(a PepsiCo franchisee)

Varun Beverages Limited

Q2 & H1 CY2017 Earnings Conference Call
August 10, 2017

Moderator Ladies and gentlemen, good day and welcome to the Varun Beverages Limited Earning 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 telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Anoop Poojari of CDR India. Thank you and over to you, Mr. Poojari.

Anoop Poojari Thank you. Good afternoon, everyone and thank you for joining us on Varun Beverages Q2 and H1 CY 2017 Earnings Conference Call. We have with us today Mr. Ravi Jaipuria – Chairman of the company, Mr. Varun Jaipuria – Wholetime Director, Mr. Raj Gandhi – Group CFO and Wholetime Director and Mr. Kapil Agarwal – CEO and Wholetime Director of the company. 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 results presentation shared with you earlier. I would now request Mr. Ravi Jaipuria to make the opening remarks.

Ravi Jaipuria Good afternoon, everybody 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 second quarter and half year ended June 30th, 2017.

Before sharing some of the operational highlights for the quarter, I would like to update you all on an important corporate development that has taken place today. We are happy to announce that the Board of Directors of Varun Beverages has approved its intent to enter into a binding agreement to acquire PepsiCo India's previously franchised rights of Odisha and Madhya Pradesh, along with three manufacturing units at Cuttack, Bargarh and Bhopal, subject to the satisfactory completion of due diligence and final approval of PepsiCo. Upon completion of this acquisition we will be a franchisee for PepsiCo products across 18 states and 2 union territories. This is part of our strategy to consolidate our presence in contiguous territories and garner market share. These are highly underpenetrated markets which offer long term, sustainable growth opportunities. Further the manufacturing facilities are strategically located close to target markets which will reduce time to market and enable optimization of freight and logistic costs, aiding margin expansion.

Moving into the financial and operational highlights, we are glad to report an increase of 65% year-on-year in our net profit in H1 CY 2017, which covers the peak season for our products and accounts for majority of our sales and profits. We constantly strive to drive operational excellence. We have robust end-to-end capabilities across the value chain. Our solid backward integrated model together with consolidation of contiguous territories has resulted in driving strong margin improvement during the first half of the year.

We have seen strong volume growth in Nepal, Morocco and Sri Lanka. However, overall volumes were impacted on account of the implementation of GST in India, which lead to substantial inventory de-stocking in May and June. In addition, early onset of monsoon in India and floods in Zambia impacted volumes. We believe, the impact of GST is transient and will bring in enhanced efficiencies and smoothen business operations going forward.

Varun Beverages looks upon good Corporate Governance practices as a key driver of sustainable corporate growth and long-term stakeholder value creation. The Board's approval of the dividend policy is a reflection of our continued focus to deliver on that commitment. The dividend policy reflects our confidence that the successful execution of our strategic plans will continue to generate strong cash flows, enabling us to strike the balance between investing in the business and regularly rewarding shareholders through dividends. In line with the stated policy the board has recommended an interim dividend of 25%.

To conclude, we are committed to our strategic intent to drive growth and market share gains across all our territories. We will continue to evaluate strategic acquisitions of new contiguous territories which will provide economies of scale. We also regularly seek to introduce new product lines and diversify the product portfolio in line with the changing consumer preference. Our robust business model, strong end-to-end execution capabilities and track record puts us on a strong footing and we will look to strengthen our position further in the coming years.

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

Raj Gandhi

Thank you, Mr. Chairman. Good afternoon, everyone and a warm welcome to everyone on the investors call. Let me provide an overview of the financial performance for the second quarter and the first half which accounts for majority of our revenue and profits. Revenue from operations net of excise remained flat in H1 CY 2017 at 25,126 million. Total sales volume in H1 CY 2017 stood at 179.6 million unit cases as compared to 184.0 million unit cases in H1 CY 2016. As indicated earlier, volumes were impacted by the de-stocking ahead of the GST related uncertainty in India. The early onset of monsoon in certain regions, further had an adverse impact. However, international operations in Nepal, Sri Lanka and Morocco have recorded robust growth in high teens.

