(a PepsiCo franchisee)

Varun Beverages Limited

Q2 2019 Earnings Conference Call Transcript
August 1, 2019

Moderator: Ladies and gentlemen, good day and welcome to the Varun Beverages Limited Earnings Conference Call. As a reminder, all participants' lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, 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 Anoop Poojari from CDR India. Thank you and over to you, sir.

Anoop Poojari: Thank you. Good afternoon everyone and thank you for joining us on Varun Beverages' Q2 2019 Earnings Conference Call.

We have with us Mr. Ravi Jaipuria – Chairman of the company; Mr. Varun Jaipuria – Whole-Time Director; Mr. Raj Gandhi – Group CFO & Whole-Time Director; Mr. Kapil Agarwal – CEO & Whole-Time Director and Mr. Kamlesh Jain – CFO of the company.

We will initiate the call with opening remarks from the management following which we will have the forum open for a question-and-answer session.

Before we begin, I would like to state that some statements made in today's call may be forward-looking in nature a detailed statement in this regard is available in the results presentation shared with you earlier.

I will now request Mr. Ravi Jaipuria to make the opening remarks.

Ravi Jaipuria: Good afternoon everyone and thank you for joining the call. I hope all of you had the opportunity to go through our results presentation. This provides details of our operational and financial performance for the second quarter and half year ended 30th June 2019. We are happy to share that Q2 2019 has been a standout quarter for us and we have delivered a robust performance with topline growth of 36.5%, EBITDA growth of 37.1% and PAT growth of 32%. This was on the back of strong volume growth of 43.3% driven by healthy off take in India, continuing success in our international operations and the consolidation of territories recently acquired with effect from 1st May 2019. Organic volume growth in India was robust at 18.5% on the back of increased penetration and an extended summer season.

We have made rapid progress with the consolidation of the recently acquired territories in South and West regions and also those acquired last year. This has resulted in expansion in our EBITDA margins demonstrating our strong execution capabilities, efficiency of our operations and operating leverage.

Over the last 12 months we have undertaken several business strengthening initiatives including setting up of the new plant primarily for Tropicana products at Pathankot, acquisition of South and West India sub-territories and investments to drive organic growth. All this has been achieved while maintaining a strong balance sheet position and significant proportion being funded through internal accruals. Capacity utilization in India during the peak month has come down to 60% post consolidation of South and West India sub-territories, providing significant scope for growth on the existing investments.

Commemorating the start of the silver jubilee year of the company and in appreciation of continuing support from the shareholders the board of directors recommended bonus issues of equity shares in the proportion of one equity share for every two equity shares held. Further given the strong performance delivered in H1 and the confidence that the successful execution of our strategic plans will continue to generate strong cash flow the board of directors have recommended an interim dividend of Rs. 2.50 per share on the enhanced equity capital base.

To conclude, we have delivered a robust performance in Q2 and are the peak season for our products we are on a strong footing to deliver sustainable and profitable long term growth this presents across 27 states, 7 union territories across India, accounting for over 80% of PepsiCo India's beverage volumes. We will be focused on consolidating our dominant position in the industry by further strengthening our distribution infrastructure across the country and unlocking value from the recently acquired underpenetrated sub-territories in India which provides huge opportunity for driving volumes, gaining market share and provide significant operational leverage going forward. We are constantly working towards building a winning multi-category product portfolio which is in line with changing consumer preferences and accelerating our quest for leadership across each beverage segment and category.

I would now invite Mr. Gandhi to provide highlights of the operational and financial performance. Thank you.

Raj Gandhi: Thank you, Mr. Chairman. Good evening and a warm welcome to everyone for joining the investors call. Let me provide an overview of the financial performance for the second quarter ended 30th June 2019. Revenue from operations grew 36.5% year-on-year in Q2 2019 to Rs. 28,104.5 million. This was driven by robust volume growth of 43.3%. Total sales volume increased to 195.5 million cases in Q2 2019 as compared to 136.4 million cases in Q2 2018 on the back of strong peak season sales in India and healthy growth reported in the international operations in Morocco and Zimbabwe.

