Varun Beverages Limited

Q3 2019 Earnings Conference Call Transcript
November 04, 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 call please signal an operator by pressing '*' and then '0' on your touchtone telephone. 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' Q3 2019 Earnings Conference Call. We have with us Mr. Ravi Jaipuria – the 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 point out that some statements made in today's call maybe forward-looking in nature and a detailed statement in this regard is available in the results presentation shared with you earlier. I would 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 the results presentation which provides detail of our operational and financial performance for the third quarter ended 30th September 2019.

We are delighted to share that we have delivered a robust performance in Q3 2019. We have recorded a strong topline growth of 49%, EBITDA growth of 54% and PAT growth of 84%. This was on back of a solid volume growth of 60% driven by healthy off-take in the domestic market along with the robust contribution from our international operations. Encouragingly, our India business, during the quarter, delivered an organic volume growth of 17.5% led by exceptional performance in unprecedented territories acquired in 2017 and in early 2018. Furthermore our international territories have registered 27% organic growth with key markets like Morocco, Zimbabwe, Nepal and Sri Lank reporting double-digit growth during the quarter.

This is also the first quarter that includes the full impact of South and West sub-territories acquisition, which got consolidated from May 1st, 2019.I'm pleased to share that our team has done a tremendous job in seamlessly consolidating such a large region in a compressed time frame. This demonstrates our exceptional execution capabilities and the dedication within our team to deliver results.

Over the last few years, we have focused on widening our portfolio mix with new products additions, catering to varied demand of the fast growing Indian beverage market. In sync with this approach, the company, during the quarter, introduced ambient temperature and value-added dairy beverages, under the 'Cream Bell' brand across three variants of Belgium Chocolate, Cold Coffee and Mango Shake. These beverages are priced at Rs. 30 for a 200 ml PET bottle, having a long shelf life of 180 days. We will be leveraging our existing distribution network and chilling infrastructure to help expand volumes in this new segment and remain confident of the products' long-term growth prospects.

In a key development during the quarter, the company successfully raised Rs. 9000 million through fresh issue of 147 lakh equity shares. We are glad with the confidence reposed by marquee domestic and foreign investors in our business in a challenging market environment. This capital raised considerably strengthens our balance sheet and reduces our debt providing room for sustained growth. Our growth initiatives continue to be on track including setting up a Greenfield facility at Pathankot, acquisition of South and West India, sub-territories and other investments to drive growth.

During the quarter, the company also acquired an additional 20% stake in Lunarmech Technologies which makes and sales PET bottles caps and crown caps. This transition has increased VBL's total shareholding to 55% in Lunarmech. Additionally, we have also concluded the acquisition of two production facilities, one situated in Dharwad, Karnataka for the total consideration of 747 million and second situated at Tirunelveli, Tamil Nadu for a total consideration of 200 million. These manufacturing facilities are strategically located close to target markets, which will reduce time to market, enable optimization of freight and logistics cost, and aids in margin expansion.

Over the last 12 months, we have made significant investment to strengthen our leadership position in the beverage industry in India. We remain confident that these new investments, once optimally utilized, will further enhance the company's operational and financial performance, enabling us to improve cash flows and augment return ratio in the near future.

On the whole, we have delivered an encouraging performance in Q3 2019. Looking ahead, we continue to build upon our strong positioning in the beverage industry with presence in the fastest growing markets, solid infrastructure and well entrenched distribution network across micro territories. We today have a diverse multi-category product portfolio and are constantly innovating and upgrading to tap various consumer preferences and emerging markets. We are confident of strengthening our market share across categories and drive volumes to sustain our growth momentum going forward. Overall, we remain confident of delivering a healthy and sustained operational and financial performance, going ahead.

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 third quarter ended 30th of September 2019.

Revenue from operations grew 49.2% year-on-year in Q3 2019 to Rs. 17,397.3 million. This was driven by robust volume growth of 60.4%. Total sales volume during the quarter was 124.5 million cases as compared to 77.6 million cases in Q3 2018. The growth was supported by robust performance in India as well as in the international territories. Morocco, Zimbabwe, Nepal and Sri Lanka have all grown in double digits in the current quarter. Organic growth in India stood at 17.5% while in international territory, it stood at a healthy 27%. This is the first quarter that includes the full impact of South and West sub-territories acquisition.

