(a PepsiCo franchisee)

Varun Beverages Limited
Earnings Conference Call Transcript
February 16 2018

Moderator

Ladies and Gentlemen, Good Day. And Welcome to the Varun Beverages Limited Earnings Conference Call. As a reminder, all participant 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 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 Q4 and CY2017 Earnings Conference Call. We have with us Mr. Ravi Jaipuria – Chairman of the Company, Mr. Varun Jaipuria – Whole Time Director, Mr. Raj Gandhi – Group CFO and Whole Time Director, and Mr. Kapil Agarwal – CEO 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 the question-and-answer session. Before we begin, I would like to state that some statements made in today's call may be forward-looking in nature and a detailed statement in this regard is available in the results presentation shared with you earlier.

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

Ravi Jaipuria

Good evening, everybody. Thank you for joining the call. I hope all of you had the opportunity to go through the results presentation which provides details of our operational and financial performance for the fourth quarter and year ended 31st December 2017.

We are happy to report that we have delivered a strong performance in the first-year post listing, recording a profit growth of 346% year-on-year to Rs. 2,141 million. EBITDA margins have improved 30 basis points year-on-year to 20.9%, the performance has to be viewed against a challenging year with the residual impact of demonetization and the de-stocking by the trade ahead of the GST implementation which impacted volume growth. We continue to focus on initiative where we can drive the outcome and improve our operational parameters to create a more efficient and substantial business and now take advantage of the improving external conditions to accelerate growth.

It has overall been a very busy and progressive season for us where we have undertaken multiple initiatives to deliver substantial growth in the future. In line with the acquisition guidelines we shared with you earlier in the year, we have furthered our strategic intent to expand into contiguous territories when an opportunity presents. We concluded the acquisition of PepsiCo India's previously franchised territories of the State of Odisha and Madhya Pradesh along with two manufacturing units at Bargarh (Odisha) and Mandideep (MP)with effect from 27th September 2017, on slump sale basis and the manufacturing unit in Cuttack, (Odisha) with effect from 19th January 2018. In addition, we have concluded the acquisition of PepsiCo India's previously franchised territory of the State of Chhattisgarh with effect from 11th January 2018 and the State of Bihar with effect from 17th January 2018. We have further signed a BTA for the acquisition of PepsiCo India's previously franchised territory of the State of Jharkhand along with the manufacturing unit at Jamshedpur on 20th December 2017, where currently the due diligence process is on. The total consideration for the above acquisitions is Rs. 2,550 million and we expect to further spend Rs. 350 million on upgrading the plant and machinery and marketing assets in these territories. These are all highly underpenetrated regions and provide huge opportunity for increasing volumes and gaining market share, in line with the company's strategy to expand into contiguous territories, to garner better operating leverage and asset utilization through economies of scale. The above acquisitions will help in garnering incremental PepsiCo India volume of 6% and further providing access to an additional consumer base of 21% of India's population. VBL is now a franchisee for PepsiCo's products across 21 States and two Union territories in India, and accounts for more than 51% of PepsiCo's beverage sales volume in India.

We have also established Greenfield production facility in Zimbabwe for selling and distribution of PepsiCo products. Commercial production and operation will commence soon. This is an updated untapped market with huge potential and as the sole franchisee for PepsiCo in Zimbabwe, we are confident of replicating the success that we have had in Zambia, in Zimbabwe as well.

We remain agile by keeping on top of new trends and changes in consumer preferences, working closely with PepsiCo India to adjust our product portfolio and processes accordingly. After the launch of zero calorie ‘Pepsi Black’ and the energy drink ‘Sting’ earlier in the year, during the quarter we entered into a strategic partnership for selling and distribution of the larger Tropicana portfolio that includes Tropicana Juices 100%, Delight and Essentials, Gatorade in the sports drink category and Quaker Value-Added Dairy in territories across north and east India.

To conclude, the strength and resilience of our robust business model has been once again proven through our performance against the challenges we have faced during the year. We are present in geographies that offer great long-term sustainable growth opportunities. Average per capita consumption rates are significantly lower than global averages, in contrast to the stronger GDP growth, increasing disposable incomes and young demographics. So in a normalized year, we are confident of delivering strong growth on the back of our solid business model and expanded product portfolio.

In line with good corporate governance practices and our confidence that the successful execution of our strategic plan will continue to generate strong cash flows, the Board of Directors of the company formalized a dividend policy and recommended an interim dividend of Rs. 2.5 a share in Q2 CY2017 which has been approved as final dividend for CY2017.

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, everyone. A warm welcome to everyone on the investors call. Let me provide an overview of the financial performance for the fourth quarter and year ended 31st December 2017.

