Varun Beverages Limited
Q2 & H1 2021 Earnings Conference Call Transcript
August 2, 2021

Moderator Ladies and gentlemen, good day and welcome to 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 phone. Please note that this conference is being recorded. 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 afternoon everyone and thank you for joining us on Varun Beverages Q2 and H1 2021 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'll have the forum open for a question-and-answer session.

Before we begin, I would like to point out that some statements made in today's call maybe forward looking in nature and a detailed statement in this regard is available in the results presentation shared with you earlier. I would now request Mr. Ravi Jaipuria to make his opening remarks.

Ravi Jaipuria: Good evening, everyone. And thank you for joining us on our earnings conference call. Trust you and your families are keeping safe and healthy. I hope all of you had the opportunity to go through our results presentation. This provides details of our operational and financial performance for the second quarter and half year ended 30th June 2021. We have delivered an encouraging set of results during the quarter despite a soft operating environment due to pandemic induced lockdowns and restrictions. While we registered strong sales in the month of April, May witnessed moderate sales on account of the disruptions.

I'm happy to share that our team efficiently outlined and executed a set of SOPs and workflows to secure our business model and ensure continuity across operations during this time. With last year's, learnings we had all the necessary protocols in place to handle and mitigate the business impact to a certain extent. Further as lockdowns and curbs started easing from June onwards, we saw faster recovery in demand which assisted growth in the quarter.

Overall, we have delivered a healthy performance with a top line growth of 49.4% year-on-year. The higher growth rate is on account of robust volume growth over a lower base of previous year as well as marginal increase in realizations. On the profitability front, we were able to maintain most of the cost optimization measures that we had undertaken last year, allowing us to report stable EBITDA margin at 23.3%. PAT increased by 123%, primarily driven by lower finance cost on account of lowering of average cost of borrowing and reduction in total debt. We are also pleased to share that in-line with our dividend policy, the Board of Directors has recommended an interim dividend of 2.5 per share.

Our newly launched product variants Mountain Dew Ice which is a lemon fruit juice based drink has reported strong uptick in sales in the quarter and continues to be positively received by consumers across markets.

As we look ahead, we continue to monitor changes in the operating environment and are undertaking necessary precautions to safeguard our business and people, given that there are concerns triggered by a potential third wave of COVID. We believe the momentum in demand and consumption is steadily building and will further strengthen with higher vaccination drives, improving economic indicators and supportive macros, such as good monsoons. We remain confident of reporting robust performance in the quarters ahead.

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

Raj Gandhi: Thank you, Mr. Chairman. Good evening and a warm welcome to everyone joining us today. Let me provide an overview of the financial performance for the second quarter and half year ended 30th June 2021. Consolidated sales volume registered a solid growth of 45.4% to 152.3 million as compared to 104.8 million cases in the Q2 2020, primarily on account of strong growth in the month of April as compared to lower base of the corresponding period last year, and a steady recovery in the month of June 2021 post easing of lockdown restrictions. CSD constituted 78%, Juice mix was 7% and Packaged Drinking Water mix was 15% of total sales volumes in Q2 CY2021.

Revenue from operations adjusted for excise/ GST grew by 49.4% year-on-year in Q2 CY2021 to Rs. 24,498.5 million. Realizations per case improved by 2.8% to Rs.160.8 in Q2 CY2021, mainly on account of higher realizations in international territories partially offset by higher mix of water.

Gross margins declined by 128 basis points year-on-year to 53.5%, primarily due to change in product mix and marginal increase in raw material prices. EBITDA increased to 51.1% to Rs. 5,708 million in Q2 CY2021 from Rs. 3,777 million in Q2 CY2020. EBITDA margin marginally improved by ~30 basis point to 23.3% in Q2 2021 even after a 128-basis point decline in gross margins, as we were able to sustain cost optimization measures that were implemented last year.

Depreciation increased by 3.6% to Rs.1,287.8 million as compared to Rs.1,243.1 million in Q2 CY2020. Finance cost reduced by 36.9% to Rs.467.8 million from Rs.741.9 million in Q2 CY2020. This is due to repayment of debt as well as the reduction in average cost of borrowing. PAT increased by 123% to Rs.3,188 million in Q2 CY2021 from the level of Rs.1,429.8 million in Q2 CY2020, driven by lower finance cost. During the quarter, an amount of Rs.114.4 million from the total foreign currency provision was reversed to other income, due to corresponding reduction in the total foreign currency liability in Zimbabwe.