Moving onto the margin scenario, gross margins have expanded 27 basis points year-on-year to 52.9% in H1 CY 2017. EBITDA margins expanded to 24.6% year-on-year in H1 2017 from 23.1% in H1 CY 2016. Margins have been driven by efficiencies which we are pursuing to sustain going forward. The consolidation of contiguous territories, new plants close to demand and solid backward integration infrastructure has brought in significant cost efficiencies and has resulted in 146 basis points year-on-year expansion in EBITDA margin in the first half of the year. Capacity utilizations remained at the earlier level under 70% on account of moderate growth in sales volumes during the peak month and additional capacity added ahead of time for strategic logistic reasons. We have also leveraged our strong balance sheet and recent credit upgrades to drive a significant reduction in our cost of borrowing. This along with the debt reduction from the IPO proceeds has led to significant reduction in interest cost. Consequently, our profit after tax grew 65% year-on-year to Rs 2,481 million in H1 CY 2017.

Net capex during the period (including change in capital work-in-progress) was about Rs 4,040 million and if we reduce CWIP, then it is around Rs 3,900 million which also included setting up of a new production facility in India, the capex for which is around Rs 3,250 million. Our balance sheet position as on 30th June 2017 is robust with a net debt/equity of 1.2x. The company effectively utilizes its balance sheet for inorganic growth for acquisition of new territories or product categories. Acquisitions have been a key component of our growth strategy for last many years and substantially accelerated the company's revenue growth rate and made a significantly positive contribution to the net income and cash flow. The company believes it evaluates acquisitions in a measured manner to have conservative acquisition cost and has the experience to drive efficiency and benefits of scale to realize strong value and earnings from its acquisitions.

VBL applies stringent strategic and financial criteria to any potential acquisition or partnerships. In addition to the dividend policy mentioned by the Chairman, and to further enhance transparency, the Board has decided to set few guidelines to further the company's M&A activities for viable acquisition. A detailed perspective to this is available on our website.

To conclude, the strength of our supply chain and distribution network position us well to leverage the large size of opportunity. With aggressive capex already incurred in recent years, we expect future spends to be low in existing operations which would drive strong organic free cash flows generation over the coming years.

On that note, I come to an end to 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 sir. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Percy Panthaki from IIFL. Please go ahead.

Percy Panthaki Sir, just wanted some more idea on this Odisha and MP acquisitions that you are planning to make. Can you give me an idea on what is the size of that business, the sales in Rupees crore? Once you acquire it and you have your synergies in place what kind of EBITDA margins you can make on this business and also what is the acquisition cost that you will have to pay for this business and how is that derived? Is it based on a price to book multiple or is it based on the EBITDA multiple? How is that acquisition cost derived?

Raj Gandhi Look, as indicated in our presentation it is about 5-6% of our existing India volumes which translate to about 12 million cases and in value terms it may be not exceeding Rs 170 crore and as given in our acquisition policy guidelines, wherein we have stated the purchase considerations around 1x of the existing revenue of the target company and our acquisitions here are going to be around that and as far as the margins are concerned, see our margins today are around 21% EBITDA margins and we always feel that any new addition to our geography will give us that much margin. Our confidence comes from the fact that about 50% cost of concentrate sugar, raw materials for packaging material, etc. that is going to be same. We have noticed in the past that acquisition of contiguous territories, close to our existing territories, have been a good deal since it has brought economies of the scale which have a positive impact on EBITDA margins.

Percy Panthaki Secondly, just wanted to know your other expenses line in the P&L. This quarter has declined 18% on a Y-o-Y basis. So, what is the reason for that?

Raj Gandhi If you notice that in 2015, we acquired PepsiCo's large territory and that got strengthened by acquiring one co-packer in the month of March-April last year and a second co-packer in the month of August last year and in the month of May'17 our new plant started operations. But gradually and consistently on a persistent basis there was rationalization of our territories and the geography and the logistics cost. This is a net result of all the above changes and we can only assure that it is permanent in nature and coupled with GST, going forward these expenses on logistics are expected to move only in one direction to come down from existing levels.