Before we delve into the numbers, I would like to point out once again that consequent upon the introduction of the GST with effect from July 1st 2017, Central

Excise, VAT, etc. have been subsumed into GST. In accordance with Indian Accounting Standard - 18 on Revenue and Schedule III of the Companies Act 2013, unlike excise duty, levies like GST, VAT, etc., are not part of revenue. To facilitate comparison of the numbers of the earlier Indian GAAP and Ind-AS we have provided adjusted revenue calculations on slide #18 of our presentation, which we feel shall be helpful.

Revenue from operations adjusted for excise/GST, grew 3.7% year-on-year in CY2017 to Rs. 40,034 million. Total sales volume went up by 1.1% year-on-year at 278.8 million cases in CY2017 as compared to 275.8 million unit cases in CY2016. As the Chairman already pointed out, overall sales volumes were impacted on account of residual impact of demonetization and inventory destocking ahead of the implementation of GST seen in the first quarter of the year. EBITDA increased by 5% to Rs. 8,358 million in CY2017 against Rs. 7,960 million in CY2016. EBITDA margins expanded by 30 basis points year-on-year to 20.9% in CY2017. We have successfully offset the 9.3% year-on-year increase in sugar prices during the year through cost efficiencies on account of consolidation of contiguous territories, new plants closer to demand and solid backward integration infrastructure. We consolidated our Goa operations into single larger facility from two earlier. We have shifted one CSD glass line each from Sathariya in UP and Bazpur in Uttarakhand plant to Nepal and Zimbabwe respectively, and have shut down four depots in India as part of rationalization exercise post GST implementation. We will continue to undertake such initiatives and measures to bring in operational efficiencies and are confident of sustaining margins in this range going forward too. PAT increased by 346% to the level of Rs. 2,141 million in CY2017 from Rs. 480 million in CY2016, driven by operational improvements and interest cost savings.

Net working capital days remain steady at 30 days in CY2017. Net debt to equity stood at 1.3x primarily due to incremental debt availed towards the fag end of the year for the acquisition of the new sub-territories in India and adjustment in equity due to Ind-AS implementation. With majority of capex behind us we expect strong free cash flows on existing investments in the coming years.

Let me quickly summarize the numbers for the quarter ended 31st December 2017. But as mentioned in the past, our business is seasonal and best monitored on an annual basis, Q4 is a seasonally soft quarter for us with November and December the weakest months in the year. Revenue from operations grew 21.4% year-on-year to Rs. 5,274 million in Q4 CY2017 as compared to Rs. 4,342 million in Q4 CY2016. Sales volume grew 14% year-on-year, EBITDA for Q4 CY2017 stood at Rs. 225 million as compared to Rs. 363 million in Q4 CY2016. We have reduced our losses to Rs. 721 million in Q4 CY2017 as compared to loss of Rs. 1,117 million in Q4 CY2016.

To conclude, we have delivered a good performance in a challenging year. We are confident of generating strong cash flows over the coming years by leveraging existing investments. We have made several value accretive acquisitions and are well positioned for the next phase of growth and to garner market share by increasing our penetration further and through the continuous introduction of new product categories, staying in the path of relevance of our customers.

On that note I come to an end of 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 very much. Ladies and Gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Pritesh Chheda from Lucky Investment. Please go ahead.

Pritesh Chheda Sir, I have just a couple of questions. The 6% market share that you acquired, what does it correspond to in terms of cases and EBITDA and what would be the traction there? And my second question is, from your initial remarks you mentioned that the capex is largely done in the operations, so the existing capex or asset block, what kind of cases or volume or business can it support?

Raj Gandhi As mentioned, Rs. 35 crore additional capex will be required in the five States which we have acquired. We also mentioned that during the last year, we had incurred capex in our Zimbabwe territory where operations would commence next week. That is a new opportunity which in fact we saw after the exit of President Mugabe and the economy being opened up. We had a small presence earlier through the export market from Zambia, and would like to penetrate this market by way of having a local presence by putting up a manufacturing plant. Zimbabwe is a 30 million cases market and we see a good opportunity, and as the Chairman mentioned it should be a profitable opportunity. To add to this, on the capex in Nepal, for the last four to five years, we were stagnant at a market share of ~42%, the reason being that we have one plant in Nepal while the competition has two plants, so some part of Nepal which is the downhill area, we were never been able to reach because competitively this was becoming unaffordable because of the freight cost. So, we have decided to put up a plant and to have a presence there.

