(a PepsiCo franchisee)

Varun Beverages Limited
Earnings Conference Call Transcript
August 4, 2020

Moderator: Ladies and gentlemen, good day, and welcome to 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 call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Anoop Poojari from CDR India. Thank you, and over to you, sir.

Anoop Poojari: Thank you. Good Afternoon everyone and thank you for joining us on Varun Beverages' Q2 2020 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 and Whole-time Director, Mr. Kapil Agarwal – CEO and Whole-time Director and Mr. Vikas Bhatia – 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 and a detailed statement in this regard is available in the earnings presentation shared with you earlier. I would now request Mr. Ravi Jaipuria to make his opening remarks.

Ravi Jaipuria: Good afternoon and thank you for joining us on our earnings conference call. Trust all of you had the opportunity to go through our results presentation, which provides details of our operational and financial performance for the second quarter ended 30th June 2020. I hope and wish that you all and your families are keeping safe and healthy.

The quarter, gone by, was an unprecedented one, which started amidst an uncertain and unpredictable operating environment. The spread of the COVID-19 pandemic, leading to multiple lockdowns, resulted in significant disruption across domestic and international markets. With this period being a key season for our product portfolio, the disruptions in production levels, supply chain, and distribution operations, particularly in the months of April and May had a negative impact on overall demand and volumes performance. With the relaxations provided by the Govt. of India for essential services and particularly packaged food and beverages, VBL got the requisite permissions from respective State Governments to operate most of its production facilities during the quarter; however, the manufacturing operations were at a significantly scaled-down utilization levels. Against this backdrop, organic volumes for the quarter declined by 50.1% in India and 33.3% in

International territories. Revenue from operations during the quarter declined to Rs. 16,401.8 million.

As the country moved to the unlock phase towards the end of May, we witnessed a steady uptick in demand on a month-on-month basis, which continued in the months of June and July. To address this steady uptick in consumption, we steadily ramped-up operations across manufacturing units to increase production levels and ensure continuity in deliveries and supplies.

Over the last three months, we have been undertaking maximum efforts to secure our business operations by putting in place stringent safety standards across our plants and offices to ensure well-being of our people, rationalizing operating costs to boost financial strength and driving higher efficiencies in our overall business model. Showcasing a high degree of agility, our teams have efficiently adapted to the unprecedented changes in the operating environment and consumer ordering patterns in these uncertain times. As lockdown norms further ease, we are hopeful that the demand scenario across the country will stabilize in the months ahead. In July itself, we have seen a steady uptick in consumption, especially from rural and semi-urban regions and there are positive signs that this momentum will strengthen on a month over month basis. In addition, a gradual recovery in economy led by normal monsoons in India, a good rabi season and Kharif crop sowing should further enable higher recovery in demand and consumption.

With the overall macroeconomic environment expected to normalize by the end of this calendar year, we remain confident of the strong demand revival in our product category in the coming fiscal, which we believe should enable us to deliver a robust operational and financial performance, going ahead.

Before I conclude, I would also like to share that the Board of Directors have recommended an interim dividend of Rs. 2.50 per share.

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

Raj Gandhi: Thank you, Mr. Chairman. Good afternoon and a warm welcome to everyone joining us today. Let me provide an overview of the financial performance for the second quarter ended 30th June, 2020.

The quarter gone by, was challenging with an unprecedented level of disruption. The spread of the COVID-19 pandemic and the subsequent lockdown restrictions imposed by the Govt. of India severely impacted Company's operations throughout the second quarter. In Q2 2020, Revenue from operations, adjusted for excise/GST, declined by 41.6% YoY to Rs. 1,6401.8 million while EBITDA declined by 52.1% to Rs. 3,777.0 million.

Total sales volume stood at 104.8 million cases in Q2 2020 as compared to 195.5 million cases in Q2 2019, declining by 46.4%. Sales volumes in India were down 48.2% YoY at 88.8 million cases in Q2 2020 as compared to 171.5 million cases in Q2 2019. This includes in-organic volumes of 3.15 million cases from South & West India sub-territories for the month of April 2020 as the acquisition date was 1st May, 2019.

Organic volumes for the quarter declined by 50.1% in India, 33.3% in international territories and 48% on a consolidated basis. As lockdowns and restrictions eased from mid-May onwards, sales volume gradually recovered in June and in the month of July, the company saw a steady revival in the volumes. The product mix underwent a change in Q2 2020. CSD constituted 85%, juice at 7% and packaged drinking water at 8% of total sales volumes. Realization per case improved by 8.9%

approximately during the quarter, essentially on account of higher mix of CSD and controlled trade promotions.

On the profitability front; EBITDA declined by 52.1% to Rs. 3,777 million in Q2 2020 from Rs. 7,878.8 million in Q2 2019. The overall input cost environment was favorable during the quarter as there has been moderation in key raw materials. This, in addition with the sharp focus on cutting non-essential costs during the quarter enabled healthy margins compared to Q1 2020 on a similar revenue base. So, while EBITDA margins declined by 501 basis points in Q2 2020 as compared to Q2 2019, on a similar revenue base, EBITDA margins expanded by 685 basis points as compared to Q1 2020 on account of cost control measures undertaken during the COVID period. Gross margins improved by 300 basis point year-on-year, due to favorable PET chip prices and higher mix of CSD.

