Varun Beverages Limited

Q3-CY18 Earnings Conference Call Transcript
October 25, 2018

Moderator: Good day, ladies and gentlemen 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 this conference call, you may signal an operator by pressing '*' and 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 evening everyone and thank you for joining us on Varun Beverages Limited Q3 and 9M 2018 Earnings Conference Call. We have with us Mr. Ravi Jaipuria - Chairman of the company, Mr. Varun Jaipuria – Wholetime Director, Mr. Raj Gandhi – Group CFO and Wholetime Director, Mr. Kapil Agarwal – CEO and Wholetime Director and Mr. Kamlesh Jain – CFO and Wholetime Director 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 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 our results' presentation which provides details of our operational and financial performance for the third quarter and nine months' ended 30th September, 2018. We are happy to report another strong quarter with a revenue growth of 21% year on year and a net profit growth of 31% year on year in Q3 2018. This was on the back of robust volume growth of 17.2% and value growth of 3.8%. Strong organic volume growth momentum has continued in India at 9.3% in Q3 2018 despite marginal impact on account of shift of the festive season this year to Q4.

We are enthused by our performance this year as we have reverted to our historical growth trends. For the nine months ended September, 2018 revenue grew 24% year on year led by robust volume growth of 19.8%. Value growth of 4.5% was driven by better portfolio mix with the introduction of higher realization product like 'Sting' and 'Tropicana'. Our India business has delivered organic volume growth of 11.7% during this period on the back of strong peak season sales. PAT increased by 31% year on year driven by strong volume in India as well as in international operations.

The demand environment continues to be robust. We are on a strong footing and proceeding as per our strategic road map of driving profitable growth. We will be focused on unlocking value from the recently acquired underpenetrated sub-territories in India by strengthening distribution and installing visi-coolers. The acquired sub-territories provide huge opportunity for driving volumes, gaining market share and seem significant operation leverage going forward. Further our customer-centric approach, new product innovation and ethnic flavors in the fast growing juice segment and the Tropicana juice portfolio augur well for our long term prospects. We have a strong balance sheet and sufficient capacity in place, providing significant scope for growth on existing investments resulting in robust cash flow generation. I would now request Mr. Gandhi to provide highlights of the operations and financial performance. Thank you very much.

Raj Gandhi: Thank you Mr. Chairman. Good afternoon and a warm welcome to everyone for joining the investor's call. Let me provide an overview of the financial performance for the third quarter ended 30th September, 2018. Revenue from operations adjusted for excise/GST grew 21% year on year in Q3 2018 to Rs. 11,657 million. Total sales volumes were up 17.2% year on year at 77.5 million unit cases in Q3 2018 as compared to 66.1 million unit cases in Q3 2017. Further, the introduction of high realization products and re-classification of freight cost (instead of netting off from revenue) have resulted in 3.8% value growth during the quarter. Growth momentum continued in India with strong organic volume growth of 9.7% in Q3 2018, despite marginal impact on account of shift of the festive season this year to Q4.

Gross margins remained stable year on year at 54.8%, EBITDA increased by 14% to Rs. 2,112 million in Q3 2018 from Rs. 1,854 million in Q3 2017. Underlying EBITDA margins have improved in existing as well as recently acquired territories on the back of operational efficiencies, increase in organic volumes and consolidation of contiguous territories. However, blended EBITDA margins reduced by 113 basis points year-on-year to 18.1% due to sub-optimal volumes / margins in the acquired sub territories and contribution from the Tropicana juice portfolio where at present we only have a supply and distribution arrangement, and we are not manufacturing the product. Further, depreciation has increased 13.7% year on year during the quarter on account of inorganic expansion. The robust volume growth in India as well as in international operations has resulted in 31% year on year increase in profit after tax to Rs. 442 million in Q3 2018 from Rs. 337 million in Q3, 2017.