Ravi Jaipuria To also add on that, we were in season not able to supply in the downhill region since our capacity utilization was already running at 100-110% in Nepal. So, the growth was getting hampered and that is why this year we have decided to enhance that growth and make sure we are able to service the entire country. Nepal is one of our most profitable territories so we are putting a greenfield plant in the downhill belt which is near the borders of India, so that we can reach the full country and take full benefits. We are also expanding our portfolio in Nepal to include juices and water, these are the two categories further being added in Nepal which never existed. So we expect going forward that we should come to close to a 50% market share in the near future against 42% which we were holding till last year.

Raj Gandhi So the capex is basically a mix of organic and inorganic and you must have seen the page number 14 of our presentation, there we have mentioned that the capex during the year had been on organic basis at ~Rs. 391 crore, which was more or less around the guidance given in the past. Also, added to this is new territories which we had acquired, the capex for which has been incurred. So that has provided us access to 21% of more population of India. And secondly, the second plant of Nepal will provide us access to more population within Nepal where we were not able to reach earlier. And the third is Zimbabwe's new territory. So these initiatives on all sides should help drive growth in the top-line as well as better utilization of our resources.

Pritesh Chheda My question was actually the infrastructure that you have on ground now, this 278.8 million cases that you did in CY17 what kind of volume can this current infrastructure support?

Ravi Jaipuria Infrastructure is being utilized only about 70%, so technically another 30% volume we can do through the same infrastructure. But what happens is like if we are entering a new country obviously this infrastructure cannot be used. Nepal for us is a separate country where because we were running at about 110% of our capacity, infrastructure in India cannot be used. India infrastructure utilization still remains below 70% and there is a potential of growth which we expect coming from this year onwards where we will not have to spend on creating additional capacity.

Pritesh Chheda And my second question was, this 6% addition market share that you get what is the corresponding volumes that you are getting with 6% market share and what is the EBITDA that you are getting with this 6% market share as on date?

Ravi Jaipuria Well, 6% market share is what it is today, but these are really very sparsely penetrated markets and that was one of the key reasons why PepsiCo had asked us to take over these territories. In some of these territories the current market share is at 10-15%, so the potential of these territories is significant, and also on top of that the volumes in the States which we have acquired is so low because of the per capita incomes in these States that the opportunity going forward is going to be immense and like the rest of the country where we have ~40 market share, there is no reason why in these territories over next few years we should not be able to reach to the same level from the level of 10-15% currently. So the growth factor is just unimaginable if we do the right job which we have been doing in the other territories.

Raj Gandhi And to be precise on your question the territories of five States in India which was acquired were doing a volume around 30 million cases with a top-line of around Rs. 420 crore and as the markets are under-penetrated, there is huge potential for growth.

Pritesh Chheda What is the EBITDA?

Raj Gandhi EBITDA, normally we do not get access to that and as mentioned in the earlier call we calculate the EBITDA basis what we can do, because ~55% of the direct cost includesconcentrate, sugar, etc, are similar and it helps us bring economies of scale. So if broadly we are to calculate for 30 million cases and if VBL makes Rs. 28 to Rs. 30 EBITDA per case, so there would not be a much difference in new sub-territories, it may be a time lag of few quarters and ultimately it will reach to ~Rs. 30 per case EBITDA level and with 30 million cases, ~Rs. 90 crore EBITDA is what we are talking about.

Pritesh Chheda It will go to that number, right?

Ravi Jaipuria It might take one or two quarters, it won't take years to reach there, and that also if we do not have any growth. Our expectation is in the next year or so we should be doubling the volumes there, so there is huge opportunities as I said, since it is so underpenetrated by PepsiCo.

Pritesh Chheda Just your thoughts on the new Tropicana addition, the Quaker addition, these two, three additions which happen if you could share some

Ravi Jaipuria As you see that juice and water category is growing faster than the carbonated categories and there is a volume which is already happening which has been transferred to us. As the juice categories are growing faster, we expect the same to continue with our acquisition, that the juice category will continue to grow at a faster pace than our carbonated beverages.

Moderator Thank you. We have the next question from the line of Vicky Punjabi from JM Financial. Please go ahead.

Vicky Punjabi Sir, the first question is still on this juices front, if you can give us an idea as to how is this arrangement is going to work in future with regard to Tropicana and the Dairy beverage?

Ravi Jaipuria Right now we are not manufacturing this category, there is a co-packer who manufactures this and PepsiCo has transferred the selling & distribution rights of these products for our territory in India which is about close to 51% of the country. We will be marketing and distributing till we start manufacturing ourselves, which we hope to do by the end of this year. So till that time we will continue to get it co-packed from suppliers which PepsiCo was doing before also. So the volumes will add and it will create additional profitability to the business.

Vicky Punjabi Sir, by this logic I believe the profitability will come in the later part of the year when we start manufacturing or it starts…

Ravi Jaipuria Well, it will be much higher that time, I mean there is already profitability in it but obviously it will be much higher once we start manufacturing ourselves.