Depreciation remained similar to last year, and finance costs declined by 12.5% on account of QIP done by the Company in September, 2019 and the repayment of debt during the quarter. Net debt reduced to Rs. 29,392 million as on June 30, 2020, as against Rs. 32,461 million as on December 31, 2019. With this, debt-to-equity ratio stood at 0.84X at a very healthy level as on June 30th, 2020, and debt-to-EBITDA ratio stood at 2.70 for the trailing 12 months EBITDA.

In H1 2020, net CAPEX stood at approximately Rs. 2,437 million. The adjustments are mainly capitalization of Rs. 433 million in implementation of Ind-AS 116 for leases and impairment provision of Rs. 665 million provided in last quarter. CAPEX incurred is primarily towards commitments made prior to March for brownfield expansion at certain plants for new tetra lines for Slice and backward integration. Capacity utilization in India during the peak month remained well below the last year's peak month utilization of approximately 60%.

On the working capital front, working capital days increased to approximately 20 days as on June 30th, 2020, as compared to 14 days as of June 30th, 2019, on account of lower sales volumes.

On the whole, the company's financial position remains robust during the quarter. We have undertaken concerted efforts towards cost management and rationalized non-essential cost to boost financial strength in these tough times. We have also instituted optimum working capital measures and operating discipline to conserve cash flows and ensure steady profitability. The company has not availed moratorium for its debt repayments and has been timely servicing all its debt obligations. Here, I would also like to share that CRISIL has reaffirmed the credit rating for long-term debt as 'CRISIL AA' and for short-term debt as 'CRISIL A1+'.

Overall, VBL is strong and robust and focus remains on generating strong free cash flows over the ensuing quarters and coming years. On that note, I come to an end to the 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. Ladies and gentlemen, we will now begin the question-answer session. We take the first question from the line of Abneesh Roy from Edelweiss.

Abneesh Roy: My first question is related to the cold nature of the product. So the FMCG companies in the fruit juice business had a very tough quarter. And they said that consumer is cutting down on anything, which is cold because he doesn't want to fall ill, doesn't want to get cold, etc. So have you also faced this issue and how are you building this in your marketing campaign to overcome this issue?

Ravi Jaipuria: We have not felt that. The only thing we have felt is, since there are less people going out in the market, so our on-the-go sales have dropped and our sales in hotels, restaurants and cinema halls have dropped. But I don't think we have faced any challenge on the cold aspect of the product, as our in-house consumption has gone up drastically.

Abneesh Roy: What will be the breakup of the institutional and out-of-home, the cinema hall, restaurant, hotel, etc.?

Ravi Jaipuria: Close to 10% would be the institutional sale, which we are missing at the moment.

Abneesh Roy: How are you seeing competition at the Rs. 10 price point, the FMCG companies have also become more aggressive? So are you also going to increase the aggression at the Rs. 10 price point, especially in the fruit juice side?

Ravi Jaipuria: No, we already have our fruit juice (Slice) at Rs. 10 and we have also put-up additional tetra lines this year for the same. Unfortunately, by the time the lines could start, COVID-19 had hit in March, so we couldn't get full results out of it. But Rs. 10 is very aggressive and a very interesting price point for the consumer, and we will see results from that coming next year.

Abneesh Roy: Last question on the product side, are you doing something based on this crisis? So we have seen ice cream companies come out with Haldi ice cream, for example and Haldi Doodh, some of the other beverage companies have come out. So are you also launching some products basis this crisis?

Ravi Jaipuria: No, we are not changing our product mix. Though we are promoting juices. Tropicana juices are being promoted in a big way and that is doing extremely well for us and we are promoting in-home consumption, so that is what we are focusing on.

Moderator: The next question is from the line of Vivek Maheshwari from Jefferies.

Vivek Maheshwari: You mentioned about July trends being better, but a lot of consumer companies and in fact, companies across sectors are highlighting that because of the localized lockdown, things are a bit softer than what were in the month of June. So how are you reading the situation given all the issues around the lockdowns and everything that's happening right now on the ground?

Ravi Jaipuria: We have done well in July, even after the lockdowns. Our sales in July have been much better as compared to June, percentage-wise in comparison to same period last year. So we are not complaining. Lockdowns are, of course, affecting, but that is not within our control. Otherwise, we have seen better results in July than June.

Vivek Maheshwari: Do you have any sense on the regional local competition, there is a bit of a tail in certain geographies, southern or central part of the country. How are those guys coping up? Do you have any intelligence on that piece?

Ravi Jaipuria: Local brands have gone down drastically because it was not possible for them to remain open or they were much more vulnerable because of the drop in volumes. So, we see much less competition, except from our main competitor.

Vivek Maheshwari: You have done well on the cost-savings side. But do you think as the quarter progressed and you look at perhaps all the heads under the expenses base. Do you think some part of the cost savings that you have done in this quarter is going to sustain as normalization sets in again in few months from now?

