"Dabur India Limited's Q3 FY 2017-18 Financial Results Investor Conference Call"

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MANAGEMENT:

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Gagan Ahluwalia: Good afternoon, Ladies and Gentlemen. On behalf of the management of Dabur India Limited, I welcome you to this Conference Call pertaining to the Results for the Quarter and Nine Months ended 31st December 2017.

We have with us, Mr. Sunil Duggal – Chief Executive Officer, Dabur India Limited; Mr. Lalit Malik – Chief Financial Officer; Mr. Ashok Jain – Vice President (Finance) & Company Secretary and Mr. Ankush Jain – Head (Financial Planning & Analysis).

We will start the call with an "Overview of the Company's Performance by Mr. Duggal", after which the "Q&A Session" will open. I now hand over to Mr. Duggal. Thank you.

Sunil Duggal: Thank you, Gagan. Good afternoon, Ladies and Gentlemen. Welcome to Dabur India Limited's Conference Call pertaining to the Results for the Quarter and Nine Months 31st December 2017.

Comparable consolidated constant currency sales growth was 12.9% for the quarter. Domestic FMCG business witnessed comparable growth of 17.7%, driven by strong volume growth of 13%. Profit after tax reported growth was 13% for consolidated and 16% for standalone business respectively.

The category growth being discussed in this presentation refers to the underlying growth after adjusting for GST impact. The Home and Personal care vertical posted growth of 23%, led by all around strong performance of all categories. Oral Care grew by 23.2% with growth of 26.1% in Toothpaste. Red franchise continued to perform well, driven by increasing penetration, aggressive marketing and visibility initiatives. Babool and Meswak posted strong double-digit growths and market share in Toothpaste category reflected an increase YoY.

Hair Oil category registered growth of 16.7% with both Coconut and Perfumed Oil segments performing well, despite continued decline in the CSD channel. Excluding CSD, Hair Oil category grew by 21%. Perfumed Oil reported growth of 13%, including CSD, and 17.6% excluding CSD. Corresponding growth in Coconut Oil was 32.8% and 35.7%. Market share in Hair Oils moved up by 90 bps vis-à-vis the same quarter last year. Shampoos posted growth of 56% on the back of re-launch of Vatika Shampoos. The brand was supported by focused marketing activities and ATL spends.

Home Care posted a strong performance, growing by 36%, backed by high growth momentum in Odonil and Sani Fresh brands. Odomos had a muted quarter on account of relatively lower incidences of mosquito borne diseases and lower institutional sales.

Skin Care registered a growth of 14.5% driven by Gulabari Rose Water, which grew in strong double-digits. Supply issues hampered growth of Gulabari Cold Cream. Fem and Oxy bleaches posted robust high-teens growth.

The Healthcare vertical reported growth of 16.6%. Health supplements grew by 19.5%, led by strong performance of Chyawanprash and Honey, slight slowdown in the CSD category. The category recorded a healthy 27% growth net of CSD. Dabur Honey recorded growth of 33% including CSD and 40% excluding CSD, and also gained market share. Digestive category performed well, growing by 19.3%. Hajmola tablets and Pudin Hara reported double-digit growth. OTC and Ethical grew by 8.7%. OTC products such as Lal Tail, Honitus, Ashokarishta and Dashmularishta parcels posted good growth, backed by marketing initiatives and activation.

Foods business was flattish during this quarter, nearly on account of high base of last year where the business had grown by 52%. In addition, Diwali gift sales got impacted as Diwali came earlier and the gift pack loading shifted to Q2 instead of Q3. Although sales growth was muted, profit margins in Foods saw good improvements on account of lower consumer promotions and network optimization.

International business reported constant currency growth of 5% during the quarter. Saudi Arabia which had been under pressure for the last few quarters witnessed a strong revival with growth of 34%. Overall, constant currency growth in GCC markets was 20%, Egypt witnessed high growth of 45% and sub-Saharan Africa 21%. Transmission impact of Rs. 66 crores impacted top-line. However, this impact is reducing as currencies are becoming comparable to last year. SAARC business posted good growth, led by Pakistan and Nepal.

Consolidated operating profits increased by 28% and operating margins expanded from 18% to 20.5%. If we exclude the GST impact, improvement in operating margins was around 180 basis points. A&P spends in the domestic business saw an increase of 31.6% while A&P spends in international business were lower due to business environment not being very supportive.

SG&A expenses reflected some savings on account of cost synergies. PAT reported growth of 13% because of higher depreciation and lower treasury income. Post the GST implementation the channels had seen some disruptions which seems to have stabilized. The implementation of the E-WayBill mechanism is likely to throw up some more challenges in the future. However, the business is on a strong footing with revival in volumes and momentum of brands.

We will continue to invest strongly in our brands, distribution and other infrastructure to grow ahead of the market and enhance shareholder value.

With this I now open the Q&A and invite your questions.

Abneesh Roy from Edelweiss

Abneesh Roy: My first question is on the Foods business. If you could tell us how is the market share, what has been the impact of ITC? And what percentage of Foods business is culinary? And if you could discuss the supply issues, what exactly is happening there?

Sunil Duggal: 10% of the business is culinary, 90% is beverages, so it is substantially dominated by beverages. In terms of competition, the challenges have not really come from the higher price competition like ITC but it is very deep discounting by the mid-level players like paper boat, etc, which have been able to gain some share on the back of these proportional activities. And also a lot of value players emerging in the segment. But keep in mind a very high base of 56% growth or thereabouts last year, Foods business was not really materially impacted by demonetization to that extent. And also the fact that a lot of the sales come from the Diwali gift packs which this year happened substantially in Q2 whereas last year it was Q3, so there is a base issue on that account. Now, going forward I think we would see stabilization of beverage volumes, a lot depends upon consumption recovery, etc, in urban markets. Definitely we will see growth ahead, we hope it will be double-digit growth, but not to be taken as a given. What we will be doing is that we are sitting on substantially enhanced margin in the Foods business on a YoY basis, we will be willing to sacrifice some of those margin gains to drive the top-line stronger. And we are beginning that journey now, results I am sure will come.