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

Vicky Punjabi My first question is on your international operations, there seems to be a double-digit growth in that operations during the quarter. I just wanted to know what aided this kind of growth and how sustainable is this?

Ravi Jaipuria We have been growing in these markets sustainably and this growth is definitely sustainable and if you look at our past couple of years also these international markets have been growing in double digit and we do not see any reason why it should not continue to grow at that level. There is no GST effect or demonetization effects or any effects like that in any of the international countries. So, the market has been growing steadily and most probably gaining ground.

Vicky Punjabi And sir, just on this, if I look at the domestic volume growth performance has been a little more sluggish in comparison to international then. So, I thought that the growth opportunity in the domestic was much larger. So, why has this kind of phenomena I am not just talking about this quarter because that is impacted by GST, but over the last 1 or 2 years, it seems like domestic performance has been more sluggish? Can you diagnose the reasons for the same?

Raj Gandhi The reasons for India had been number one, you will appreciate we consolidated a large territory, which on the one hand gave us lot of leverage effects in our expense and consolidating our business and territory by and large have been new for us, which always takes sometime to consolidate and reach the distributors and the retailors. If you will appreciate in our existing territories where we are present for 25-40 years, it is a matter of very strong relationships which we have been able to leverage and grow our share. However, the new territories which we had acquired that has taken little time and the live example of this is Morocco, which for the first 2-3 years the growth was at a very subdued single digit, or negative which for the last 2-3 years is about 18-20%. So, in these territories definitely it has to go up. Secondly, we are very cognizant of the fact every product has got a product cycle for which we have been talking about in our product mix, you see Cola is getting replaced by other flavours or by juice or water. Wherein, there is a large pipeline PepsiCo is working on and hopefully every quarter they will be rolling out a new product range and once that happens, you will see growth return in India. Your observation is spot on the point as far as the past is concerned but going forward I think we will have good news to share.

Vicky Punjabi Just a second question on the capex side. So, my perception was that even before the new facility coming in, the capacity utilization was still below the 70% level. So, now what was the actual reason for the new capacity and the second and the follow up would be how do we look at this capacity expansion going forward?

Raj Gandhi Yes, we have built capacity ahead of time and there are few developments, may be in 1 or 2 quarters we will be able to share, explaining reasons for capacity creation.

Immediate effect of this is that it has helped us in improving our margins, 146 basis points on an India turnover of roughly Rs 3,000 crore, if we calculate, Rs 40 crore or something, I mean it has already started giving us returns, despite creating this capacity ahead of time. Going forward it will have lot of benefits. This capex, for logistic issues, was planned earlier itself and committed that and going forward our capex is not going to be that much and with this capacity available in hand, as we have already said, the capex, on organic basis, is not going to be more than 50% - 60% of our depreciation figure.

Vicky Punjabi Just last question if I may ask. The volume decline in juices seems to be much higher than in the carbonated soft drinks, what could be the reason for the same during the quarter?

Raj Gandhi Actually there are few countries, where we have yet to launch juice and in the juices segment, few more innovations are in the pipeline which are going to be launched. Decline is getting addressed from various corners and will be corrected.

Moderator Thank you. Next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir, just wanted to understand this, since the season this CY 17 main season has gone for us. How do you see this volume decline or volume growth whatever way itself rectifying and what in your opinion should be the organic volume growth for us blended for water, juices, CSD all put together in India operations over the next couple of years based on whatever strategies, etc. have been devised by Pepsi. So, your best guess on the volume growth, that is one question and I will take another two once you through with these questions?

Ravi Jaipuria Well, I think as far as volumes are concerned, this year definitely it will be soft because our main quarter is gone and we have had a slight volume decline in the first half. Going forward we hope we can recover this but to expect anything better than that would be very tough. Going forward, there is no reason why we cannot get back to growth as soft drink industry has been growing well except in the last two years that the industry did not grow. With new variants coming into the market and with the logistics getting much better, with power situation getting much better I think only one way to look at and that is going to be growth but exact percentage, I think it will be very difficult to put at this point but we definitely see a robust growth going forward in the next coming years.