Ravi Jaipuria: We have been very successful in cutting costs and it gave us a real wake-up call. We expect at least 50% of the cost savings to continue, going forward. So we feel we have cut non-essential costs and we have cut some fat, as the company was growing very fast and with a very healthy balance sheet, everybody tends to get carried away. So, we have cut those non-essential costs. Going forward, we see a minimum 50% of our total costs not coming back.

Vivek Maheshwari: Could you quantify? When you say 50%, as a percentage of revenues, what is it that you are mentioning?

Ravi Jaipuria: It's not based on percentage of revenues, because revenue will be depending on what the sales are going to be. But whatever cost cuts we have done, which you can see from the P&L and the Balance sheet, we will be able to sustain a reasonable portion of it, going forward.

Vivek Maheshwari: Any support from PepsiCo, specifically, in this quarter in any respect?

Ravi Jaipuria: We have not asked for any support from PepsiCo because the Company is doing well. And if need be, we will definitely go to them and maybe they will help. We have not had the need to go to them.

Moderator: The next question is from the line of Kashyap Jhaveri from Emkay Global

Kashyap Jhaveri: It looks like in this quarter, realization quarter-on-quarter as well as on Y-on-Y basis seem to have gone up by almost about 4%- 5%, so any reason for that? And question number two is that we have given a slide in our presentation, Slide #6 about customer management and market execution. Just wanted to understand, the markets that we have recently acquired in terms of South and East and existing territory, how much more penetration is really possible and if you could give some numbers on that front?

Ravi Jaipuria: In terms of realizations, the water sales have gone down because of on-the-go market, hotels, restaurants and transportation being a constraint during the lockdown; hence CSD mix has gone up drastically and water mix has come down, thereby there is an improvement in realization. And secondly, as far as the market penetration is concerned, we were not able to do it this year due to impact of COVID-19. That planned market penetration will only happen by early next year, when the situation improves because half of the outlets are not open now. So it was very difficult to expand further this year, rather, we were only supplying goods to the outlets, which were open.

Kashyap Jhaveri: What is the opportunity and where are we today in terms of number of Visi-Coolers?

Ravi Jaipuria: Opportunity still remains in the acquired territories where we have low market share. And obviously, the opportunity still remains. As the outlets were shut, there was very little work that we could do this year. So, forget expansion of outlets, the number of outlets which were open contracted rather. So this expansion is only going to happen next year.

Kashyap Jhaveri: In those geographies, in terms of outlets, what's the opportunity?

Ravi Jaipuria: We have very low share in the acquired territories. So even if we want to come to our regular share, which is in the rest of the markets, practically, we can double our number of stores and volumes, but that is not an easy job. We are going to try it but that's a long process. So the opportunity is huge.

Moderator: The next question is from the line of Rajiv Gupta from RBC Financial.

Rajiv Gupta: My first question was on the cost-savings that we will carry forward in the future. Is there any way where you could give some indications so that it helps us quantify, in absolute basis or in percentage terms?

Ravi Jaipuria: We can share this with you, offline. We don't have exact numbers handy. But if you look at it, even with volumes lower than last quarter, we have been able to get our PAT to double, so it has to be substantial.

Rajiv Gupta: In terms of the loss, while the outlet constraints were there in all territories, your competitors would also have the same constraints during this period, including your local suppliers in various territories. So, how did we fare in terms of taking away the local suppliers? And did we see early indications of being a little nimble-footed in starting our factories a little faster than others? Did we see some early indications of gaining market share in various territories from local suppliers as well as our biggest competitor?

Ravi Jaipuria: We definitely took some share from the local players because most of the local plants come up only in the season. Our peak season starts from Holi and ends at Diwali and that's the normal practice in the soft drink industry. Before the season could start, the COVID-19 problem started. So lot of these local players didn't even open up. So I think we definitely gained share from them and we were reasonably nimble footed to make sure that a lot of our plants started as early as April. We were able to make sure that we didn't have to take any write-offs of stock expiry because we were able to move stocks from one plant to the other wherever the sales were happening. So we took some hit on transportation cost, but we made sure that we didn't take a hit on expiry of goods. So we did whatever was possible under those circumstances and that is one of the only reasons why even with less volumes, we were still able to be profitable and much better than what we could have been.

Rajiv Gupta: Did we take away more from the local suppliers, from the local manufacturers than our biggest competitor? Did we do better than our biggest competitor?

Ravi Jaipuria: We believe we did, .

Rajiv Gupta: In terms of our expansion, our future capital expenditure, cash conservation, has this last 3 months or 4 months affected any of that? Are we going to change our plans, cut down on capital, or conserve more cash, going forward?

Ravi Jaipuria: We are not going to be putting a lot of capex, going forward. And next year, we expect our capex to be lower than 50% of our depreciation.

Rajiv Gupta: How are we doing on the Zimbabwean currency and the reserves? Is everything being honored? And when do we expect that reversal of those provisions, which we have made in Zimbabwe over the last couple of years?

Ravi Jaipuria: Everything is being honored. We are getting paid. That's the only country, where we have not seen a negative in this quarter also. So things for us are very good in Zimbabwe. All our plans are intact and things are going well for us.

Rajiv Gupta: And the reversal of the provision, the quantum and when should we expect that then?