Organic growth in India stood at 18.5% while in international territory stood at 34.2%. Realization per case has fallen by 4.7% on account of change in product mix in India post consolidation of South and West sub-territories, introduction of water in Morocco and lower sales realization in Zimbabwe in USD in terms due to forex fluctuation. CSD constituted 74%, Juice 8% Packaged Drinking Water 18% of the total sales volume in Q2 2019.

EBITDA increased by 37.1% to Rs. 7,878.8 million in Q2 2019 from Rs. 5,748.6 million in Q2 2018. Gross margins declined by 74 basis points during the quarter and 26 basis points during H1 with rising input cost of sugar (which saw average price increase of approximately 3%) and preforms (which saw an average price increase of about 13%). Despite this, EBITDA margins expanded 12 basis points during the quarter and 43 basis points during H1 on account of operating leverage and economies of scale.

PAT grew of 32% to Rs. 4,049.9 million in Q2 2019 from Rs. 3,067.9 million in Q2 2018 on the back of robust volume growth. Depreciation has increased during the year on account of capitalization of Pathankot plant and consolidation of South and West India sub-territories with effect from 1st May 2019. Finance cost has increased by 63.9% as the purchase concentration for South and West India sub-territories has been funded through long term debt.

We have incurred a net capex of Rs. 23,500 million in the first half of the year. This included setting up of a new plant primarily for Tropicana products in Pathankot (~Rs. 4,800 million), acquisition of certain parts of Maharashtra, Karnataka and MP (~Rs. 500 million), acquisition of South and West India sub-territories (Rs. 16,150 million net of investment fund) and organic capex of ~Rs. 2,250 million. Given the strong cash generation of the business, we have limited increase in our net debt to Rs. 37,295 million as on 30 June 2019 as against Rs. 26,715 million as of 31 December 2018.

Working capital days have remain stable at 14 days as on 30th June 2019 as compared to 13 days as on 30th June 2018 despite consolidation of the new territories acquired in India during this period. Efficient working capital management has ensured inventory and debtors days have remained stable despite strong growth in net revenue and addition of a number of production facilities.

To conclude, our performance in the first half has been robust with revenue growth of 32.2% to Rs. 41,696 million; EBITDA growth of 34.6% to Rs. 10,063 million and PAT growth of 36.3% to Rs. 4,450 million. The success of our integrated business model is underscored by our growing portfolio and extending territory of operations. Our business model is central to everything we do. It enables us to ensure excellence in execution, strengthen our relationships and improve outcomes. We fortify our business model to deliver sustained value creation for our stakeholders.

On that note I come to an end of opening remarks and would like to now ask the moderator to open the lines for the Q&A. Thank you.

Moderator: Thank you very much. We will now begin with the question-and-answer session. The first question is from the line of Sameer Gupta from IIFL. Please go ahead.

Percy Panthaki: This is Percy here. Sir, my first question is, last quarter, there was a sort of provision for some currency-related issues in Zimbabwe, so if you could give us an idea of what is the quantum of similar provision this quarter and what is the outlook on these numbers going forward.

Raj Gandhi: Last quarter's number was about Rs. 65 crore of net provisions. This quarter we did majority of our sales in US dollars so that we do not have to make provision for currency conversion. Let me explain that why there was a little bit of fall in our sales realization, one of the reasons is in Zimbabwe, we started billing in US dollars and realizing money in US dollars. So, on consolidation, the topline is reduced and the provision is not required. Profits remain the same and there is no provision required in this quarter.

Percy Panthaki: Okay. And going forward also? So if I understand it correctly, the sales is lower and the provision is no longer required, but the profit per case would be similar versus last quarter post provision, right?

Raj Gandhi: Your understanding is correct. However, going forward, we will have to resort to the earlier accounting as per the notification of Reserve Bank of Zimbabwe dated 24th June which states that the currency of operation in that country has to be the local currency. So, the option of selling in dollars, which was earlier available, is no more available. So, we believe, going forward, the revenue will go up and the provision may also come up from this quarter.

Percy Panthaki: Okay. But understanding was that the Rs. 65 crore kind of number was a peak and then gradually that would taper off? So, can you give some idea on that issue?

Raj Gandhi: Definitely, it will taper off because our liability of the foreign currency exposure in that country is getting reduced anything between US$1-2 million every month.

