(a PepsiCo franchisee)

Varun Beverages Earnings Call

Earnings Conference Call Transcript

May 09, 2019

Moderator: Ladies and gentlemen, good day, and welcome to the Varun Beverages Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode. 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. I now 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 Q1 2019 Earnings Conference Call. We have with us Mr. Ravi Jaipuria -- Chairman of the Company; Mr. Raj Gandhi -- Group CFO and Whole-Time Director; Mr. Kapil Agarwal -- CEO and Whole-Time Director; and Mr. Kamlesh Jain -- CFO and Whole-Time 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 may be forward-looking in nature, and a detail statement in this regard is available in the 'Results Presentation' shared with you earlier.

I would now request Mr. Ravi Jaipuria to make his opening remarks.

Ravi K. Jaipuria: Good evening 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 first quarter ended 31st March, 2019.

We have started the year on a strong note delivering a robust performance on all fronts with topline growing 24%, EBITDA growing 26% and PAT growing 103% in Q1. We have recorded volume growth of ~12.3% in Q1 2019 driven by strong growth in our international operations, especially in Morocco and Zimbabwe. Better product mix and higher realizations in international operations drove value growth. India volume growth came in lower at 4.6% on account of the extended winter and late onset of the season with Holi in the end of March. However, the summer season has begun well and we are confident of seeing acceleration in our sales trajectory in India as we enter the peak season.

We have also been able to drive significant expansion in our gross margins and EBITDA margins in Q1 on the back of benefits realized from consolidation of sub-territories acquired in 2018. This demonstrates our strong execution capability and ability to successfully replicate and leverage the learning, knowledge and mastery over the process that we have attained in one territory to expand into other territories.

We are happy to report that we have recently concluded the acquisition of franchise rights in South and West regions from PepsiCo for a national bottling, sales and distribution footprint in 7 States and 5 Union Territories of India. This consolidates our dominant position as a key player in the beverage industry. VBL now accounts for 80%+ of PepsiCo India's beverage sales volumes in India from ~51% earlier, and has expanded its presence to 27 States and 7 Union Territories across India. We are confident that this development will help us acquire greater scale, operational productivity and efficiency, leading to higher revenues and profitable growth. We should also generate better asset usage as the seasonality in these regions is relatively lower.

Further, we are pleased to share that the Bottling Appointment and Trademark License Agreement for India with PepsiCo India has been extended till April 30, 2039 from October 2, 2022 earlier, further strengthening our close to three-decade long partnership.

We are excited about our prospects going into the peak summer season. We will be focused on consolidating and unlocking value from the recently acquired underpenetrated sub-territories in India by strengthening distribution infrastructure and increasing availability. The acquired sub-territories provide huge opportunity for driving volumes, gaining market share and provide significant operational leverage going forward. We will remain agile by keeping on top of macroeconomic trends and changes in consumer preferences, and adjust our portfolio and processes accordingly, offering innovation and choice.

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 investor's call. Let me provide an overview of the financial performance for the first quarter ended 31st March, 2019.

As you are aware, given the seasonality in the business, it is best to monitor the business on an annual basis as a significant portion of the revenues are realized in the Apr-June quarter. Revenue from operations grew 24.1% YoY in Q1 2019 to Rs. 13,591.5 million. Volume growth was robust at 12.3% as total sales volumes increased to 90.3 million cases in Q1 2019 as compared to 80.4 million cases in Q1 2018. This was on the back of strong growth in the international operations in Morocco and Zimbabwe. CSD constituted 71%, Juice – 6% and Packaged Drinking Water – 23% of total sales volumes in Q1 2019.

India sales volumes grew by 4.6% in Q1 2019, impacted by the prolonged winter season. As noted by Mr. Chairman, the uptick since the onset of summer has been encouraging and we are optimistic of driving improvement in our sales velocity. Better product mix with the introduction of Sting, Tropicana, etc, and the higher realizations earned in the international operations have resulted in value growth of ~11.8%.

EBITDA increased by 26.5% to Rs. 2,183.8 million in Q1 2019 from Rs. 1,726.9 million in Q1 2018. Gross margins expanded 85 bps YoY to 55.9% and EBITDA margins expanded 29 bps YoY to 16.1%. We have been able to drive margin expansion on the back of operational efficiencies, increase in organic volumes and consolidation of contiguous sub-territories acquired in 2018.