Pritesh Chheda: And you have put down the acquisition principles in the earnings presentation, it was very nice. Just wanted to understand one more thing, what would be your geographic expansion principles or thoughts for the business?

Ravi Jaipuria Our choice is always contiguous territories but that really depends on what is made available to us from PepsiCo side. But if you look at it most of it is whenever we are acquiring it is becoming contiguous and if you look at even Odisha and Madhya Pradesh it is absolutely contiguous to our territories which are there.

Pritesh Chheda: Aspirations outside India?

Ravi Jaipuria Outside Indian subcontinent, fundamentally we want to keep it at about 10% of the total volumes but give or take if we get any opportunity, the mix would not cross much more than 10-12% of our total business.

Pritesh Chheda: And lastly sir, just 2 clarifications, I think the previous participant you answered the reduction in other expense, I actually could not understand and second for the acquisitions done for not exceeding Rs 170-crore revenue that we have, what is the corresponding EBITDA that the operation makes today?

Ravi Jaipuria Depends on each territory, we look at our EBITDA level what we can make. We know what we can make with the same margins because the costs are practically the same and we would be able to improve our EBITDA level much strongly than what it is at the moment and we have clearly given in the guideline (available on company website) that our normal acquisition would be about 1x of the topline and not more than 6 times EBITDA. So, it would be within that framework.

Pritesh Chheda: And on your operating margins of 21%, the EBITDA margin that we have on this last year what kind of expansion is possible over the next 3 years in your own operations if you could highlight?

Ravi Jaipuria If you see the results our EBITDA margins have gone up but to be more aggressive than the 21% EBITDA would be being very aggressive and our guideline would be being around this and may be half of percent to 1% up or down. But fundamentally to maintain 21% plus which is one of the highest in the industry worldwide, if you look at the soft drink industry, we have one of the highest EBITDA margins in the world practically. If you look at any of the listed companies, be it either Coke or Pepsi or franchisee.

Pritesh Chheda: And my one question went unanswered on the other expense reduction side in the quarter what was your response? I did not actually get.

Raj Gandhi Here, basically what we mentioned was that we have been constantly putting our endeavour to rationalize our territory dispatches from one geography to another as 4 plants from PepsiCo in 2015, 2 co-packer's plants which we acquired later and 1 plant we built this year and the net effect of all this is we have been able to rationalize our movement of goods which has resulted in reduction of our logistic cost and improvement in the other expense heads. Which also we stated that is going to be perpetual in nature, and rather shall further get supported by way of GST in place.

Pritesh Chheda: So, it is basically reorganization of the movement of goods?

Ravi Jaipuria That is one of the major reasons.

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

Prashant Kutty: Just an extension to this logistics cost which you were referring to incrementally what are the kinds of benefits you are expecting on account of GST, sir?

Raj Gandhi Prashant, here the incremental effect on logistics because of GST on the P&L, we have not very precisely quantified but we are definitely working on it. The cost reduction on various component have already started showing through improvement on the fleet utilization, time taken at the border check-posts. How much further it will come, we have not quantified because we already have very tight operations. However, it will not only be to the P&L, but also the asset utilization, the efficiency and the staff timings which get spent on attending to various earlier statutes. Savings on all this have not been quantified exactly, may be as the time passes, and we have two quarters of actual operations we will definitely be able to share it.

Prashant Kutty: What I ask is that do we feel that because of the GST benefits would get nullified by any other cost incrementally which is why we are maintaining our EBITDA margin numbers?

Raj Gandhi Definitely, at times what you are saying can actually be true. Last year improvement in EBITDA margins were nullified after sugar prices went up, still overall margins remained the same. Yes, something it goes up something it comes down that is very true and the bottom line is that we always will endeavour that margins will remain in 20-21% range, costs keep on fluctuating although effort is to pass it on by taking the price increase, but if there is a time lag same can fluctuate margins either side.