Percy Panthaki: Okay. So, like the Rs. 65 crore, I mean any kind of guidance possible going ahead instead of this Rs. 65 crore, will it be Rs. 40 crore or Rs. 30 crore or anything of that sort?

Raj Gandhi: Actually, it may not be required and still the revenue may go up. As per the recent circular, out of the export proceeds, some portion has to be surrendered to the government which will be allocated by government to meet the import requirements. So, with the availability of dollars, the local currency is becoming more stable, and we will have to wait for situation to get stabilized.

Percy Panthaki: Second question is if you could give an idea on the international business growth by geography, how it has done?

Raj Gandhi: In this quarter, Morocco has been the outperformer with H1 volume growth of over 80%. We have not even grown cumulatively 80% in the last 6-7 years in Morocco and in this year, in H1 only we have grown over 80%. This is on the back of introduction of bottled water in that country, which has been well received. In water industry, we have already become ~ 3% of the market in the first 2 quarters, which has helped us to push our CSD volumes also. We have already crossed ~12% market share with a single plant as against the 88% market share through seven plants by the competition. If we are able to maintain this growth, the territory of Morocco, which earlier used to be in red, will start making profits.

Percy Panthaki: Understood sir and also some color I mean we have seen this quarter and even last quarter, general FMCG slowdown. Companies are struggling to give even 4%, 5% volume growth. And in this environment, you have clocked 18% kind of organic volume growth, and it has not only maintained versus previous level but also accelerated. So, just wanted to understand, of course, there might be some market share gain that you are experiencing and if it is possible to quantify that that would be great. But apart from that, is the CSD category itself not witnessing any slowdown like the rest of the FMCG business?

Ravi Jaipuria: You are correct that the CSD category is not witnessing any slowdown. Rather, water and juice are growing much faster, and CSD is growing at a reasonable pace. So, there is no slowdown in demand which we are witnessing. We don’t think categories like Rs. 10 or Rs. 20 or Rs. 30 are slowing down. Moreover, the extended summer has helped us. But fundamentally, overall, the industry has done well. We have had a great year, and the consolidation of new territories has happened much faster than what we had expected.

Percy Panthaki: Sir, what is the overall industry growth in CSD over the last 3-4 quarters if you can give that number?

Raj Gandhi: We get the industry growth numbers only with a lag of 3 to 6 months. During the last year, we have grown in-line with the industry and this year, at this moment, we are not in a position to give a comparison with the industry growth.

Moderator: The next question is from the line of Pritesh Chhedda from Lucky Investment Managers.

Pritesh Chhedda: On the debt side, sir, I just wanted to understand the movement between quarter 4 of last year, which is your ending debt, which was net debt at Rs. 2,671 crore, and the current debt, which is at Rs. 3,700 crore that you called out. So, between these two periods, what is the cash flow from operations and what is the capex run, and if you could give the bridge between the two debt figures?

Raj Gandhi: As per the regulatory requirements, this year we have provided the cash flow statement also. The capex is about Rs. 2,100 crore and operating cash flow is Rs. 1,214 crore which includes interest expense of Rs. 139 crore. Net debt has gone up by ~ Rs. 1,100 crore, the capex is ~ Rs. 2,100 crore and the balance of about Rs 1,000 crore has come from the operating cash flows.

Pritesh Chhedda: Okay. And so this Rs. 1,214 crore is before interest. Or is it after interest, this Rs. 1,214 crore of cash flow?

Raj Gandhi: This is before interest.

Pritesh Chhedda: Okay. Second is have you done the entire Pepsi payment? Or any Pepsi payment that's left, which will come incrementally in the forthcoming quarters?

Raj Gandhi: Our Pepsi account is totally settled on account of the assets, current assets or any other.

Ravi Jaipuria: Everything is paid.

Pritesh Chhedda: Everything is paid for. And there was one note return that inventory is yet to be adjusted. So, is there, what was that if you could explain? Any opinion on that, sir?

Ravi Jaipuria: There is nothing left now everything is paid and closed.