At this point, I would like to point out once again that it is the best to monitor the business on an annual basis given the seasonal nature of the business. In terms of the performance for the nine months ended 30th September, 2018 revenue from operations adjusted for excise/GST grew 24.3% year-on-year in 9M 2018 to Rs. 43,196 million led by a robust volume growth of 19.8% and value growth of ~4.5%. During 9M 2018, CSD constituted 77%, juices 6%, packaged drinking water 17% of total sales volumes. EBITDA grew 19.4% to Rs. 9,588 million while net profit expanded 29.5% to Rs. 3,707 million in 9M 2018.

To conclude, this has been another strong quarter for us, we have demonstrated strong cash flow generation, working capital efficiencies and are well capitalized to sustain our growth momentum in the years ahead on the back of our robust eco system, enhanced product portfolio and ability to drive growth and garner market share.

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 very much.

Moderator: Thank you Sir. Ladies and Gentlemen, we will now begin the question and answer session. We have the first question from the line of Anand Shah from Axis Capital, please go ahead.

Anand Shah: Just few questions; one is can you also highlight this organic consolidated growth in terms of volume; you have given the India organic growth?

Raj Gandhi: Consolidated volume growth is 8.5% for 9M 2018 and for Q3 it is 5%.

Anand Shah: So any particular reason, slowdown I think last quarter you had highlighted Sri Lanka, the tax rate thing and all also**.** So how is the International performance being?

Raj Gandhi: In Sri Lanka, the slowdown has been arrested in Q4, earlier de-growth was about 30%+, now it is under 20% and should further come under control by this quarter end as we got slightly delayed in introducing our zero-calorie, zero-sugar products. We are happy to report that the expenses are already under control even with the reduced volumes.

Anand Shah: And how are Zimbabwe and Zambia doing?

Raj Gandhi: Yes Zimbabwe is doing well and it has already reached a threshold volume of 10 million cases which is required for making any territory profitable. Zambia is again doing as per expectations and if we do a like-to like comparison of growth over last year's numbers, the domestic sales in Zambia have shown 35.7% growth.

Anand Shah: Okay perfect and on the domestic side Sir, what is your general take on the demand, I mean you see this sustain recovery especially in your markets in the North and East and the rural sides, I think you were fine of the demand size?

Raj Gandhi: Demand should be there because of the various initiatives we have undertaken. The response to new launches has been quite overwhelming and with the introduction of 'Pepsi Black' and 'Sting' which already have become 2% of the sales, we expect the growth momentum continuing in the near future as well.

Anand Shah: And just lastly on this slight drag on the EBITDA because of the stabilization in new territories and Tropicana, when do you expect this to stabilize?

Ravi Jaipuria: Once our new plant for Tropicana is in production, expected by March or April next year, we believe that the margins in Tropicana will improve because at the moment it is being traded, we do not have margins and also the new territories which we have taken are already starting to get stabilized and by early next year they will consolidate with our existing territories and we think we will start seeing the same EBITDA margins in the new territories.

Raj Gandhi: Anand, as you know in the last call also we said we have already doubled the margin since these territories were acquired but still there is a lot of potential to grow and also, except Jharkhand, most of the territories are at 20-25% market share so there is a huge potential to increase the market share. Once the volume gain will start, we will have good potential to enhance the margins and the market share.

Anand Shah: So both essentially, perfect. And just one last thing, if I may, are you seeing anything special on gross margins because of the maybe on the higher fuel cost, or on power and fuel, delivery, packaging in general because of the higher crude prices?

Ravi Jaipuria: Something always keeps happening, either sugar is high or petroleum is high. If the costs goes up by more than 5% we normally pass it on to the consumer, so we do not think there will be significant impact of these as far as our EBITDA margins are concerned.

Moderator: Thank you. The next question is from the line of Kaustubh Pawaskar from Sharekhan Limited, please go ahead.

