“Future Consumer Limited Q2 FY 2017 Earnings Conference Call”

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MODERATOR: **MS. SONALI SALGAONKAR – YES SECURITIES**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Future Consumer Limited Q2 FY 2017 Earnings Conference Call, hosted by YES Securities. As a remainder, all participant lines will be in a 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 Ms. Sonali Salgaonkar from YES Securities. Thank you and over to you, ma'am.

Sonali Salgaonkar: Good evening, everyone. We at YES Securities are pleased to host the Q2 FY 2017 Conference Call for Future Consumer Limited. With us, we have the Management Team of Future Consumer Limited, represented by Mr. Sanjay Jain – CFO, Future Group; Mr. Devndra Chawla –Food and FMCG Brands, Future Consumer Limited; and Mr. Manoj Saraf – CFO, Future Consumer Limited.

I now hand over the conference call to Mr. Devndra Chawla for his opening remarks. Thank you and over to you, sir!

Devndra Chawla: Thank you so much. Good afternoon, everyone. On behalf Future Consumer Limited, welcome all of you to the second quarter conference call. We continue to ride the wave of revenue growth and our journey towards profitability with each passing quarter.

Revenues for the first-half grew by an impressive 53% on a like-to-like basis as we surpassed the INR 10,000 million mark. We remain on track on achieving profitability as we report a positive EBITDA of Rs. 88 million in H1 FY 2017 versus the loss of Rs. 128 million during H1 FY 2016.

Our brands business continues to drive our top-line growth, it accounted for 91% of top-line in H1 FY 2017. We broadly categorize our brands business in two major buckets; first is the Food and Beverages which is 94% of the brand business and then HPC(Home and Personal Care) contributing 6% to the brands business.

Within Food and Beverages segment Tasty Treat registered a strong growth of 40%. We saw a very strong growth in gifting of over 200%. We launched a Chocolate Gift Box on a small scale but we received a fantastic response. Branded Staples also registered a robust growth of 56% on the back of brands like Premium Harvest which grew by 65% and Golden Harvest which grew by 54%.

Our frozen vegetable brand, Veg Affaire reported a strong growth of 123% Y-o-Y, and it was driven by new product development and launches. Karmiq grew to over six times as compared to same quarter last year and Nature's Choice grew by 75% Y-o-Y owing to seasonal demand. The branded fruits and vegetable business grew 200% on a Y-o-Y basis, largely driven by the launch of wholesale distribution business.

Within HPC, Clean Mate reported a strong growth of 31%. Kara, a brand which was acquired in 2015 also grew 3.5 times in the first-half of the year on a Y-o-Y basis.

The quarter saw interesting launches in food and beverages space, marked by our entry in the oats market with the launch of brand Kosh. Kosh is available in four variants which are 100% Oats Atta, Wheat plus Oat Atta, Instant Oats; and lastly, Broken Oats. The idea is to place Kosh in the staples basket of Indians, freeing it from the current shackle of packaged foods. The aim is to make Kosh, the third grain of India, after wheat and rice. We launched the brand in Big Bazaar, followed by the launch in other modern trade stores. And as we speak, it is present in more than 200 general trade stores in Mumbai and over 2,200 stores in India. The plan is subsequently to undertake a much larger General Trade launch. It is supported by a large media campaign across both traditional as well as digital channels. Two TV commercials were launched as a part of the campaign, one with the tag line "Ab khaana yummy yummy, pet healthy healthy" and the other being "Roti ke pet me kya hai?" and these were running on all leading television channels.

Secondly, apart from Kosh, the frozen foods and vegetable space is also well placed to grow as cold supply chain is gradually developing in the country. Again, within Tasty Treat we launched French Fries and a range of ready-to-eat 7 minutes Pizza. Pizza was launched in variants like Margherita, Veg Supreme, Olive and Jalapeno. Under brand Veg Affaire, we launched unique Recipe Ready Mixes such as Carrot Peas Mix, Mixed Bell Peppers and Chinese Mix.

In the Food Park business, we have signed additional customers since last quarter. We have completed required trials for the Rice Mill Facility in partnership with LT Foods which was inaugurated today. This facility will process Sona Masuri rice, specialty rice in Southern India. We completed trials for the Wafer Mill at the Food Park, and it is ready for commercial production. And our installed IQF facilities are also witnessing good demand.