Abneesh Roy: Sir, this margin sacrifice strategy, will it help in combating a smaller player like Paper Boat? I understand you had launched a product in the category of Paper Boat, I think Hajmola Yoodley so how has that done? Do you expect that this will be enough to combat them?

Sunil Duggal: We think so, I think Paper Boat in its new avatar is no longer that single serve format, it is really 1 liter. And basically, on the same platform is our beverages, so there is no huge difference in terms of proposition given by Paper Boat which is the one which is being discounted and what we have. So, I think we need to lubricate the trade more, we need to advertise more and there is obviously a strong consumer preference for our brands which should translate into business once the price levels are a little bit more stable.

Abneesh Roy: And sir the culinary business what was the specific supply issue?

Sunil Duggal: Well, this is entirely outsourced, we do not make any of the culinary products ourselves, these are the vegetable paste, food pastes and coconut milk and powder. All these are outsourced and some of our co-packers had working capital issues, consequent to GST other issues.So we were very reliant upon them and it was entirely a supply side problem, there was no inherent issue in terms of demand.

Abneesh Roy: Sir my second question is on the Toothpaste business, you have grown 26%, two-year CAGR of 10% which is still a very good growth. You and Patanjali are essentially in the naturals now competition scenario is changing with Ayush, which they have called out that in Toothpaste seems to have started out well. And even Vedshakti of Colgate has gained around 100 bps market share. So, do you need to respond to these and would you say that the worst of Patanjali in this and some of the other segments where you compete against Patanjali, seems to be behind?

Sunil Duggal: I do not think there was much of a Patanjali impact on our Oral Care business, we consistently grew the Red and the Meswak franchise 20%, 25%. Babool was a bit of a laggard, but then Babool also has staged a sharp recovery over the last two quarters. So I do not think that was very material. It was very material in honey and I think we have recovered almost entirely the lost ground by just giving a better product at a sensible price. So the 33% growth in Honey, 40% if we exclude the canteen stores, is the very visible sign of that recovery, and this is two quarters in a row of growth. I hope the trajectory will continue. I think the competition effects have been, I would not say entirely eliminated, but substantially mitigated.

Abneesh Roy: And any comment on Ayush and Vedshakti, would you need to respond, or you think your product is differentiated?

Sunil Duggal: No, I think we have got very strong products with very strong growth paths. Having said that, we need to do a little bit more in this category and you will see that happening very early in the next year.

Abneesh Roy: And sir, last question from my side. So, in household insecticides we have seen the market leader also struggle for the last four, five quarters, you also called that out. So, I have two questions here, one is, earlier it was thought that consumer had made this as a habit, now suddenly every company is pointing towards seasonality. Second is, of course, in terms of the out-of-home, has the category expanded with Godrej coming in there and you have also come out with a roll-on, so how do you see this category? Currently it is quite small, but where do you see this from a longer term?

Sunil Duggal: Well, household insect repellants, mosquito repellents are not really a habit, I think that is wrong to say so. When you have mosquitoes visible in the air and they start biting you will start using these products, and when there is an epidemic you start using them even more so. But when there is no such thing, like in winters in North India then you stop using them and that is a behavior which nobody can change. When there is such a situation happening then you will have high usage, well, fortunately there was not much evidence of any epidemic, dengue, etc, in the northern part of this country, even the south. The overall insecticide table came down and I think the results of Godrej reflected the same situation as what we are in. And coming back to your personal application category, it is highly underpenetrated, I think total category size will be around Rs. 100 crores which is ridiculously small, given the sheer size of the problem. So, in a sense, having somebody else come in would serve to enhance consumption and in fact increase market size. So, we would welcome that, I think it requires more than just one player to grow this market.

Percy Panthaki from India Infoline

Percy Panthaki: Hi sir, this is Percy here. Sir, on 10th November there was an announcement of GST rate cut in some of the categories and it was applicable from 15th November. Most FMCG companies obviously cannot change the prices, etc, within a period of five days, most companies have staggered the price changes over the next 15 - 20 days. Now the market leader has said that they have parked in escrow certain amount which they gained in that change over period and does not belong to them. So, what have you done in terms of passing on the benefits of that sort of lower rate to the consumer in that 15-20 day' period it would have taken for you to change the pricing, etc?

Sunil Duggal: Yes, what we did is that with immediate effect we reduced the prices to the stockists, That we did without any pause. Obviously there would be some stocks where the older price would exist, but we have written adequate amount of communication to our stockists as well as heavily advertised in the newspapers informing them of the price change and requesting them to pay only the lower price. And then the change over which we did also happened very rapidly. So I do not think we have any exposure at all, our books are open, anybody can have a look and I think we have taken whatever action which was required to deal with this whole anti-profiteering issue.

Percy Panthaki: Okay So, you are saying that basically for the short period of time that MRPs could not be changed the difference was passed on to the distributors as additional discount sort of?

Sunil Duggal: And communicated to the consumer. That is why we do not believe, we did discuss this issue, we do not believe there is any need to provision any amount towards any eventuality, our books are very open to anybody who wants to scrutinize them.

Percy Panthaki: Understood. So, just wanted to in that context understand your gross margin expansion, I mean YoY it has expanded very significantly and even QoQ there is a decent expansion. So, what has driven this expansion when generally crude and such inputs are moving up and you also have not I think taken any significant price increases?

Sunil Duggal: Well, it is just standalone material cost change which is 360 bps, right, out of which 70, correct me if I am wrong Lalit, 70 bps is entirely on account of the GST related issues which are not really material, because your numerator comes down your margins improve, the raw material comes down and MRPs improve. So, out of the balance 290, 150 basis points in account of reduction in CP and the balance…

Lalit Malik: Balance is because from the last year there has been 2.4% price increase, so 50% of that roughly, 1.2% is the effect.

Sunil Duggal: So the balance is mix of price increase and material deflation, and Q3 we are still sitting on small level of deflationary costs. So, it is really on account of that, and perhaps a little bit on account of mix. Juice has come down…low margins, HPC has gone up high margin, so it is a lot of moving parts here.

Percy Panthaki: Okay. So, is this the quarter, I mean, Q3 FY18 is the quarter in which your promotions have gone down materially or it has gone down in 2Q itself and just on a YoY basis Q3 has gone down or is it gone down even sequentially?

