Godrej Agrovet Limited

Q2 &H1 FY19 Earnings Conference Call
November 06, 2018

Moderator: Ladies and gentlemen, good day and welcome to the Godrej Agrovet Limited Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I now like to hand the conference over to Mr. Anoop Poojari from CDR India. Thank you and over to you, sir.

Anoop Poojari: Thank you. Good evening everyone and thank you for joining us on Godrej Agrovet Q2 & H1FY19 Earnings Conference Call. We have with us Mr. Balram S. Yadav – Managing Director and Mr. S Varadaraj – Chief Financial Officer of the company.

We will like to begin the call with brief opening remarks from Balram S. Yadav, following which we will have the forum opened for an interactive question and answer session. Before we start, I would like to point out that some statements made in today's call may be forward looking and a disclaimer to this effect has been included in the earnings presentation shared with you earlier.

I would now like to invite Mr. Balram S. Yadav to make the initial remarks.

Balram S. Yadav: Thank you Anoop. Good evening everyone. I welcome you all to the Godrej Agrovet Conference Call to discuss the operating and financial performance for the second quarter and first half of the financial year 2018-19. I shall take you through the summary of our results followed by key developments and operational highlights for each of our businesses.

For second quarter of 2019, our consolidated total income was 1,622 crore compared to 1,434 crore in the corresponding quarter of the previous year registering a growth of 13.1%. Consolidated profit before taxes was Rs.144 crore compared to Rs.122 crore reported during the same period last year. Similarly, for the first half of the year consolidated total income was Rs.3,110 crore compared to Rs.2,806 crore in the corresponding period of the previous year which is a growth of 10.9%. Profit before taxes was Rs.265 crore registering a growth of 13.7%. Please note that second quarter and first half of the current year includes nonrecurring income of Rs.29.9 crore earned on the sale of land which is included in the other income.

Now I will discuss the performance of each business segment:

In the animal feed business, we continue to enjoy strong growth with volumes growing at 16% during the quarter driven by broiler and layer feed segment. Strong volume growth also resulted in revenue growth of 15%. However, segments results during quarter were lower than last year due to decline in profitability in the aqua feed segment which was adversely impacted by challenges being faced by the industry.

In the palm oil segment, there was a postponement of the season leading to decline in FFB arrival during the second quarter. This adversely impacted revenues and profitability levels, but it is expected to lead in higher FFB volume arrival in coming month compared to last year. We have already seen that happening in October 2018. This should lead to better sales and profitably for the segment in the coming month.

In the crop protection business, standalone segment revenues and profit grew by 25.3% and 19.6% respectively. In terms of product category, insecticides and plant growth regulator posted strong growth during quarter and also for first half of the year. Our new product launches also contributed to revenues and profitability.

In our subsidiary Astec Lifesciences we had a strong revenue and profitably growth during this second quarter of the year, especially in exports. Further scheme of amalgamating Astec Lifesciences with Godrej Agrovet has been approved by the board of directors of both the companies in September 2018 and necessary formalities of the process are expected to be completed as stipulated.

Creamline Dairy Product Limited, another subsidiary of GAVL recorded a revenue of Rs.300 crore in second quarter of current year compared to Rs.293 crore recorded in the same period last year. However, the profitability of the business was impacted by high provisioning costs/losses of around Rs.12 crore incurred during the first half of the year due to low butter prices. We expect situation to improve from current quarter onwards as butter stocks has significantly reduced. Also, value-added products form around 25% of revenue in the first half. We have launched new products like thick shake, flavored yogurts and premium ice creams during first half to increase our product offering in this segment.

In our poultry joint venture, Godrej Tyson Food Limited revenue grew by 13.7% in the quarter aided by improving sales in the Yummiez business and in the live bird business. Further, Godrej Tyson also launched Yummiez Royale product range in the second quarter of the year.

GAVL's another joint venture in Bangladesh ACI Godrej recorded revenues of Rs.196 crore in the quarter compared to Rs.200 crore in the previous year. This was due to decline in volume in aqua and the broiler feed segment.