On the distribution side, we continue to bolster our distribution network with each passing quarter. We are now available at 22,000 stores which include an access to over 780 convenience stores and hypermarkets of Future Group. We also have potential to expand access to over 128 stores of Heritage. We are also present in over 100 other modern trade outlets outside Future Group. We launched Kara at SRS Value Bazaar, a chain in North India. We also reached 5,000 stores milestone of Rajasthan Fair Price Stores which now covers all 33 districts of Rajasthan. So, in all just to summarize the store count, Future Group - 900 stores; other modern trade - 100 stores; general trade - a total of 16,000 stores and Rajasthan Fair Price stores - 5,000 stores totaling up to, roughly 22,000 stores.

With a strong portfolio of Food and FMCG brands and extended distribution reach, we aim to continue our growth momentum. I think these are exciting times to be at Future Consumer Limited and we are very happy to be a part of this journey.

I would now like to hand over the call to Sanjay Jain at this stage.

Sanjay Jain: Thanks Devndra. Good evening, everyone.

As Devndra mentioned, the Company continues its growth momentum. In six months we achieved 53% growth on a like-to-like basis excluding the convenience stores business last year. We have already crossed a Rs. 10,000 mn top-line during the first six months because of the growth.

We continue to witness improvement in EBITDA, we reported a positive EBITDA of Rs. 88 mn in first of the year versus a loss of Rs. 128 mn in the first six months last year versus. The similar phenomena has been visible in the second quarter as well, wherein the growth was 49% and the EBITDA loss has been cut down from Rs. 44 mn last year to Rs. 52 mn profit this year.

Because of the equity that we raised, we have also witnessed a decline in the interest expense, wherein the interest cost of the Company declined by 24% in the first six months from Rs. 315 mn last year to Rs. 240 mn this year. As a combined impact of the top-line growth, the EBITDA turnaround, and reduction in the interest expense, we narrowed PAT losses of the Company from about Rs. 577 mn in six months last year to about Rs. 369 mn this year. We believe this trajectory of growth, EBITDA expansion and as a result, cutting down of losses, and eventually momentum to profit should continue.

What is also important is, the concentration from the top brands today constitutes 86% of the top-line of the Company. Therefore while we are launching more and more products but the launches are more across the top brands. As a result, we would be now deriving more and more benefit out of the existing brands which are getting strengthened.

The Company's net debt for period ended September 30th was around Rs. 3,490 mn. The combined impact of equity raise from IFC, and five days reduction in operating cycle of the Company from about 53 days at June end to about 48 days at September end shall help us contain the debt at the same levels.

To summarize, from here onwards we see top-line expanding, therefore we see resultant impact of that on EBITDA; and as a result we gradually see ourselves cutting down the losses and heading towards positive trajectory of growth.

With this, I hand over back to Sonali to take any questions that would be there for Devndra and me.

Moderator: Sure, thank you very much. We will now begin with the Question-and-Answer Session. The first question is from the line of Ashwin H, he is an Individual Investor. Please go ahead.

Ashwin H.: I just had one question really. Even last quarter and for the first-half the gross margins seem to be down by about 50 basis points - 60 basis points, if you can just throw some light on this?

Sanjay Jain: The growth in relatively low margin categories of fruits, vegetables and branded staples has been far in excess of the higher margin categories. So, that is the reason we see a small decline in gross margins. We have also taken premiumization initiatives in the fruits and vegetable and branded staples segments. For example, in branded staples we are launching various varieties of Atta (flour), and moving up the value chain to spices. In the fruits and vegetable segment as well there are premiumization initiatives. So, therefore, this should lead an overall expansion in gross margins. And what is also interesting is, although these are relatively low gross margin categories, but their impact on the return on capital employed for that particular segment is very good. So, I think this combined impact of the two should not only allow the Company to gradually expand the gross margin, but generate more gross margins for lesser incremental capital employed.

Ashwin H.: One more question. The recently announced Booker Group partnership, when does it come into effect, I mean, will we start seeing any impact on sales in this year itself?

Sanjay Jain: We just signed a term sheet, I think it may take us two months to get the definite agreement up and running. So, I think any meaningful impact should be visible from the first quarter next year, I guess we will take three months to four months to put the formalities behind us. So it is still four to five months to go before we start benefiting in a meaningful way from this joint-venture.

Moderator: Thank you. We have the next question from the line of Ms. Sonali Salgaonkar from Yes Securities. Please go ahead.

Sonali Salgaonkar: Sir, my first question is with reference to the launch of your branded oats Kosh. Now, in the presentation you do have mentioned what are your plans, but if you could just detail out that would be very helpful, as in what formats do you plan to launch it next? And there was also mention that you are in the process to set-up the distribution network to accelerate the launch. So, if you could highlight something more on to it that would be very helpful.