Sunil Duggal: No, we did massive promotions in Q3 which spilt over into Q4 of last year. We realized that that is not really the way to go, GST also made consumer promotions less attractive because you had to pay full tax on them and not get any credit. So, net, net, it made sense to kill consumer promotions and to increase ATL. So ATL went up by 31% and CPs and TPs have gone down by similar amounts. So we are rebalancing the entire A&P portfolio, what is visible to you is advertisement and publicity which has gone up very substantially.

Percy Panthaki: So, basically you are saying these margins are sort of more or less sustainable, it is not as if it is just a flash in the pan?

Sunil Duggal: Inflation remaining the same, yes, but we have every reason to assume that inflation is going to pick up starting in the fourth quarter, particularly on account of petroleum derivatives, we are seeing sharp increases in LLP, Coconut Oil is already on fire. Coconut oil is of course an outlier, big agrarian product which is very, very inflationary. But all the oil derivatives are now kicking in with higher costs. So, we will have to deal with that, I think we will see a minor uptick in inflation in Q4 and then perhaps more substantive in the quarters ahead.

Percy Panthaki: Okay. And my last question is on demand, sir this quarter numbers are fairly good, but if I look at your two-year CAGR for most of the categories it is low to mid-single-digit sales growth, of course there are a couple of exceptions like homecare and Toothpaste is also almost 10%, but otherwise mostly it is low to mid-single-digit CAGR. So just in view of that underlying demand situation your growth aspirations of high single-digit volume growth would mean that the underlying demand needs to improve from the current levels quite materially. So, how confident are you sort of achieving?

Sunil Duggal: That is one way to look at it. The other way is that you just improve market share. So, even if environment which is not supportive of growth, which is the situation today to be very honest, we can still show good growth even on a normal base on the back of market share gains. So, the reality of the situation is that there has been a sharp trending down of FMCG growth rates. Just to give you a data point, the growth rates peaked in Q1 in terms of volume at 13.9%, of course this 13.9% trigger we should take with a pinch of salt, it is obviously much lower than that. But subsequently they have trended it down to 8.5% in Q2 and 5.7% in Q3, now these are hard numbers in terms of FMCG, our category which we operate are similar. And I think that is something which is of some concern. We do hope that subsequent to tomorrow's budget there would be a sharp reversal of the downward trend because this is really a part of the whole rural distress, agrarian distress, etc, and we will be able to ride a much higher level of secular growth. And then coupled with market share gains we should definitely be able to get to that high single-digit volume trajectory, not to be taken as a given but every reason to expect that it can happen.

Percy Panthaki: So, sir what will drive this market share expansion?

Sunil Duggal: Better execution largely. What we have done is consequent to, and I have mentioned this in my last con-call this Project Buniyad which had which meant we will deploy a substantially higher number of people on-ground in rural areas by dividing the portfolio around the middle into the two components of HPC and HC.Food is not really material in rural. This has given a big fillip to our rural growth. Rural growth this quarter was 23% in a pretty stressed rural environment. So, it is really execution and market share gains which will, that is the only thing we can depend upon, we cannot depend on category growth reviving, if we keep using that as sort of an excuse to justify low growth that is not going to work, so we have to outperform.

Amit Sinha from Macquarie

Amit Sinha: Sir, my first question is on the Oral Care business and despite a significant step-up from some of the large competition in the naturals and the Ayurvedic space your growth has remained pretty strong. Just wanted to understand from you that how much of this market share gain has been on account of your distribution and some of the distribution steps which you have taken and how much of that is coming on account of the Ayurvedic natural trend which is emerging in the category?

Sunil Duggal: Well, hard to say how much, it is obviously coming from both, we are gaining share in the aggregate sense and of course the natural space is growing ahead of the non-natural one. The competitors other than Patanjali are still very, very small, so I do not think they would really move the needle in terms of growth for us. And I think the Patanjali effect which was perhaps at its peak around a year ago is now waning a bit, he is still doing well in Toothpaste, I am not denying that, but we are now getting back whatever losses we had in some of the markets like UP where he had gained some share. We are getting the share back very rapidly.

Amit Sinha: Okay. And there has been absolutely no impact on account of big launches from some of the other players?

Sunil Duggal: Aggregate to 0.5% - 1% in terms of market share, so I do not think that is a very material level where it can upset our growth rates. It is only Patanjali which grew from 0 to something like 7% - 8% literally in a matter of few quarters that could have had an impact, I think our growth would have been even higher if he had not been here. But having said that, he has further in a sense expanded the whole herbal base and we can take advantage of it. So, whether it is in honey or whether it is in Toothpaste or in personal applicator, insecticides, often the advent of competition is very positive for market expansion and growth. And we have seen every evidence of that, Patanjali did help us to expand the natural space much beyond what was originally envisaged.

Amit Sinha: Sure. I mean, just wanted your commentary in the longer-term let's say for the next five to ten years where do you see the naturals Ayurvedic space in the Oral Care category to be in the overall scheme of things?

Sunil Duggal: Well, it is hard to guess and I think we keep pushing the numbers northwards. Now I would say that let's say by 2022 the natural space could be as high as 40% to 50% five years from now, 2023. So, I would not have said that even a year ago, but definitely the preference for natural products is very strong, almost unstoppable. And there is no counter from the folks who are manufacturing the regular products, because they can counter it by having high priced specialist products like sensitive, etc.But those are beyond the reach of vast majority of people.

Amit Sinha: Sure, sir. Sir, my second question is on the Hair Oil category and if I do a two-year CAGR then third quarter FY17 was exceptionally bad for you, the entire hair care. So just wanted your commentary on how do you look at these numbers, is it still weak and you have specifically mentioned about strong Coconut Oil performance, so what is the price hike taken there and how much of the growth is because of volumes?

Sunil Duggal: Well, it is almost entirely volume growth, except for coconut of course where there has been some price increases, but it has been driven really by LUPs. So, I think our volume share growth has been very substantial. And going forward I think our volume shares will continue to definitely grow ahead of anybody else. The challenge will be to continue to maintain or increase the value share that is going to be harder. Let us put it this way, the volume share growths I think we have now got our act together in terms of both distribution. It was Project Buniyad that was very instrumental in pushing our low-priced Hair Oils in to the deepest interiors and that process will continue. But yes, there will be pressure on the top-line in terms of overall growth.