Depreciation has increased over the last year on account of in-organic expansion. Finance cost has remained stagnant even after considerable organic and in-organic expansion during 2018 and in Q1 2019. PAT increased by 102.9% to Rs. 400.4 million in Q1 2019 from Rs. 197.4 million in Q1 2018 driven by robust volume growth.

We have recently concluded the acquisition of franchise rights in South and West regions from PepsiCo at a transaction value of Rs. 18,025 million, including manufacturing facilities. Given the growth prospects and promising earnings potential, the acquisition comes at a very reasonable valuation and offers an attractive payback. The acquisition will be funded partly through internal accruals, debt and the rest through equity. We expect our balance sheet to remain healthy post the acquisition as we continue to see strong cash generation.

With our existing 20 state-of-the-art manufacturing facilities in India, we have added one newly installed facility at Pathankot and acquired 9 new manufacturing facilities in South and West region under transition and also own 6 manufacturing facilities overseas. This makes in total 36 state of the art manufacturing facilities owned by the Company. Our distribution infrastructure is strengthened with 90+ depots, 2,500+ owned vehicles, 1,400+ primary distributors and have installed 750,000 visi-coolers.

To conclude, we enter the peak season on a strong footing. With our fundamental strengths – strong sales and execution capability, market leadership, attractive geographic diversity, and diversified brand portfolio – we are well-positioned to satisfy evolving consumer preferences and create sustainable value over the long term.

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. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Percy Panthaki from India Infoline. Please go ahead.

Percy Panthaki: I just wanted to understand the growth in your international business because this quarter it is in high double digits. So if you could give some flavor, geography-wise, how the growth has been and what have been the issues in each of the geography, if any?

Ravi K. Jaipuria: The growth has been quite remarkable in Zimbabwe and Morocco. In Morocco we have added a new line of Aquafina water and water is a big category in that country. Even soft drinks have grown in double-digits and water has really put us in a very commanding position in that country. Zimbabwe as it is, is growing in a fabulous way for us and we are growing more than double-digits in Zimbabwe and hope to continue the same going forward.

Percy Panthaki: Has Sri Lankan performance stabilized after sugar tax issues, is that back to growth?

Ravi K. Jaipuria: Sri Lanka got fully stabilized and we were doing well, we started the quarter with growth but unfortunately with this new calamity, We think we might still struggle for another month or so because there is a curfew everywhere. This is something which is not within our hands.

Percy Panthaki: Secondly, just wanted to check, in Zimbabwe, what would be your market share currently?

Ravi K. Jaipuria: Currently, we should be at about close to 50%.

Percy Panthaki: So then the kind of growth that we are seeing in Zimbabwe, at this kind of market share, are we expanding nearby geographies outside Zimbabwe? Otherwise the kind of growth that we are seeing, at this kind of market share is quite surprising sir?

Ravi K. Jaipuria: Actually we have been very active with our go-to-market strategy in Zimbabwe. We have also got the capability of producing at a very reasonable cost as compared to our competitor. We have the right pricing, so that we are competitive and growing at a fast pace. We have spread our distribution in every nook and corner of Zimbabwe, and also, we are exporting to Botswana and Malawi.

Percy Panthaki: Finally, can you give us the capex guidance for CY19 and CY20, of course excluding the Pepsi payout at a consolidated basis including the international geographies?

Ravi K. Jaipuria: We are not looking for any major capex. As per our earlier guidance, it would be less than half of our depreciation. We have enough capacity in our original territories as well as the new territories which we have recently acquired. We might have to tweak it a little bit here or there. Of course we will have to keep on putting the chilling equipment and the marketing assets. But our endeavor for the next two years is to make sure that we keep it less than 40% of our depreciation.

Percy Panthaki: This includes the international geographies as well at a consolidated basis, right?

Ravi K. Jaipuria: Yes.

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

Pritesh Chheda: I just have two, three questions: One, if you look at the revenue growth and the volume growth, now the difference is about 12%-odd. So just wanted to understand the realization part and the growth rate as to why difference is high and why the growth rate is so high?