Kaustubh Pawaskar: Good evening Sir, thanks for giving me the opportunity and congratulations for good set of numbers. Sir coming back to operating margins question, we have seen that this year the margins are lower and obviously the reason is because of the consolidation and the lower margins of Tropicana and you mentioned that consolidation will happen somewhere early in CY 2019 and also a new facility of Tropicana will be operational next year. So can we see CY 2020 should be a right year to look from the margin's perspective, like we can expect steady kind of margin expansion from CY 2020?

Ravi Jaipuria: We believe that you will see benefits coming in by the next year itself because all our new territories will get fully consolidated starting next year, which we have not been able to fully consolidate this year and Tropicana plant will be operational for at least 7-8 months of the year, so we do not see any reason why it would spill over to 2020.

Kaustubh Pawaskar: Okay, so margin expansion should be there from CY2019.

Ravi Jaipuria: That is right; it would be come back to where we were i.e. above 20%, which is what we expect.

Kaustubh Pawaskar: Okay and sir mentioned about working capital improvement in his initial comments. So can you throw some more light on it, you know whether you have seen any reduction in the working capital days or what kind of efficiencies you are looking into working capital?

Raj Gandhi: Yes, it is quite apparent. In fact last year we had given guidance, when working capital cycle used to be 29 days, that at optimum levels we want this to be under 20 days. During the season when half yearly balance sheet was prepared, which is also the busy season when majority of our sales volumes are recorded, it came down as low as 13 days, but we have still maintained the 20 days guidance for the year end and we are absolutely on the track.

Kaustubh Pawaskar: Okay and post the consolidation of the territories can we expect some more improvement in the working capital because post the consolidation things would be more stabilized and there might be more benefits at the working capital levels?

Ravi Jaipuria: I think 20 days is quite the optimum and although we will keep trying but I think to achieve anything better than that would be quite difficult.

Kaustubh Pawaskar: Sir one last one on the debt; are we looking at releasing the debt or the inorganic initiatives will continue and there will be you know the debt position will continue to remain at the current level?

Raj Gandhi: In fact, there was very good improvement in debt levels in June and we have already achieved the debt equity of 1:1 which we have kept as a target for us and debt to EBITDA itself also has come to 2.1:1 as against 3:1 which we have guided on the company website. And further, inorganic opportunities also keeps on coming as during the last 25 years it has been and you know last year also we could add some territories and let us see what happens in the future.

Moderator: Thank you. The next question is from the line of Bhavesh Shah from CLSA, please go ahead.

Bhavesh Shah: Can you share some thoughts on your outlook for concentrate prices for 2019?

Ravi Jaipuria: Well concentrate pricing has been at 20% of net wholesale price for the last 25-30 years since we started this business and it will remain constant. So we do not see any changes happening in that. For any reasons, our selling price goes up, the concentrate price will go up but it will remain at the same percentage.

Bhavesh Shah: And any thoughts on, with the recent increase in crude prices how your PET products, given your large exposure to PET products, how is your inputs shaping up on that side, are you comfortable or you will be required to take some price hikes?

Ravi Jaipuria: We will see closer to the year-end because this is like a see-saw, every year something or the other happens, crude prices are already starting to come down, PET prices have come down by over 10% in the last one and a half month. So I think we need to look at what the final pricing is going to be at the year end and if it really makes a significant difference then we might look at taking some slight pricing action, otherwise, we do not see any major changes happening from this year to next year.

Raj Gandhi: And Bhavesh, just to supplement this, this year whatever increase in petroleum prices has been there, it is compensated by reduction in sugar prices. So net-net if you see at the gross margin level this year margins have actually improved. So as of now there is no challenge but going forward we will evaluate once we reach there.

Bhavesh Shah: Sir secondly, on your Tropicana portfolio what is the current margins you are making and where do you expect these as you commission your Pathankot facility, if you can share some thoughts on that?

Ravi Jaipuria: Currently, we are not making much margin. Basically we are paying huge freight costs since the products are coming from Baramati, Maharashtra in the western side and going, to East and North. But once we start in-house production, we will have our regular margin like any of the other categories.