<u>Arnab Mitra from Credit Suisse</u>

Arnab Mitra: Firstly, on the international business, so two parts to it. One is, going ahead how much does the difference between the constant currency and the reported growth narrow down given your basket of currency in your view from the fourth quarter onwards based on whatever is the current situation? And secondly, what is the issue in Namaste because of which there is again a big negative dip on the CC and how do you see that situation evolve over the next few quarters?

Sunil Duggal: Well, to answer your first question, we had around a Rs. 90 crores transition loss in Q1, similar in Q2. Q3 this quarter which we are talking about is Rs. 66 crores, next quarter we anticipate it will be Rs. 25 crores, so that gives you a trajectory. After next quarter, I cannot really hazard a guess because there could be shifts which I cannot envisage. So, therefore the currency, and a lot of this Rs. 25 crores next quarter is going to be actually on the rupee strength rather than on the downstream currency weakness. Out of this Rs. 25 crores around half is going to be from let's say Turkish Lira to Dollar, and half of it is going to be Dollar to Rupee, assuming that the Rupee continues to remain at the current levels. So, the overhang of currency is going to be substantially if not entirely eliminated by the fourth quarter. That is one big monkey off our back, because this was impacting top-line of international.

And the second big positive is Saudi Arabia which again was literally on oxygen last couple of years. We have done major changes in Saudi Arabia, recovered growth substantially, improved by 30% plus this quarter and we hope that strong growth would continue in Saudi Arabia. So that is one big reversal. There have been some setbacks too, Algeria, Libya and Yemen, these three countries which cumulatively account for around Rs. 30 crores a quarter they have been almost reduced to zero levels because of internal strikes or other issues. But having said that, we do believe Algeria and Yemen would come back not to normal but to better than earlier performance in the fourth quarter, and then let us see going forward how does it look.

Sub-Saharan Africa, both for Namaste and Dabur is doing extremely well, so we are doing around 25% in dollar term- that is a very big plus. Now, Egypt is doing spectacularly well in their own currency, but up to this third quarter we lost most of it in translation. So Egypt grew by 46% in Egyptian Pounds but -5% in INR, and this is a big market for us. With the Egyptian Pound normalizing we should see very strong growth in INR from Egypt coming in Q4. Namaste remains an overhang but the pace of deceleration of the business has now come to a halt and I think we would be plateauing out at almost zero growth levels in Q4. While that may not be a situation but I think the pain of Namaste would now come to an end and we would see how sharp the reversal of that business can be in the year ahead. I am not saying it is going to be easy because North America will continue to remain stressed. But we are seeing, like I said, a very good growth in sub-Saharan Africa which should take away some of the pain of North America. So, that remains the only issue.

The other issue that we are facing is currency in Turkey which again is the only currency which has not really stabilized and is continuing to weaken. That is going to be a little bit of a headwind from Turkey. But overall, if you put all the pieces together, you will see substantially improved performance from the overseas business in Q4 and we hope that that will continue in the quarters ahead.

Arnab Mitra: Sure, sir. So while clearly the top-line will recover, what is the outlook on margins there because there would obviously be input cost?

Sunil Duggal: The margins will mirror the top-line, because one of the issues with regards to currency depreciation is their gross margins come down because you import a lot into the country and the importation cost is high, you cannot pass it on to the local market in entirety, so your margins shrink. Our margins have shrunk by 10%, or more than 10%. And I think we should be able to cover most of them now with the currency stabilizing. The bottom-line also would look good, I do not have clear visibility about what the trajectory is, but the first cut numbers do show that the international profitability will be again a strong growth on a YoY basis starting from this quarter.

Arnab Mitra: Sure. And one bookkeeping question, I mean, I just wanted to understand the other income dropped this quarter and how should we look at that going ahead?

Ashok Jain: Main reason for that is in the base quarter there was certain capital gain booked due to some sale in the base quarter which had not happened in the current quarter.

Sunil Duggal: And also the rise of interest rates have lowered the yields.

Lalit Malik: There is one-time profit gain on account of sale of investments to the tune of Rs.16 crores, that made the difference. And also the interest cost is firming up, it has an impact on the yield.

Sunil Duggal: This pain will remain as long as the interest rates continue to harden, we would see growth in non-operating income.

Richard Liu from JM Financial

Richard Liu: Good evening, everyone. This is Richard here. Sir, you have partly dealt with this in the previous question, but I just want to get your broader high-level thoughts on the topic of international business. A few years back of course a lot of Indian companies went overseas, but I guess the objective of these was providing a delta to the overall growth profile versus the India rate of growth. But if you see the last few years they actually prove to be decretive and extremely volatile, there are of course lot of valid reasons to this and which we just mentioned to the previous question. But in light of all these how do you now look at international investments? The short question is that are you as structurally bullish about going international as you would have been some years back?

Sunil Duggal: Yes, I think Richard what we thought we would get is immediate gains from acquisitions, and that obviously has not happened. But having said that, the long-term strategic reasons for these acquisitions, Namaste really to build a franchise in sub-Saharan Africa more than anything else, they remain intact. And I think without Namaste happening we could not have built any substantial presence in South Africa, I mean, if we did not do Namaste, we would have to do something else. But we could not have done this on our own, the black consumer is very different from what we are used to and we did not have the knowledge to deal with the consumer. Now we do. So, if you take a 10-year perspective I think these are good deals, if you take a short-term perspective they do look a little bit tough. While I think I do not regret these acquisitions, obviously with the benefit of hindsight we would have executed them a little bit differently than what we did. But I think if you take the long-term we will definitely benefit from them. Sub-Saharan Africa is a big prize and Namaste is a perfect entry point into that market.

Richard Liu: So, if you are given an opportunity for another international buyout you will continue to evaluate those despite the kind of volatility?

