross block. Rs. 250 crores is the CAPEX that we have already announced.

Moderator: Thank you. We will move on to the next question, which is from the line of Nikhil from Perpetual Investment Advisors. Please go ahead.

Nikhil: I have two questions. So when do we see ATC Beverages stop bleeding on a quarterly basis and start contributing positively? I understand that last summer was not good because of the lockdown but do we have any good plans here?

Sameer Kothari: Nikhil, you have touched a wrong number. The logic of acquiring ATC Beverages included a couple of things and one of them is that it has a guaranteed supply of water from the Government of Karnataka which is an asset, which we believe going ahead will be very important. You are absolutely right that we could have performed better in ATC than what we have. Last summer season was a complete washout because of Covid. This season as you know we are currently making only beverages there.

This season is shaping up to be all right but again with the Covid situation what is happening is that the consumer behavior as far as cold drinks is concerned is changing a bit. So for example people are still avoiding to have a cold drink because they think they will get a sore throat or they will get a cough or cold and that is really affecting the take-off from ATC Beverages.

As management what we have done is after having gotten beaten twice for two years already we have decided to hedge our bet in ATC. We have actually started building another factory in the same campus which is going to be shared facility for a different product category all together.

So we hope that ATC Beverages will start producing other product categories as well at least by Q3 of the coming financial year and that should then hedge against the vagaries of the beverage business. Hope that answer your question.

Nikhil: Yes. Just one follow up. So what will be the quantum of CAPEX and may be you have already given us an idea about the asset turns in that and what percentage of the land bank at the plant is currently used? I mean your presentation says that the land bank is around 15.5 acres?

Sameer Kothari: Correct. So ATC Beverages has around 15.5 acres. It has a short water supply of around 250 KL. We are currently building a factory of around 35,000 square feet but in terms of the availability of open space I think we can expand at least 10 times more there.

Moderator: Thank you. We will move on to the next question that is from the line of Nishit Shah from Nepean Capital. Please go ahead.

Nishit Shah: My questions were answered.

Moderator: Thank you. The next question is from the line of Vinod Malviya from Union Mutual Fund. Please go ahead.

Vinod Malviya: Just one question from my end. I appreciate your outlook on the longer term strategies for the revenue growth but can you just give some kind of numbers like historically majority of your growth has come from acquisitions from the promoters as well as some of the inorganic growth which we have done. Moving forward beyond FY22 what kind of a revenue growth you are internally working with? If you can share some thought on that, it would be very helpful?

Sameer Kothari: So Vinod, one is that historically when you say that we have grown through acquisitions and through promoter consolidation that is partly true and partly not. The large part of the growth has come in through new CAPEX. I think we have invested a little more than Rs. 200 crores in the last couple of years and Mayank can give the exact number. Secondly, when we look at the end of this financial year or rather by August when we expect to have merged our malt beverage unit in Coimbatore and ATC Beverages subject to the NCLT permissions nearly 90% of the promoter business would have already been consolidated.

So going ahead I do not think the growth is going to come in form of consolidation from the promoter business. However, we are very confident about the growth in spite of the fact that it is not going to come in from projects or factories that we already have and that is because of a lot of visibility that we have in terms of the projects that we are working on. I think in the next six months or may be like four months we will have better details on it. We will definitely try and give more granularity in terms of our expansion plans for the financial year 2023 onwards may be in our next investor call or in the annual report.

But for FY22 you know that we have already given out our guidance and we are quite confident that we should be able to meet that and for FY23 it is looking good as well.

Vinod Malviya: The reason I was emphasizing more on FY23 is because generally if you have to grow organically going for a brownfield expansion or Greenfield expansion it will take at least six to nine months for the new plant or new capacity to come on stream. So for a new revenue which has to come from FY23 you should at least start now so that the you have the plant on stream by end of FY22 and start contributing to the revenue. As of now what I know is that there is one facility being set up in Hyderabad from Q2 and there is another facility in the North India, UP facility which has already been taken into consideration for majority of your FY22 revenue except for the UP facility.

