"United Spirits Limited Q3 FY16 Conference Call"

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Moderator: Good day, ladies and gentlemen and welcome to the United Spirits Limited Q3 FY16 Conference Call. As a remainder, all participant 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 this 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. Vinod Rao, Asia Pacific Regional Finance Director of United Spirits Limited. Thank you and over to you Mr. Rao.

Vinod Rao: Thank you very much, a very good morning and good day to everybody on the call. Thanks for joining us and a very warm welcome to all of you. I am Vinod Rao, I spoke to you all last quarter as in my role as Interim Head of Finance for United Spirits. I have since reverted back to Finance Director of Asia Pac, Diageo.

First of all, I would like to apologize for the absence of Mr. Anand Kripalu, who being unwell has not been able to join us in the call today. Secondly, I would like to introduce to you Sanjeev Churiwala who has joined United Spirits as CFO in the month of November last year. Sanjeev comes with a lot of experience in the Indian market. Sanjeev will be anchoring the call today and I will pass it on to you. Over to you, Sanjeev.

Sanjeev Churiwala: Thank you very much, Vinod. Once again, ladies and gentlemen a very good morning to all of you. As we continued the tradition in the last conference call that we had you already have with you the Press Release and the idea was that we now get into this Investors Call so that we can take your questions-and-answers according. Now we understand that there are around 200 people in the call so we would request and appreciate that your questions are very brief and short so that most of the people in the call can get a chance to post their questions to us. So without much ado, we can get into the question-and-answers. So please go ahead please.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Latika Chopra from J. P. Morgan. Please go ahead.

Latika Chopra: My first question is on Diageo brands, what would be the contribution from these brands to the EBITDA in Q3?

Sanjeev Churiwala: Okay, thank you very much. As we have mentioned last time we anticipate on an annualized basis an EBITDA of roughly 10% to 11% coming from the Diageo brand to the overall portfolio, this would vary from quarter-to-quarter but as of now our overall plan is to retain it around 10% to 11%*.

For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document

Latika Chopra: Okay. So in Q2 you had mentioned a 15% margins so that was more a quarterly aberration?

Sanjeev Churiwala: Yes, absolutely. So this will vary quarter-to-quarter but annualize would be around 11% to 12%*.

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Latika Chopra: 11% to 12%, okay. The second is on the recent relaunch of McDowell's No.1 how is that progressing? Would it possible to share the growth rates in Q3 for this brand?

Sanjeev Churiwala: So a good question, I think this goes back to our overall innovation agenda before I answer on McDowell maybe I can come back to the RCW the lunch that we did about a year back. As you may have already see as part of our Press Release the RCW has been doing well and I think for the quarter we have done about a 58% growth on RCW that shows that possibly McDowell launch would also be very successful. We have just done the McDowell launched in October-November. The initial outcome is very-very positive and we would expect to get a more visibility in the next quarter onwards.

Latika Chopra: And last question is on the raw material trends, we did see a gross margin expansion but sense and how much of this is being driven by lower raw material cost what are you seeing on ENA glass front?

Sanjeev Churiwala: ENA has been by in large flattish of course improvement on the cost is also because of our a lot of productivity that we have put in and this goes across various lines including manufacturing, including our procurement so I think this goes back to what we explain also in our previous Q&A session.

Moderator: Thank you. Next question is from the line of Manish Poddar from Motilal Oswal Securities. Please go ahead.

Manish Poddar: I had a couple of questions. First thing is could you allude sir how much would be volume growth of UNSP's own Prestige brands including excluding Diageo?

Sanjeev Churiwala: So if you look at the overall growth volume and we have to split it up between USL and Diageo. The Diageo overall volumes is very small but the growth is about 2 odd percent. The USL brands including the USL there is a flattish growth overall.

Manish Poddar: That is on the premium side which you are alluding to.

Sanjeev Churiwala: Yes.

Manish Poddar: And is that the reason that is why gross margins on a Q-on-Q basis have not seen a significant jump despite the significant jump on the Prestige brands volumes contribution.

Sanjeev Churiwala: So coming back to your original question then linking back. If you have to break it up between Prestige and Above Popular, the Prestige and Above for the quarter grew by about 9%. Popular was a negative growth of 5% and overall the growth was about flattish.

Moderator: Thank you. Next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta: Sir, I wanted to understand the working capital better. You have indicated there is 400 crore change in working capital increase and the incremental sales is 750 crores. Does that suggest the new sales that we are getting from Diageo have a higher working capital intensity or is this more a one-off increase that we are seeing?