Sunil Duggal: We certainly would, but having said that, we have gained huge amount of experience, remember these were our first two acquisitions outside India. So there was a learning curve which we had to go through and now having been through that we are far more prepared to see the underlying risks and to deal with them and to take preventive action to deal with them. For example, in Namaste we did'nt see this huge natural base coming, so we did not map it out properly, we were not used to that ecosystem and we were not used to that piece of change. So we would not be caught napping I think this time, we will do our diligence in a far more structured manner. And I think after having gone through this learning process, some of which has been painful, it would be foolish just to disregard it. But like I said, we will be much better prepared.

Richard Liu: So, if you look let's say over the medium-term and let's say three to five years out in your own business plan that you are drawing up, do you still envisage a situation where your current basket of international businesses, do you think that basket is going to grow faster than your Indian business?

Sunil Duggal: Well, last whole year has grown slower, in fact this year on a YoY basis our international business has shrunk to 27% down from 30% a year ago. So it is really the Indian business which is moving the whole needle.

Richard Liu: No, I am saying that what is your expectation for the next, okay now that…

Sunil Duggal: Honestly, I do not know. We deal with international growth on a case-by-case basis, we pursue deals which we believe are good, we walk away which we do not think so. So far after Namaste we have not done any acquisition, even though we have been looking all the time. So it is really hard to put a number to it. I mean, I still think that the current trajectory, between three-forth and two-thirds India and one-fourth to one-third international is probably the band which we will operate, but this can change.

Richard Liu: Okay. And one more question if I may on Foods margin, if we look the festive packs got advanced to Q2 and I guess these packs are relatively low margin products, what is the reasons for Foods margin of Q3 being lower compared to the levels seen in Q2?

Sunil Duggal: No, I think the gift packs do not have any material impact on margins, the net margins are similar. Couple of points here and there, mainly because of CP. We did give massive CPs in the base quarter, if you remember that. So, the CPs we have taken off the table and that has partly lead to this vastly improved margins. We have also made network changes, we have got rid of a lot of third party co-packers and moved that production in-house in Pantnagar, and that has also been better. And we got some area-based exemptions in Pantnagar. So the margins have expanded, the strong rupee has helped because a lot of**fruit concentrates** are imported, so we get them at a lower price because of the strength of the rupee. So that is the real reason.

Richard Liu: Okay. No, I was actually talking about the 15% clocked in Q2 of FY18 which has come down to 13% in Q3 of FY18, I am just talking about quarter-on-quarter.

Lalit Malik: Yes, actually it is a product mix also because the 200 ml has a lower margin versus one liter. So what you see is that we have more than 200 ml this quarter versus what we had in the Diwali gift pack earlier, so that is one of the reason on the mix side.

Sunil Duggal I think 2% is not very meaningful I think, once you look at in the context of YoY where I think 8% has moved to 13%, that is really the big change, a couple of percentage could be just a small mix issue. And part of it, yes you are right on Diwali gift pack, but like I said its not a big number.

<u>**Vivek Maheshwari from CLSA**</u>

Vivek Maheshwari: My first question is on the margins, so you mentioned something in case if let's say crude and all the crude derivatives remain where these are right you, you mentioned you will be able to maintain margins, is my understanding correct?

Sunil Duggal: Yes, I mean I think in Q4 we should be able to, because we are still sitting on substantial amount of low price inventories which we will be consuming, and our margins are on consumption as you know. Now, going forward once this whole anti-profiteering overhang and all is over we will take up prices in line with the inflation numbers, and that would happen early in Q1 of next year. We have not really done that mapping in terms of price increases, but Q4 will be fairly subdued, Q1 I think if inflation continues as it is, oil prices remain at this level, Coconut Oil prices again remain historically high then we will get our price increases.

Vivek Maheshwari: So, basically, if I understand you correctly where the spot prices are in general you need a price hike to basically manage margins, right?

Sunil Duggal: Yes, where the input cost increases are in strong double-digits we need a price increase, there is no other way we can maintain the margin profile.

Vivek Maheshwari: Okay. And this anti-profiteering issue what you mentioned, one, I am not very clear, I heard you on CNBC also a while back and you mentioned about you are not very clear how do you take up prices, what authorities will look for, do you need to have a product price list or basically the calculation around how much is the inflation, etc, is there any concern on that or by first quarter you think that concern will be behind?

Sunil Duggal: I think that concern will disappear in the first quarter. At this point in time since it is a very live issue it is better to err on the side of safety and not take up prices even if the input prices are hurting, which like I said will not be doing so meaningfully this quarter. But at the end of this quarter they will, but we can postpone it by a few weeks just to not cause any issues with the regulators. But whatever we do, since anti-profiteering is not going to disappear, we will have to justify those increases with the detailed calculations and the rationale behind those price increases. So we will take that also in to cognizance. Proactive price increases I think for the next few quarters may not be that easy to get.

Vivek Maheshwari: Okay. Are there rules which are formalized on this issue, I mean the way in which crude, if that is the only one variable if we take, the way in which crude prices have moved up I mean let's say in a market like India you should be allowed to take up prices, there should be no concern as long as… and once you have passed on the GST impact it is up to the industry or the company to take up prices, right?

Lalit Malik: Absolutely. See, the fact remains is the anti-profiteering only says that when the rates were reduced from 28% to 18% the benefits was to be passed on to the consumer, but it does not prohibit or stop any company in terms of increasing their price if the input cost is going high. So that is very clear. The only question is if there is a rate reduction have we adequately passed it on, and that is what Mr. Duggal was talking of that we have taken adequate step to ensure that we have passed on all the benefit that we got to the consumer and therefore there is no impact. And while going forward if there is any inflationary pressure, that will be evaluated in terms of increasing the price, but that probably will happen in the first quarter because we are sitting on some inventory which is at the low level. But whatever be the situation even in the first quarter we will have to build a detailed rationale and a case for price increases by having visibility over our value chain so that there is no disconnect. Ee will see how the anti-profiteering issues shape up, at the moment there is not too much other than a couple of notices here and there.