Pritesh Chhedda: Okay. My second question is on the soft drinks part. So, in the presentation, bulk of the growth is in soft drinks, which was 74%. Is it fair to assume that the entire Pepsi volume is sitting here? And if it is so, then what is the organic growth in the carbonated drinks if you could call out?

Raj Gandhi: 74% is not the growth. This 74% is the mix of CSD in overall volumes. And 8% is the mix of juice and 18% of our volume mix comes from water.

Pritesh Chhedda: So, what is the organic growth in soft drinks?

Raj Gandhi: 18.2% is organic growth for the CSD.

Ravi Jaipuria: For soft drinks, it is the same actually, pretty well same as everything else.

Raj Gandhi: And for juice, it is 24.6%.

Ravi Jaipuria: Juice is slightly higher.

Raj Gandhi: And the water, 17.2%.

Pritesh Chhedda: Okay. And last question is on the margin side. So, first, I want to know whether Pathankot operations have started. And did it contribute anything to the extra margin? And incrementally, over the next 2, 3 years, since we are operating our peak capacity utilization at 60%, and we have juices now eventually being made in-house, what kind of margin expansion is possible in the business operations?

Ravi Jaipuria: Well, the juice production has just started in July, so it is not showing in Q2 2019. So, that will show in the next quarter results. The manufacturing margin of juice, which we were earlier buying from outside, will get added to our profitability.

Pritesh Chhedda: And capacity utilization?

Ravi Jaipuria: Capacity utilization, the 60% what you are saying is post consolidation of latest acquisition as the PepsiCo plants, which we have acquired were much less utilized, and our plants were at about 70% utilization. So, when we combine the two, it comes out to 60%. So, hopefully, for the next two years at least, we will be not looking at any greenfield expansion.

Pritesh Chhedda: So, what kind of margin expansion is possible when you ramp up the capacity utilization? So, you were operating at about 19%. We want to call it out that over the next 2, 3 years, the operations can be whatever higher margin than what it is today, the number, if you could put out?

Raj Gandhi: We do not see a large scope in the margin enhancement. Slight movement either ways is always possible. What it could definitely help is in the enhancement of our ROCE, which you will notice constantly is going up. Three years back which used to be ~ 12%, this year it already has crossed 17%. Every year, our ROCE is increasing by about 200 to 250 basis points. The main factor behind this increase is the capacity utilization.

Pritesh Chhedda: So, via margin the ROCE will come or via working capital, the ROCE will?

Raj Gandhi: Through better plant capacity utilization and the sweating of our assets in a better way, the ROCE will go up. Margins are more or less the same and there is not much scope.

Pritesh Chhedda: Okay. And lastly your consolidated Pepsi territories for full quarter or you are consolidated for part of the quarter?

Raj Gandhi: It is a truncated quarter as the acquisition happened with effect from 1st May. So, the results include only 2 months which has helped us in the 36% PAT increase in H1 or in 32% PAT increase in Q2 2019.

The one big thing South and West can now bring in is, in the earlier calls, we always had said 110% of annual PAT we do in H1, which we do not think will hold true anymore, South and West being less seasonal. So, the upside in H2 at PAT level will be visible going forward. That is another change these territories have brought into our business model.

Pritesh Chhedda: Okay. And you are holding on with your QIP equity issuance plan or you are okay with your debt, which you will eventually draw down any case or not in the end of the year?

Raj Gandhi: We are holding it on as there are a lot of assets, which, we get an opportunity to look at. And once within 6 months after QIP we reach to the earlier debt level and earlier financial ratios, we believe we will be prepared for doing something new in 2020.

Pritesh Chhedda: Okay. This will be outside India?

Raj Gandhi: Not necessarily.

Moderator: Thank you. We move to the next question. The next question is from the line of Manish Shah from Comgest. Please go ahead.

Manish Shah: I just want to clarify; this 18.5% excludes South and West. It is just the old North and East business organic growth?

Raj Gandhi: Yes, 18.5% is organic growth, because South and West was not in the previous year with us. So, it is only for the territory, which we had in the last year also. You are right.

Manish Shah: And 18.5% is only India. So, can you give me kind of a breakup in organic growth internationally?

Ravi Jaipuria: There is 18.5% organic growth in India and 34.2% in international territory.