Prashant Kutty: Second question is on the gross margin front in this particular quarter again we see the gross margin impact of 120 bps, anything you would like to call out over here specifically with regard to any raw materials?

Raj Gandhi Prashant, in the first portion itself we answered, although in the first quarter there was improvement on the gross margin, for second quarter it was marginally slower. The biggest reason is that sugar prices which we had finalized did not cover us for the full quarter and the bit of impact of that came in negative but because of savings on the other expenses, ultimately net result is we were positive. Yesterday in one presentation from auditors to audit committee, a slide showed that going forward the sugar price is going to stay benign in the coming few quarters. So, let's see how much positive impact that brings in and may be in the coming quarters the Gross margins are back to what they were in the quarter earlier than this quarter.

Prashant Kutty And then lastly sir, on the capex guidance if you could highlight what is the capex guidance for this year because I think you already mentioned in the presentation you have done already Rs 400 odd crore, so incrementally what are we looking at?

Raj Gandhi Around 95% of capex happens in H1 as per our 25 years' experience, in H2 we have never seen incurring a major capex, so you may take whatever we have done is for the year.

Moderator Thank you. Next question is from the line of Bhavesh Shah from CLSA. Please go ahead.

Bhavesh Shah Sir, 2Q is the most relevant quarter for the company and both May and June were impacted due to substantial inventory de-stocking. So, if you could just crystal gaze I think what would have been the underlying growth in your view if there was no GST impact here or problem we can just share what was the growth in the month of April or even in the first half of May just ahead of GST, we are just trying to understand growth without this GST-related impact?

Raj Gandhi Bhavesh, our answer to this will drive us to a speculative question but yes, we would have definitely grown which cumulatively may be seen in the next year and coupled with our improvement on the margins and additional territory. We only can say we will have good news in the next years also. But today crystal gazing will be little speculative, let me stay away from that.

Ravi Jaipuria Also as you are asking, for April – 2016, we had a massive growth of more than 30% and this April we were still positive over last April. So, up to April everything was going good till the GST issue came in and also there was some effect of early monsoon which happened which was not in the earlier years.

Bhavesh Shah Sir, secondly one of the question which were asked previously on the juices category it declined almost 17% Y-o-Y for the first half. Sir, can you just share what exactly happened because I actually missed your commentary on that part?

Raj Gandhi Actually in India when we call it juices, juice means 92% mango and mango usage or the consumption is too much related to the actual summer or rain.

Ravi Jaipuria The biggest sale of mango juices is actually in the second quarter and because our second quarter got disturbed because of the GST, that is one of the main reasons for the decline. Early rains also effect juice category, this juices mostly especially the mango juice which is main product for us is drunk more when it is the warmer weather.

Raj Gandhi People somehow have a belief, that first rain means mango season is getting over.

Bhavesh Shah Secondly on the acquisition of Odisha and Madhya Pradesh, so when do you expect this transaction to complete I do understand the due diligence and you need to have final approvals in place but when can we expect this final transaction?

Ravi Jaipuria Sure, we are hoping to start the due diligence soon and hopefully within this quarter we should be able to complete the transaction.

Bhavesh Shah And sir just one more thing lastly, if you just look at your footprint, North and East India seems to be more or less completely mapped. Are there any more territories or more room to expand in the Eastern region that you will be looking forward or would you like to comment anything on that?

Ravi Jaipuria We are looking forward to everything but it is not in our hand as and when we get an opportunity we will be looking forward to add more territories and as these two States have come, may be we hope PepsiCo offers some more territories to us but it is not that we know today or it can be discussed at this point.

Bhavesh Shah And sir, just final question on the raw material price outlook you did mention about sugar prices that you expected to be benign going forward but anything else that you can like to call out on your input basket inflation?

Ravi Jaipuria No, we do not have too many products in our input cost. Our key major input costs are concentrate which is stable, the sugar which is the second and the third main product is based on the petroleum which is PET resin. So, I do not think we see petroleum prices or oil prices going much higher than where we are today. So, the only thing looking positive is sugar prices may be slightly negative next year, so which will impact positively in our bottom line.