Raj Gandhi: This is because of the mix which has undergone a change. The main reason being the Tropicana sales which is high value. The second is the increased contribution from Zimbabwe where the realization is much higher. In Zimbabwe, we have to take the realization at gross and then adjust for any currency fluctuation in other expenses. These two reasons are primarily contributing to the increased realization.

Pritesh Chheda: If you could just tell what would be the currency depreciation-led growth in the top line growth?

Raj Gandhi: We will have to calculate that separately. But, these are the two major reasons why the realization is higher.

Pritesh Chheda: In the 90 million cases, you said 4% plus growth rate is India. So how many cases we sold in India?

Raj Gandhi: India in this quarter we have sold 72 million cases.

Pritesh Chheda: International is the balance 18 million cases?

Raj Gandhi: That is right.

Pritesh Chheda: In these 18 million cases, how much is Zimbabwe?

Raj Gandhi: Zimbabwe is 6.29 million cases.

Pritesh Chheda: My second question is when will we start consolidating PepsiCo acquisition that we did, and what is the EBITDA at the time of acquisition?

Ravi K. Jaipuria: We have already started consolidating as we took over the new territory on 1st May. As far as EBITDA of PepsiCo is concerned, they do not share with us their books. However, going forward there is no reason why their EBITDA should not be the same as what we have within 4 – 6 quarters.

Pritesh Chheda: Current EBITDA at the time of acquisition should be similar to what you are currently doing?

Ravi K. Jaipuria: We do not have access to their books.

Pritesh Chheda: But it would not be significantly different, is that what you are highlighting?

Ravi K. Jaipuria: We cannot comment on how well they were doing or not doing. It is very difficult because their expenses are totally different than ours.

Pritesh Chheda: This margin expansion that we see, will it continue for the full year? What kind of upside to these margins exists on the existing consolidated or acquired business ex-Pepsi?

Ravi K. Jaipuria: Our margins are already one of the best in the world amongst our peers in the beverage industry. We believe the real growth will come from volumes and if we can keep maintaining our margins, it will be a very good business proposition.

Moderator: Thank you. The next question is from the line of Varun Goenka from Reliance Mutual Fund. Please go ahead.

Varun Goenka: My question is around volume growth. If you see Coke across North America, South America and China, somehow it tends to win in all the categories – sparkling, still juices. or other product categories. VBL in North India whenever it has taken over a territory has always gained and made the difference between Pepsi and Coke same, so going forward, what could be your product differentiation or distribution-related differentiation so that Pepsi can materially win in India, somehow in other countries it has lagged Coke?

Ravi K. Jaipuria: It is not so simple. You have named a few of the countries where PepsiCo is behind Coke, but there are a lot of countries where PepsiCo is way ahead of Coke, you look at Middle East, Saudi, Dubai, UAE, Pakistan, Vietnam, etc. there are so many countries. PepsiCo is a diversified conglomerate and Coke is only in the soft drinks business. In juices, PepsiCo leads Coke with Tropicana. That is one of the winning edges we have also got this year and this is the first time that we will produce it ourselves also with the production in Pathankot starting by next month. So that is going to give us edge and growth factor. Apart from that, as we have seen in the North which is our existing territory, we have a stronghold in the markets and similarly as we have acquired East if you look at it last year, we are already growing much faster than our competition and adding market share. So it is a process, our go-to-market, our cost of operations is much lower than any of our competitors and hopefully we will keep maintaining that.

Varun Goenka: If you could give us some light on the South India demand opportunity where is Pepsi market share versus Coca Cola today, how much of distribution expansion there is scope of for VBL?

Ravi K. Jaipuria: PepsiCo is reasonably in good shape, especially in the States of Kerala and Tamil Nadu, they are the market leader. However, they are lagging quite badly in Telangana. Karnataka, they are reasonably okay. So each State has a different issue and we think scope-wise, there is scope everywhere. The way you look at it is India is sitting on 22-24 per capita consumption against our neighboring countries which have more than double. So if you look at Sri Lanka, Pakistan, Nepal, they are double than what we are. So growth is just going to be there as long as you are ready to go-to-market, invest in the market in the chilling equipment, there is no reason why the growth in double-digits cannot continue for the next 5-10 years.

Varun Goenka: Just one more question on the logistics side. Post GST, have you seen any improvement in movement because our business is logistics-heavy?