Raj Gandhi: That will happen once the bank liability is paid for fully. Luckily out of USD 25 million, which we borrowed, about 50% is already paid. And once the balance is paid, after that, we will start reversing that provision, which we created in our books. So that is intact as of now and hopefully we will have to reverse it to the P&L only.

Rajiv Gupta: What is the quantum?

Raj Gandhi: It is around the same, Rs.1300 mn, which we created. So that's still preserved in the books.

Rajiv Gupta: We should repay this in the fourth quarter of this financial year, the entire loan?

Raj Gandhi: Every quarter, about USD 2.5 million gets paid, so five more quarters. And apart from this, there is some loan of about USD 9 million from VBL India to that subsidiary. That also is to be paid. That's internal and we can start reversing after that, maybe 5-6 quarters.

Rajiv Gupta: Do you plan to reverse at one go or you'll reverse it over a period of time?

Ravi Jaipuria: We can reverse it anytime as soon as we feel that there is complete safety. So we are rather giving more comfort level to everybody.

Moderator: We take the next question from the line of Varun Goenka from Reliance Nippon Life Insurance.

Varun Goenka: Our out-of-home consumption is significantly higher than our in-home consumption. And I'm talking about a normal year, where we could increase the share in terms of a product or go-to-market strategy, e-commerce strategy, anything that we can share? Secondly, over the next maybe 12 to 24 months, the demand is going to be unpredictable. So are we making any changes to our production planning so that we are more just-in-time, not getting saddled with any kind of inventory or we are more agile to responding to any product SKU packaging? The third question is our digital ad strategy, is there any major changes to our ad strategy at your level or at Pepsi level because all the FMCG companies are radically changing their media strategy?

Ravi Jaipuria: As far as stocks are concerned, we don't carry large inventory anyway. And even in March, when COVID came and suddenly there was a lockdown, we were able to make sure that we did not have any losses due to inventory write-off. So now there is no reason for us to overstock ourselves. We normally do not keep more than a week's finished stocks. It's only in the peak season, sometimes we pre-build some stocks, which also we were able to take care. We don't see any issue as far as our stocks getting stuck. And worse come to worse, if one State goes into lockdown, if we have to move the goods, we'll do that if we feel that the lockdown is going to be much longer than planned. So we don't see any issue on that.

Varun Goenka: You could have excess demand in one product or SKU and you might lose on demand also. We've seen it in several companies.

Ravi Jaipuria: We are closely monitoring what is happening. The demand doesn't change in one day. We know where the movements are, what packs are moving, what flavors are moving. We are working on what is required in the market. The production lines are all flexible. They can produce smaller bottles as well as bigger bottles. As in-home consumption has increased, our medium and large bottles are selling much more than our single serve, so these changes we have made in production planning. On the positive side, we are making people getting used to consuming at home, which is happening all over the world, and which was not happening enough in India. And once the on-the-go market starts when the market opens up, we'll get the benefit of both.

Varun Goenka: How much would be your guess as to the consumption at home?

Ravi Jaipuria: People are still not consuming bottled water at home and that's one of the main reasons why we have taken a hit in our contribution from water. But people are sitting at home and they are consuming soft drinks and hence in-home consumption has gone up drastically. It's very difficult to predict because every day policy changes, weekends are sometimes closed or there is a complete lockdown. But under the given circumstances, we have reached closer to our normal sales levels.

Varun Goenka: What is our media strategy or at Pepsi level?

Ravi Jaipuria: We are working on digital & e-commerce and our deliveries, etc. So those are happening and PepsiCo is fully involved in it. PepsiCo is taking a lot of initiatives to move that forward.

Moderator: The next question is from the line of Anand Shah from Axis Capital.

Anand Shah: First question is essentially, if you can share any color on the month wise progression in the quarter and also especially on July versus June, you did indicate that July is even stronger. Would it be now sort of a marginal decline or any color that you can share on this, especially in India?

Ravi Jaipuria: In July, for example, depending on the territory, where the lockdowns were not there, we are pretty well coming back to our normal sales levels. But depending on which State and the lockdowns or what the conditions are, it's differing and changing every few days. But the good part is wherever the lockdowns are pretty well lifted, we are coming back to our normal volumes.

Anand Shah: Would that mean that it is in the unhindered territories where the lockdowns and all are not there and demand is consistent, your in-home volumes have actually gone even up pre-COVID levels?

Ravi Jaipuria: That's right. Even though the water volumes are still much lower, but overall, our CSD volumes have done better than normal in some territories where the lockdown is not happening.

Anand Shah: And also, if you can share some color on international, how the territories are progressing in this quarter, especially on the exit side, how things are looking. You see that also recovering now to sort of normal or near normal?

Ravi Jaipuria: Internationally, we are reasonably in good shape now. The COVID effect is pretty well behind us. And going forward in H2, we should be looking at 2019+ numbers.

Anand Shah: And just lastly, in the past quarter, you did share that despite the hit in volumes and revenue this year, your endeavor will be at least to maintain percentage margins. Are you on that trajectory with the cost-cuts that you've done?

Ravi Jaipuria: If you look at it, if we can maintain our margins in just half the volumes on a full year basis, then we are already doing very well. We have really squeezed our operations and become nimble footed and wherever we could cut costs, we have cut costs and increased our efficiencies.