So ideally you are going to have much visibility in terms of FY23 what kind of a revenue as a company you would be able to deliver. So I was just emphasizing more on FY23 numbers so what will be the likely growth rate?

Sameer Kothari: Okay happy to give you some granularity on that, Vinod. So if you look at our last quarter turnover it was around Rs. 380 crores and the quarter before that was I think around Rs. 320 crores as well. So if you look at our run rate even at a Rs. 350 crores level we are already at a run rate of around Rs. 1,300 crores to Rs. 1,400 crores as far as annual figures is concerned. So

when we are talking of the Rs. 2,000 crores turnover next year it actually does not take into consideration full running of the CAPEX that we have already announced.

So the current new CAPEX that we have announced which is to the tune of Rs. 250 crores will add to revenues beyond FY22 as well because what it will do is it will come in, in FY22 and it will ramp up beyond a certain time and contribute completely in FY23. So part of the growth will come in from the existing CAPEX that we have announced and other will come from new projects, new pipeline discussions that we are having which as I said we are not at a liberty to discuss right now, may be in the next three or four months we will give you more details about FY23.

Vinod Malviya: And can you just provide some timeline with respect to the completion of merger of these two entities?

Mayank Samdani: We have filed our application with NCLT and we are awaiting the approval. There is definitely a procedural delay at the NCLT but we will try to do it by August actually.

Vinod Malviya: Okay so it is only a regulatory delay nothing delayed from our side or the company side?

Mayank Samdani: No, nothing. So we filed this application in NCLT in October. The order is still not received from them. Once the order is received, we will have to do the EGM and all those things. There is nothing apart from the process delay that is holding it up.

Sameer Kothari: As you can imagine, Vinod, because of the Covid the courts are also not functioning completely at their full strength and unfortunately we have been a casualty of that.

Moderator: Thank you. The next question is from the line of Ankit Agarwal from ARC Capital. Please go ahead.

Ankit Agarwal: So you have been growing exponentially for the past few quarters. So can we expect this growth part to continue for the next few years?

Sameer Kothari: Ankit, you are sounding like my Board of Directors now. They are also asking me the same question and my answer is yes.

Ankit Agarwal: So I mean how are we going to maintain this growth sir, you have any plans for that?

Sameer Kothari: So Ankit, like I mentioned in answer to the previous question and like we have tried to elaborate in the investor presentation and all the press releases, we are going in for a substantial CAPEX. Like I said we are investing closer to Rs. 250 crores over the next one year.

In addition to that our sales team is out there working, trying to get new projects, trying to set up new customers etc. And I think all I can say is I am reasonably confident about growth. We

will see how much we are able to deliver but let us say that all of us here are working towards it.

Ankit Agarwal: Okay sir, with this investment in the CAPEX how do we see the balance sheet evolve over the years?

Mayank Samdani: So Ankit, we have a current debt-equity ratio of 0.91. Because the new capex will entail a new debt as we have indicated hat we will have the 75:25 ratio of debt versus equity for the new project. So right now we have Rs. 220 crores of equity and Rs. 200 crores of debt. That will change accordingly.

Ankit Agarwal: And some questions regarding the order book. So what is the current order book for the company under the different segments?

Sameer Kothari: Ankit, we have kind of indicated that we should be able to do Rs. 2,000 crores by FY22 for an annual figure. So basically that is the number we are shooting for.

Ankit Agarwal: And sir, okay you have new CAPEX coming online and so sir, from the existing capacity what is the optimal capacity utilization that we can expect from the existing facilities?

Sameer Kothari: Ankit, so for us in case of dedicated manufacturing capacity utilization is actually a wrong indicator because for us in terms of dedicated manufacturing it is a take or pay contract. So as a result we do not have any operating leverage. Once the capacity is ramped up we manufacture at that capacity for the next 5, 7, 10 years whatever the contract is.

The ramping up generally takes between 3 months to 6 months and like Vinod was saying earlier about the new unit with gestation period from the time we do ground breaking to actual production is between 9 months to a year. So within that timeline is what we ramp up from ground breaking to full capacity utilization. Post that it is constant for the next 5, 7, 10 years whatever the contract is.