Ravi K. Jaipuria: Absolutely it has become much easier for us to do business post GST. We have shut down extra warehouses which we had in every State. We go directly from our plant to large distributors / large hubs and we do not waste time standing in queues at every border. That is one of the reasons for slight improvement in our EBITDA margins.

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

Bhavesh Shah: Sir, my first question is on India. What is the organic India volume growth for the first quarter?

Ravi K. Jaipuria: It is mostly organic. There is very small portion from the broken period volumes from acquisition of the small territories like Dharwad and Nagpur.

Bhavesh Shah: So this 4.6% which you reported is more or less organic volume growth?

Ravi K. Jaipuria: Largely yes.

Bhavesh Shah: Secondly, sir, you have mentioned that summer has started on a good note. Can you share some more thoughts on how is your performance in the month of April? The reason I am asking is that we have seen some of the corporates have sounded of growth moderation and in this context it would be useful to know your thoughts here?

Ravi K. Jaipuria: We have had a good April and practically 10-days of May are also over, so half of the quarter is over and with this heat the way it is going there is no reason why we should not look at double-digit growth and this is our peak quarter.

Bhavesh Shah: When you say double-digit growth, this is only for North and East because South and West you consolidate?

Ravi K. Jaipuria: South and West we have just acquired on the 1st of May. It is very difficult to predict their volumes. We are talking about our existing territories.

Bhavesh Shah: Sir, secondly, you did mention in some of the comments that you will be starting production from Pathankot facility next month. So is it that the number like we are seeing in this quarter, Tropicana is still under the distribution agreement and you have not started manufacturing of this?

Ravi K. Jaipuria: That is right, Tropicana is expected to start sometime in the month of June. So in this quarter, our results will not reflect the manufacturing profits from Tropicana. It will actually show in the next quarter. There is a quality certification which takes two months. So we are in the process of getting it right now.

Bhavesh Shah: And my final question is on your South and West territories. I know you mentioned somewhere on your capex outlook. But do you think you need to incur any additional capex in South and West regions, maybe immediately in terms of upgrading any of the bottling plants or?

Ravi K. Jaipuria: The plants are all in good shape and at the moment at least for the next year we do not see any upgradation.

Bhavesh Shah: Sir, any investments is required for your backend operations because North and East is completely integrated?

Ravi K. Jaipuria: There will be some investments required for packaging and our backend. We are in the process of evaluating the same, but it will be within the guidance of 40% - 50% of our depreciation, it would not be beyond that.

Moderator: Thank you. The next question is from the line of Shekar Singh from Excelsior Advisors. Please go ahead.

Shekar Singh: Your revenue growth is 24% and you said your domestic growth is only 4.6%. Can you just reconcile how you come to this 24% growth?

Ravi K. Jaipuria: 24% is the revenue growth on consolidated basis whereas the volume growth of 4.6% is in domestic market.

Shekar Singh: So volume growth for the company as a whole is 12.3% and domestic is 4.6%. International volume growth is how much?

Raj Gandhi: It is about 58%.

Shekar Singh: This growth is primarily on account of consolidation of new geographies?

Ravi K. Jaipuria: No, this is on our organic growth from existing plants in international territories. We had a very good quarter in overseas markets and it is a sustainable growth. We have added some new products and that has done extremely well for us.

Shekar Singh: What percentage of the total volumes is from international business?

Ravi K. Jaipuria: Out of 90 million, 18 million is from international and 72 million is from domestic.

Shekar Singh: 20%, 80%. Okay.

Ravi K. Jaipuria: But you must understand one thing, this keeps changing because the seasonality is different internationally. When Africa is in summer, it is peak winter in India and our volumes in India are very low whereas their volumes are higher.

Shekar Singh: What is the difference in profitability between India and international operations?

Raj Gandhi: It is broadly the same. The only difference overseas is because of the currency depreciation, margins are kept slightly more. There may be some adjustments related to foreign exchange but normally it is more or less the same.

Shekar Singh: Next I just wanted to know, once you take this Rs.1,800 crore worth of acquisition and consolidate it, what will be the consolidated debt to equity ratio?

Raj Gandhi: Our debt post the proposed QIP should be the same where we were on Dec 31, 2018, debt-to-equity around 1:1 and debt-to-EBITDA around 2:1.