Devndra Chawla: I will touch upon on the brand idea for a minute and then on the distribution question which you have asked. We believe that oats is by and large is part of the breakfast category. And given that it has been around for 15 years, it is just a Rs. 350 crores to Rs. 400 crores market, it is probably one-tenth of even the noodles market. Since people are trying to be, healthy and trying to have a healthy diet, the market needs to be much larger than Rs. 350 crores. And our insights clearly tell us that unless it is a part of our mainstream food which we have in lunch or dinner, like Thali or the Roti - Subji or in South India we have Idli or Dosa or like Paratha in North it will continue to remain so. I mean, only when you integrate health into everyday food we eat, then the penetration or the consumption will increase, otherwise you will have it once in breakfast or once in a week. Health & wellness cannot be once a week or once in three days agenda, it has to be a part of your everyday life. If you have something unhealthy once in ten days, it is not going to make you unhealthy. You have to have something unhealthy every day and then you become unhealthy. And the reverse is true for health.

So, we believe that if you integrate oats as a part of atta, you can make a Roti, Idli, Dosa everything. In my house even the Chutney is be made with 40% oats and when you eat it you can hardly make out there is oats in it.

So the whole idea is to bring oats in the center of the Thali, which is the Indian Thali. And all cuisines whether it is Gujarati, Punjabi, South Indian, most of the things can be made as long as you integrate oats with atta. And thus the idea of 100% oats atta, as well as 90% wheat and 10% oats atta in pre-mix form so that people can start the habit. Now, in future we will also have other new sub-categories of oats coming, so currently we have Instant Oats, Broken Oats which you can have like a porridge / khichadi, it can even replace the rice. So, whatever you have with rice you can actually have it with oats.

Now on the distribution side, it is already available in all of our own stores which is Big Bazaar and Easy Day. It is also available in other modern trade stores like Star Bazaar, Hypercity. And we are making it widely available; we are appointing distributors, like a classical distribution strategy. As we speak, we have already appointed 45 distributors. We roughly have 2,200 general trade outlets, and the number will be far larger by December-end, by March-end we are targeting a significantly large number. Across India, we have already appointed distributors in North, South and West. We are already seeing good results. So the idea is to reach as many people as possible, not just through modern trade and supermarkets but also through the general trade stores. We started this excise a month back, I think it is absolutely work is progress. And though getting into general distribution is long-term as it takes some time, but I think within three months to six months we should be at a substantial number of stores, general trade in India as well. Sonali, I have tried to answer this, if anything more, please let me know.

Sonali Salgaonkar: Sure, sir. Sir, this is very helpful. My second question is now with the launch of oats, you have already extended the portfolio across foods and beverages. So any more new categories that you are focusing or may be down in the pipeline which you are expecting to launch any new products?

Devndra Chawla: See, there are many new categories which we are working on right now. First of all, India as a commodity business is way too large, so the processed food industry will grow over the next 10 years to 20 years - is something which we all in the food industry believe in. Secondly, 60% of the population is young. Classically we grew up with the term FMCG as fast moving consumer goods; actually you have to relook at that term itself. We believe it is for the fast moving consuming generation. And if you see what products they will consume tomorrow, I think a lot of innovation is required. So we are working on a lot of products. Sanjay mentioned that a large chunk, around 85% of our business comes from existing top brands, and within those existing brands whether it is Golden Harvest or Tasty Treat or even our global tie-up with Sunkist**,** we are working on at least 10 to 15 more categories which we could launch in the coming couple of months. There will be numerous launches in processed food categories in the next three months to six months.

Moderator: Thank you. The next question is from the line of Rajiv Handa, who is an Individual Investor. Please go ahead.

Rajiv Handa: I just had a couple of questions. One is, would we have any metrics on what has been our same store growth, if any figure is available there? And also, if you could indicate what is the kind of revenue split between our Future Group stores versus non-Future Group stores like general distribution or modern trade? Would we have any integration of that, how would our revenue split between Future Group and non-Future Group stores? And also, what has been our same store growth, if any indication is there? That is my first question.

Sanjay Jain: Rajiv, we do not have any stores as part of Future Consumer Limited, so metrics such as same store sales growth is not relevant for us, all these stores that we had were already franchised earlier. However, I can speak for the second part of your question which is Future Group constituting how much of the overall sale. At present approximately 70% of our total sales is through Future Group outlets, and with every quarter passing by, the trend is that the third-party share is gradually increasing, it used to be 80% one year back and now it is 70% and the trend should continue.