Manish Shah: And this 5% reduction in realization, do you attribute one reason is water introduction in Morocco, but what is the realization in India and international?

Ravi Jaipuria: When you look at the total picture including the acquisitions, their water mix is much higher than the mix we have in our existing territory. So, because of that, the overall realization has gone down.

Manish Shah: Okay. For India, it has gone down because of the south and west water, because of south?

Raj Gandhi: Yes.

Ravi Jaipuria: Yes, because, their mix was much higher in water.

Manish Shah: I have a query on capex. Earlier, you said that 110% first half, utilization and then?

Ravi Jaipuria: 110% was our PAT earlier, and it was only for North and East sub-territories. Now with South and West regions coming in, it will not be skewed so much in the first half. So, we expect between 90% to 95% PAT in the first half and balance will be in the second half. So, our PAT will be positive in the next half as well, which used to be negative until last year.

Manish Shah: Is it again because south and west is slightly higher proportion of water and maybe due to?

Ravi Jaipuria: It is because of the seasonality difference. North gets very cold and our volumes drop drastically in North in the winter season whereas South and West is reasonably stable throughout the year.

Manish Shah: And what implication does it have on the capex going ahead?

Ravi Jaipuria: Well, going ahead, we do not need significant capex because the capacity utilization in South and West is very low. So, we have a lot of headroom to grow.

Manish Shah: And how about north and east?

Ravi Jaipuria: In North and East also, we are not looking for any greenfield plant, because we still have enough headroom, but not the same level as what we have in South and West.

Manish Shah: Going ahead can I assume that your capex will be lower than your depreciation?

Ravi Jaipuria: Yes.

Raj Gandhi: That is right.

Moderator: Thank you. The next question is from the line of Anand Shah from Axis Capital. Please go ahead.

Anand Shah: My first question is can you break up this volume of 196 million in domestic and international?

Raj Gandhi: Domestic is 172 million, the rest is international.

Anand Shah: So, 172 million is domestic?

Raj Gandhi: Yes, approximately 24 million is international.

Anand Shah: Okay. And is it possible to share out of the 172 million, how much was from south and west for the 2 months?

Raj Gandhi: South and West contribution is 26 million.

Anand Shah: And in international, why have you called on organic growth as now, is there anything which is inorganic in international?

Raj Gandhi: For International territories, organic and inorganic is the same number.

Anand Shah: Second, if I look at your margins, surprisingly, I mean, despite the acquisition and consolidation of new territories, I mean, they are still quite healthy on a Y-o-Y basis as well. We have not seen a drag in generally. In the past we have seen them in your acquired territories. Initially they operate at lower margins and then you increase them and get back to your company level margins. So, that does not seem to happen this time. I mean, you started off itself at a higher margin base. So, any comments on that?

Ravi Jaipuria: Even we had expected it to take between 6 months to 1 year to consolidate these new territories and bring them to our levels of EBITDA margins. Our team has worked much harder and done a fabulous job in consolidating these territories, and we have seen improvement within the first 2 months.

Raj Gandhi: And also, Anand, the extended summer helped us to have the benefit of operating leverage.

Anand Shah: Okay. So, the season being good you got operating leverage plus even the integration process much smoother?

Ravi Jaipuria: Yes it happened much faster.

Anand Shah: So, I would assume now that the acquired territories must also have similar margins levels broadly?

Ravi Jaipuria: Should be.

Anand Shah: One more question on margins is in the international territories we have seen quite a bit of expansion. I mean, if I look at the consolidated numbers alone, your margin seems and EBITDA seems to have gone up by 4%, 5%. So, any reasons for that? There that also again driven by strong growth on leverage?

Ravi Jaipuria: This is primarily because of Morocco where we were losing money and now we have become profitable this year because of the massive growth we have had this year.

Anand Shah: Okay. So, that is led by water that you are seeing?

Ravi Jaipuria: It is led mainly by water, but we have grown in CSD also.

Anand Shah: So, in international is that profitability?

Ravi Jaipuria: Yes.

Raj Gandhi: Also, last year, at the same time, we were talking about the 30% decline in volumes in Sri Lank due to introduction of the sugar tax, which at the year-end, was substantially withdrawn. Operating leverage driven by strong growth in Sri Lanka, Zimbabwe and Morocco is helping the increase in profitability.