Vivek Maheshwari: Okay. And if I may just one follow-up on this, when you say you have to have a case, basically that is for your internal working or every time that you take up prices you have to…

Sunil Duggal: Well, let us put it this way, if I do any price increases in this quarter I will first make sure that there is detailed rational to support the price increase so that I do not fall foul of the regulators. Now going forward obviously this is not going to continue forever, we are in a free market, but we have to see, manage the sensitivities which are there, and I am sure they would not last for long. Perhaps by the end of this quarter anti-profiteering would become redundant because other aspects of the value chain will then begin to factor the margins.

Vivek Maheshwari: Okay, got it. Second, quick comments on wholesale and CSD for this quarter, like you mentioned last quarter what was the growth in both these, or de-growth in both these channels?

Sunil Duggal: Well, the CSD declined by 22.5%, this was a big-big drag. Okay let me give you a breakup in terms of various channels, because this is interesting. What you call GT distributors (General Trade distributors) grew by 13.7%, these are distributors whom we sell in urban centers and then who sell to retail and to local wholesale. A super stockiest which is really the rural wholesale grew by 26%. Modern trade grew by 17.6%, not spectacular but above the stockiest growth. Cash and carry which is modern wholesale grew by 16%. Food services which is enterprise grew by 73%, but the this is not a big, it is only 1% saliency. Paramilitary, again 1.4% saliency, grew by 27%. Other institutions grew by 12.2% and Canteen which is a big daddy in terms of enterprise, B2B business, declined by 22.5%. So all this growth you see are net of CSD and CSD is very material in Chyawanprash, in Amla Hair Oil, Honey, so these three is very big. So the growth that you see which are already good are despite this overhang of CSD. And of course, CSD impacting everything, including Juices where it is has got 2% - 3% saliency and Oral Care, everywhere. So I think we have managed the CSD deceleration quite well by tapping into other channels, particularly the rural wholesale, which at 26% is a very high growth.

Vivek Maheshwari: Thanks for all these numbers. All these numbers are like-for-like, adjusting for GST and the base as well?

Sunil Duggal: Yes, they are all adjusted for GST. Everything which you hear now will be adjusted for GST.

Vivek Maheshwari: Okay, got it. And last bit on Chyawanprash, how did Chyawanprash do in this quarter if you adjust for CSD?

Gagan Ahluwalia: 12.2% overall and net of CSD it was 20%.

Sunil Duggal: Again, 12.2% if you include CSD. So again, it was a great growth, despite the fact that the winter has been fairly subdued in the north, so we are pretty happy with the way Chyawanprash has performed. We did not really pump in too much money behind the flavors and the variants because we felt that we should wait for another year, so let the market be totally normalized, and our own financials are back on track to really then include into it. So next year we will have a massive program of investment behind the Chyawanprash franchise which we did not this year.

Aditya Gupta from Goldman Sachs

Aditya Gupta: A couple of questions. One on Oral Care, you mentioned that the growth is driven by increasing penetration may be channel wise or geography, can you just throw some more light on how much more scope this penetration lead growth is remaining, how much you have covered already?

Sunil Duggal: Depends on upon the rate of conversion now, I think the penetration in terms of geography, while still a lot of headroom still exists but that would not continue forever. So it is really going to be a conversion game, how much can it convert from the regular non-herbal Toothpaste into Toothpaste, and everybody is playing the same game, the recruitment is from the regular products. Now who does this conversion best will be gaining the most. I do not think the Toothpaste category is growing at more than higher single-digits. So, the herbals if they are growing at 25 - 30%, I do not know what Patanjali grows by but Multinationals on a zero base they would have done some growth. So, slice of the pie is increasing, but in our case, we do the recruitment from our competitors. In the case of the multinationals they probably will have to do recruitment from their own franchise.

Aditya Gupta: And second you mentioned on the E-Way Bill will now impact demand in the near-term, there are limited details I guess but do you expect this impact to be a month or longer than that, and will be homogenous across your categories or some categories will be more impacted?

Sunil Duggal: See, 14 states have implemented the E-Way Bill from tomorrow, the big one is UP of course and then most of the southern states have done it. I think all the four southern states are implementing it. Then there are a couple of smaller states in the northeast, etc. But the middle one is UP for us and I do not know, it could be disruptive because it is very restrictive, any movement above 10 kilometers and any consignment size of more than Rs. 50,000 has to be supported by E-Way Bill Now, while the process is reasonably simple, but even doing that, given experience of GST, will definitely be a challenge. There is some bit of surprise, we are fully prepared for generating an E-Way Bill because that is entirely in our own hands, we ship from factories to C&FAs, which are controlled by us. So, no issue there. But suddenly two, three days ago, this intrastate which we are expecting from June came, and there is a little bit of concern about its impact in terms of day-to-day movements. Even within a city like Lucknow moving a shipment from point A to point B if it is more than 10 kilometer there needs a E-Way bill. So it is pretty complex and there are so many issues with regards to this E-way bill, if I am having say 25 cases which is Rs. 50,000 from my stockiest to may be 30-40 retailers, in which what form it will take. So, because the E-way bill has to specify a certain consigner and a consignee and if there are 30-40 consignees, then what do you do. So, it is another issue which again I think we will navigate it, how long it will take I do not know, but there is some concern, yes.

Manoj Bansal from Ambit Capital

Manoj Bansal: I just had a question around the OTC pharma range. So, the growth seems to be relatively muted compared to most of the categories, so anything specific about this category which could have led to the lower growth? And secondly, there has been a big product launch which has been in the works for few years around this whole range where products around diabetes, cholesterol, blood pressure, arthritis, etc, have been under developments, so any updates on when can we expect a larger launch in this product range?

Sunil Duggal: You know, to answer your second question first, around 10 products under the Ethical range have already been launched. You may not have seen them because they have been launched through the prescriptive route. There are products for liver, for stress, for arthritis, a long list of ailments. Very good products, very safe and efficacious, but we still feel it is prudent to incubate them through the prescriptive space for a couple of years before we take them OTC. That is why they are not very visible, but if you want to see some of those you can go on our website or Gagan will give you some more information about them. So these are some very exciting and very promising products which we will take to market through media whenever we feel it is right. At the moment we are still scaling up our prescription infrastructure, we have got a new team onboard to deal with it and we would look at highly accelerated pace of supporting this whole detailing framework in the current year.