Vicky Punjabi And sir just on the India business again, I was just going through your presentation and in the end one of the slides mentioned that the carbonates segment has a growth potential of around 3% in terms of volumes. So how do you look at it, because this does not really sound exciting, so how do we go…?

Ravi Jaipuria Well, we are being very conservative, hopefully we should do much better than that and we are already doing better than that in the first two months. So I think we have put that safe number looking at what has happened last year and the year before that, but having said that I think all the negatives are behind us and I think the carbonated beverages will also grow much faster than we have mentioned, but we are just putting a safe guard.

Raj Gandhi Vicky, we believe you are reading the Euromonitor's projections. They estimate growth for carbonates to be between 3-4%. Juices and water categories are expected to grow between 17-20%. Hence, we are making a conscious effort to change the product mix by enhancing our carbonated drink portfolio (with zero calorie and low sugar content variants) and having more variants of juices and dairy products. This would help the company on organic basis to drive double digit growth, which the company had been achieving in the past too. Apart from this, we also have our inorganic strategy which would help us achieve the ~20%+ growth which the company is achieving for the last 25 years.

Vicky Punjabi Sir, just once more on the capex side, I just wanted to know going forward I believe that Rs. 35 crore is going to be incurred incrementally for Nepal?

Ravi Jaipuria No, Rs. 35 crore is being spent for upgrading the plants which we have taken for these five States in India.

Vicky Punjabi So incrementally apart from this what is the incremental expenditure that we are expecting in the domestic market?

Ravi Jaipuria One is the plant which we have setup in Zimbabwe as a new greenfield plant. And the second plant which we are setting up in Nepal to meet the total requirement of Nepal and adding juice and water line in it which did not earlier exist.

Vicky Punjabi Okay. What will be the approximate guidance on this for the next year?

Raj Gandhi See, Nepal should be to the tune of around Rs. 150 crore, ± 3% / 4%, and Zimbabwe should be something like Rs. 165 crore. And other than these two, there may be additional we can say Rs. 140-150 crore of organic capex apart from acquisition of new sub-territories in India.

Vicky Punjabi Sir just one last thing, book-keeping question here, I think the tax rate for this year looks quite low, any specific reasons for that and how do we build in further going forward on this?

Raj Gandhi Well, it can improve another 1-2%. Actually, as we have explained on earlier calls, last year tax rate was at 43% and has come to ~ 26% this year, is because there were subsidiaries which were making losses, and in India there was a full tax of 30-31%. Consequently, in consolidation PBT was getting reduced while the tax was paid on the whole amount. Reported PBT was lower because of the consolidation of loss-making subsidiaries. As the losses of these subsidiaries are reducing, the tax rate on overall reported profit will be looking much better. For your modeling purposes, I think you can take a couple of percentage further improvement, but more than that I do not see any more potential on the income tax side.

Moderator Thank you. We have the next question from the line of Bhavesh Shah from CLSA. Please go ahead.

Bhavesh Shah Sir, in your opening remarks you alluded to some GST related benefits, specially closing some of the depots. So can you just share some more thoughts here?

Raj Gandhi Bhavesh, as mentioned we have shut down four depots post GST and we are likely to reduce further depots. And going forward even smaller plants we will be consolidating and that is one opportunity we are definitely seeing to enhance the margins. And this is too early actually, just six months passed and four depots we have been able to close so far. But this is a continuous process actually.

Bhavesh Shah And I know it is too early, but any indication on savings on logistics cost because of GST, I know it is too early but do you foresee any benefits going forward over next couple of years?

Raj Gandhi In the H2CY2017, it is already showing in the last two quarters and this is something that will be a play between logistics cost and capex, somewhere we will save the operating expenses by reduction in depots versus incurring little bit of extra freight cost. So net effect of these I can only say there will be savings. But there will be an interplay which will keep on happening between the two.

Bhavesh Shah Sure. And sir secondly, can you share some thoughts on your margin profile for juices / dairy business which you intend to wrap up in 2018, so any thoughts on the headline margins, will it be little bit more dilutive for the business, how do you see this business from the margin profile?

Ravi Jaipuria Well, for juices, as we have said earlier, the margins are approximately the same because the cost of production of juice is higher but at the same time we have saving of about 28% on taxes which compensates us in the costing. So our end margins are approximately the same in CSD as well as juices.

Raj Gandhi Here, Bhavesh, to answer your question in a little more detail, one is that what we are presently doing in the juices category which is with 15% pulp for the products like Tropicana Slice, what Chairman said is happening, but going forward on the Tropicana 100% or on the Diary the situation may be slightly different There the asset turnover will be much higher and the seasonality is supposed to be lower than what we are presently doing. So, the return on capital employed and other things, what we feel is much more advantageous for the company.