During H1 CY2021, the net organic CAPEX of Rs.190 crore including forex adjustments was primarily towards expansion in India, Morocco, and Zimbabwe. On the working capital front, working capital days marginally increased to around 24 days as on June 30th, 2021 from 20 days as on June 30th, 2020 on account of higher stock of PET resin and preform inventory, to take advantage of lower PET prices at the start of the year.

Net debt reduced by Rs.4,666 million to Rs.25,492 million as on June 30th, 2021 from the earlier level of Rs.30,158 million as on 31st December 2020, resulting in debt equity ratio, which was comfortable at 0.63x as on 30th June 2021. Debt EBITDA ratio stood at 1.69x for the trailing 12 months EBITDA. On the whole, the company's financial position remained strong during the quarter. We have seen a healthy month-on-month improvement in demand and the outlook remains positive for all our product categories over the medium to long term. Overall focus remains on generating strong free cash flows over the ensuing quarters and coming years.

On that note, I come to an end to the opening remarks and would like to now ask the moderator to open the forum for questions and suggestions that you may have for us. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Vivek Maheshwari from Jefferies India. Please go ahead.

Vivek Maheshwari: On the realization on a y-o-y basis, there is a 2.8% positive number and that is despite the fact that, water actually has moved up quite a bit. So, I'm just curious, can you just elaborate if there is any price hike because to my understanding, you haven't taken price hike YTD at least?

Raj Gandhi: We have not taken any price hikes. One of the things is that the mix has changed over last year, because of the COVID quarter which resulted in marginal decline in realizations in India. However, on a consolidated basis, a combination of the growth in higher realization SKUs like Sting, Mountain Dew Ice and Juices and the fact that international sales have grown at a higher pace where the net realizations are higher resulted in higher net realization in consolidated financials. If we talk about the breakup, our realization per case in international territories was Rs. 180+ while in India it was Rs. 156+.

Vivek Maheshwari: The second question was on the gross margins. So, gross margins at 53.5% have come off quite a bit, but when I look at your other comment about higher working capital because you took positions ahead of expecting or anticipating a surge in let's say key input prices. So, can you just elaborate on the two comments that you made and what is your outlook on gross margins?

Raj Gandhi: In India, the stocking of the raw materials resulted in higher number of WC days. As, in the earlier calls we had stated, we expected that the PET prices internationally are likely to go upwards and therefore, we had covered ourselves for the full season. And therefore, the number of WC days have gone up. Gross margins are down primarily because of change in mix and higher sugar prices.

Ravi Jaipuria: Also, because of the lockdowns, we had to transfer goods from a certain plant to another plant, instead of letting the goods expire. The extra freight we incurred was one of the other reasons why our landed cost of goods became higher.

Vivek Maheshwari: Do you think the gross margins should stay at this level or let's say start to move up?

Ravi Jaipuria: Due to pandemic every day the correlation keeps changing as there is so much uncertainty right now, but we have been still able to manage and make sure there are no stock expiries. Even today, we are not sure if the third wave will come or not, so it is very difficult to predict these things right now, these are not normal circumstances. Our increase in stock of resin was only because we lost our peak month of May. Otherwise, this would have got consumed and we would have not carried this kind of inventory.

Vivek Maheshwari: A lot of your peers in FMCG space have been taking up prices given that, the input price environment is quite against, so do you anticipate any price hike in the foreseeable future to pass on some of that impact?

Ravi Jaipuria: Right now we are able to cover that up with our cost cuts. We can manage our margins without taking price hike.

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

Pritesh Chheda: Versus 2019, what would have been our volume growth or decline on a like-to-like basis?

Raj Gandhi: If we compare on an organic basis, 2021 over 2019 up to April month, which was like a pre-COVID period time, where the effect was not much, we have been growing at a CAGR of over 10%, as stated in the first quarter. Similar growth continued for the first four months. And then again June onwards, the growth has come back. So, out of seven months of the current year, five months were substantial growth months. As the Chairman said while it’s not possible to give guidance, but we are confident that we shall record good growth over last year.