Moderator: Thank you. The next question is from the line of Sagarika Mukherjee from Elara Capital. Please go ahead.

Sagarika Mukherjee: Sir, in your current revenue mix or let us say your revenue mix in the forthcoming future in the next three years will it be more HPC or will it be more foods? That is my first question.

Sameer Kothari: Sorry can you repeat your question?

Sagarika Mukherjee: Sir, in your current revenue mix which is today let us say your HPC versus foods if you could give the break up and how does it look in the next couple of years? Let us say after you are ramping up of the UP plant etc for foods?

Sameer Kothari: So Sagarika, we actually do not maintain segments wise accounts and as I have been at pains to explain even earlier. We are quite agnostic as far as product categories are concerned. So we are indifferenent between home care, personal care as well as foods especially because in case of dedicated facilities our business model is the same irrespective of the product category.

In terms of our wish list for our domain like I said we concentrate more on hedging the best against the customers. We want more customers, we want to diversify our customer base, we want to diversify our product categories and geographies. But like I said we do not look at it as HPC or Foods. We are happy to manufacture foods, we are happy to manufacture pesticides, we are happy to manufacture toilet cleaners.

Sagarika Mukherjee: So just in general wanted to understand then let us say your margins or your profitability in a dedicated manufacturing versus a non-dedicated manufacturing in which case will it be higher and what is the mix today in terms of your capacity in the two things like one dedicated and the other one which is not dedicated?

Sameer Kothari: So the dedicated manufacturing is accounting for close to 80%, 85% of our business. The margin profile when you look at it as a percentage of sales is better in case of shared facilities and private labeling and lower for dedicated manufacturing. That is in consensus with the fact that in case of dedicated manufacturing we do not take on any risks either in terms of operating leverage or in terms of working capital and inventory obsolescence. However, in case of shared facilities we take on the risk of operating leverage and in case of private labeling we also take on some risks of inventory obsolescence.

Sagarika Mukherjee: So the forthcoming Rs. 250 crores of CAPEX you would say it is dedicated or non-dedicated in nature?

Sameer Kothari: 90% of it is dedicated. The small part of it which is coming up in Mysore is a shared facility.

Sagarika Mukherjee: And sir, over the years you have had a very great transition in terms of adding product categories, amazing set of clients that you have across categories in India generally. But would you say that over the years you have added more work from the same client or has it been like a new client getting added for new categories also?

Sameer Kothari: Sagarika, we would like to say both. So we continue to work with new customers but we also continue to increase wallet share within our existing customer base. So frankly I would not be in a position to tell you which has worked better for us. We have done both of it.

Sagarika Mukherjee: And sir, this whole guidance that you are giving today your margins have squeezed because of the inflation have been abnormally high for the whole industry and hence passing on of these things have been slightly tough for everybody actually. But then the outlook that you have that your margins will stabilize again it come from what kind of comfort that you are getting from

your clients I mean how should your margins have increased is it just the reversal of the commodity prices which we are expecting or is it something else?

Sameer Kothari: Sagarika, our business model is such that our margins are protected by virtue of a contract. So as a result the raw material prices frankly even if they start becoming benign or even if it go down the benefit goes back to the customers. Our margins are protected upwards as well as downwards.

Sagarika Mukherjee: So then why should your margins declined this time then?

Sameer Kothari: That is like Mayank was explaining earlier, there is a time lag and what I was explaining to Anand in his first question was that we are very confident that this margin erosion will get recovered within the next couple of quarters in absolute sum as well as in terms of percentage.

Sagarika Mukherjee: So sir, I was just trying to understand let us say today your margins are at 9%, gross margin is 9% or 9.5% then do you expect it to go up something like 13%, 14% so that you can say over a period of time your margins remains stable but if it just goes back to 12% you are just back to normal you have not really recovered the losses that you had in this short period of time?

Sameer Kothari: I mean in terms of our margins whatever our historical performance is that should be the way the margins should be. As far as this particular quarter is concerned it was a little bit of an abnormality which is why we as the management team decided to flag it off. Going ahead we expect it to normalize again to the levels that it was in the past.