Anand Shah: Okay. So, 50% growth in Zimbabwe. So, Morocco has grown at (+80%). Zimbabwe has grown at (+50%). And even Sri Lanka would have grown at a quarterly base?

Ravi Jaipuria: That is right.

Raj Gandhi: And Sri Lanka is helping more in profitability because of the sugar tax substantially going away than in the volumes.

Anand Shah: Okay. Than the volume! Okay, so that gives more margin. Okay. And that is on the international part.

And on the capex, I mean, I have seen that you spent about Rs. 1,650-odd crore for the acquired territories roughly the 2x level. Initially when you had announced this, was the capex was supposed to be Rs. 1,800 crore to Rs. 2,000 crore? And is there anything like which will defer payment that will come later also?

Raj Gandhi: In the last call, we have mentioned the purchase consideration as Rs. 1,802.50 crore. After that we had gone back to PepsiCo because in their territories, we have to spend some money on the acquisition of the co-packer, as well as some for the capex which needs to be done. So, they created an investment fund for these and a payment of about Rs. 209 crore has been made back to us. This ~ Rs. 1,600 cr figure is the net figure reported here.

Anand Shah: Okay. So, the payout was there but the investment again you got back.

Raj Gandhi: Because this expenditure was on their behalf, which we will have to do in the next subsequent quarters. We have already convinced them and realized this money in our account.

Moderator: Thank you very much. The next question is from Varun Goenka from Reliance Mutual Fund. Please go ahead.

Varun Goenka: Just two small questions. One, there are some water issues going around in the country. And the Trucking Association also has sounded some kind of alarm because of the slowdown. So, are we facing any challenges on this side? Also Bihar and Assam are facing floods, so are there dispatch issues there?

Ravi Jaipuria: There is no such major issue. In the rainy season, there are always some parts of the country where floods happen. But in the overall context, it does not have any major issue. I think if we look at July, which is already completed, we have had a healthy growth. So, we do not see any issues related to floods or Industry slowdown.

As far as water scarcity is concerned, we are maintaining positive water balance at the company level. We put in more water back to ground than we take out. If and when we have some challenge in one State, then we have to manage and sometimes transport goods from one State to the other.

Raj Gandhi: Also, we are working on a document which we will put on our website. One how we are compliant to water recharge obligations, and how much we are doing more than that, realizing the importance of the water and sustainability and just to educate the society how much we at our own are doing on this. This is very important to us.

Moderator: Thank you. The next question is from the line of Prashant Kutty from Sundaram Mutual Fund. Please go ahead.

Prashant Kutty: Just on the margin side, sir, you said that there is not much of scope of margin expansion. At what levels are we looking at from a margin perspective? Because CY18, we delivered about 22% margins in the standalone business. What is the steady state annualized level of margin that you look at?

Ravi Jaipuria: EBITDA margin between 21-22% range is reasonable, these are also one of the highest in this industry. So, we believe if we can keep on sustaining these, we are in a good shape. And we feel with the expansion of territories, we will be able to maintain somewhere around this.

Prashant Kutty: Because you just said that in these two months obviously the consolidation happened much faster than expected. Incrementally the volumes get improved from here on wouldn't you get further operating leverage? That is the reason I am asking it?

Ravi Jaipuria: There is always a scope but we do not want to consider the same at the moment. There can be challenges like sugar prices increasing which can adversely affect margins. So, we believe guidance of 21-22% is a reasonably good figure. And if we can maintain that, we would be quite happy.

Prashant Kutty: Okay. And the second thing is, like you said that, for now onwards H2 will also see profitability because of the south and west. Would that the same? Would that be the case with the international operations as well? Because typically, in international also Q3, Q4 tend to be a loss-making quarter?

Ravi Jaipuria: Q3 is the peak season for us in Morocco and Q4 is the peak season in Zambia and Zimbabwe. Hence, second half is much larger in the African subcontinent whereas Nepal is similar to India and Sri Lanka is same throughout the year. So, second half is actually better in international than the first half.

Prashant Kutty: The reason I asked is, typically from a PAT perspective or even from an EBITDA perspective, I think in the last two years, the number have been a little lower as compared to the first half of the year?