Pritesh Chheda: In a normal year, let’s say hopefully next year is a normal year, at what run rate should South grow higher than your national average in a normal business scenario?

Ravi Jaipuria: The new territories should grow faster than our existing territories. But again, we have not even had one normal season to stabilize those territories. We need to wait one season before we can start giving you the details on how fast we can grow. Because after we took over, both the seasons have been impacted by the pandemic.

Pritesh Chheda: For the next two years, what should be our CAPEX in 2021 and 2022? And how should the net debt look like in 2021 and 2022?

Ravi Jaipuria: We are expecting capex to be very close to our depreciation. It could be little more one year and less in another year depending on when the new plants are capitalized.

Pritesh Chheda: And net debt will keep on coming down right?

Raj Gandhi: Even in the pandemic year, our net debt has come down by Rs.450 odd crore. If pandemic would not have been there, the reduction figure would have been much higher, but luckily we got supported by a reduction in the interest cost. So, interest servicing cost in any case is much lower.

Moderator: Thank you. The next question is from the line of Dhruv from Monarch AIF. Please go ahead.

Dhruv: On the balance sheet part, if we see the other current liabilities and other financial liabilities, there is a big jump. So, the other current liabilities have gone from Rs.318 crore to Rs.528 crore and other financial liabilities have gone from Rs.85 crore to Rs. 130 crore. So, what would be the reason for this jump in these two-line items?

Raj Gandhi: The major portion of the current liabilities is the term loans which are due in the next 12 months.

Dhruv: Okay. So, these both constitute the current portion of long-term debt which is payable this year?

Raj Gandhi: Yes, that's the major portion.

Dhruv: Okay, because cumulative it goes to around Rs. 250 crore, maybe I'll connect with you separately on this. And sir for the first six months of this year, what has been our total debt repayment which has happened?

Raj Gandhi: Rs.466 crore.

Dhruv: And what is the plan for the last six months of this year, what is our plan to repay debt additional?

Raj Gandhi: Normally, in H2 mainly tax payments, the dividend payment, CAPEX, etc., takes place however we are generally able to repay about one to two hundred crores. The major portion of debt reduction happens in H1 only.

Dhruv: Okay. So, maybe additional couple of Rs. 100 crore we can expect to reduce from the long-term debt?

Raj Gandhi: That's right.

Moderator: Thank you. The next question is from the line of Devanshu Bansal from Emkay Global Financial Service. Please go ahead.

Devanshu Bansal: Sir, my question is on margins on a slightly longer term. So, we did around 23%, 24% margins in India business over 2016-17 timeframe. And since then, margins have dropped for understandable reasons. But when do you expect getting back to those margin levels in India, even if we assume CY22 to be a normal year?

Raj Gandhi: If we assume CY22 to be a normal year, we should be back to those level of margins. We are totally geared up as explained by Chairman to go to that level.

Devanshu Bansal: India gross margins in the current quarter have been more or less stable. So, the RM inflation and higher water share is that international operations?

Raj Gandhi: International operations gross margins are generally slightly higher which got impacted due to RM inflation during the quarter.

Devanshu Bansal: Sure. You indicated that new innovation, new introductions have been doing well for us so if you can highlight some of the trends and in Sting and in Mountain Dew Ice, what is the current contribution and possible potential contribution that we foresee from these new introductions?

Ravi Jaipuria: Our energy drink, Sting that we had launched a couple of years back has really taken off and is becoming an important part of our mix. Mountain Dew Ice has also done very well, but unfortunately as soon as we launched it, within two months, the pandemic came again and our go-to market became very difficult as mostly Mountain Dew Ice was originally launched in smaller packs, which is mainly go-to market. So, that's why it's very difficult to say what will be the contribution, because we have to give it a year or year and half for the brand to make any meaningful contribution.

Raj Gandhi: On new launches, we have Mountain Dew Ice, Creambell diary-based value added beverages and Sting. The only requirement is, these have to be expanded further due to huge potential. Like for Sting, within a span of two years of the launch, in H1 we have already crossed 10 million cases volume mark which is supposed to be very good for any brand from a long-term perspective. So, the potential of these is yet to be exploited.