In terms of product mix, CSD constituted 69%, Juice equal to 6% and packaged drinking water 25% of the total sales volume in Q3, 2019.

Realization per case was down by approx 7% on account of change in product mix in India post the consolidation of South and West sub-territories, introduction of water in Morocco and lower sales realization in Zimbabwe in USD terms. The EBITDA stood at healthy Rs. 3,256.6 million in Q3 2019 from Rs. 2,112.4 million in Q3, 2018, registering a growth of 54.2%. EBITDA margins expanded 60 basis points to 18.7% on account of operating leverage and gross margins improved by 223 basis points during the quarter led by lower PET prices in India, lower sugar prices in Zimbabwe in USD terms and change in the product mix.

PAT grew by to 83.7% to Rs. 811.2 million in Q3 2019 from Rs. 441.6 million in Q3, 2018, on the back of robust volume growth. Depreciation increased by 27.5% during the quarter on account of capitalization of Pathankot plant and consolidation of South and West India sub-territories.

Finance cost increased by 83.9% as the purchase consideration for acquisition of South and West India sub-territories has been funded through debt initially.

As shared by the Chairman, during the quarter, we raised Rs. 9,000 million through fresh issue of 147 lakh equity shares of face value of Rs. 10, the entire proceeds of the QIP, net of the issue expenses of 164 million, were utilized for repayment of debt during Q3 2019.

In another key development, we are pleased to share that CRISIL has upgraded the credit rating for our long-term debt as CRISIL AA which was previously AA- and has reaffirmed for our short-term debt as CRISIL A1+ as it was earlier. A significant debt reduction along with the rating improvement should enable us to lower interests cost going forward.

To conclude we have delivered a robust performance in the third quarter of 2019. We are excited of the potential of our winning product portfolio, well entrenched distribution network and our agile business model and remain entrusted of the upcoming growth prospects. We will be focusing on generating steady free cash flows over the coming years, leveraging upon the existing and new investments. On the whole, we look forward to delivering a healthy and a sustainable operational and financial performance, going ahead.

On that note I come to an end of 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 next question from the line of Vivek Maheshwari from CLSA.

Vivek Maheshwari: Few questions, first on the India business volume growth. We have seen company after company reporting or complaining about the macro slowdown and its impact on overall category growth rate and company growth rate. How is it that in case of aerated beverages and for your entire portfolio the organic growth rate is still 17%-18%? So how do you read the entire situation given that everything else is kind of slowing down quite a bit?

Ravi Jaipuria: We think Vivek the main reason behind this has been the rural expansion for the beverage industry and especially for us. For example, a State like UP which two years back had no power in the rural area for about 16 to 18 hours, now we have power for about 16 to 18 hours coming, which has enabled us to put more chilling equipment and expand our reach in the rural markets. Earlier, it was very difficult to sell a warm soft drink and now as we are going deeper into the rural markets expanding our chilling equipment, there is a visible improvement in performance and this is true not only for UP, but also in other States wherever power has become more accessible.

Vivek Maheshwari: And in your sense would you have gained share or the competition would have also gained in terms of market growth rate or would it be similar?

Ravi Jaipuria: We believe the market itself has grown. We might have gained minor share but we feel the overall category has grown and we have also grown with it.

Raj Gandhi: Also, in this quarter even the mix of CSDs has gone up, this was usually not the case in the previous quarters.

Ravi Jaipuria: There was a feeling that the sale of water is driving the growth. However, our carbonated beverage sales have grown faster than the water sales.

Vivek Maheshwari: One more follow-up regarding this, if you leave aside rural expansion would you say that the existing territories or urban centers are seeing pressure or are you not seeing any kind of pressure in your markets pretty much across the board?

Ravi Jaipuria: The only thing we can tell you is if we can get this 17%-18% growth, we hope the pressure continues.

Vivek Maheshwari: Second on the gross margins; when I reduce consolidated/standalone numbers or gross profits from consolidated, I get to other subsidiaries profitability. On a standalone basis your gross margins are going up by 90 basis points but at a consolidated basis it is changing by 640 basis points and probably there may be some base rate issue—I am not sure about it—but could you just highlight it and give some insights into that, on the subsidiary performance?

Raj Gandhi: Vivek, as stated, this quarter, the cost of sugar and PET both were lower. It has helped increase the margins and another reason which is stated in the opening remarks, is that the mix is changed. The mix of water has gone up with the consolidation of West and South India territory and introduction of water in Morocco which has enabled us to grow by 50% in that territory. So with the water mix going up, the gross margin looks high.