Moderator: The next question is from the line of Jaspreet Singh Arora from Equentis.

Jaspreet Arora: My first question was related to the EBITDA margin expansion, in which the main factor was the gross margin expansion of 300 bps. So if you could give an indicative idea about the gross margin difference between the three categories, CSD, water and juices?

Ravi Jaipuria: EBITDA margins, as we have said before are the same for three categories. It's just that the value of each product is different. For example, we have to sell 3 cases of water to get the same value of 1 case of CSD, but EBITDA margins percentage-wise are about the same. If the sales volume come down on water and they go up on CSD, realization per case increases and EBITDA margin remains the same and that's why you see our growth is about 8% to 9% in realization in Q2 2020 as compared to Q1 2020.

Jaspreet Arora: So, what I was referring to is this 85% share by volume of CSD, this was partly attributed to this rise. So as things stand today, do you see this moving to the steady state contribution of less than 70% of CSD or it's still a couple of months away before water could pick up and this could go down?

Ravi Jaipuria: It's much more than couple of months. You don't see the hotels, restaurants or movie hall opening so far. So, there will be a time gap, we don't expect that this year. It would depend on when the vaccine comes, to make people comfortable and how many more people are actually willing to go out in the market.

Jaspreet Arora: So you think till that time this mix could be skewed in favor of CSD and therefore, 80% plus would continue?

Ravi Jaipuria: CSD and juices both. Juices are picking up well. Water will definitely stay low till things open up.

Jaspreet Arora: And in terms of the comment that you made in terms of carrying forward the savings that you've done, so I'm trying to understand and quantify. So we've had other expenses of roughly Rs. 494 crore on a quarterly basis till this quarter. And this quarter, we've had Rs. 322 crore. So the savings is about Rs. 170 crore. So are we trying to say that half of the Rs. 170 crore will be gone for good? Is that the right way to look at it?

Raj Gandhi: It may not come to exactly 50%. In Q2, the offices were closed, starting from power, conveyance, travel, the repair and maintenance as the plants did not run for the full time, so lot of expenses are related to operations, when there was restricted movement, all those expenses were saved although we lost on revenue. And apart from this, there were lower trade discounts and commodity prices remained moderate, so everything helped us. And for the next few quarters, we see the same trend and this should help us in maintaining our margins.

Jaspreet Arora: And this tailwind you get from the PET chip prices being soft. Does this continue as of today? And do you think it's there for some time?

Raj Gandhi: So far yes, because sugar prices have not shown any trend of going upwards. And petroleum has not gone back to the pre-COVID level. So, these advantages are partially still there. The mix, which has changed is also helping us. The peak season for Zambia and Zimbabwe is during November-December, which is still intact. The foreign territories are coming back to normalcy faster than India. Nepal and Sri Lanka, have already started showing growth over the last year numbers. So maybe they are coming out of COVID effect faster.

Ravi Jaipuria: Internationally, we expect doing better than last year, going forward starting from this quarter. So that will help a lot in the overall scenario.

Moderator: The next question is from the line of Nikunj Gala from Principal PNB Asset Management .

Nikunj Gala: I wanted to understand about the government grant, which you have mentioned in the annual report. I just want to understand the nature of this grant and till which year this would be continuing? So what is the expiry of this government grant?

Raj Gandhi: As per the erstwhile policy before GST was introduced, Governments had a practice of inviting investment to their State, and we took advantage of the government policies, and made investment in those States and that's linked to the volume, which we make and the GST which they will refund us in 7 years or so. Under the Ind-AS, it is all accounted for. Even if the grant comes, the money will become payable or any effect on the balance sheet now gets captured because all assets and liabilities are on fair value. These may be running for another at least 4-5 years. These are longer duration benefits and the impact of that is not large.

Nikunj Gala: These are GST rebates which we get?

Raj Gandhi: It's before GST started. Post GST, all these things were modified and these are certain policies of the State Government under which we had made investment in Guwahati, Haryana, etc. So these investments were made taking advantage of the erstwhile Government's policy.

Nikunj Gala : If I just look at the last 5-year number, and still, ~60% of that number is still in the under Government receivables. So how do you see that number going forward?

Raj Gandhi: There are delays, but it will come. The total grant we had to capitalize on one side and the liability we had to show on the other side and amortize during the period. So separately, we can explain you the accounting year by year.

Moderator: The next question is from the line of Devanshu Bansal from Emkay Global.

Devanshu Bansal: The other peer has been indicating market share gains in the juice category. So what is your take in terms of industry growth for this segment, going ahead as well as our market share in this category?

Ravi Jaipuria: At the moment, juice is pretty well where it was. So we don't think there is a major market share shift.

Raj Gandhi: Devanshu, here there is a huge opportunity in the juice category. Since we took Tropicana, it is one of the fastest growing product in our portfolio. It is a 100% juice category, which is highly under-penetrated. The only thing is we should not run out of capacity as far as Tropicana is concerned. It comes with a lot of promise. And we have a lot of potential to enhance the share.

Devanshu Bansal: What is your current utilization of juices in a normal scenario?

Raj Gandhi: By the end of 2021, we might run out of capacity as far as Tropicana is concerned because the same equipment is also being used for our ambient temperature value-added dairy products, under the brand of Cream Bell, which we had launched a few quarters earlier.