Shekar Singh: Once your Pathankot facility comes on stream especially the Tropicana one, how will that impact your margin?

Ravi K. Jaipuria: It would have a positive impact on our margins because right now we are getting it produced by a third party in the West and we are paying extra freight for transporting all the goods for the North and East. On top of that, we are giving a co-packing margin, which we will be able to save once it starts getting manufactured at Pathankot facility.

Shekar Singh: So this is what I wanted to know. So by how much the margins can go up?

Raj Gandhi: The margins should be between 15-20% but we will know the exact numbers once the production starts and we start selling it.

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

Kaustubh Pawaskar: Sir, one question on the other expenditure part. This quarter we have seen about 180 bps increase in the other expenditure. Is it mainly because of the consolidation cost which is happening because of the territories you are consolidating on your books or also it includes the element of higher advertisement and promotional spends before the season?

Raj Gandhi: None of these. Actually the new territories we have consolidated from 1st of May and these results are for the period ending 31st March and here the one big item which is making the difference is the foreign exchange currency fluctuation provision.

Kaustubh Pawaskar: How much that could be because that could be one off kind of a thing?

Raj Gandhi: That maybe about Rs.65 crore.

Kaustubh Pawaskar: Sir, going ahead in Q2, should we expect other expenditure to be higher because it is going to be one of the strong quarters for you in terms of domestic business and so we should expect promotional spends to go up, also the consolidation cost will come in?

Raj Gandhi: Actually, it is going to be just the reverse as Q2 is a big quarter for us and because of the operating leverage our margins are highest in that quarter. As told on previous calls, in H1 contributes about 105-110% equivalent to our annual PAT, and about 75% of our annual EBITDA happens in H1. So the next quarter is going to be significant.

Kaustubh Pawaskar: Sir, what will be the current debt on the consolidated books?

Raj Gandhi: We ended CY18 at Rs. 2,671 crore. In addition, out of the Rs.1,800 crore, Rs.1,480 crore is already paid to PepsiCo and the balance will be paid by this month end. If we add this Rs. 1,400 crore to the original debt of Rs.2,671 crore, it comes to around Rs.4,000 crore roughly, maybe Rs.50-100 crore up and down.

Moderator: Thank you. The next question is from the line of Jasdeep Walia from Infina Finance. Please go ahead.

Jasdeep Walia: Sir, the investment that you are doing in your plant at Pathankot, I think roughly the amount is Rs.500 crore. What will be the asset turns on this investment at full utilization? By full utilization I mean including the seasonality impact which we have.

Raj Gandhi: It will be around 2x.

Jasdeep Walia: Sir, but when I look at your current balance sheet, your asset turns which is sales on gross block, they have never gone above 1 in the past. Why would asset turns be…?

Ravi K. Jaipuria: The difference is that this facility is primarily for Tropicana juices where the seasonality is lower and this is the only plant which is going to produce Tropicana juice and service our whole territory. So, our utilization of this plant will be much larger than any other plant which we operate.

Jasdeep Walia: At what rate do you depreciate your plant and machinery?

Raj Gandhi: It is on 20 years useful life for the plant and machinery, most of the items like bottles, etc is 5 years, visi-coolers is 8 years. Weighted average depreciation is about 8%.

Jasdeep Walia: Is it in line with the standard depreciation rate used by other companies or you depreciate at higher rate?

Raj Gandhi: We may be charging slightly higher depreciation if we compare to the actual life time of the asset that we see, but rate-wise it is standard, as per the best accounting practices.

Moderator: Thank you. The next question is from the line of Sajal Gupta from FE Securities. Please go ahead.

Sajal Gupta: I just wanted to know a few things: First thing is that you had increased your capacity in Zimbabwe. What is your current capacity there and when was this capacity increased?

Ravi K. Jaipuria: This capacity was increased at the end of last year, in the month of December. Both the lines are fully operational now. So the first quarter has seen the full utilization of both the lines.

Raj Gandhi: If you are interested in knowing the number of cases, if we convert the BPM assuming 28-days working in a month, then it works out to 25 million cases.

Sajal Gupta: Regarding last year, I think you made a turnover of about Rs.560-odd crore in Zimbabwe and you have made PAT of Rs.75 crore to Rs.80 crore approximately, on which you have done a provision of $7-8 million because of currency exchange fluctuation, am I correct?