Moderator Thank you. Next question is from the line of Rohit Chordia from Kotak. Please go ahead.

Rohit Chordia A very quick question, I just wanted some comments from you in terms of the underlying market, number one whether you are seeing any shift in consumer behavior anything you have picked up? Number two, anything on PepsiCo's innovation pipeline for the next 6 months or 12 months essentially for the next season what are we looking at, how has the latest innovation Pepsi Black done? That is the second question and one quick question on the acquisition again are these territories with PepsiCo today running the bottling operations in these two markets and how old would these plants be, the 3 manufacturing facilities that you are talking about?

Ravi Jaipuria Your last question the acquisition is not from PepsiCo, it is from the PepsiCo bottler. So, these plants have been running for the last I think 10 -20 years, I do not know the exact timing at the moment. But we are taking it from franchisee not from PepsiCo. Secondly, on new innovations, every quarter there will be new innovations which last quarter was Pepsi Black and going forward there have many more innovations coming in the form of flavored water and other things which we are looking at and PepsiCo is perpetually going to keep on giving us new products as the market is shifting slightly from the CSD model. So, we will have a regular innovations going forward for the next 6 months to 12 months.

Moderator Thank you. Next question is from the line of Aditya Joshi from Anand Rathi Securities. Please go ahead.

Aditya Joshi Sir my question again remains related to gross margin contraction that we have seen. Sir, obviously one is the increase in sugar prices and second is sir, is it because of the increase in packaging cost as the SKU, we offer now a smaller SKU at Rs. 18?

Ravi Jaipuria No, it is basically only sugar and there is no other additional cost. So, there is actually overall reduction in other expenses which has improved our EBITDA and sugar is the only component which has impacted us.

Aditya Joshi Has the contribution from the smaller SKUs increased over this quarter?

Raj Gandhi Here, that has come to our advantage as smaller packs 200 ml glass being returnable has a little packaging cost. That to some extent helps us, so the smaller packs have not affected us adversely.

Second thing which to a limited extent has helped us is elimination of Mozambique loss which in comparison in H1 of last year was Rs. 5 – 6 crores because we sold that geography in the month of February 2017. So, that saving also is one of the components and the various line items which has helped us in improving our margins.

Ravi Jaipuria Just for your knowledge singles or smaller pack mostly are more profitable than the larger pack as singles serve sales improve, our profitability would improve rather than going negative.

Aditya Joshi Sir another thing is that there are offers where Pepsi Black can has offered free with a Doritos. So sir, how is the treatment for selling that Pepsi Black, so how do we treat that?

Ravi Jaipuria These are all supported through PepsiCo, so it does not affect our bottom line.

Aditya Joshi And sir last question is that have we acquired the geographies from SMV Beverages?

Ravi Jaipuria Yes, SMV Beverages is the franchisee for that territory.

Moderator Thank you. We have a follow up question from the line of Percy Panthaki from IIFL. Please go ahead.

Percy Panthaki Sir, you mentioned that in the first half of this year there is a capex which has been done of Rs 440 crore?

Raj Gandhi Percy, I would like to correct its Rs 404 crore.

Percy Panthaki Can you give some details as to what is the purpose of this capex, is there a new plant you have set up or is there brownfield expansion you have done?

Raj Gandhi Out of this if we have to go to the breakup, about Rs 325 crore is on the brand new facility which we created in Hardoi, Lucknow for which we have shared the details during the last investors call and the balance is our normal capex during the year. Out of Rs 404 crore, about Rs 14 crore is the capital work-in-progress differential between opening and the closing balance. This total comes to Rs 404 crore.

Percy Panthaki And given that you have significant over capacity what was the need to put up this new capacity in Lucknow?

Raj Gandhi As I have already mentioned one, of course it has helped us in reduction in the freight and the other expenses, which has resulted in increased profitability, helping us by improving our margins by 146 basis points. Secondly, we have created this capacity strategically and in next may be 1 or 2 quarters we shall be able to share some more details on that.