Devanshu Bansal: Realization in India is up 11%, but we saw a decline in international realization. So what is the reason for this? Why are we seeing a different trend there?

Raj Gandhi: That is the because of the currency fluctuation.

Devanshu Bansal: As per the PPT, we have indicated that we have reached 75% of last year sales in June. And we are indicating that July is better than June. So in terms of volume decline, how should we see July?

Ravi Jaipuria: Definitely better than 75%, so we are improving on month-on-month basis.

Moderator: The next question is from the line of Shantanu Basu from SMIFS.

Shantanu Basu: What was your out-of-home consumption in the pre-COVID era? If you could just give me the other operating revenue figure for Q1 and Q2?

Ravi Jaipuria: In the pre-COVID era, including water, on-the-go used to be close to 70% at one time. Now that has come down to less than 50%

Shantanu Basu: What about the other operating revenues for Q1 and Q2 and can I assume that your other expenses and employee expenses, what you booked this quarter would remain more or less the same for Q3 and Q4?

Ravi Jaipuria: That's right, it should remain the same.

Moderator: The next question is from the line of Percy Panthaki from IIFL.

Percy Panthaki: For the international business, can you give some sort of flavor geography-wise, not only on the performance that we are doing now, but what is happening on the ground in terms of the COVID situation and what sort of growth expectations we can have in the next couple of quarters?

Ravi Jaipuria: The one indication that we can give you is that, from July onwards, the international business, would be ~ 90% of normal levels. Secondly, in Zambia and Zimbabwe, even though they have lockdown, it's still partially open and our business is back very close to normal. In Nepal, Sri Lanka and Morocco, we are now growing. So we don't see any issue, going forward. In Zimbabwe, we have grown even in the last quarter. So I think internationally, we are back to normal and we see positive signs, going forward.

Percy Panthaki: And in terms of the India business, you are saying that out-of-home is still about 40% to 50% of the turnover.

Ravi Jaipuria: It used to be. If you take out water, it's lower, but it's slowly coming back.

Percy Panthaki: But how much would it be, your out-of-home turnover? Pre-COVID, what was this number? Was it 70%? Did I hear that correctly?

Ravi Jaipuria: It used to be 70%, including water.

Percy Panthaki: And excluding water, how much would it be?

Ravi Jaipuria: Water was about 26% of our volumes and it has come down to 8% from 26% practically. So there's a clear 18% difference in just water itself.

Percy Panthaki: So, excluding water, even in the CSD portfolio, we are at like 40% to 50% kind of out-of-home exposure. Out-of-home has sort of really taken a beating because restaurants are closed, movie theaters are closed.

Ravi Jaipuria: It is not that large. Out-of-home when we say is what we call, on-the-go, people drinking, standing at the shops, while sitting in a bus or at bus stations, railway stations, all this is out-of-home.

Percy Panthaki: But even that kind of activity has reduced so if I look at in-home consumption, what kind of growth are you seeing in that to offset a 40% salience of out-of-home, even excluding water?

Ravi Jaipuria: We would say more than half of it, so about 20%-25% has been captured by in-home consumption.

Percy Panthaki: So there is like a growth of 20%- 25% in in-home consumption. Is that the correct way to read it?

Ravi Jaipuria: Yes, you can look at it that way. Because if you look at it, if we have reached 75% - 80% of our business and water is down 18%, so practically, it's in-home consumption, which has taken over the on-the-go market difference.

Percy Panthaki: Your market share in the old geographies of North and East, earlier, I think it used to be around 40%. Has there been any change to that number?

Ravi Jaipuria: We don't know yet because this quarter, we don't have agency's data and it's very difficult to say this year till the actual figures come out.

Percy Panthaki: But earlier it used to be 40%, is that correct?

Ravi Jaipuria: That is correct.

Raj Gandhi: Based upon market intelligence, we have not lost any share, We can only say this.

Moderator: The next question is from the line of Chirag Shah from CLSA.

Chirag Shah: Have we changed strategy on the dairy product rollout? We were planning for a national rollout. But given the circumstances, I'm assuming that could have got delayed?

Ravi Jaipuria: Yes, we have deferred it till next year, and we are going to do a proper launch early next year.

Chirag Shah: I'm assuming that realization this quarter was also partially helped by rationalization and promotions. Was this rationalization and promotion consistent across product segments? And do you think promotions are now back to usual as we speak?

Ravi Jaipuria: They're coming back slowly. They are not fully back because reach and distribution is still a challenge in lot of places since many outlets are shut till date. So, promotions are coming back, but not exactly to where it used to be at one point.

Chirag Shah: Given the fact that we have one plant servicing the entire market for juices, did we face higher supply chain constraints in juices and from that perspective, what is the capex that we are planning next year on the juices portfolio and are we thinking of an additional location for juices?

Ravi Jaipuria: There is no capex on juices planned for next year and we have not faced any challenge of supplies or for product availability. It has not been a challenge and we will not be expanding next year.

Moderator: The next question is from the line of Pritesh Chheda from Lucky Investments.