Devanshu Bansal: Lastly sir, is Sting catering to a different consumer base or it may cannibalize the existing consumer base?

Ravi Jaipuria: It is the same consumer base, the only difference is, that compared to Red Bull, we are at a very reasonable price point. So, people who could not afford or wanted to have a Red Bull are now going for Sting and lot of new customers are also going for it as they like the taste. It's going to become a big brand and one of our core brands. This would have been much larger provided pandemic would not have been there, because this is a small pack and all small pack sales happen more on-the-go instead of in-home. So, we expect huge growth in Sting coming in the near future.

Devanshu Bansal: PepsiCo U.S. consistently has been indicating market share gains in India beverages space, but somehow we have remained tight lipped on this front. So, any comments that you can share in this regard?

Ravi Jaipuria: We have done well and that is where I would like to keep it.

Moderator: Thank you. The next question is from the line of Sameer Gupta from IIFL. Please go ahead.

Sameer Gupta: Sir, first question was on the Zimbabwe provision reversal. So, I just wanted to understand now, how much of this foreign currency liability is now remaining and when is it expected to be settled?

Raj Gandhi: About USD 15 million is left and about USD 2 to 3 million of this amount we are settling on quarterly basis and this is committed by the Reserve Bank of Zimbabwe. So, we will be reviewing this provision every quarter and if need arises, we will be reversing it to the P&L.

Sameer Gupta: Sir, USD 15 million is currently the liability on the balance sheet as well and every quarter you're expecting USD 2-3 million to be reversed just like this quarter?

Raj Gandhi: That's right, to be settled every quarter.

Sameer Gupta: For the dairy-based beverages portfolio, it's been a difficult time. You re-launched it this year and again, the pandemic struck but any kind of update on this product, where is it being sold currently, have we resumed the scale up in June or are we going to again postpone it to the next year, which market this is being sold at, what is the current consumer feedback, anything on this would be helpful?

Ravi Jaipuria: We have again resumed the sale and we are focusing on the North India territory as of now. Right now, we are not sending it everywhere, and our conscious decision is to make sure it is fully marketed properly in the North India belt first.

Sameer Gupta: But it is capable to be scaled up as and when required, you don't need to set up plant?

Ravi Jaipuria: It's capable and that is why it was doing well, but again, any new product launch cannot be in the off-season as it doesn't work fully.

Sameer Gupta: My question was from a shelf-life point of view?

Ravi Jaipuria: Shelf life is not an issue because it has a six-month shelf life. But when there is any crisis or pandemic, retailers only want to buy what is currently selling, nobody wants to keep stock. So, anything which is new or is slow moving initially, retailers don't like to buy it.

Moderator: Thank you. The next question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: When you ideally guide for adding one lakh outlets each year on the base of 2 million that we have, is that something that can happen regularly, even in the offseason, or most of it would happen during the season. And ideally, we'll have to wait for next year to do that addition again?

Ravi Jaipuria: Store addition is not going to happen this year, rather lot of stores have shut down. So, we don't expect additions coming this year, it has to be a normal year for number of stores to increase.

Nihal Jham: So, most of it can only happen during the season time.

Ravi Jaipuria: It's not only the question of season time. Even if we are opening new spaces, there are outlets that have shut down. So, the net addition is not going to happen this year.

Nihal Jham: That's helpful. The other part was, is it right to assume that most of our international operations did not face any COVID impact this quarter?

Ravi Jaipuria: Well, some of them did, for example Nepal and Sri Lanka, but African countries saw much less impact even though COVID was there, but it was not complete lockdowns like here in India.

Nihal Jham: Absolutely. And if I compare our performance of the subsidiaries also say two years back there is a significant improvement, so most of it would be driven by Zimbabwe, or it would be some other?

Ravi Jaipuria: Zimbabwe and Morocco.

Nihal Jham: Now while you've spoken of Sting, and also dairy is one of the recent additions that we've added. Ideally over a longer term, in terms of product addition, are we looking at mainly extension of the brand like in case of Mountain Dew or there could be a new category also that we contemplate launching anytime soon, similar to Sting?