With this, I conclude our business and financial performance update for the quarter and first half of the year. We will now be happy to your questions. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-answer session. We take the first question from the line of Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: My question is basically regarding the working capital front. If I notice the balance sheet we are seeing a higher receivable intensity in the first half versus what was there in March and may even in the same period prior year, but overall working capital has been well managed because payable has also moved up. So just wanted to basically understand if you can give us some color on this. Secondly, also on the perspective of debt because the consolidated debt is around 400+ crore, how do you see that shaping up going forward?

S Varadaraj: There is increase in receivable during H1 is primarily driven by two of our businesses- the crop protection business and the aqua feed business. The crop protection industry has been facing the challenges in terms of cash flow because of the drought like situations which is prevailing in the country. We are quite hopeful of recovering good amount of money from the receivables during the second half of the year. Typically, the crop protection business is a cyclical business where the first half is where the sales happen, and second half is where the collections happen. So, we are hoping to recover good amount of receivable during the second half. On an overall debt situation as you rightly pointed out we are on a consolidated basis of (+400) crore as of H1. We hope to reduce this by at least 200 crore during H2.

Kashyap Pujara: If I look at capital intensity of the animal feed business, I understand that there has been a margin compression because of aqua, but despite of higher top line growth of 15%, 16% in terms of volume we have actually substantially shrunk the capital employed in that business, so what is your thought there and given that H2 is more relevant for a feed business because H2 even last year we did significantly higher profit in H2 versus H1 and I do not see any reason why this year we should not follow. So, which means that my ROCE by the looks of it actually looks like we are at 80% or there about to end of year if this capital intensity were to remain?

S Varadaraj: You are right in terms of our capital employed is not expected to go up in H2 in the animal feed business. It would be remaining at similar level and with the capital employed remaining at this lower level and the profitability sort of growing up during the H2, which has trend has been for animal feed business, the ROCE will definitely sort of look good.

Kashyap Pujara: Just one question regarding animal feed margin- could you basically give your sense on outlook of the aqua side of the business because the fish meal prices have surely shot up and the shrimp seems to be weak at the end product price, so what is the new norm and do we expect a situation to reverse and go back to what used to be a low fish meal price and high shrimp price scenario or do we basically get adjusted to the new norm. Secondly what if we disregard the current quarter and if one were to look at sustainable volume trajectory over the next two, three years what is the trajectory we can look at especially that some of the cost initiative that we have done are still to bear fruits, so how do we look at this?

Balram S. Yadav: Let me break aqua feed into two parts. Our fish feed volumes are growing and fish feed profitability is also not bad and likely to improve further when the prices of raw material come down in a week or so. This is one segment where the CAGR of about 10% to 12% plus is possible for next three to five years easily. Our big problem continuous to be the Shrimp feed where we are a small player, which is point number one. Point number two is that, in spite of cost increases in last few months we could not take a price increase because the shrimp price has crashed. And that situation is now slowly getting reversed, but this being off- season we may only come to know this sometime in mid-February onwards when the season starts. On consolidated animal feed business, I can say in Q3 and Q4 the profitability will start going up, but we do not want to compromise the volume growth which is very critical as scale determines cost leadership and profitability in this business and we still want to work on building scale in this business for at least a few more quarters. Having said that my sense is overall feed business a 12% to 14% CAGR in volume is something which we are very comfortable with.

Moderator: The next question is from the line of Prakash Kapadia from Anived Portfolio Managers. Please go ahead.

Prakash Kapadia: If I look at other income it has the sale of land, if I we were to exclude this there has been no growth in PAT in H1 you did mention about dairy suffering a mark-to-market loss of about 12 crore, any other one-off or specific cost which has affected profitability in H1, if you could highlight some one-off or something else which is not declared?

Balram S. Yadav: Dairy hit is one-off now that has corrected, and we can see total reversal of situation in October already. The other one-off was I think, after very long time we saw such bad situation in Shrimp feed which is not likely to repeat because it was bad for a few months and it corrected but it is already off-season. The oil palm business there is deferment of oil palm season and some part of the oil palm season is spread over to October and November. That is some feedback because unfortunately if you have to really look at each of the segment, there are these seasonal variations, sometimes postponements, so some of the profitability flows.