Bhavesh Shah Sure. And sir any capex you need to incur to setup, I believe you will be getting into manufacturing towards the end of the year, so do you have to incur any capex for setting up those plants?

Ravi Jaipuria Yes, we will have to setup greenfield plant for manufacture of juices and dairy which we are in the process of working and discussing with PepsiCo and hopefully in the next few days we will have exact figures of what all we need to do.

Bhavesh Shah Sure. So capex would be in 2018 or this would be towards the end of 2018 or say 2019?

Ravi Jaipuria It will be towards the end of 2018 and may be flowing through 2019 a little bit.

Raj Gandhi Quite likely cash flow wise it may be this year but it will be for 2019 season.

Bhavesh Shah Sure. Sir, finally on your concentrate prices, what can we expect in 2018, any change there, any thoughts there?

Ravi Jaipuria No, it will be same as what we have had before.

Moderator Thank you. We have the next question from the line of Percy Panthaki from India Infoline. Please go ahead.

Percy Panthaki Sir, this is Percy Panthaki here. Sir, on this Tropicana business would you be able to give some idea as to how much of EBITDA that would accrue to you on account of this business, just assuming for now only the distribution and not the manufacturing on a sort of annualized basis if we just take the simplifying assumption that 2018 will not see any manufacturing activity and only distribution, then what kind of EBITDA we can have?

Ravi Jaipuria It is a bit too early, we are in the final stages of negotiating the pricing and going to the market. So I think by next quarter we will be more clear to what our margins are going to be and how we have to take it forward.

Percy Panthaki And Mr. Gandhi gave this of about Rs. 150 crore of capex in 2018 in India organically, does that include any capex necessary for Tropicana or that will be over and above that Rs. 150 crore?

Raj Gandhi That would be over and above.

Percy Panthaki Understood.

Raj Gandhi Greenfield plant will be more expensive, so it will be a completely separate plant, Rs. 150 is for our existing business.

Percy Panthaki Okay, fair enough. And sir what do you think about the growth prospect for calendar 2018 overall, I mean 2017 we have had flat volume growth possibly because of the GST disruption and we have seen some pickup now, but what realistically you think…?

Ravi Jaipuria As Mr. Gandhi had answered and if you look at our third quarter and fourth quarter July onwards, we have been growing in double-digits and hopefully we should continue to do that or even do better.

Percy Panthaki Right. And lastly sir on your juices business, that is excluding Tropicana, your fruit drinks as we call it, that is pretty small part of our overall business because of our geography mix or market share mix of Pepsi in those geographies, etc. So, what is the medium-term to long-term outlook there let's say five year down the line what percentage of your India business do you expect to come from fruit drinks?

Ravi Jaipuria Well, I think if nothing more it should double to what percentage we are today in the next five years at least. So if we are about 6% at the moment I think it should go up to about 12% of the mix, that is what we are hoping, but it is very difficult to predict exactly. A lot of new variants will be in the market March onwards and these are juice based carbonated beverages, so you can put it in carbonated or you can put it in juice.

Moderator Thank you. We have the next question from the line of Kaustub Pawaskar from Sharekhand Limited. Please go ahead.

Kaustub Pawaskar Most of my questions are answered, sir just a book-keeping question on Q4 numbers. Sir, for this quarter we have seen other expenditures going up significantly, so anything we should read into this or you have to look into yearly numbers?

Raj Gandhi Yes, you have answered the question yourself. Firstly, one should look at the yearly numbers; secondly, what happens that at the year end, there is a lot of provisioning, etc, which is required to be done. Here I can highlight one major item which has come is the foreign exchange fluctuation provisioning for the loan given to Zambia subsidiary by VBL India. See, what happens is in a country like Zambia where the interest rates are high, what we had done is we have borrowed here in India at 8%, which is the cost of borrowing and lend the money to Zambia, which at the end of the year was $13.49 million when the money was actually transferred and as on 31st December 2017, rupee strengthened and it was at Rs. 63.93, while the Zambian Kwacha did not appreciate with the same speed. Wherein in the books we had to provide under the Ind-AS, FCMITD, foreign currency monetary item translation difference of Rs. 11 crore which is just a book entry as required, it is not a cash flow. It is otherwise not an incurred loss as far as the company is concerned. Then there had been few items, travelling and other expenses, due diligence, etc of the new territory and under the new territory there was Bargarh and Mandideep plants which had already come in. So what we did is we started correcting these territories ahead of time, so there are certain expenses for that booked in this quarter, the benefit of which actually is going to happen to us during next season. These are the small, small things which have accumulated to this, otherwise in this quarter other expenses or in this quarter also profit from operations is intact and is in line with earlier quarters.