Raj Gandhi: Last year Rs.468 crore of turnover we did and Rs.120 crore EBITDA before the adjustment for the foreign currency. We had provided a provision of Rs.65 crore last year as we were anticipating the de-linkage of the US dollar from the local currency which was in the use. So Rs. 65 crore was provided last year and around the same amount is provided in this quarter. Now the Zimbabwe accounts are aligned to the local currency of trade in that country and going forward we do not expect that further provision will be required unless there is variation from the current exchange rate.

Sajal Gupta: This provision will be reversed somewhere down the line, do you see this…?

Raj Gandhi: No, actually last time when we made this provision, it was only a provision as a prudent policy. But unfortunately, by February end this year, government actually delinked both the currencies and now it is required as per the auditors to provide for that currency difference, which we have accordingly done under the advice from our auditors.

Sajal Gupta: My question is that if you are providing, do you see a reversal happening down the line or is it just provided and it is gone, talking of Rs.130-140 crore amount right now in two quarters, last year Rs.75-80 crore, do we see a write-back at some point of time?

Raj Gandhi: Not exactly. This is what we are trying to explain. Earlier the local currency which is called RTGS dollar was freely exchangeable with the US dollar. Now both are delinked and for any foreign exchange exposure like the bank loans are in foreign exchange, we have to buy the dollar from the open market. US dollars in open market are available on a premium, so all our dollar-related liabilities, we have to bring those at a level of the current prevailing dollar rate vis-à-vis the local currency, which necessitated this provision, which has accordingly been done. We do not think this will be reversed because as and when we will be buying dollars, we will have to actually pay for it that much.

Sajal Gupta: Do you see this provision in every quarter you will be having?

Raj Gandhi: As advised by our auditors, we have already converted the balance sheet to the local currency. Now, only the US dollar liabilities relating to the bank loans or import of raw materials are required to be restated in case the local currency further depreciates viz. a viz. US dollar.

Sajal Gupta: If you see the consolidated and the standalone numbers, there is a loss of Rs.15-odd crore from the international territories. Which are those territories which are still bleeding right now?

Raj Gandhi: Loss is there because of Rs. 65-70 crore provision only. If that conversion of the total balance sheet in this quarter would not have happened, then there would not have been any loss. Last year it was same Rs.14-15 crore loss. This year with the improvement that loss would not have been there. This is only because of this provision happening in one of the weaker quarters.

Sajal Gupta: Can you just throw some light on Morocco because Morocco I think again it was quite a huge loss-making country for you?

Raj Gandhi: You are right. In fact, as the Chairman mentioned, in Morocco during last quarter, the volume growth had been 71.6%. Historically, in Morocco, when we purchased, there was a non-compete for water and in the market it used to be a challenge to offload only the CSD products and the customer had to buy water from someone else. But after non-compete is over and we have installed the water line, we have become a comprehensive beverage supplier. Since then we are registering month-after-month growth. So last three months the average growth is 71.6% in volume and April is also on the same track.

Sajal Gupta: But that means for the current year we do not see a loss? I think there was a loss of Rs.40-odd crore in Morocco at that point of time last year.

Raj Gandhi: It always used to show a loss which is expected to be reversed from this year only.

Sajal Gupta: So basically all your international territories will start making money now other than Sri Lanka which you said sugar problem is also now…?

Raj Gandhi: We can take one-by-one. Morocco, we explained already. Zimbabwe from the day one is a market leader. In Zambia, we never had losses. Sri Lanka last year was exceptionally bad because of sugar tax however from December that situation turned around and it is growing again. Nepal had been good from the day one.

Sajal Gupta: So we see all the international territories doing good? Last thing is I just wanted to know what is your debt? You said your debt now stands at Rs.4,000 crore.

Raj Gandhi: Rs.4,000 crore is in the interim. We cannot give you the number of 30th June right now but it should be substantially lower and post QIP this number should be at the same level where we were last year in December, and by then we also would have consolidated new territories of about 35% equivalent footprint to our existing business.

Sajal Gupta: When are you planning to do your QIP?

Raj Gandhi: We have not yet decided the date. We have been advised by our bankers to just hold on and let the new territory be consolidated and consolidated results be made public and by then uncertainty related to election results will also be over.