Prakash Kapadia: And this palm oil seasonality you obviously mentioned in the opening comments and you mentioned in the PPT also, so how does this get deferred is it from the government side or is it ageing?

Balram S. Yadav: We have been in business for 20 years. The graph of production has not been same for any year. So, I am saying we do budgeting based on an average for example we say 13% of annual crude will come in the month of September, but sometimes it is 12%, 11% or 14%. So, it depends on various factors and one of the big factors is water and humidity. I think if the monsoon is very good then the pattern which is very high production in the first half happens. If the monsoon is not very good these take another one or two months to complete their whole production. So, already if you ask me, what we have budgeted in October fruits were almost 25% more than the budgeted level.

Prakash Kapadia: You mentioned about dairy value-added products being 25% so how concentrated is it in terms of key products like say ghee, lassi or a curd and what are the plans to increase that and what is the new product pipeline here?

Balram S. Yadav: So, let me make a disclosure here. The disclosure is that by definition even the bulk ghee being sold has been clubbed into the value-added products. If you ask me the branded value-added products which we sell are close to about 20% salience. So, that salience is critical because there the contribution is protected. I would say this salience, our target was to take it to about 24%, 25% this year and we are quite hopeful the way the next few months are shaping with the launch of flavored milk and the ice cream and the season is yet to come I think this will eventually happen.

Prakash Kapadia: And lastly from my side, if we look at media report, if we look at agriculture outlook, it has been month into Kharif arrival and you read about cereals, pulses, oil seed most of them seem to be selling below MSP in Mandis and even the government has been talking about price support, price deficiency and procurement by private players, so somehow that does not seems to be working in this context. What does the remainder of the year look like, next few quarters look like, and what is the risk to earnings because of this?

Balram S. Yadav: So, the issue is that it is really going a bumper Kharif and no government whether it is state or central and no initiative will be able to procure whatever this country produce in Kharif. So, point is part of it will be produced and part of it will be traded below MSP that is going to happen. The positive spinoff of that which is likely to happen is that the animal feed raw material has already started falling and we believe animal feed profitability will jump significantly in the coming weeks so this is the positive. The second thing which is bothering us a little is that in case it trades below MSP then the farmers will get lower income as compared to what they expected and that might hurt us in the next seasons when the season in agro chemical comes, but let us see because one of these things which is also likely to happen which we are seeing is that because of dollar appreciation exports have become expensive.For example corn, everybody thought that prices will collapse and it will be traded below MSP. Suddenly the corn arrival season and corn is firming up and the reason is rupee depreciation and a little bit of less rain in the last few weeks which resulted in lower grain in corn. You know these kind of things which we will come to know when the harvested product comes into the market.

Moderator: The Ashutosh Shirwaikar from Quantum Mutual fund. Please go ahead.

Ashutosh Shirwaikar: My question is not specific to this quarter, but I had a question on your historical balance sheet. I just thought I will take this opportunity to put this question through, so your trade receivable in 2016-17 it shows that it includes some acceptance which led to its shooting up as compared to 2015-16. Was it purely because of some reporting issue?

S Varadaraj: When we moved to IndAS, at that point there was some reclassification which happened in terms of the acceptances so that is the reason why that kind of aberration was there.

Moderator: The next question is from the line of Aniruddha Joshi from ICICI Securities. Please go ahead.

Aniruddha Joshi: So, just two questions- one in case of dairy business we have seen due to lower milk procurement prices almost all dairy companies are reporting very strong expansion in margins, whereas we are yet to see some expansion in margin also compared to the peers which enjoy margins in the range of maybe 6% to 9%. Creamline's margins are significantly lower so if you look at the acquisition price that we paid and the current profitability somehow the ROE on that investment is still not looking upwards of maybe 13%, 14% that is cost of capital. So how do you see the profitability moving and how do we see around 13%, 14% ROE on our investment in creamline that is question one. And secondly in case of animal feed do we work with any target margin in mind that we will not allow the margin to go below maybe 5% or 6% and we will not also allow it to go beyond 8% so if it goes beyond 8% we will cut prices if it goes below 5% we will raise prices because I guess you said the prices almost on a monthly basis looking at the input prices?