Ravi Jaipuria: There are so many things we have added actually, Mountain Dew Ice is a completely new category, it's a juice-based lemon drink. Then Sting is only three years old and huge traction is coming now. Tropicana juices we have expanded significantly and that is showing traction. So, there is enough work for us to do with the products that we have launched. We have enough potential in the products we've already launched and we would first like to get enough momentum on that.

Moderator: Thank you. The next question is from the line of Rakesh Roy from Indsec Securities & Finance Ltd. Please go ahead.

Rakesh Roy: How do you see demand scenario especially in South India, after the rising cases?

Ravi Jaipuria: South India is doing well for us but as I said, the real go-to market changes that we wanted to do, we have not been able to do completely. But otherwise, we are doing well that's why you are seeing growth overall.

Rakesh Roy: Can you share the volume details, such as domestic and international for Q2?

Raj Gandhi: In Q2, India volume was 127 million cases and 25.3 million cases in international, so total 152.3 million.

Rakesh Roy: Out of 127 million cases, how much is from the South India?

Raj Gandhi: Broadly, we could give you the benchmark. So, two-third volumes comes from North and East and one-third comes from West and South.

Moderator: Thank you. The next question is from the line of Mahavir Jain from Aditya Birla Money Please go ahead.

Mahavir Jain: On the other expense side, when we see on a sequential basis, we have sustained cost efficiency. So, just wanted to know, which are the areas of cost where we have worked well, and how much is it sustainable, going forward?

Raj Gandhi: As we have mentioned in the earlier calls, it is in transportation cost, consolidating of plants, this is actually not under one head but broadly under other expenses. Realization, for example, has gone up over last year substantially. It's efficiencies across which have come in. So, we have to look at entire P&L for that.

Mahavir Jain: Okay. So, we can expect it to be sustainable?

Raj Gandhi: What has come this year is definitely sustainable.

Moderator: Thank you. The next question is from the line of Suvarna Joshi from Axis Securities. Please go ahead.

Suvarna Joshi: I had about two questions. One was, if you can just help us understand how has the SKU mix done for us, because in the last two concalls we have said that the larger SKUs have typically done well because of the in-home consumption. So, two parts to that question, one is on the SKU mix and how is the in-home consumption trend doing - is it continuing to grow at the rate that we have been seeing or there has been some tapering down. The second bit is on, if you can help us understand the growth in semi urban and urban markets, because during this second wave of the COVID, we have seen that the hinterland and the rural regions were more impacted versus the first wave. So, what has been our experience on that?

Ravi Jaipuria: So, far in-home consumption is steady and has been doing well, and similarly, the large packs are doing much better than the single serves. So, both these things are continuing. During the pandemic time both these things continue to remain dominant. As far as rural or urban is concerned, last year rural was very strong, even this year rural was good, but not as strong as last year and urban did quite well this year compared to last year.

Suvarna Joshi: So, can you give us the delta of how the rural has grown versus the urban this year versus last year?

Ravi Jaipuria: We don't have the exact numbers, but we can tell you only one thing, last year substantial growth, was out of rural and now it is balanced and rural as well as urban is growing at about the same pace. Last year, it was completely skewed on the rural side.

Raj Gandhi: Basically, the total business including the growth pattern, sales mix is coming to pre-COVID levels, there has not been any substantial change including market discounts, penetration except few items, like HoReCA that was mostly shut and May was totally shut. Still, five out of seven months of the current year did well.

Ravi Jaipuria: Also, what happens is, in the summer months rural grows much faster, which is the basic change we saw this year. Urban was doing as expected and rural did not grow as fast as what we had expected.

Suvarna Joshi: Sure, this is helpful. So, going forward, can we then say that gradually urban will start picking up over the rural region growth or it should remain in the balanced territory of growth?

Ravi Jaipuria: Right now, it will remain balanced because the peak season is gone, and after peak season, always urban sales are better than the rural.

Moderator: Thank you very much. I now hand the conference over to the management for closing comments.

Raj Gandhi: Thank you. I hope we have been able to answer all your questions satisfactorily. Should you need any further clarification or would like to know more about the company, please feel free to contact our Investor Relations team. Thank you once again for your interest and support, and for taking the time to join us on this call. Look forward to interacting with you soon. Thank you very much once again.