Percy Panthaki And you also mentioned that your capex organically would be less than 50% of depreciation going ahead, so that statement would hold true for how long in the future?

Ravi Jaipuria Well, it will hold true until the growth becomes so much more robust that we need to expand, because our line utilization is only about 70% currently. Going forward for the next couple of years, unless we acquire new territories or new countries or new businesses, the capex would not be more than 50% of our depreciation.

Well we are in a position since our utilization is only 70%, next 40 to 50% growth we can actually support from the existing facilities which we have. So, till that type of growth comes, we would not be spending more than 50% of our depreciation in capex going forward unless until it is a new territory or new market which we are taking over.

Percy Panthaki And just a question on your different product lines going into the future, your fruit juices and fruit drinks, I expect would be relatively faster growing. So, can you give me an idea over the last 3 years or 4 years what has been the CAGR in your fruit drinks or fruit juices segment and what you expect as a CAGR for the next 3 years to 4 years?

Raj Gandhi See Percy, here last few years on the juices front there was not much innovation that had come in. The only innovation on the juice front was Nimbooz Masala Soda, which historically we had been classifying as the carbonated juice which has already become 1% of the mix and has been going very fast and more innovations in the field of the carbonated juices shall be coming in the next quarters and should take much more share in our portfolio. Historically, growth has been lesser because there was not much of innovation and yes going forward there is going to be lot of new product launches in this category.

Percy Panthaki And this quarter you said or was it this first half that the juices down some 16% or 17%?

I think someone on the call mentioned that juices have decline by some 16% was it for this quarter or for the first half of the year?

Ravi Jaipuria Well, second quarter is basically the main quarter for juices. So, the juice volumes declined because of de-stocking due to GST implementation.

Percy Panthaki And here you had mentioned that the demand was affected because of early monsoon. So just wanted to understand that because I thought the seasonality aspect of it was equally impacting juices as well as your carbonated drinks. So, just wanted to understand why juices declined more than your carbonates or more than the company average?

Ravi Jaipuria Because the mix of juices in the months of April, May, June increases considerably to the overall mix in the year. So, when you decline or when your sales are soft in May and June the major decline also comes in juice segments.

Percy Panthaki I still do not understand but I will take it offline with Mr. Gandhi.

Raj Gandhi I can supplement here, see it is like this, yes you are right the seasonality for all the three is different. Water is less seasonal. Carbonated is a little seasonal and the juice is maximum seasonal within the three categories. Also having said that the juice consumption is different in Indian geography. If you see the juice mix in the southern part of India may be 50-70% higher than the North India. The geographical factors also contribute a bit on the juice consumption. Like the last call we discussed on the Mountain Dew versus 7 Up, the mix of Mountain Dew in the North India is higher than the South India where 7 Up mix is higher. So, these factors also make a difference and I can share more data with you whenever you would like to.

Moderator Thank you. Next question is from the line of Nitin Gupta from Axis Capital. Please go ahead.

Nitin Gupta How we are going to pay for this new acquisition?

Raj Gandhi Nitin, this year we are going to be paying it out of our retained earnings because if the capex is Rs 400 and our retained earnings are going to be higher than that and quite likely, we do not see us having to borrow anything to fund this acquisition.

Nitin Gupta And like you have mentioned that it is part of Madhya Pradesh will be getting that territory, so how much percentage of Madhya Pradesh we can expect?

Ravi Jaipuria It is most of Madhya Pradesh, practically 90%.

Raj Gandhi Basically, why we have use the word part of Madhya Pradesh is because small part of Madhya Pradesh is already part of our existing territory and besides three other districts which will not be part of this. So post-acquisition barring three districts, 100% of MP will be part of Varun Beverages.

Nitin Gupta And last is on like your distribution system, can you please help us understand how is the direct reach and how much percentage does it constitute?