Balram S. Yadav: Answer one is that you are absolutely spot on that our profitability is not at par with rest of the industry there were several reasons for it. The first reason is that the salience of value-added products is extremely low if you see it is sub 20% if you exclude the bulk product which we sell at a loss so that is point number one. Point number two is that buffalo milk constituted a large portion of our procurement almost 60% was buffalo milk and that is what got us into trouble when the glut came because we were left with more than 2000 tons of buffalo butter and because of the glut there was no takers for that and the prices were almost 30%, 40% below cost of production. However, all these corrections have been made we also made investments in producing value-added products like thick shakes, flavored milk and ice cream, etc. And we believe that in the coming months when these products have been launched, when the volumes of these product pick up, we will see improvement in margin and a glimpse of that we saw in October already.

Point number three- in the animal feed business yes, at one time we used to work on the formula which you said that on cost plus basis we will work at this kind of a profitability and profitability was not in percent, but in rupees per ton because raw materials can go up and down and then the percentage will not stand because corn and soya can go up and down and suddenly percentages will look different so it was as rupees per ton, but the intensity of competition increase and we also realize that instead of competing with one dozen people we are competing with at least 5, 6 dozens competitors in different market. So, what we did was that we now set our prices based on the local competition and we have divided the whole country in almost 80 zones and we compete with them tooth and nail in those zones and since growth of volume for is the problem. If you see from FY13-14 onwards to about FT16-17 onwards, we grew at about 2%, 3% CAGR in volumes and we said that we have to break out of all these and we said that we will sacrifice a little bit of margin for a few quarters, but get the growth back because scale is a great determent of cost leadership in this business and we wanted to achieve a scale because we had already made significant investment in plant in these business.

So, all these things have played out in last five, six quarters. We have maintained an upwards of 15% volume growth in these quarters. We have also retained number one position in cattle feed at least in two states which we have lost during those two years. I am saying that the strategy is in place, the action is in place, the execution is happening. So, our first target is to stabilize the volume growth at about 15% or so and I am very sure that once this happen capacity utilization go up and you will see margin also expanding in next few quarters starting from the current quarter.

Aniruddha Joshi: Can we say that we have maybe lost 100 to 150 bps but we have got the 15% volume growth rolling now?

Balram S. Yadav: So, your first six month this year the volume growth is 19.5% which we have never had in any of the years. So, I am saying there are several parts of the strategy which are working. The only thing is that we thought that we will reach a critical mass and then we will expand margins through our R&D, through cost reduction initiatives, we hired consultants also last year to look at our costs and they also reduce certain costs. So, I think we just want one of the things is that we have about 1.4 tons production and we have 2.3 million ton installed capacity and this kind of capacity can be very costly in low margin business. So, our effort is to get to about 70% capacity utilization by FY20 and I am very sure that once this happened cost leadership will come then I think we get into virtual cycle as far as margin expansion is concerned. Having said that because of raw material prices going down product salience changing, you will see that uptick from this quarter onwards.

Aniruddha Joshi: Last question from my side, what will be our direct procurement of milk versus the procurement from the agents in diary business?

Balram S. Yadav: When we took over this business it was almost 0% today. Today out of about 650,000 liters of milk about 100,000 has become direct procurement. Having said that, the price wise is there is no difference, but there are other benefits like quality and I would say reliable supplies.

Moderator: The next question is from the line of Rishabh Bothra from ShareKhan. Please go ahead.

Rishabh Bothra: I just wanted to understand slightly in detail, you mentioned that in animal feed business the margins will grow going forward next quarter onwards on account of input cost reduction. However, there will be higher volume growth which will continue and we may not take price hike so just wanted to understand by when we will be taking price hike and achieve a certain scaling size?