Rajiv Handa: The second question was, you mentioned about your top brands contributing around 85% - 86% growth. I just wanted to check with the business side, what are we doing to make it more broad based? Because I believe we have got some 27 brands already created and if only top brands have given 86%, I mean, what are we doing to make it more broad based? And also Sanjay, if you could just indicate, because the margins is becoming a little up and down and I understand because various categories in this is leading it, so is there any margin band that you plan to operate, assuming the mix is going to be seasonal in demand?

Sanjay Jain: I would request Devndra to add more to what I am going to answer to the first part of the question. I guess we should be happy if there are fewer brands leading to much larger sales. I mean, any company would probably not like to be in a situation of too thinly spread across many brands, as your marketing spends; all your resources get thinly spread. So it has been a conscious effort that the brands become big. But then we bank on those brands to get into more and more categories. So DC, you want to add something because I go to second part of question on the margin?

Devndra Chawla: See, Mr. Handa, 85% - 86% coming from the top brands is because some brands have already started having sales outside the Group. We have also seen a lot of launches within these top brands such as Tasty Treat leading to their growth.

On the other side, brands like Sangi's Kitchen whose contribution may be small were launched only around six to nine months back. These are the categories which can be very large tomorrow. Spreads, as a category itself is very nascent in India, as the market has by and large been dominated by jam or a cheese spread. We believe these are categories which will grow sizably in the long term.

So if you see the mix of the business, there are categories in which we are large and leading and then there are categories which are nascent today. In these nascent categories, which are small in size at present, we command a significant market share. We are going to grow these categories which will also be supported by favorable Indian demographics.

So I think some of these will take one to three years, and top brands contributing 85% to 86% of course will come to 70% - 75% at some stage. For example, it has just been a month since we launched Kosh. I think after one year from today Kosh would be a significant contributor of business probably making it to the top brands. The numbers in the last one month itself have shown good traction and we are backing it up with media campaigns.

And we are also setting up a general trade right now, like Kara. Now, in India if you see the dry wipes are normally available for 50 paisa to 60 paisa. Nobody has offered wet wipes and hence we can charge a premium which goes up till Rs. 6 to Rs. 8 per wipe making it the most premium wipe in this country. Or if you know, there are brands which have liquid nail polish remover for women. As the remover is in liquid form, you need to take cotton, then you put the liquid on the cotton and then you remove the nail polish. Under Kara, we have launched a nail polish remover which is in the wipe form which offers immense convenience. We started it recently and the numbers which we are seeing are outstanding. Now as these products start going into other channels and distribution, the business mix will continue to change. So I think with every quarter with more brands going out, this mix of 85% to 87% being on top brands will keep coming down. It is not because these brands will perform slower than the top ones, it is because the rest will start going out and will start seeing traction. Sanjay, over to you.

Sanjay Jain: So on the margin side, I think these short-term fluctuations may continue for some time, as we are launching more and more categories, so depending upon performance of individual categories you could see the small fluctuations. But I think on the whole we believe we are well placed on the trajectory of margin expansion from 13% - 14%. To put numbers in perspective, for example, we had growth of over 50% in Golden Harvest, Premium Harvest which are essentially staples brands. So these products have relatively low gross margin of 10% to 11%. However, as the premiumization happens, there should be more margins flowing through this category. As an example, we have also launched our brand of Desi Atta under branded staples, and when it starts growing further it will be margin accretive to the overall category.. Bloom and Soo Fresh, which is a fresh fruits and vegetables category saw a growth of 198% in the first six months over the same period last year, where again the margins are relatively lower. We also received an access to 5,000 Fair Price Shops through Aadhaar, leading to more sales of relatively low margin categories. However, as our relatively higher margin categories such as HPC start increasing penetration into these Fair Price Shops the margins start expanding as well. With Christmas coming up, this quarter is also a seasonally strong for Nilgiris further providing support to the margins. increasing, So I think we are very well poised to enhance the margins from current level in next few quarters.

Rajiv Handa: Can I ask another follow-up question, if that is okay with you guys. And that was on your rural distribution network. I did hear Kishoreji also speaking about demand is equal to supply in these markets. What I wanted to understand is, while our top-line growth has been very impressive, going forward on a revenue trajectory what will we be limited by, is it our distribution network or is it by our own production capacity which is yet to go full steam. So which kind of constraint are we expecting for us to reach that stated goal of Rs. 20,000 crores by 2021. What is the most challenging one, is it our own production capacity yet to go full steam or is it our distribution network which is still in the making?