Raj Gandhi We do not have any wholesalers in our system, whatever we do, either we do directly or through distributors where either our customer executives are there or our Development Managers are there and they are supported with all the modern data analytical tools and latest instruments. So, here either are the direct distributors and they supply to the retailers and wherever in smaller villages we cannot reach directly, we have a wonderful time-tested mechanism of hub-and-spoke through which we reach. I want to drive here a point that wherever we have our distribution this is robust and end-to-end distribution is under control of the company.

Nitin Gupta So, how much percentage we reach directly?

Raj Gandhi Directly or through our distributors all our sales are through these two ways. There is nothing through the wholesalers.

Nitin Gupta But if you can help us like understand how much we are reaching directly now?

Ravi Jaipuria What you mean by directly when you are saying?

Nitin Gupta Like we are servicing directly not routing through distributor?

Ravi Jaipuria Everything is through distributors basically. Directly means basically our sales people are going there but it is all being distributed through our C&F agents or distributors.

Nitin Gupta And the de-stocking we have started seeing from May onwards?

Ravi Jaipuria Well by May end a lot of de-stocking started and in June was the heaviest.

Moderator Thank you. Next question is from the line of Harish Shiyad, Individual Investor. Please go ahead.

Harish Shiyad I wanted to understand the pre-GST and post-GST taxation over on carbonated drink. What was the excise and sales tax earlier and now what is the GST?

Ravi Jaipuria If you average it out, we are neither negative nor positive. So we are about neutral, so GST has not affected us in anyway negatively.

Harish Shiyad So, there is no cess on along with the GST, it is 28% now?

Ravi Jaipuria 28% plus 12% Cess.

Harish Shiyad One more question is regarding the reporting the numbers under the Ind-AS after the GST comes in. Now as of now excise duty is a part of the sales and we are showing it under expenses. Now there will not be any excise duty that will be GST how this will get reported now?

Raj Gandhi Under the accounting standards what so far we have seen, we will have to follow the circulars / notifications.

Harish Shiyad Like excise duty GST also will be part of expenses?

Raj Gandhi We will follow the guidelines for this.

Harish Shiyad But as of now sales tax is not a part of sales now?

Raj Gandhi Is not part of the sales. From next quarter, mentally we will have to readjust these adjustments because the previous year figures, we will try to give comparable with that in our presentation. Here in the published accounts we will have to go strictly by the format prescribed under the Companies' Act. In our presentation we will help it by way of giving the pre Ind As numbers plus the post, so that it helps to have a meaningful comparison of the two period data.

Harish Shiyad So, what was the excise duty earlier on our product?

Raj Gandhi It was earlier working out around the same maybe it 38-39% on the carbonated which is same and the water it was working out to 24% earlier and now it is 18% and juice stays the same around 12%.

Harish Shiyad One more thing on the GST only, now we were operating through C&F agent as you said just now. So, on the GST will there be any effect through C&F business because I understand that they also will have to now be part of the GST channels how does it work now?

Raj Gandhi It is the same. Earlier the fact is they were getting billed, excise paid goods and VAT was to be collected by them, now it will be at our portion of sales there will be GST and there will be GST on their value added sales.

Harish Shiyad So, that means, now we will have to first bill to C&F and then they will bill to ultimate customers?

Raj Gandhi That is right.

Ravi Jaipuria Before also it was the same.

Raj Gandhi See, I think I am seeing here a point Ind-AS for what this term is used in our industry is different than what we stated in our books. Here C&F is where the title passes on to them but the control to the market through our staff still stays. It is a hybrid mechanism where the stocking of the goods and the depot operations is ours, marketing is ours, ownership is theirs.

Harish Shiyad One broad question sir, just to benchmark your seasonality of business what percentage of the business done in the peak season out of your total sales like say the Q1 and Q2 will constitute how much of the total sales by benchmark?

Raj Gandhi 65% is in the H1, 45% is in Q2 out of this 65%.

Moderator Thank you. Sir, there are no further questions, you can go ahead with your closing comments, please.

Raj Gandhi Thank you very much to all the participants 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 or data you may require. We look forward to interacting with you soon. Thank you very much to all participants. Thank you.

Moderator Thank you very much, sir. Ladies and gentlemen, on behalf of Varun Beverages Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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