Ravi Jaipuria: That was mainly because of Morocco. Morocco was losing money for us and that was pulling it down. But now with Morocco making money for us, the whole thing is going to be changed.

Prashant Kutty: You will actually see profitability in the next two quarters as well?

Ravi Jaipuria: Well, Morocco, the peak season is third quarter.

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

Aniruddha Joshi: Sir, can you indicate any price hikes that we have taken? Or are we looking at any price hike considering there is inflation in sugar as well as the preform prices?

Ravi Jaipuria: We have not taken any price hikes. The preform prices have again come back down. So, we are not looking at any price hikes right now. And especially, with the South and West coming to our fold, the sugar prices are usually lower in that region as compared to the North and East.

Aniruddha Joshi: Okay. So, second, there were some talks about the launch of dairy products under our own brand. Any update on that front?

Ravi Jaipuria: Well, we have just started the production of Tropicana in our plant. In the next month or so we will start producing our dairy brands, which will be in the market in the third quarter.

Aniruddha Joshi: Sir, last question. Could you share capex guidance for CY '19 as well as CY '20?

Ravi Jaipuria: Well, it will be not more than the depreciation.

Moderator: Thank you. The next question is from the line of Sameer Gupta from IIFL. Please go ahead.

Sameer Gupta: Our understanding is that with south and west we are below Coca-Cola in market share. So, can you just elaborate on our vision as to how we intend to take share in those territories where Coca-Cola is stronger in terms of distribution and regions and those things?

Ravi Jaipuria: Well, we think it is a bit too early. But fundamentally, it is our go-to-market which is to be strengthened in these territories. And as we strengthen our go-to-market, the market share automatically starts flowing in. So, that is what we are working on and that is why I said, we were able to consolidate this territory much faster than we had anticipated.

And we had thought it would take us at least 6 months to get our act together in these territories, but looks like we have been able to get it done fast enough.

Sameer Gupta: So, sir, in these two months of operation, has there been any share gain?

Ravi Jaipuria: Well, we do not know because unless until we get some figures from outside independent source, but we have had a good growth.

Moderator: Thank you. The next question is from the line of Anchal Ostwal from Sharekhan. Please go ahead.

Anchal Ostwal: I just have two questions. First, can you give me the organic value growth for India and international?

Raj Gandhi: This number at this moment is not handy. Maybe offline, if you contact we shall be able to provide.

Anchal Ostwal: Okay. And the second question, you have had a realization decline this quarter. So, do you expect the order decline to sustain or is it going to get better in the next quarters?

Raj Gandhi: Basically, this is a result of the change in mix in Morocco and West and South regions and the accounting for Zimbabwe. Accounting for Zimbabwe will be taken care because of the circular of the Reserve Bank of Zimbabwe and the mix is a gradual function and that will change over the period.

Moderator: Thank you. The next question is from the line of Pritesh Chhedda from Lucky Investment Managers. Please go ahead.

Pritesh Chhedda: Sir, I have two follow-ups. This other financial liability which is showing on balance sheet and there is this change in other financial liability which is showing on cash flow. Are they kind of part of this is, must be interest in that, right?

Raj Gandhi: Part of this is the current portion of long term loans due in the next 12 months.

Pritesh Chhedda: Okay. So, when you show a Rs. 650 crore inflow on account of that that will include the part of term loan repayable in less than one year?

Raj Gandhi: That is right.

Pritesh Chhedda: So, your debt figure, when you call out that Rs. 3,700 crore, does it include that figure?

Raj Gandhi: The net debt includes current portion as well. Net Debt includes current portion, long-term portion, OD limits, CC limits, any tax benefit repayable in the future, each and everything.

Pritesh Chhedda: And second, I wanted to know the market share changes between Pepsi and Coca-Cola at the national level, if any?

Raj Gandhi: Actually, as we already mentioned, there is lead time of few quarters in receiving market share data. Once this is available, we will definitely be sharing.

Pritesh Chhedda: But intuitively 6 months of this season, which has been good season because it was really hot throughout India. Intuitively, if Pepsi would have gained market share or the market share will be equal and hence?