Pritesh Chheda: One on the expenses side, where you said that some of the expense cut would be permanent reduction in nature. So let's say Rs. 32 EBITDA per case that we have seen for the past few years. What would be the upside to this Rs. 32 EBITDA per case on account of this cut in expenses beginning Calendar Year 2021?

Ravi Jaipuria: Very difficult to say because this depends on the market conditions, what products are going to sell, how far the market comes back and what percentage of water remains in the mix. We have been able to cut our cost but of course depending on our competition and the market reality next year, what the competition is going to be or what packs will sell, it is very difficult to predict the cost structure.

Pritesh Chheda: My second question is on the capex side. So CY21, you called out that capex is less than depreciation, the juices line you need in CY22. On a structural side largely the capex will be less than depreciation is what we should look at and incrementally for a significant number of years you do not need any large growth capex in the CSD side?

Ravi Jaipuria: Well first of all next year we are talking of capex less than 50% of depreciation and going forward in CY22, there will be capex requirement but very little in greenfield in CSD. If there will be a greenfield, it will only be for juices otherwise it will be brownfield and wherever we feel that volumes have gone up and we need to add a line. So overall capex will be much lower than what we have been having.

Pritesh Chheda: Up to what kind of volume scale up, you would have this kind of a structure and you will not need a greenfield plant?

Ravi Jaipuria: For the next 25% to 30% growth we don't need because we are at about 70% utilization. This year, it has been even lower because of the volume drop but otherwise about 70% of utilization is happening.

Pritesh Chheda: Which means if you grow the beverages at about a double-digit volume of about 8%-10%, then for another 3 years you don't need any large capex in CSD?

Ravi Jaipuria: Fundamentally, yes. Except sometimes, what happens is one territory grows faster than the other and we don't prefer to transport goods from one territory to the other, which is higher than certain kilometers. So sometimes, even though our overall capacity might be higher, we still do some capacity expansion in an individual territory.

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

Aniruddha Joshi: As you indicated that most of the cost savings will be structural in nature, so what will be the plan of the company? Whether it will be completely pocketing the benefits and we will see jump in EBITDA margins in coming quarters or there would be more push for promotions or investments in expansion to increase the revenues or straight way we will be passing on the benefits via price reductions?

Ravi Jaipuria: We are not doing any price reduction. Since our revenues are lower, there is no question of pocketing anything. Right now we are making sure that we survive and while still doing a good job for our shareholders. We have been very rigid in cutting our costs and making sure that we don't have to ask for any moratoriums from banks or anything like that. The company has done extremely well in cutting costs and making sure we are still equally productive and we have cut all the fats, which we may have gained over the last few years. Going forward, the discounts or promotions are based on market demand. So if the competition is aggressive and we need to go more aggressive, we will be more aggressive.

Aniruddha Joshi: What is our total institutional contribution including hotel, restaurant, the cinema halls, all put together?

Ravi Jaipuria: Less than 10%.

Moderator: The next question is from the line of Rakesh Roy from Indsec Securities.

Rakesh Roy: Can you share the international volume number and South-West number for Indian market?

Raj Gandhi: India, it is 84.6% and the balance is international for Q2 2020.

Rakesh Roy: For India, how much is it from the South-West market, the new acquired territories?

Raj Gandhi: Two-third and one-third normally is the split between the existing and the new territories and the growth in the South and West in Q2 was slightly better than the North and East.

Rakesh Roy: Can you highlight on the demand scenario in urban area, rural and semi-urban compared to last year, in last 3 months?

Ravi Jaipuria: The rural has been the fastest growing during these COVID times and semi-urban is the second one and the urban is the least growing or negative because of the major lockdowns happening in urban towns and the main cities are getting hurt much more than rural and semi-urban.

Rakesh Roy: If I am right, your semi-urban is nearly 30% to 33% and rural is 32% to 33%?

Ravi Jaipuria: You can say, very close to that.

Rakesh Roy: If you compare this growth to last year, any improvement in the sales volume or sales number?

Ravi Jaipuria: The mix has definitely changed. 70% used to be urban and semi-urban and 30% used to be rural. Now that 30% could have gone up to 35%-38%. Exact number I don’t have handy right now but the rural mix has definitely gone up.

Rakesh Roy: Can you highlight on this quarter’s juice volume? Juice is mostly in-home consumption, so why it has declined this quarter?

Ravi Jaipuria: A lot of juice was being sold in single-serve. There was no ‘on-the-go’ during this quarter and juice in-home consumption is not very large still in India. So that is what has hurt us. We are making some changes in the portfolio so that we can increase the in-home consumption of juices.

Raj Gandhi: The juice mix has not changed. Overall, the portfolio has come down

Rakesh Roy: On the value-added dairy beverage, is it already launched or you will launch next year?

Ravi Jaipuria: We have launched it in February but by the time we could actually send it across the country, the COVID effect came and we didn’t want to have a poor launch, so we held it back and now we are going to launch it next year. We had great success wherever we launched it, but we didn’t want to go beyond a point because we couldn’t launch it properly.

Moderator: The next question is from the line of Soniya Varnekar from Equentis Wealth.

Soniya Varnekar: My first question is on the number of outlets which are open currently, if you can just share the percentage? Second question is on the region-wise mix, if you can share from North-East, South-West, what was the mix, pre-COVID?