Vivek Maheshwari: Two more questions quickly, on the balance sheet cash flows; how much will be the CAPEX in nine-months and in the full year number now?

Raj Gandhi: CAPEX numbers - we have already given for last quarter. This quarter there were only two things, one co-packer of the PepsiCo which we have added for Rs. 20 crore in Tirunelveli that is about (+500) km away from Chennai, towards the South which will cater to both lower part of Tamil Nadu and Kerala. The other one is at Dharwad, this we had announced that we have done the deal for the territory excluding the plant as they needed certain approvals for transfer. Now those approvals have come in and we have acquired that plant also. In this quarter, these two CAPEXs have happened; rest of the CAPEX is as last reported in June's figures, if there is any change it will be announced.

Vivek Maheshwari: Lastly the latest debt number, gross debt?

Raj Gandhi: It's Rs. 2911 crore.

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

Percy Panthaki: Just wanted to understand, for the South and West territories that you have acquired, can you give some details in terms of the initiatives or the inputs you have put into the business post acquisition? We can see the numbers and the results speak for themselves. But what exactly have you done to improve the performance in terms of top-line as well as margins?

Ravi Jaipuria: Our key initial initiative which we have taken is on our GTM. Our Go to Market has drastically improved as we have hired more people, which were required and we have increased a number of routes, which were needed. So initially, in the first 3-4 months, that is the best we could have done and going forward we are further correcting our distribution system and our go to market which is giving us the initial results and we hope going forward it should be much better.

Percy Panthaki: Anything you can share in terms of, whether you have increased the number of outlets reached or any such data points which will give us a flavor on this?

Ravi Jaipuria: The numbers of outlets which we were going through were much lesser than what was needed to be. And that is exactly what we are expanding; by increasing the number of routes, number of people and increasing the number of outlets. The exact number I don't have handy here but maybe we will prepare it and give it to you. But it's an ongoing process and it will continue for the next 6 months to a year because there was such a gap which had got created that we are covering it up now and hopefully this will give us the growth which is needed in the coming year.

Percy Panthaki: Any specific measures you have taken to counter competition from low cost players such as Bovonto, etc.?

Ravi Jaipuria: Again, our key issue was we were not able to reach the market. So first we need to resolve that before taking any other steps. The key step which we have taken initially and again as I said would take another year for us to start combating the whole thing would be to reach to the number of outlets. We are going to practically double the number of outlets that we go to in the next few years.

Percy Panthaki: On our international business, could you give us the growth rates for the individual geography.

Raj Gandhi: Actually average growth during the quarter for International territories is 27%. In Morocco and Zimbabwe we have been growing in the vicinity of about 50%. Nepal has been grown at 12% and Sri Lanka 11.2% and Zambia is -10% during the quarter.

Percy Panthaki: I think in India your capacity utilization for the month of May is now approximately 70% just correct me if I'm wrong or just give me exact figure on that. If you continue growing at this kind of double-digit kind of pace, you will run out of capacity in about 2 years or so. Do you think we should factor in some CAPEX into CY21 or

CY22 when we make your models and if so, can you give us some guidance on the same?

Ravi Jaipuria: If we keep growing in mid-double-digits, the business can afford incremental capex from internal accruals. Today, if we are at 70%, we are not looking for any major capex at least for another 2-2.5 years, which means in the coming years we will require more capex only if we grow another 30% in the business. Moreover, going forward, capex will mostly not be Greenfield plants. It will mostly be Brownfield which means adding one more line to each plant wherever required. Because of GST now we don't have to go and have a Greenfield plant. So our capex will be much smaller in amount compared to what we used to have.

Percy Panthaki: If you could just give some guidance, so in Brownfield I think your asset turnover will be high, so let's say you do a Brownfield CAPEX of 200 crore, what kind of sales you can generate on that CAPEX?

Ravi Jaipuria: About double. Initially for a year, on a Rs. 200 crore capex, turnover would be about Rs. 400 crore.

Moderator: We take the next question from the line of Anand Trivedi from Nepean Capital LLP.

Anand Trivedi: My question is more on the potential of a plastic ban that we keep hearing out in the papers and how much of a concern or risk is that for you and is there anything you can do to mitigate that in the future?