Kaustub Pawaskar So about Rs. 11-12 crore would be because of the foreign exchange expenses, so that can be considered one-time and rest are your normal course of businesses?

Raj Gandhi This is not only one-time but actually, by the time the money will be due to come back to India, if rupee does not stay at Rs. 63.93 at which now the value of that has been brought in, so this loss will actually convert into profit. I do not want to call it a notional loss but for now it is considered as a provision based upon the rupee dollar conversion rate on 31st December of Rs. 63.93.

Kaustub Pawaskar Right sir. Sir, my second question is on PepsiCo's global head Ms. Indra Nooyi in the conference call she mentioned that she is looking for more franchisee partners in India. And since you are one of the top bottlers for them should we expect more territories to come in in CY2018, already we have got four to five territories in 2017.

So, should we expect more to come in 2018 considering the fact that the global leader is looking for partnership in market like India?

Ravi Jaipuria Well, she is the best person to answer that actually. But we can only hope, I think they are showing enough faith in us and they have shown faith by giving us five States this year and transferring the Tropicana and Quaker Oats business to us. So, I hope if we still keep on continuing with good work and if PepsiCo decides they want to disinvest, there is no reason why it should not come to us.

Moderator Thank you. We have the next question from the line of Nitin Gupta from Axis Capital. Please go ahead.

Nitin Gupta On capex just wanted some clarity, like we have called out for India maintenance capex will be Rs. 150 crore and Rs. 350 crore will be towards the five territories that we have acquired and Jharkhand. ~Rs, 650 crore is additional capex which will happen in CY18. So can you give me some clarity like whether I am doing the right math?

Raj Gandhi Well, we have so far spent in the last year on certain territories Rs. 255 crore and Rs. 35 crore additional will be incurred to strengthen the marketing infrastructure and some manufacturing equipment in the plants. Further, Rs. 150 crore will be spent for Nepal, another Rs. 165 crore is for Zimbabwe and another Rs. 150 crore in India, which also takes care of market spends in Sri Lanka and Morocco, other two territories of the company.

Nitin Gupta Okay, in terms of Jharkhand, what is it capex like?

Raj Gandhi Jharkhand due diligence is happening but it will work out to about Rs. 110 crore roughly, which is already taken in the figure of Rs. 255 crore which you mentioned.

Nitin Gupta And in terms of volume growth for this quarter how was the India volume growth and international?

Ravi Jaipuria For the last quarter?

Nitin Gupta Yes.

Raj Gandhi India Q4 CY2017 revenue was up 21.7% and international was lower and blended was about 14% or so.

Ravi Jaipuria Blended volume was 14%, revenue was 21%

Nitin Gupta India volume growth was around 14% for this quarter?

Raj Gandhi India volume was 21.6% during the quarter. International was slightly subdued, it was 1.5% and overall was 14%.

Nitin Gupta Okay. And on international side can you give us some update in terms of like the key markets like from Zambia and I guess this is the key season, so how was the performance there?

Raj Gandhi Zambia grew 9.8% during the quarter and for H2 growth was 9.6%.

Nitin Gupta And in Tropicana I just wanted to get sense on accounting, so we are under distribution arrangement so is it like whatever profit we make or commission or whatever we will get, will it get accounted as other operating income or we will get normal accounting, like we have purchased from PepsiCo?

Ravi Jaipuria No, it will be normal accounting. It will come through PepsiCo but it will be like normal supplies.

Nitin Gupta Okay and in terms of under GST like for energy drink it is classified under 18% slab, so just want to get a sense like which all products we have apart from Sting under this 18% slab?

Ravi Jaipuria Our only product at the moment is Sting, the energy drink.

Nitin Gupta And this Pepsi Black, is that also part of 40% GST?

Ravi Jaipuria Yes, because it is not an energy drink, it is just a low sugar or no sugar drink.

Moderator Thank you. We have the next question from the line of Amit Kumar from Investec Capital. Please go ahead.

Amit Kumar Quick question on the volume growth side, sir this 14% overall volume growth that is seen, because MP and Odisha units which we acquired were there for the full quarter. Could you give us a rough estimate what would have been the contribution within this 14% volume growth coming in from these two newly acquired territories?

Ravi Jaipuria Practically nothing. Actually the numbers of these two territories would be so small that it will be insignificant at the moment. But starting this quarter they will start performing normally.

Raj Gandhi And whatever little volume has come from the territories which were added last year, if you see this year Mozambique was offloaded, so that is not consolidated which offsets the additional volume from the new territories acquired.