Ravi Jaipuria: About less than 50% of the outlets are open and for the Jan-Feb mix you might have to call offline. We don't have it handy right now.

Soniya Varnekar: At domestic level can you just share which are the top 5 States' contribution to revenues?

Ravi Jaipuria: UP is the largest State for us. Since our strength was more in the North, our market share was also stronger in the North. So technically some of the States might be overall larger in the industry, but we might not be strong. But for us, UP has been the largest and some of the Northern States have been much larger for us.

Moderator: The next question is from the line of Ankit Mahajan from Reliance Securities.

Ankit Mahajan: My first question is on the working capital. As you said that there is increase in working capital days and also receivables and inventory is also higher. So can you throw some light on it?

Raj Gandhi: These look marginally higher, because the denominator has been reduced by 40%-50%. If the sale is lower and the inventory stays the same, number of days goes up. Otherwise if you see in absolute terms, numbers are not that variant from the last year's.

Ankit Mahajan: My second question is what are the steps taken by you to drive the demand and are there any changes due to upcoming IPL schedule?

Raj Gandhi: Firstly, IPL is happening in UAE, it's not happening here so we don't think that benefit will accrue. Secondly, it is happening in the off-season time. We believe, the delivery and the opening of the outlets is going to drive the volumes more. In-home consumption, whatever best we could do by reaching out to the people through digital or otherwise we already achieved and we have achieved 25%-30% increase.

Ravi Jaipuria: We are changing our pack sizes and making the in-home consumption more viable as that is where the demand is going now. So our pack size and focus on in-home consumption has changed drastically and we are focusing and marketing that much more vigorously.

Moderator: We take the last question from the line of Shirish Pardeshi from Centrum Broking.

Shirish Pardeshi: If I refer the May 5th presentation, it says that you had 38 manufacturing facilities while this presentation says we have 37. So is there a mistake or have we closed any of the production facility?

Raj Gandhi: Thank you for the minute observation. We appreciate it. If you see the last presentation, we took impairment of our Bargarh plant in Odisha and we also stated that we have reduced lot of our expenses, which are going to be permanent in nature. So what we have done is we have rationalized our deliveries and the production and smaller unprofitable plant, one has been shut down. So the 31 plus 6 is the number of operating plants as against 32 plus 6 in the last presentation and we believe this process is going to continue for another few quarters. We are in the process of rationalizing and that's what Chairman meant when he said lot of fat is getting reduced, part of which is going to be permanent.

Shirish Pardeshi: What kind of rationalization can happen because now practically you are covering all the geographies in India? So that number can come by maybe 25%?

Raj Gandhi: No 25% is too large. Out of 38 plants, 1 plant is equal to the fraction of ~ 3% but multiple such plants will make it big. If we have to give a ballpark figure, average about Rs. 30 crores are the fixed expense in a year in a single plant, which is now saved and it's going to come in the few quarters again. So, we will come back on this when we update our numbers in the next quarter.

Shirish Pardeshi: Related question on the same slide, on the distribution front, we said that we have 90 depots and 1500 primary distributors. So now we have acquired South and the West part, would you be able to specify or give us some indication how this number will look like next year, March 2021?

Raj Gandhi: South and West territory is already a part, which we acquired in 1st May, 2019. It's not a development of this or the last quarter. Secondly, going forward in the next year, hopefully we will be back to the normal volumes and it should not change drastically.

Shirish Pardeshi: Would you be able to quantify or give some color in our CSD business? What is the Cola versus non-Cola growth or maybe, if you can tell us how the consumer perception and behavior has changed during this lockdown?

Raj Gandhi: You have to break it in various parts to understand fully. If you look historically, Cola mix used to be 70%, today it is 15%-16%. So behavioral change, major part of that has already played out and is captured in our presentation and in our market mix. Now impact of COVID did not bring any significant effect to this. Secondly, things are evolving and if you see our product portfolio slide in our presentation and if you compare it to last few quarters; you will see new additions coming up and share is going towards the new product lines. We never used to have value added dairy products, for example which we are now launching. We never used to have our presence in the energy drink or sports drink – Gatorade. Tropicana was never franchised anywhere in the world. VBL is the only company in the world, wherein PepsiCo has taken initiatives and franchised it to VBL and therefore, we look at a big opportunity in that to grow fastest. Company is evolving in all these fields.

Shirish Pardeshi: What is the sports drink contribution in Q2 versus last year Q2?

Ravi Jaipuria: Right now it's quite small, but it is picking up considerably and in the coming couple of quarters, you will see it playing a reasonable role.

Shirish Pardeshi: So if I look at the price point, the perception is that our margins on sports drink are much higher than our CSD business?

Ravi Jaipuria: It is slightly higher and we have positioned the product accordingly.

Shirish Pardeshi: Do you think there will be a price change which will be required, going forward?

Ravi Jaipuria: Not at the moment, we don't see any price changes right now.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I would now like to hand the conference back to the management for their 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 all soon and hopefully in person. Thank you very much. All the best.

Moderator: Thank you. On behalf of Varun Beverages Limited we conclude today's conference. Thank you for joining. You may now disconnect your lines.

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