Sajal Gupta: So basically, we are talking somewhere in July and August?

Raj Gandhi: Yes, at least till then.

Moderator: Thank you. The next question is from the line of Atul Mehra from Motilal Oswal Asset Management. Please go ahead.

Atul Mehra: In terms of return on capital for us, last year we ended at 13.8%. So what is the outlook of this particular number if you were to think about for the next three years time?

Raj Gandhi: Year-after-year we are increasing ROCE between 200 to 250 basis points and the trend is likely to continue. Maybe one year we have to see the consolidation of territories which we have acquired, but otherwise improvement of 200 to 250 basis points should go on. That will basically be coming because of better utilization of assets. The capacity utilization is under 70% in our existing territories. So that means about 40% of volumes we can increase without even investing anything behind capacity and working capital number of days are also improving substantially YoY. Both together should help us in improving our ROCE.

Atul Mehra: Just to talk about the capacity utilization, given it is a seasonal business, would 70% be an optimal number by itself or would we have any more to do increase capacity utilization?

Raj Gandhi: As explained in the earlier calls, we calculate the capacity utilization only for the peak month, for example, for North India the peak month is May, in which we will do 17-18% of our annual business. So the capacity utilization of 70% is for the peak month, rest of the months we do not calculate.

Atul Mehra: The second part of the ROCE component, will you see scope for EBITDA margins to improve from here on or do you think we have in terms of optimize on the margin part?

Raj Gandhi: Potential of increasing EBITDA margins is very less. These may go up in one year slightly or may come down slightly. But our guidance is to remain within the vicinity of 20%.

Atul Mehra: Pretty much where we are?

Raj Gandhi: That is right, last year was few basis points lower because of the five sub-territories getting added. This year with those territories getting stabilized, may go up slightly and with the new territories for PepsiCo coming in, may be coming to the same level, but would not differ much from that level.

Moderator: Thank you. The next question is from the line of Rajiv Gupta from RBC Financial Group. Please go ahead.

Rajiv Gupta: I am still a little confused about the foreign exchange provision which you are making. You call it a reserve; you call it a provision. Have we actually incurred that actual loss or is it merely a book entry? What is the justification of creating a reserve or a provision against future losses which you may make on your loan repayments in dollar terms? This is just not coming out clear and it is a very large sum of about $16-17 million in two quarters.

Raj Gandhi: This is a provision and this is a provision on the dollar liabilities sitting in the Zimbabwe balance sheet. Earlier there was one account for dollar and the RTGS dollar, these were interchangeable and sometime in February this year Reserve Bank of Zimbabwe decided to delink those currencies. So now, to repay our dollar-related liabilities as and when they will mature on future date, we will have to buy the dollar from the market by paying RTGS which is our earning. Earlier we were earning in dollar. Now we are earning in RTGS. So the differential between the two we are providing. It is not paid yet but it is a provision to be utilized at the time, say if we have to discharge this dollar liability today, We have to spend that many more RTGS dollars to buy US dollar. So, as on date this has been provided based upon the exchange rate of that day. It is only a provision as of now.

Rajiv Gupta: But is this a mark-to-mark loss on that? And if it is only a provision, then why did you say that it can never be written back?

Raj Gandhi: Because unless the exchange rate between RTGS dollar and US dollar reduces, it will not be written back and we do not see a possibility of that because local currency cannot be more stronger than US dollar.

Rajiv Gupta: If that being the case, then the similar provision can happen next quarter also? You are saying it will not happen in future quarters. If the local currency devalues against the dollar next quarter, you will require to make another provision? Why do you say that it will not be required in the next quarter then?

Raj Gandhi: Our assumption is based on the fact that we had to change or convert the balance sheet into the local currency, once. There are certain fixed assets which will stay there and now will not be changed. We do not have to create those fixed assets, plant and machinery again, and the only dollar-denominated liabilities are to be converted to that date. Hence, now the provision will be limited to US dollar liabilities only. Having said that, our earnings are also increasing in dollar terms since we have started exporting from Zimbabwe to the neighboring countries like Botswana, etc., and our effort is to bring the US dollar inflows to the same level. Therefore, no additional requirement of any provision happens. But still that possibility cannot be ruled out, but it is never going to be of this magnitude because we do not have to convert balance sheet again, having done it already and it is in RTGS terms, that has nothing to do with dollars going forward.