Amit Kumar I am sorry, Gandhi sir, I was not talking about the full year numbers, I was talking about the previous quarter because full year they were there only for three months, I am saying in this quarter when they were fully there?

Raj Gandhi Mozambique volumes would be 1.9 million cases while the volumes in the new sub-territories would be ~800,000 cases. So you can take it for all practical purposes these numbers represent organic growth only.

Amit Kumar Okay, probably I can discuss it in detail offline. Quickly on other expenses, this forex translation, the Zambia entity is the subsidiary of the company, so when you are consolidating the financials whatever loss is there at the standalone P&L level wouldn't that get sort of netted off when you sort of consolidate the financials? Or am I reading something wrong, because inter-party transactions sort of tend to get netted off in consolidation, right?

Raj Gandhi Perhaps what you were saying is correct. However, when the movement of Zambian Kwacha vis a vis US dollar and INR vis a vis US dollar does not show the same trend and movement, the resultant loss / profit is recognized in P&L account even after elimination for consolidation.

Amit Kumar And is there some sort of derivative loss?

Raj Gandhi It is not derivative, and if there would have been direct from INR to Zambian Kwacha what you are saying is very true.

Amit Kumar It is a dollar loan that this element is done, understood. Finally, question in my mind, I think in these five or six new territories you have acquired in India, you sort of mentioned the current market share for PepsiCo in these territories, I missed that, but if you can help me with that. But my main question here is, in either Pepsi or some kind of third party franchisee that were sort of already operating there, what are you going to do differently to be able to double the volume in these territories over the next couple of years? So just some sort of color on that would be very helpful.

Ravi Jaipuria I think if we look at the national average of PepsiCo's share and if you look at our national average share where we are operating before these five sub-territories came to us is much higher than what the overall share of the PepsiCo is. So, we definitely are doing something better than what the other bottlers or the company owned plants are doing. That is one of the key reason why all these territories, every year one after the other are coming to us because we believe we can perform better and we can get a much better market share. Secondly, our overall scale and consolidation of territories which save us financially give us much more muscle and strength to go to the market in much better ways than smaller bottlers who do not have the infrastructure or the full know-how to do it. We believe and which will show in the next six months the differences coming and we can clearly point out to you each territory what growth have been there and how long it will take us to the growth that we are talking about.

Amit Kumar Sir, that is exactly what I was asking how the go-to-market strategy for Varun Beverages is going to be different. I understand it is a little bit of a strategic question, you may not want to sort of discuss it in detail, but just one or two sort of key elements and top-down elements either in terms of marketing or distribution in terms of the people, the quality of people that you deploy, anything would be helpful on this.

Ravi Jaipuria Quality of people in our system which of course the other bottlers do not have because being a large company we can afford to have certain systems like SAMNA, which gives us exact detail of each outlet what they are buying, what they are not buying, when they bought, what flavor they bought, we can see it in our office what is happening at each outlet, which is not possible for smaller bottlers to afford and to maintain quite senior people. Also, of course, as I said our key people are much more experienced, and our costs are much lower, our purchases are cheaper, our overall costs are cheaper given our scale benefits. So we are in a much better position if we need to strengthen the market which a smaller bottler again is not able to do.

Moderator Thank you. We have the next question from the line of Kunal Jangda from KR Choksey. Please go ahead.

Kunal Jangda Sir, I understand that acquiring new territories is an ongoing process for organization and it is a key growth driver. Sir, earlier you had mentioned that most probably this acquisition would be done from the internal accruals, so going forward how it would be, acquisition would be funded from debt or it would be from internal accruals?

Ravi Jaipuria Well, our target is to fund through internal accruals unless and until we get a very large territory which we cannot fund through the internal accruals then there is an issue. But if we keep getting smaller territories we can definitely fund it through our internal accruals. That is what it looks like unless and until PepsiCo decides they want to transfer the whole territory then of course we have to think differently and see how the funding is to be organized.

Raj Gandhi Kunal, in this case also you will notice that whatever borrowing has been done at the fag end of the year, by the end of H1 with the internal accruals debt will again be at the same level. And we have not done anything more to enhance our debt more than quarter or two quarters overlap.

Kunal Jagtap So that will not affect the cash flow I think so?

Raj Gandhi Yes, that will not affect the cash flow.

Kunal Jagtap And sir what is the repayment schedule of this new debt?

Raj Gandhi There is a mix in the repayment schedules. We have shifted certain loans of subsidiaries to HO, there is a foreign currency loan also which is 4.5 years, otherwise other debts are for 5.5 year. We always structure our debts such that we have two installments in the season months and the rest nine months we do not schedule any repayments. So, most of our debts are for a period of 5 - 5.5 years' time.