Ravi Jaipuria: We think the key issue here is that the government is keen on restricting single use plastic whereas what we are telling the government and they are reasonably accepting it is that our PET is completely recyclable. We are giving them a proposal as per which we will be collecting all our used PET which we produce. So in the next two years there should not be any negativity associated with us. If we produce say 10,000 tons of plastic, we will be collecting 10,000 tons of plastic which will be recyclable.

Anand Trivedi: So, as far as you are concerned you won't see that much of a risk for the time being?

Ravi Jaipuria: Even currently we are not polluting the environment and if we are collecting 100% of the plastic produced by us, there is no question of polluting the environment.

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

Anand Shah: Firstly, can you give me the breakup of the 124-125 million cases into India and international business in terms of volumes?

Raj Gandhi: India out of 124 mn cases is 98.06 mn cases and international in this is 26.41mn cases.

Anand Shah: Of this 98.6 mn cases, I just want to know, how much was from the newly acquired territories that we would have in this quarter?

Raj Gandhi: It is 31.36 million cases.

Anand Shah: So, roughly 32 million cases.

Raj Gandhi: That's right

Ravi Jaipuria: You see in this quarter, the contribution of international market becomes higher because the peak season starts there, whereas peak season has finished in the Indian market.

Anand Shah: Second question I had is on your tax rate. There have been corporate tax rate cuts and you were on the higher side; haven't you availed of this benefit or is it not shown in your numbers yet?

Raj Gandhi: We are evaluating this currently. In fact, firstly, we have MAT tax credit available with us. We want to use that. Secondly, this year we have put up a new plant at Pathankot and additional depreciation on that is available and we want to use that. In the light of these two factors we want to continue at least for another roughly two years on the earlier tax rates before switching over to the concessional tax rates announced by the Finance Minister. However, having said that, the advantage of 3.5% on the MAT tax rate reduction on the cash flow is already started being availed by the company as you must have seen on the standalone accounts; as the current tax charge for the quarter in India is not there. However, we are evaluating this, and I think by next quarter, we will have more specific answer. Also, in the light of the recommendation of the Institute of Chartered Accountants, even if you are switching over say after a period of 2 years and can the pro rata deferred tax liability be reversed and if so, how. So, we are evaluating all these aspects and I think by the next quarter we will provide you with definite answers and share more details.

Anand Shah: So, for now we should assume that the steady state continues at least on the P&L side.

Raj Gandhi: Yes with 3.5% plus surcharge advantage in the cash flow. And if we switch, that will be as per the issued guidelines in the next quarter. Let's wait till then, we will have definite answers by then.

Anand Shah: And one more thing, on the subsidiary financials, I was looking at the other expenses, if you reduce that consolidated minus standalone as Vivek was suggesting on the gross. On the other expenses, it has gone up by almost 40% odd, so anything there to read into?

Raj Gandhi: This is basically foreign exchange provision for Zimbabwe on the ~ USD 12 million liability. In fact, we have Dollar exposure of ~ USD 42 million in Zimbabwe out of which for ~ USD 30 million, Reserve Bank of Zimbabwe has undertaken to provide equivalent USD on the date of loan repayment at 1:1 exchange rate on local currency and hence, no provision is needed. On the balance amount, foreign exchange provision has been created.

Anand Shah: Lastly, on the employee expenses, we have seen a sharp jump both in YoY and QoQ. So, can you highlight there?

Raj Gandhi: This is because of the new territories in South and West India region and the new plant at Pathankot.

Anand Shah: So, this is the most sustainable level or run rate we should take?

Raj Gandhi: Yes.

Moderator: Next question is from the line of Pritesh Chhedda from Lucky Investments.

Pritesh Chhedda: What would be the annualized volumes for Pepsi in CY19, for the acquired territories?

Raj Gandhi: Broadly if you see, India volume is split as two-third for the old territory and one-third for the new territory.

Pritesh Chhedda: But, since you will be consolidating for only three quarters, could you help us with the annualized volumes for Pepsi?

Raj Gandhi: In the last call also we have stated that PepsiCo volume was 135 million cases in West and South India region and this year 60% of that will be coming along with some growth.

Pritesh Chhedda: Pepsi will be 135 million cases annualized CY19? And you would have?

Raj Gandhi: Annualized yes, 135 million cases, and 60% of that.

Pritesh Chhedda: So, 60% of that would have flowed in so about 81 million cases?