Moderator: Thank you. The next question is from the line of Vinod Jayaram from Composite Investments. Please go ahead.

Vinod Jayaram: Sir, you have been experiencing tremendous growth during the last few quarters what I want to understand was is it just you that is growing or is it a general trend of increased outsourcing of manufacturing within the FMCG industry and if it is the later could you talk about the reason supporting the growth….

Sameer Kothari: We have been fortunate on both accounts. A part of the growth I would like to say is because of our efforts and obviously we would like to claim some credit for it but yes you are absolutely right that we are also fortunate to be in an Industry at a time where it is growing disproportionately.

We have explained this in our investor presentation and in our annual reports etc that because of certain macro changes, the bigger ones being GST, change in the distribution networks of the FMCG companies, we have seen some huge tailwinds which is helping the contract manufacturing space.

I am happy to take you to through that thesis but like I said a lot of it has been explained in our investor presentation and I will just broadly touch up on it without getting in to too much details. Broadly what is happening is decentralization of manufacturing in FMCG is becoming a thing because of GST because of the fact that the distribution network is becoming more and more modern trade and e-commerce and all of this is leading to demand for new factories. The COVID in the last six months has further accelerated this process because people realized in those six months that supply chains were very, very delicate.

I am sure you are aware that when the lockdowns were announced there were stores which were running out of even basic staples etc and FMCG companies have realized that they need to have a far more decentralized supply chains. It does not make sense to manufacture a product in Himachal or in Baddi and then ship it all the way to Pondicherry. Now they would much rather have a factory closer to the market. So contract manufacturing is gaining because of this decentralization. You have seen this frankly not only in our industry but also you are seeing contract manufacturing increase in terms of its importance even in other categories like electronics etc.

So frankly we have been blessed to be in an industry which is growing and within the FMCG industry I think we can humbly say that we are the largest contract manufactures in this industry and we are pretty much the go to for all FMCG brands who are looking at contract manufacturing.

Vinod Jayaram: And you had also mentioned in one of the previous con calls about going forward at a later stage you would also look at putting in the R&D efforts in terms of developing the products. So where do we stand on that, is it still early to talk about it or are you already planning on that front?

Sameer Kothari: So we do some very, basic level of R&D. Since we have last spoken we have launched I think around 20 private label products for various customers, various small brands, various D2C brands. However, I would hate to say that we are doing our cutting edge R&D I think that is at least two to three years away, Vinod.

Vinod Jayaram: And lastly would you be able to talk about the revenue concentration in terms of how much does your top client contribute or probably top five or ten clients and also how many clients do we have and how many have you been able to add in the last one or two years now?

Sameer Kothari: So we actually work with most of the FMCG companies in the country. However, we are unable to give out client wise business percentages but just at a very top level around the top five customers will constitute around 70% to 80% of our business.

Vinod Jayaram: Okay and approximately how many clients would we be dealing with?

Sameer Kothari: Vinod, so when you come to private labels we work with many D2C brands and our count for these clients would be like more than 50.

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

Nikhil: Just a small follow up. So I think that looking at your business from a margin point of view does not make sense. So rather if I can ask you that the current ROCE of the business is around 18% to 20%. By when can we start seeing the incremental ROCE to be higher than the current one?

I mean I can just think of three reasons where this starts moving up. One is like you already spoke about that currently you are a CMO or a CDMO and you will start sitting towards more on the CRAM side of the business. The other is higher share from shared facilities and do you have any plans for backward integration may be into agrochemicals or something like that?

Sameer Kothari: Okay Nikhil, bang on. Frankly you haver already laid out the answer to your question. So let me just talk about the second part of your question about what we intent to do about the ROCE. So you are absolutely right. Shared facilities is something which will give a huge sweetener as far as the ROCE is concerned. We definitely believe that our shared facilities will be our go to business model in the future.

However, I think for the next couple of years what we intent to concentrate on is building more dedicated facilities having more assets on the ground. If we have to invest the kind of money that we are investing, we obviously cannot and do not want to allocate capital for shared facilities because they come with an inherent risk which the dedicated model does not.