Moderator Thank you. We have the next question from the line of Aditya Joshi from Anand Rathi. Please go ahead.

Aditya Joshi Sir, my question is regarding to the carbonated and sports energy drink market in India. Sir, what would be the market in India, who would be the leader and any number that you can throw with regards to volume number or value market size?

Raj Gandhi We have given lot of data from the Euromonitor's report and there is a data available on the internet or sometimes other market research is given. And in our presentation also we have provided the per capita consumption in India and other places. From one of the reports, I can give you some statistics that 89% of the market, that is carbonated and juices, basically carbonated if you stick to that, is between the two big players, Pepsi and Coke. As per the report, the market share should be around 38% for PepsiCo.

Aditya Joshi Okay. So this will be for energy drink and sports drink market, correct?

Raj Gandhi That is very small.

Aditya Joshi Sir, the product that we have launched would be targeting that particular market, correct?

Raj Gandhi Sting will be targeting the energy drink market where the presence of Red Bull is there.

Aditya Joshi Sir, I just wanted to know what would that market be, how many million cases or value wise what that would be?

Raj Gandhi That is a very small market and actually during the last quarterly call we mentioned that our product, one, it has 50% lesser sugar than the normal Pepsi, price wise it is 50% lower than the immediate competition and now it has been launched in PET which is 70% cheaper than the other product, and taste wise it is good, flavor wise it is good. It is too early to comment on this but it will build market for itself in coming years. In neighboring countries where it has been launched the results had been very successful and in one country the market share it has already reached around 20%.

Aditya Joshi Okay. Sir, which all contents we have launched, is it Vietnam where we have reached 20%?

Ravi Jaipuria Vietnam is one of the countries and Pakistan also is growing extremely fast, and I think it has already taken 7% to 8% market share.

Aditya Joshi Okay. So, what kind of market share are we expecting in next three to five years' time?

Ravi Jaipuria I think it is too early, it will be all guess work. So I think let us be in the market for one season before we can say what share we will get.

Aditya Joshi Sir, next question is regarding the sugar prices. Have you seen any inflation in the current quarter and where do you see sugar prices in CY18 per say? And what would be the impact of MSP pricing that was announced in the budget?

Ravi Jaipuria Well, I think sugar prices will be back to 2016 level and what additional we had to pay in 2017 will be covered this year and hence, we will have a benefit of that this year. We should at least get 10% benefit over 2017 pricing. It could be more but 10% for sure we will get.

Aditya Joshi Sir, my next question is regarding the territories that we have acquired in last four months, sir for MP, Bihar, Jharkhand, Chhattisgarh and Orissa that is what we have acquired with an outgo of around Rs. 290 crore. Sir, what would be like the full sales value that we can get from this geography in say next one or two years, what would be the annual sales of these?

Ravi Jaipuria Existing revenue in these sub-territories is about Rs. 400-odd crore, but obviously we hope to increase it may be by 25-30% at least this year and going forward we feel that it will be growing at a much faster pace than the rest of our territories.

Aditya Joshi And the EBITDA margin in these territories would be same as the company's average?

Ravi Jaipuria We hope to bring it to the same level as VBL's existing margins, it might take us three to six months to bring it to that level, but we will bring it to the same what the rest of the company is.

Aditya Joshi And sir my last question is pertaining to the Mineral Water, sir where did we end the Aquafina's market share as on 2017?

Ravi Jaipuria It is about 12% of the national volumes.

Aditya Joshi Okay. So, sir have we gained some market share from last year or have we lost some?

Ravi Jaipuria In Aquafina?

Aditya Joshi Yes.

Ravi Jaipuria Our mix has slightly gone up, but it is about stagnant, the market is growing so our business is also growing, but I do not think there is a big shift in the growth in the share.

Moderator Thank you. We have the next question from the line of Arihant B from Atlas Global. Please go ahead.

Arihant B Sir, I would like to understand regarding the Tropicana, in the current 21 states what would be the volume or the sales currently?

Ravi Jaipuria It is approximately 7-8 million cases in our territory where we are.

Arihant B And what would be approximately revenue potential out of these 7 million to 8 million cases?

Ravi Jaipuria About close to Rs. 300 crore, may be a little more.

Moderator Thank you. Well, that was the last question. I now hand the floor back to the management for their closing comments.

Ravi Jaipuria Thank you very much, everybody. And please feel free anytime you need anything from the management we will be more than happy to answer you. Mr. Gandhi is always available to you. And we hope to have a good year. Thank you very much for joining us.

Moderator Thank you very much. Ladies and Gentlemen, on behalf of Varun Beverages Limited it concludes this conference. Thank you for joining us. You may disconnect your lines. Thank you.

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