Raj Gandhi: Yes, 60% of 135 million cases plus growth

Pritesh Chhedda: Secondly, on your growth outlook organic basis for India, this year you also highlighted about distribution led growth, is it fair to assume that you will continue to grow high double-digit for another couple of years considering the argument that you shared for CY19 about distribution led growth?

Ravi Jaipuria: Well, we hope, but of course we cannot commit as it depends on a lot of factors like rains, etc. but hopefully, if things go well we should continue the same way as we have been showing consistent double digit growth.

Pritesh Chhedda: And when we calculate the EBITDA per case this quarter is it fair to assume that because of lower volumes seasonally the EBITDA per case is always lower for the quarter versus the full year?

Raj Gandhi: EBITDA per case in this quarter is always lower than the main quarter but EBITDA per case is higher than the same quarter last year.

Pritesh Chhedda: There is nothing of lower realization to play in into the EBITDA numbers, right?

Raj Gandhi: EBITDA percentage over the last year doesn't change.

Pritesh Chhedda: Lastly, I wanted to know the cash flow bridge for the calendar year 2019. What is the CAPEX that we would have incurred, what is the acquisition amount that we would have paid and what is the cash flow we would have generated and the equity money I know is about Rs. 900 crore that you have raised.

Raj Gandhi: Yes, it’s about Rs. 2,200 crore including the PepsiCo’s territory, net of Rs. 200 crore which we have got back from PepsiCo.

Pritesh Chhedda: So, 2,200 crore includes Pepsi plus?

Raj Gandhi: Plus the capex for Dharwad plant and territory, Nagpur territory and acquisition of one co-packer in Tirunelveli are all included in the above figure of Rs. 2,200 crore.

Pritesh Chhedda: What would be the replacement CAPEX in this, of about 200 crore within this?

Raj Gandhi: Our replacement basically you are saying on the existing?

Pritesh Chhedda: Yes.

Raj Gandhi: It should be around that figure.

Pritesh Chhedda: What is the cash flow that would have generated from the operations in 9 months?

Raj Gandhi: Typically what you can see, is that our debt has gone up by ~ Rs. 100 crore even after the above capex figure. We had also declared dividend on the enhanced capital. Only Rs. 900 crore is funded out of the QIP, rest is from the internal accruals.

Pritesh Chhedda: So, that is Rs. 900 crore minus Rs. 2200 crore.

Raj Gandhi: Yes, that is Rs. 1300 crore.

Pritesh Chhedda: Whatever was the EBITDA is your cash flow?

Raj Gandhi: It's coming around that figure as the tax payment comes substantially in the Q4.

Pritesh Chhedda: Lastly, when you are giving your comments on the tax part, lower tax rate, you said that this year you don't know, next year there can be?

Raj Gandhi: Because we are evaluating in this quarter and our year end is December. So at the time of December accounts we would have evaluated all the guidelines of the Institute and market practice. We will be forming our opinion on the excessive deferred tax liability of 9.61% because of the reduced tax rates and how we should treat it in our P&L.

Pritesh Chhedda: And you said that 3.5% benefit if possible, that's what you said, right?

Raj Gandhi: We have already started availing the benefit of reduction in MAT in the cash flows. However, the deferred tax liability of that is already created by us.

Pritesh Chhedda: And all your CAPEX incremental will be Brownfield?

Raj Gandhi: Most of them, yes. Because we have excess capacity. Even if we are utilizing 70% now, we have room to grow 40% from here. So at least for the next 2-2.5 years we have capacity available with us.

Pritesh Chhedda: After that you will have Brownfield in the same plants. So you said 2 years we have the capacity available to grow, after that whatever capacity you need incremental will be all Brownfield at the same locations. That's how should I understand?

Ravi Jaipuria: Yes. Most of it will be Brownfield.

Raj Gandhi: There will be various factors to be considered, such as nearness of the market, for example, Tropicana has been recently launched in Pathankot. If it grows faster in South and freight is coming higher then ahead of time, we may think of it at least to match that. So, there may be a lot of factors on an overall basis. But even if we do this it may spread over one more year.

Moderator: We take the next question from the line of Deepan Mehta from Elixir Securities.

Deepan Mehta: It's more of a macro-question, has there been any situation where Coke or Pepsi have discontinued with a bottler anywhere globally and what are the general terms and conditions under which such disconnect or disassociation would take place?