Manoj Bansal: So sir, has this launch gone national, because I believe we had been test marketing them in a couple of states, is the prescriptive route and the launch taken national?

Sunil Duggal: Yes, it is still regional, what we are doing is we are putting different products in different regions, through the prescriptive routes there is a limitation and the number of products you can take to the practitioner is typically four or five. So we are doing something in some states, something in the other, and then we see which ones are most suited to take to market when. And there will be a lot of learning from this whole exercise, there is a whole Ethical piece going, there is a lot of attention and disproportionate attention on the part of the management towards this particular initiative, and we are pretty happy with the way it is performing.

Manoj Bansal: Right sir. And on the overall growth rate for the category, anything specific about this category which has picked up?

Sunil Duggal: Very hard to say, but I think the growth rates would definitely be in the double-digits from next year onwards.

Harit Kapoor from IDFC Securities

Harit Kapoor: Just had two questions on the international part, firstly on margins. So, both the acquired businesses, Hobi and Namaste, have over the years seen shrinkage in margin and probably towards the end of last year margins were at all-time lows at the EBITDA level. Just wanted to get your sense now that you are hopeful that these businesses are going to stabilize and grow going forward, what is the specific outlook on improving the margins here?

Sunil Duggal: Well, I think the Namaste margins are already showing signs of improvement and we will rapidly scale up the margin delivery from here, the challenge is more on the top-line rather than on margins because we have cut cost now tremendously over the last couple of years to support the smaller business size. And the sub-Saharan Africa would support the margin growth also substantially. The challenge is more with Turkey in terms of margins, because the currency issues still remain relevant there and this is only currency which is in the continent shows sign of weakness in the entire basket. The moment currency stabilizes our margins will improve, there is no doubt about that. But it is very difficult to improve margins with a depreciating currency, the price increases which you take can never compensate for the margin erosion on account of the weak currency.

Harit Kapoor: Okay. My second question on the international front was, a large part of this international business has been developed organically over the last few years. Just wanted to get your sense on whether you see cross pollination opportunities from some of these successful international launches to India and is there an opportunity there sitting possibly in the future, next one, two years that you can think of, something that you are thinking of going forward?

Sunil Duggal: Yes, definitely. I think from the Dubai franchise there is definitely a lot of cross pollination that can happen in India, and we can begin to do that with hair care products, high end hair care products like serums, etc. Now that E-com offers us a window to go to consumer without the whole issue with regards to trade, that is probably a good platform and it will become increasingly powerful as the years go by to introduce new products without the issues which you have to deal with in selling through the traditional trade. So the cross pollination happens, between Namaste and Dabur quite frankly there is very little, because that is what is for Black people and so it is not really relevant to the Indian consumer. But the cross-pollination of Namaste is really happening in Africa from the US, and that is really the reason like I said earlier we brought this business, how do we populate Africa with Namaste products and have the whole learnings from the Namaste business to leverage the Africa opportunity.

Harit Kapoor: Okay. My last question is on India and on really the underlying rural urban trends, I know you have touched on the fact that rural growth for you is quite strong but that was really led by your internal initiatives. Just wanted to get your sense on the environment that has tracked in rural over last may be two or three quarters as well as urban, and the thoughts going forward?

Sunil Duggal: Like I said the growth, a lot of the growth which you have seen across companies are really a base issue and going forward stimulus could lift the whole growth trajectory into a different orbit or it could not, depending upon what the budgets, etc., presents. So, I think we really have to be prepared to slug it out in terms of better infrastructure, better execution, and therefore share gains to drive growth. I am still saying that double-digit growth in rural markets, even in a very slow burn environment is eminently possible for us. We do believe we have world-class infrastructure which we have built over the last one year or so in rural India in particular to deal with the challenges of low growth.

Nillai Shah from Morgan Stanley

Nillai Shah: Just two questions from me, sir. Could you comment on the recent management changes at the mid-managerial level between India and international business, and what triggered that?

Sunil Duggal: Well, I think we are building up to the next year in terms of succession planning and we have a strong desire to do it from internal resources rather than to do from outside. So this is part of a cross pollination process that you move people around, give them exposure to different geographies, challenge them in a different operating environment and that would reveal the qualities which we require for orderly succession from within. So, it is part of a very carefully crafted process which would have happened a couple of years ago, but then this whole issue is with regards to demonetization, etc., put this process back by two years. But now we are back in the game as far as business is concerned, it is the right time to hand over different businesses to different people. I would have not liked to do it when we were in a crisis situation which was there two years ago up to now, but since the business has now stabilized this is right time to make the move. And we will progress it in a manner which we are comfortable with at a pace which we are comfortable with. We have outside help also from leading HR company. So I think it has been very well crafted and we believe that it would lead to orderly succession in the years to come.

Nillai Shah: Got it. And just taking off from the earlier question on cross pollination, you had started the process with the baby care portfolio, but it seems to have got lost somewhere. Is it just an issue of timing or you have changed your views on that?

Sunil Duggal: I think it is an issue of privatization, when baby care was really going to be pilot in MENA region, particularly in GCC, that was there we would have got the learning to transplant into India. The entire initiative was really around baby oil which is different from Lal Tail, which everybody likes to use. But we did pilot the baby care initiative two years ago in the Gulf, but then the Gulf business fell apart with all these issues with regards to the MENA economy. And the baby care was the first casualty of that, so we withdrew it like we withdrew some other products also and we shrunk the business little bit to its core. Now with the MENA rebalancing we are really looking at baby care once again with some level of seriousness. So when we make the grand plans for next year we will definitely have baby care as initiative, how much we will be progressing I do not know. And that is another example of cross pollination, if we get it right in the Middle East we can transplant these earnings into India and have a baby care business here. But it is a very tough category to enter, and we may choose not to enter it, because if our focus is shifting towards Healthcare for adults in terms of lifestyle management, we may put more of our resources there, we cannot spread because it is too thin.

Nillai Shah: Okay and last question, in terms of the next two or three years for the India business where do you expect the max acceleration in top-line growth to come from which categories broadly speaking, without getting into the brands also it is okay, but just which category? I know Toothpaste is one of them for sure, but what else apart from Toothpaste?