Ravi Jaipuria: It should be pretty even. We do not think we have lost market share, that is for sure, but very difficult to say.

Moderator: Thank you. The next question is from the line of Manish Shah from Comgest Singapore. Please go ahead.

Manish Shah: Yes. Just can you elaborate on these milk products? Is it Quaker milks or your own brands, and we will be paying royalty to Pepsi?

Raj Gandhi: This will be in our own brand and this will all be value-added dairy products. So, it is not Quaker products.

Manish Shah: And there will be a royalty involved to Pepsi?

Ravi Jaipuria: There will be a non-compete fee of 1% involved.

Moderator: Thank you. The next question is from the line of Vaqar Khan from Angel Broking. Please go ahead.

Vaqar Khan: Any guidance regarding sugar prices for the coming quarters?

Ravi Jaipuria: Actually our overall sugar pricing should actually come down because of South and West coming into our fold. The pricing of sugar is normally about at Rs. 1.5 to Rs. 2 cheaper in South and West.

Vaqar Khan: Okay. So, what percentage are we looking at, if it is going down then?

Ravi Jaipuria: For next year, we cannot tell you what the government policies are going to be. But for this year, we do not see sugar prices going up any further for us.

Vaqar Khan: Okay. So, you are seeing sugar prices to remain flat?

Ravi Jaipuria: For our company, yes.

Moderator: Thank you. The next question is from the line of Hemant Nahata from Yes Securities. Please go ahead.

Hemant Nahata: Sir, I just wanted to ask, what are the margins for the acquired unit? Where do we see them for CY '19?

Raj Gandhi: The acquired units have similar profitability as it has not dampened our profits. So, it has come in line with our existing territories.

Hemant Nahata: So, sir, is it fair to assume that it is doing similar kind of profitability what our northern and eastern units are doing currently?

Raj Gandhi: Yes.

Hemant Nahata: And would they continue to do similar kind of margins for CY '19 as well also?

Ravi Jaipuria: That is what we expect.

Hemant Nahata: Okay. Sir, my second question was also actually when this acquisition happened; we saw that some of the distribution and infrastructure for these units were a little lower than what we used to centrally have. Like for example, 100 trucks. The vehicles were approximately 1/3 of what we currently have in northern and the eastern territories. So, despite of that, we are making very good margins in the southern and western zones. Would we scale this up further? And could that lead to higher margins in these territories?

Ravi Jaipuria: We do not think it will lead to higher margins, but it will definitely give us higher volume growth, and that is what we are expecting. And that is how we have been able to get volume growth, which is equal to our North and East sub-territory. So, we are hoping that the growth will continue in our acquired territories and next year should be a good year for us.

Moderator: Thank you. The next question is from the line of Sunil Shah from Turtle Star Portfolio Management. Please go ahead.

Sunil Shah: Sir, just one question on the drinking water segment, Aquafina that we have. Sir, could I just get some industry perspective as to we are doing around 35 million bottles or crates right now. But what is the industry positioning of how much is the difference between us and the number one player in the industry? And how are we galloping, what strategies we will be adopting to gain more market share on the drinking water part?

Raj Gandhi: Actually, water is very staggered market. There are many regional players. What we do is we try to compete with the national players or with the international brands, where we have a good share and we usually track that. Actually, it is difficult to track at the regional level or the B brands in that category. But definitely we are growing at about 17% - 18% in this quarter and every quarter the share is going up. And last two years I think about 18% is the range at which we have been growing.

Sunil Shah: Okay and so, how about margins for us versus CSD and water? How what will be the margins be between the two lines of our businesses?

Ravi Jaipuria: That is what we have stated earlier also our margins are similar in percentage basis because the price per case for water is much lower than CSD. But in percentage terms our margins are similar.

Moderator: Thank you very much. That was the last question. I would now like to hand the conference back to the management team for closing comments.

Raj Gandhi: Thank you once again for your interest and support. We will continue to stay engaged. Please be in touch with our Investor Relations team for any further details or discussions. Look forward to interacting with you soon.

Moderator: Thank you very much. On behalf of Varun Beverages, that concludes the conference. Thank you for joining us. Ladies and gentlemen, you may now disconnect your lines.