Raj Gandhi: In the last call, we all celebrated the fact that for the first time in the world, PepsiCo have increased our existing bottling agreement for a period of 20 years and also, they rewarded us by transferring their own existing territory and plants to us. At least, I can say about us we don't carry any such risk in the recent future.

Deepan Mehta: But, globally has there been a situation, if can you just give us some insight because in this 20 year agreement obviously there will be some sort of escape clause for them in case they want to leave.

Ravi Jaipuria: There are escape clauses, in case if we start doing competitive business or start preparing a product which is not fit for the market, so those clauses are there. But otherwise, nowhere we have seen that they have really cancelled the agreement, unless until somebody has really behaved contrary to the agreement. Especially, with us when their dependence is so high, especially in a big country like India and six more countries, very difficult unless until we do something really stupid or something totally contradictory.

Moderator: We take the next question from the line of Rajeev Gupta from RBC Financial.

Rajeev Gupta: I have two questions; one is the newspaper reports that your competition is selling bottling plants and distributorships to its franchises. What do you think will be the effect on margins and pricing if this was to happen in the near future?

Ravi Jaipuria: For us, instead of competing with the parent company, we will be competing with the bottlers, so it won't be much different. The rest it depends what policy and how they really come up once they have done the transaction.

Rajeev Gupta: My second question was this provision on FX has been made and I have asked this question on previous calls also; in the past 2-3 quarters in Zimbabwe what is the cumulative and will somebody throw a little more light on what is this provision, what are we hedging against? What is the total amount to the cumulative provision today? Has there actually been a mark-to-mark clause which is been moved from the provision to the P&L account? Just explain this provision and also if we go back a little to the past maybe 1 or 2 quarters you have been creating this provision and if my memory serves me right this provision amount is probably cumulative $25 or $30 million now. It's a large amount, what is it that we are doing or is it just conservative accounting and that's the question I'm asking?

Raj Gandhi: Yes, Mr. Gupta I will explain this from the beginning. Total dollar exposure in that company is about 41-42 million USD, out of which 11-12 million USD is which is mark-to- market which is against the current asset liabilities etc., the difference of that which is going to the P&L and is getting absorbed. In this quarter the provision figure or the P&L debit you are seeing; this is adjustment of that foreign exchange which is mark-to-market. There is a second part to this, it is about 29-30 million USD which is the amount outstanding to the bank which is a term liability and on this term liability in the light of the Reserve Bank of Zimbabwe hedging the provision of USD to us through an agreement at the original rate at which we had come in. Now the ~ Rs. 137 crore provision which we needed till June 2019 is not required. But we don't want to take it to P&L till this loan liability is fully discharged in the light of USD shortage in that country with the government. Whatever provision we had done in the past we have not touched upon that. We may not be requiring those or we may require, but today we are not sure because of the foreign currency situation in that country.

Rajeev Gupta: So if I may articulate that what you are saying is that there is risk, foreign exchange is volatile and while your mark-to-mark doesn't require you to provide that provision today as on the current exchange rate you may need it because it's a volatile market and therefore you are not reversing it and putting it back into the P&L account.

Raj Gandhi: Very right, you understood correctly.

Rajeev Gupta: What is this quantum, is it Rs. 137 crore?

Raj Gandhi: It is Rs. 137 crore as total.

Rajeev Gupta: If the foreign currency remains stable till the maturity of this obligation, then Rs. 137 crore would come back to the P&L account?

Raj Gandhi: Yes, we have about 2.5 years of left over maturity for this. So we will start observing it after a year or so. Once we find the reverse trend, we will be crediting this to P&L if that is required.

Moderator: We take the next question from the line of Himesh Satra from Joindre Capital.

Himesh Satra: My question is that we are seeing a fall in realization in this quarter also; can we see your increment from the realization in coming quarters or do we see a further fall in realization?

Raj Gandhi: This should slightly go up as Tropicana, which was launched in the whole of the country, has a higher realization per case. So as the mix of Tropicana goes up we should see realization go up. Secondly, the ambient temperature milk-based beverages which have been launched, there also the realization is higher, and they should slightly help increase the realization per case. As far as the water mix of the Southern and West is concerned till we will complete one year and make the base, you may see some realization decline for another 2 quarters. After that you should see the per case realization going up.

Himesh Satra: What will be the capacity for the new plants production facility that we have acquired during this quarter?