Balram S. Yadav: So, price hike is a function of raw material prices also and most of the raw materials which are used in animal feed are grown in Kharif. Now the corn has started arriving, soya meal has started arriving, Paddy has started arriving, now rice barn extraction will start arriving, all the extraction will start coming. So, this is the season where we seldom see price increases in raw material, we will see rather price decreases. It is only in say February, March when the off-seasons start the prices start increasing.

So, that is the time probably when you see price increases but let me also tell you in case we hold the prices we are very sure that there will be sharp uptick in our margins.

Rishabh Bothra: And in plantation we always hear that this is a fixed margin business so why there is huge volatility you mentioned in your statement that the shift of season this time margin has contracted significantly?

Balram S. Yadav: I am saying once you see the annual number you will see that because there is a significant shift in production which has gone into Q3 which was not the case in past several years, because the decrease are little bit unpredictable. However, we have so much of data now, that unpredictability is coming down, but still we feel that every few years this production pattern changes, and let me also repeat that the changes based on last few years if we had to produce x tons of fruit in October we have produced 1.3x. Now this kind of variation is a huge variation but having said we produced about 0.9 times what we should have produced in Q2. So, there is shifting of volumes which keeps on happening, but tree is very forgiving and tree will deliver whatever volume it has to deliver it may take a little more time.

Rishabh Bothra: And dairy business you mentioned that since we have a higher provisioning and butter prices were soft, can we have the volume growth details because it should be scaling up rapidly and management would also be eager to analyze margin in this business?

Balram S. Yadav: We can give those volume growth details offline.

Rishabh Bothra: And sir on the Astec LifeSciences business, once the merger takes place any cost synergies do we foresee and how R&D and product launches will be there?

Balaram S. Yadav: Cost synergy is not very significant the very purpose of this merger is to support rapid expansion of the Astec LifeSciences. One of the key points of Astec LifeSciences which is very different from our rest of the business is that for every rupee growth we need about 75 paisa investment in fixed and working capital because exports happen at 180 to 210 days LC and asset turns of a plant is about 1.4 to 1.5 times. So, we set up a plant for about Rs. 50 crore the sales goes up by about 60-65 crore unlike other business where sales is 5, 6, 7 times the CAPEX. So, there is a limitation which we are seeing in terms of expansion of Astec that is why we want to bring it in. The second thing is that for the kind of opportunity Astec has, it requires lot of high-quality talent. Now that talent unfortunately we are not able to attract in Astec LifeSciences but we will be attracting in Godrej Agrovet.

Rishabh Bothra: So, you mentioned high growth in Astec so what kind of growth are we growing for in Astec in next two, three years once this merger takes place?

Balram S. Yadav: Anything between 15% to 20% CAGR.

Moderator: The next question is from the line of Madhav Marda from Fidelity Investment. Please go ahead.

Madhav Marda: Just had a question on the domestic crop protection business, if you could just help us with the growth outlook, the product launches that we are doing and the margins have been very healthy in the first half, so expectation on that going forward? If you could just connect that to the kind of product that we are planning to launch?

Balram S. Yadav: Almost 70% of our business happens in the first half. The second half like always will be average, as far as crop protection business is concerned, but we are very confident that we will maintain this growth trajectory in time to come because several product launches are in pipeline and these products are mixes as well as some molecules which we have got from Japanese company through in licensing. I do not remember often the list, but they are mainly herbicides and fungicides.

Madhav Marda: In terms of our distribution reach across the country, I mean how much of the retail channel are we sort of covering as a company, so is there is a scale up possibility there or are we selling across geographies already?

Balram S. Yadav: I think one of the things is that whichever crop we cover we have almost 70%, 80% penetration in those areas, but with the new molecules coming in time to come, we will be covering more crops because we are still weak in horticulture, vegetable crop etc., and once we have some molecules which will be used on these crops definitely there is a scope for improvement of distribution which we will continuously do.

Madhav Marda: So, fair to assume 15% to 18% revenue growth in a stable margin profile for the domestic business?