Bhavesh Shah: If you can share some detail on what's your agreement with PepsiCo, do you pay concentrate charges here or do you have royalty agreement, how will it work for your Tropicana portfolio?

Ravi Jaipuria: It will be similar to our existing arrangement for other categories. It is in the finalization stage and we think before the end of the year it will get finalized.

Bhavesh Gandhi: And sir, just coming back to your base business in your recently acquired territories, when do you expect margins for these territories to converge with our existing ones? Do we expect this to happen in the upcoming quarter?

Ravi Jaipuria: We expect by next year new territories will be fully consolidated with our existing territories and we should be having similar EBITDA margins across.

Bhavesh Gandhi: And sir just one more last question on these new acquired territories, in the opening remarks you mentioned that you intend to deploy more visi-coolers and expand our distribution network, so what are your market share in these territories, I am assuming it is 20-25% across all the regions or it is a different number?

Ravi Jaipuria: Market share is different in each State and overall on a consolidated basis we are at about 20% in new territories, so I think there is lot of headroom and we hope to increase our distribution by putting more marketing assets in the territory.

Bhavesh Shah: So if I am not mistaken your current count of visi-coolers is close to 400,000, so how many visi-coolers you intend to deploy in these new territories?

Ravi Jaipuria: I don't think we would like to disclose that at the moment.

Raj Gandhi: We can only say it is close to half a million as of now.

Moderator: Thank you. The next question is from the line of Vicky Punjabi from JM Financial. Please go ahead.

Vicky Punjabi: I just want a clarification on the CSD part of the portfolio because there the growth seems a little lower at around 11%, we are doing 16-18% in the past two quarters, is this purely because of the festive season or are we seeing some other effect out here?

Ravi Jaipuria: It is primarily related to the festive season. Our growth is marginally lower in the current quarter as Dussehra was in September last year. It does make a big difference especially in our Eastern portfolio. We will see the upside in October which is already going on pretty well, so we see the volumes shifting in the fourth quarter. Also what happens is as the peak season gets over, contribution of water and juice starts increasing as they have less seasonality, so you always see more contribution of water in the non-peak season months.

Vicky Punjabi: And Sir just one more thing on this CAPEX bit, I just wanted to know how this Pathankot CAPEX will kind of work over the next year and when will the facility be finally ready.

Ravi Jaipuria: We are on track on what we had projected, there is not much gap in what we are going to spend and we are expecting the plant to be ready by March or latest by April nest year. We hope to be actually in production by March.

Vicky Punjabi: And Sir the total CAPEX expected was Rs. 450 crore, right?

Ravi Jaipuria: Yes, total CAPEX was expected to ~ Rs. 450 crore.

Moderator: Thank you. The next question is from the line of Kuldeep Gangawar from ASK Investment Managers. Please go ahead.

Kuldeep Gangawar: Sir this CAPEX for Rs. 450 crore is for CY18 only or..?

Ravi Jaipuria: This is for season '19, so what happens is some part will be in this year but that will be capital work-in-progress, capitalization will happen in 2019 only, but this is total for the plant to be operational.

Kuldeep Gangawar: Pathankot plant you are talking about?

Ravi Jaipuria: That is right.

Kuldeep Gangawar: And in Nepal, where you recently completed the expansion, how is the pickup there?

Ravi Jaipuria: Performance in Nepal is good, the plant is operational and we expect good results coming from it by next year because the plant only got operational during the middle of the peak season, so I think the real benefit of that will only come next year.

Moderator: Thank you. As no further questions from the participants I now hand the conference over to the management for closing comments.

Raj Gandhi: Thank you very much 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 discussion. Look forward to interacting with you soon in person. Thank you.

Moderator: Thank you very much members of the management. Ladies and gentlemen on behalf of Varun Beverages Ltd. that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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