Sanjay Jain: I would not say production capacity, in fact I would not say it is a challenge, I would say it is an opportunity. Because while we just got into trial production or commercial production across newly set up facilities, the entire expense is going to the P&L, however, the top-line impact is yet to come. Kosh is manufactured from a Sri Lankan factory which went into commercial activity earlier, although the brand is only a recent launch. Now the entire expense side is going to P&L, as the capacity utilization increases we should be deriving more value in terms of amortizing the existing fixed cost over a larger revenue base.

Secondly, as our brands become bigger, on one hand we do not see any constraints in capacity because we have just started to use these facilities. I would leave Devndra to add, but as brands become larger, there are third party capacities which also would be available for utilization. So capacities should not be a constraint at all, they should be in fact benefitting from a low level utilization which will be gradually ramping up.

Rajiv Handa: The only thing is, Sanjay, when I meant production capacity I assume that it is yet to go full steam and that is why we are constraint by making the products available across the entire gamut on general and modern trade.

Devndra Chawla: I can add to what Sanjay said. We already have an IQF in our own facility in Food Park and it is very well known that in India there is no cold chain to support. If you are in any western or developing economy, in any super market you find walls and walls of chillers and freezers, I normally end up counting, and they have at least 60 - 70 each. In India even in the modern trade they do not go above two or three or at best four chillers or freezers versus 70 - 80.

So the point I am making is that in many categories there are no products available. With our investments in Food Park, we have large capacity with which we have launched a brand called Veg Affaire. In India under frozen category, only frozen peas started by Safal was available, which constituted 80% of the entire frozen vegetable business. However, over the last three to six months, we have launched Carrot Peas Mix, Pulao Mix, Chinese Mix and these have brought down the peas contribution to merely 40% - 50%. Usually cooking involves a lot of chopping or cutting or if you want to make a biryani or noodles and if three or four vegetables go in it and if you have two available and two are not available, then you have to make a lot of effort to go and buy those. So what is happening is that people not just want vegetables which are not available in the off season, but they also want convenience.

So if you see these insights, we are able to combine this and give recipe ready frozen mixes. They are all utilizing our capacity in Food Park, and the capacity is large. We are able to sell a certain throughput of it in our own stores. And these are the categories which are going to grow exponentially over the next five years in India. And these are high margin and high price, high value SKUs. Obviously, they also come with a high distribution cost, because of cold supply chain. We work with our own supply chain company which acquired a company called Brattle Foods who are in a unique position to put up the whole cold supply chain. As we expand and put up our own cold supply chain, we will be able to utilize the capacity of our own facilities much, much better over the next one to two years. So there are large capacities installed, of course in many categories large capacities are yet to be installed.

One classical example is wafer biscuits, in which we are the market leaders, probably in all super markets put together, our brand would be number one. Now that factory is about to go live again in our Food Park in Karnataka and the production will shift from a third party to our own facility in a month or two. And then the gross margin would further move up because we will have more economies of scale. So I think product by product, category by category there is a migration strategy, there is a strategy to utilize capacities which will lead to higher gross margin as well.

Moderator: Thank you. Our next question is from the line of Kaustuv Bhuvana of SKS Capital. Please go ahead.

Kaustuv Bhuvana: Firstly, I would like to congratulate you on your results. Seems like your long-term strategy is in place because I believe I see you have got very good products into the market. But I just want to talk about this road block that has come in for everyone, demonetization. What does it mean for companies like Future Consumer Limited, could you give a little light on whether we will sail through talk about how does it impact your company vis-à-vis the long-term?

Sanjay Jain: While there could be some short-term challenges of lack of money supply, but from a horizon of beyond short-term approximately 85% of our sales are through organized player. So I think any organized player should be well benefitted to any migration towards plastic money. So to that extent, I think if at all from a medium-term to long-term perspective FCL should be beneficial for this demonetization initiative, leave apart any short-term hiccups.

Kaustuv Bhuvana: So how much percentage of your business is pure staples?

Sanjay Jain: So, currently the brands including Golden Harvest, Premium Harvest and Ekta constituted about 57% in the first half.

Kaustuv Bhuvana: So you are saying staples would be about 57% of your revenues?

Sanjay Jain: Yes.

Moderator: Thank you. Well, that was the last question. As there are no further questions, I would like to hand the conference back to Ms. Sonali Salgaonkar from YES Securities for closing comments.

Devndra Chawla: Maybe I will take this one. Let me thank everyone for coming on the call. We look forward to working towards delivering a good roadmap ahead. And hope to interact with you during the next quarter call. Thank you everyone.

Moderator: Thank you very much. On behalf of YES Securities, that concludes this conference. Thank you for joining us, Ladies and Gentlemen. You may now disconnect your lines.