Rajiv Gupta: Okay. My second question was on Tropicana. When this whole thing migrates from an overseas outsourcing purchase to local, what kind of numbers are we estimating in a full calendar year, and how much of it will be captured in this year, I know you cannot be sure till the production starts, but what numbers are we talking about?

Raj Gandhi: Here we are about 9-10 million cases and it is not imported, it is presently getting co-packed from a third-party in Baramati, Maharashtra. Presently arrangement with PepsiCo till recently is only distribution and distribution margin for us was close to our actual expense. When we will be manufacturing and distributing, margins should be somewhere near to our CSD margin.

Rajiv Gupta: But I was specifically looking for an annual turnover number on this product?

Raj Gandhi: Volume is around 10 million cases. So if we take at a ballpark realization per case figure of Rs. 300 for Tropicana, then annual turnover should be about Rs.300 plus crore.

Rajiv Gupta: So the same margin at same level it would add about Rs.60 crore to EBITDA?

Raj Gandhi: Rs.50-60 crore, that is right.

Rajiv Gupta: My next question was on this 4% growth in the first quarter. Was this unusually colder quarter than the normal warm quarter or the quarter we have from January to March?

Raj Gandhi: February this year was cooler than the earlier years and with de-growth of 20% in one single month of February, we still ended the quarter with a positive 4.6%.

Ravi K. Jaipuria: And also Holi was very late this year. Normally season starts with Holi. So that also made the difference.

Rajiv Gupta: In a way as far as weather was concerned, it was unusually negative, that is the point you are making? In spite of that you did 4% growth on the domestic volume?

Raj Gandhi: That is right.

Rajiv Gupta: My last question was on the Pepsi takeover. How much will we be able to capture in the new Pepsi territories or have we lost most of the peak season and the full impact in the peak season would come next year or if you could just give us a flavor on the transition from Pepsi to us and have we lost May, June, July, August or…?

Ravi K. Jaipuria: We have got that territory from 1st May and the plants are operational. The business has been transferred to us effective 1st May. So it is continuing as normal. So there is no reason for us to lose any volume in subsequent months.

Rajiv Gupta: But ramp up obviously to your levels and your…?

Ravi K. Jaipuria: Ramp up to our level has not happened so far. That is why we say that it takes at least a year and that is what we are expecting. Like last year when we took over the five States, we have ramped up this year and we are getting great results out of those.

Moderator: Thank you. The next question is from the line of Rakesh Roy from Asit C. Mehta. Please go ahead.

Rakesh Roy: Sir, my first question is regarding your India volume is impacted due to the extended climate. Sir, what is the normal volume you are expecting in this Q1 if the climate changes not happen?

Ravi K. Jaipuria: We would have been expecting 10% growth or double-digit.

Raj Gandhi: We expect annual growth in double-digits year-after-year in our business and when we break it out quarter-wise, every quarter may not grow in that exact proportion because of the seasonality and sometimes the shifting of festivals like Holi and Diwali may lead to volumes shifting from one quarter to the other, that is the only difference.

Rakesh Roy: Sir, my next question regarding the recent cyclone, any impact on your business?

Ravi K. Jaipuria: There is impact but only in the State of Odisha.

Rakesh Roy: How much is the impact in terms of percentage?

Ravi K. Jaipuria: Odisha itself is about 1% of our total volumes.

Rakesh Roy: My next question regarding your international business. For this quarter, your international business is 20% of total sales. So this trend we see in near future also sir?

Ravi K. Jaipuria: Due to seasonality, in Q2 India becomes very large, international sales become much lower comparatively. Similarly, for India first quarter is very low. So that is why the percentage looks higher.

Rakesh Roy: How much was the realization for international business and for the Indian business?

Raj Gandhi: In Q1, our realization from India had been Rs.985 crore and the realization from international it has been Rs.373 crore.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for their closing comments.

Raj Gandhi: We will continue to stay engaged. Please be in touch with our investor relations team for any further details or discussions. Look forward to interacting with you soon. Thank you very much for your participation.

Moderator: Thank you. Ladies and gentlemen, on behalf of Varun Beverages, that concludes today's conference. Thank you for joining us and you may now disconnect your lines.