So when we are talking of investing Rs. 200 crores to Rs. 250 crores in a site, we obviously would like to do that on the back of a very tight contract. So for the immediate future you are absolutely right, private labeling which is the CDMO part the shared facilities will be the way to increase our ROCE. The other thing that we do to is to try and increase our ROCE's is basically the Mayank's area of treasury and Ganesh's area, where the operations try to add some benefit in terms of operating leverages and efficiencies.

Nikhil: And do you have any plans for backward integration?

Sameer Kothari: Yes, I forgot about that. Nikhil, not right now. I think we have got our plates full and we see enough pipeline to keep ourselves busy for the next couple of years at least and to be able to post the kind of growth that we are doing. If we find that growth beginning to taper off or we find that we have more time and money to do stuff we will look at that but currently, no.

Nikhil: Any indicative range of where the ROCE can be may be 5 years from now?

Sameer Kothari: Nikhil, we cannot get that. I mean I have no idea of myself.

Moderator: Thank you. The next question is from the line of Amit from Worlds Food LLP. Please go ahead.

Amit: My question was why are not these companies setting up their own plants with India's young population and so much consumption is driving why are they shying away from setting their own factories?

Sameer Kothari: Amit, I think that is a perfect question to end the investor call. That goes right to the genesis of why we are here. So if you follow our company or if you were there in the investor call last time or if you have read any of our annual reports the classic question is why do people contract manufacture. And the question is the same that you would ask Apple about why do they not manufacture their phones or why do they outsource everything to Foxconn or to Wistron etc.

I think in terms of contract manufacturing what people have realized is that everybody would like to specialize in what they do. So Apple would like to specialize in terms of innovation, branding, marketing etc while Foxconn can specialize in terms of manufacturing. The same thing is happening in FMCG and I will just elaborate on this in two ways. One is the established brands, the bigger brands are realizing that the marketing landscape and the competitive landscape is changing because of the entry of new brands, because of the entry of new distribution networks.

So they want to concentrate on the marketing, branding and the distribution. They have realized that manufacturing is not the value add and they are happy to outsource it. Then you come to the second players or the second chunk of brands which are the D2C brands. The D2C brands or the start ups are frankly not interested in manufacturing any way because they have realized that capital is scarce and we would much rather invest that capital in building brand, marketing and distribution capabilities.

So both of these players, at the top end of the established players as well as the bottom end of the new players are beginning to look at contract manufacturing more and more than looking at setting up their own manufacturing. There was a time when they were doing more in-house manufacturing and that was more because of certain tax breaks that companies got.

I have got in to detail in this in both the investor presentation as well as the annual reports. Happy to get into those details separately because that is the entire thesis about our company. We exist because we strongly believe that contract manufacturing will be the way going ahead.

Amit: And would we see Hindustan Foods build its own brand in few years or we will only remain a contract manufacturer?

Sameer Kothari: Not till the current management is in place. I do not think we will get into the branding but never say never they might fire me and bring in a new managing director who is more into branding and marketing.

Moderator: Thank you. Ladies and gentlemen, due to time constraints, that was our last question. I now hand over the Conference over to Mr. Vimal Solanki, Head-Emerging Business & Corporate Communications, Hindustan Foods Limited for his closing comments.

Vimal Solanki: Thank you so much. So the demand for contract manufacturing in the FMCG industry has been and continues to grow and we at HFL are in continuous discussions for new projects with our existing as well as new customers. Very recently we announced a CAPEX of Rs. 125 crores in the North India. This is on the back of the Rs. 150 crores that we have already announced earlier. We keep looking forward to more such projects in the near future.

As on date, we are confident of achieving our goal of revenue of Rs. 2,000 crores in FY22. I take this opportunity to thank everyone for joining on this call. I hope we have been able to address all your queries. In case you need any more information please get in touch with us or our investor relations advisors that is Strategic Growth Advisors or SGA. Thank you all and wishing everyone a successful last quarter for this financial year. Stay healthy, stay safe.

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

Disclaimer: *The Transcript has been edited to remove and / or correct any grammatical inaccuracies or inconsistencies of English Language that might have occurred inadvertently while speaking.*