Balram S. Yadav: Seeing the number of molecules which are under registration and likely to come from FY20 to FY23, it can be a fair assumption.

Moderator: The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

Arnab Mitra: First question was on the animal feed business where you are hoping for margins to recover because input cost will come down. Now, in the past competitive landscape has kind of determined whether you had to further cut price, so how do you see the competitive scenario now? Can there be a case that input cost do come down, but you also have to lower your product prices and therefore the expansion does not fully flow? How would you look at that whole dynamics?

Balram S. Yadav: We are not any different or competition is not a different boat. So, everybody has operated on low margins for last six months because of lot of issues in the milk and animal protein industry as a whole. So, everybody is looking at this opportunity and I am very sure that all the benefits of raw material drop will not be pass through.

Arnab Mitra: And the second question related was that your broiler feed and layer feed has grown pretty well in the last four, five quarters, so are these inherently lower margin product and therefore is the mix slightly worse off than the past or do you think the operating leverage effect of having those volumes in more than offset maybe having a slightly lower gross margin there?

Balram S. Yadav: As I told you, I had mentioned we had got into a cycle where volume growth was not happening, and cost were going up. So, this was a sure death situation for a business with this kind of a margin and I think we had to fight of a situation like that. Cattle feed definitely have been consistent growth opportunities for us and will remain, but I think the big opportunity was also in broiler feed where we were having de-growth for last several years. Now one of the things was to leave this segment the other thing was to build scale and then work on profitability of the segment and we chose the latter to look at the broiler feed where margins are really low and definitely that is also one of the reasons why margin overall in animal feed is a little low. Layer feed is a consistent performer and overall when we look at the year it will have a very healthy volume growth at a reasonably good margin.

Moderator: The next question is from the line of Nishant Sharma from HDFC Bank. Please go ahead.

Nishant Sharma: I just wanted to understand on what kind of growth that we have registered on live birds' business?

Balram S. Yadav: Live bird business we have more than 70% growth.

Nishant Sharma: Sir, just wanted to understand what is our market standing and if you can give us little bit salience of this market?

Balram S. Yadav: In the broiler segment.

Nishant Sharma: Live bird business that we have

Balram S. Yadav: I will just give you a flavor, but I can speak on it for the whole day. So, industry is about 70,000 crore and we are about 500 crore, therefore long way to go. Plans are underway, investment plan are already made and we are going to set up bigger farm and then hatchery. We have already set up a Yummiez plant in Ludhiana. So, this segment has lot of big opportunity in future and we are doing everything to cater to that.

Nishant Sharma: So, currently we are at a very initial stage?

Balram S. Yadav: Yes. The only thing that I need to tell you is that the way we thought the processing will take off in this country that has not happened. So, like in lot of other sectors in India there is a big jump in value-added chicken products. So, we are selling lots of nuggets and there we have stretched for capacity. If you see this heat and eat ready to cook, ready to eat product, what is not growing in retail particularly it is plain vanilla process chicken chilled chicken that is not growing because of the supply chain, tough supply chain you have to maintain cold chain at 4 degree centigrade, deliver products everyday etc. So, that is a little bit of challenge but, live bird is growing and ready to eat product is growing very rapidly.

Nishant Sharma: So, here what would be our supply chain? Are we reaching directly to the retail channels or through the wholesaler?

Balram S. Yadav: We have breeding operation, hatchery, contract farming, our own feed meals, we have Tyson and protocol to monitor the health of chicken which has to be antibiotic free, then only the chicken which are certified by our veteran is processed, delivered 6 o'clock in the morning to a distributor who deliver by 9 o'clock to the retail shops they cover. And retail shops we have veggie coolers and freezers to store our products.

Moderator: Thank you. As there are no further question from the participant, I now hand the conference over to the Balram S. Yadav for their closing comments. Over to you, sir.

Balram S. Yadav: I hope we have been able to answer your questions satisfactorily. If you have any further questions or would like to know more about the Company, we would be happy to be of assistance. Thank you once again for taking the time to join us on this call and wishing you a very Happy Diwali and a prosperous New Year.

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