Sunil Duggal: See, most of the growth may continue to come from HPC and Foods, but in terms of long-term strategic rebalancing of the portfolio the move is towards Healthcare. So Healthcare may not be significantly impacting the mix or margins or profit over the next say two, three, four years, but it is a long-term strategic imperative. Now, many of the initiatives are slow burn, so we got to be looking at a horizon which is five to ten years rather than three to four. So, I do believe that while Healthcare may…

Nillai Shah: Sorry, for the first time I am hearing you talk about market share gains, so you obviously have your plans drawn up in terms of which categories you are going to target. Healthcare, you had in the past said it is a slow burn, so that is impossible you can drive that near-term high single-digit growth you are looking for. So, which other category are you really gunning for, you have done very well in Toothpaste, but apart from that what else?

Sunil Duggal: We look at share gains in all the key HPC categories, and we look at share gains in Healthcare categories like Chyawanprash and honey. And we look at sizing up the whole space in the digestive for example, where we have strong brands but comparably small. Now, we are not looking at market share there because that is not a relevant metric, but in let’s say digestive, in cough-cold, we would be looking at very, very high levels of growth and high levels of investment. So we are going to pressure investments, give disproportionate investments to a few brands, I do not know what they are because that will emerge over the next few weeks, but these are three, four brands which are currently perhaps in the Rs. 30 crores to Rs. 50 crores segment, but very scalable which enjoy inherently high margins and then we will be putting in substantial amount of resources, disproportionate resources. We may lose some money for a year or two, but I think if we are able to scale them up then the fruits of that investment will be very high. But definitely the way to grow, assuming that the category growth remains subdued and that is what the situation today is. The only way to grow in the big HPC category is through market share gains.

Nillai Shah: So, what you are saying is in the big HPC categories there are precise plans for which categories, which brands will be drawn up only in the near future?

Sunil Duggal: Well, a couple of weeks from now, that is when the brand plans will be crafted. It is already being worked on, now we just have to see it at the senior management level. And then prioritize as to what brand gets what investment. Obviously, we cannot afford investment across the whole portfolio, so some will get high level of nourishment, some wont, and that is really the trick in picking the right horses which can take you through that desired level of growth.

Anubhav Sahu from Antique Research

Anubhav Sahu: Any regional differentiation in rural growth, this quarter has been good, but is there any regional pattern?

Sunil Duggal: I do not know whether it is structural, that we can extrapolate it, but let's say this quarter and may be the earlier quarter before this we got very good growth from east and south, and comparatively low growth from north and the west. But like I said, you cannot read too much into it, these things keep changing.

Anubhav Sahu: Right. And sir, by any chance would you have the last year's numbers for distribution sales growth mix?

Sunil Duggal: Yes, we have some numbers in terms of the direct distribution reach which has gone up around 10% in the last quarter, 7% - 8% sorry. Now it has exceeded a million which was a big milestone. And the growth really in terms of reach has come from urban. Once again let me clarify that his whole rural outreach program is not to expand distribution width, we believe we have adequate, it is basically to get more SKUs into the whole distribution funnel and that is why we have divided the organization down the middle. So we now have 1.02 million outlets and touch points, we had 0.94 million three months ago, so that is a big increase. And most of this increase has come from urban actually, the rural is more in terms of quality of distribution rather than in terms of numbers. I think in numbers until the market revives and the category growth goes ahead, there is no point in increasing the number of touch points because the cost of which will become unsustainable. So we have not really increased the number of touch points in rural for the last almost two years, the environment did not support that initiative. But as and when rural growth increases we will scale it up, it is not really difficult to do.

Anubhav Sahu: Okay, sir. And sir just to understand the base effect, last year in Q3 what was the growth from super-stockist channel and the general business channel?

Sunil Duggal: I do not remember the number but definitely the super-stockiest which is the rural wholesale channel has grown at 2x business and substantially ahead of us. So there has been a huge rebalancing in terms of our channel mix, with canteen going down, urban wholesale going down, rural wholesale going up, modern trade increasing reasonably well, e-com even though the base is very low is increasing exponentially. So, it is a very mobile situation and I think directionally we are moving our dependency upon urban whole listening at a dramatic pace. I personally feel E-way bill is going to deal a big, big blow to urban wholesale, because when they ship the products across state lines or even when they sell it within state lines, it is all cash dealings and the E-way bill is basically there to stop this kind of stuff. So we will have to further accelerate our rural outreach in terms of the rural wholesale, also urban touch points, etc, etc. The things are changing very rapidly on the ground.

Latika Chopra from JP Morgan

Latika Chopra: Mr. Duggal, just one question, your commentary on rural was bit more cautious than rest of the peers who have reported earnings so far. You have talked about the rural market growth rates are fairly subdued, all the growth has largely come from your own efforts while others have talked about a gradual improvement. Why is there this divergence so to say, or is it that the bigger players are basically doing better in rural versus others?

Sunil Duggal: Well, our rural growth Latika this time was 23% - 24% over last year, so it was a spectacular performance in rural. Why I am being a little cautious is because the headline numbers, and that is the only data we have access to which is meaningful show a sharp deceleration in the growth rates. Now, I cannot ignore this metric now, now our growth are good and hopefully will remain good, but we have to be prepared that the growth rate may not, the inherent growth may not support our business growth and we will have to do something extra. So I do not want to lulled into some kind of complacency that growths are there, we just have to walk in and take it, we will have to fight for those, we should be prepared to fight for growth through market share gains. Now, like I said, tomorrow could be a very, very different environment where rural economy will take higher place in the budget and then we would see the acceleration happen. But there is no harm in making that extra effort, I always believe that be prepared for the worst and don't try to be overly optimistic. So that is really the way we run our business looking at the worst-case scenario.

Latika Chopra: Right. And the numbers you are referring are Nielson numbers I am assuming, right, the Q1, Q2, Q3 numbers I talked about earlier?

Sunil Duggal: Yes, every category is showing the same trend in FMCG. So you can get these numbers yourself and see.

Latika Chopra: We do not get access to them anyway. Thank you.

Gagan Ahluwalia: Thank you for joining us for this conference call. The transcript of the call will be available on the website. Feel free to address your further questions, if any. Thank you and have a nice evening.