Raj Gandhi: This quarter, one plant has only the water facility for South region - Tamil Nadu and Kerala; another is at Dharwad for about 13-14 districts of Karnataka which we had acquired this year. This was acquired on 14th February this year. We were supplying from the same plant but we were getting it co-packaged from the erstwhile seller. Now we have acquired the plant and we don't have to pay the conversion fee on that plant. This was running at about 90% capacity utilization in the peak month.

Moderator: We take the next question from the line of Yasmin Shah from Antique Stock Broking.

Yasmin Shah: My question pertains to demand for Colas; if I'm not mistaken you said it has gone up for you in this quarter. Could you elaborate more on that?

Ravi Jaipuria: We have said that the growth which we are getting in the Indian subcontinent now; there was always a feeling that water sales are driving the growth which is not the case. Our carbonated beverages sales have shown a better growth than our water sales, so when we are saying a 17% growth our carbonated beverages have grown at the same pace or better.

Raj Gandhi: So the blended this quarter organic growth over last year has been 17.5% while for the carbonated soft drinks during the quarter is 19.3%.

Yasmin Shah: Could you elaborate in terms of what is driving this?

Raj Gandhi: This is basically driven by the new sub-territories of Odisha, Chhattisgarh, Jharkhand, Bihar and Madhya Pradesh which we have acquired in CY18, they are under penetrated.

Ravi Jaipuria: And also, the rural expansion which I had said in the rural markets, where we are penetrating and going deeper with the power situation improving. As initially said, even power situation was bad, as soon as the rains started, the markets used to shut down because there was no ice available and hot soft drink is very difficult to sell. So, that's some of the things which are expanding and helping us grow the rural market.

Yasmin Shah: Do you foresee a similar trend going ahead in terms of growth?

Ravi Jaipuria: I hope so. The power situation in this country is going to keep on improving and we are going to keep on penetrating deeper into the rural markets and I think we will have a good crop this year also. So, there will be enough money in the rural markets, so we could expect a good next year.

Yasmin Shah: If I have to compare in your existing territories what would be the growth rate? Not adding any of the new territories but in the existing markets alone what could be the growth rate?

Ravi Jaipuria: We are growing approximately the same so there has not been any major difference because last year what we acquired becomes our core territory now. So, it's only in May 1st when we acquired the South and West which is considered as in-organic, the rest has become our core territory and part of organic growth.

Yasmin Shah: My last question pertains to International market; so these contracts are for how long and what is the duration and what are the terms in terms of pricing etc.?

Ravi Jaipuria: Each country has a different pricing, different number of years but fundamentally it's the same. Once they have a long-term agreement with us for India which is our base the rest automatically will fall in line with them.

Yasmin Shah: So, if I have to see the next 5-7 years down the line how much should be India's contribution or how much do you see International going up for you'll?

Ravi Jaipuria: Right now both India and International territories are growing reasonably at the same pace slightly more or less. This year International has grown little faster because we have added Aquafina in Morocco but otherwise the growths are about the same. So we are growing in both territories in double digits.

Yasmin Shah: I mean in terms of breakup, is it 80-20 or what would be there on budget?

Raj Gandhi: Broadly it should stay the same with the couple of percentage point difference

Ravi Jaipuria: But approximately around 80-20 would be the break-up.

Moderator: We take the next question is from the line of Himesh from Joindre Capital.

Himesh Satra: My question is that, we do have a gross debt of Rs. 2,900 crore on the books and do you have any plans to reduce the debt or do we see these levels maintaining in the coming years?

Raj Gandhi: In fact, we have already taken steps and brought it to the last year's level while our EBITDA from Rs. 1,000 crore is already Rs.1300+ crore and one quarter is still left. So, percentage wise we have already reduced; debt equity is less than 0.9. So for the time being we feel it is a healthy mix because our ROCE also has gone up this year. So it will add to the shareholders profits. No plans at this moment for reduction of debt anymore by diluting. Of course there will be internal accruals in the coming years and from there definitely it will come down.

Moderator: Thank you. Ladies and gentlemen that was the last question. I would now like to hand the floor back to the management for closing comments. Over to you sir.

Raj Gandhi: Thank you once again for your interest and support. We will continue to stay engaged, please be in touch with our Investors Relation team for any further details or discussions. Look forward to interacting with you all soon. Thank you very much. Thanks for participating.

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