Sanjeev Churiwala: So I think this is again coming back to the previous round that we had in the quarter two. With the DIPL Diageo brand coming in into the overall portfolio of USL it contributes about 200 odd crores to the working capital portfolio. The remaining 200 odd crores is pertaining to the USL brands and it has a bit of element of seasonality because we come in the December main season and this will go down next quarter and also as part of our efficiency build in the working capital when we look at 100 odd days in terms of days working capital we plan it to bring it down to the industry levels.

Avi Mehta: Okay. Sir and second is on the industry challenges that you refer could you please highlight that? And lastly sir, book keeping question, if you could give the split actual number for volumes for between Prestige, overall Prestige United Spirits, and regular the actual number sir in million cases if you could?

Sanjeev Churiwala: So your first question is regarding the industry challenge. I think we have mentioned about Uttarakhand and Chhattisgarh the challenges that we face.

Avi Mehta: What is this sir, what is the challenge that we are facing here if you could highlight?

Sanjeev Churiwala: In both the places it is more about the regulatory challenges that we have. So we are trying to explore the regulatory challenges in one of the states we have gone ahead with filing a writ in the High Court which has been decided in our favor. We have now gone back to the State Government requesting them to start our supply over there. We are facing some challenges to that extent we have also approach the competition commission on 6th of January and we are expecting that we should be able to resolve through a proper dialog with the government and using the legal means as well.

Avi Mehta: Sir, sorry but you are not being allowed to get supplies…I am sorry, could you just explain this again, sir. I am sorry, I am trying to understand the exact challenge that you are facing.

Sanjeev Churiwala: Yes, so the exact challenge is in these two states basically we operate through the corporation models and we have not been able to get the supply but the orders coming from the corporation because of some technical challenges which we think not warranted and we are trying to resolve that through legal means.

Avi Mehta: Okay. So is this the government basically seeing that the orders cannot be fulfilled because of some rule or some means and you are kind of challenging that rule is not applicable something like that sir?

Sanjeev Churiwala: It is a combination of regulatory and technical challenges.

Avi Mehta: Okay. I did not quite understand the technical part but if you could also highlight the volume split as well.

Sanjeev Churiwala: So the Prestige and Above volumes YTD numbers that we have the overall volumes is roughly about 70 million cases, Prestige and Above is roughly about 26 million and popular is roughly about 44 million cases.

Avi Mehta: Sir and how would it split between Diageo and non-Diageo the 26 million?

Sanjeev Churiwala: The overall Diageo portfolio largely is about a very small portfolio out of 70 million it is roughly close to about 1 million cases.

Avi Mehta: Okay. So to order is 1 million Diageo and the 25 is ours that is how it is?

Sanjeev Churiwala: Absolutely.

Avi Mehta: And sir, would you be able to give this split to the first quarter also similar split if it is possible?

Sanjeev Churiwala: Just hold on, we will have to get to the first quarter numbers. Yes. So in quarter one we roughly sold about close to 22 million cases. Prestige and Above it is about 8.5 million cases and popular is roughly about 14 million cases.

Avi Mehta: And here also Diageo would be, sir?

Sanjeev Churiwala: Diageo it is a very small volume because we have just started our distribution agreement then 0.1 million cases.

Moderator: Thank you. Next question is from the line of Manoj Menon from Deutsche Bank. Please go ahead.

Manoj Menon: Just one question on the advertisements and promotion line item. One from a medium term point of view, medium defined as more than one year, how do we see this as a percentage of revenue? Point number two, could you just talk about the accounting a bit let us say what goes through the A&P line and what actually gets netted-off in the revenue line. This question is particularly in the context of likely implementation of the Indian Accounting Standards from 1st April.

Sanjeev Churiwala: So you are talking about the Ind-AS which would be applicable from 1st April So I think at the moment we are still away from the 1st April thing I can simply talk what we have done in the quarter and this again goes back to our philosophy of reinvesting our growth reinvesting our profits back into the A&P line advertisement and promotion. So if you really see, see the particular quarter in hand. We had a good net sales growth of 22% and that has also improved our gross profits and gross margins. Large chunk of our gross profit improvement has again gone back towards reinvestment into trade spends which is the advertisement and sales promotional line that you see. On an average for this quarter we have spent about 11% of, the advertisement and sales promotion is roughly about 11% of our NSV. So going forward also in the medium-term philosophy we continue to reinvest our profits largely into our brand spend into people capabilities into our innovations and innovations partly that you already seen in terms of RCW and McDowell's No.1 coming in. We would continue to reinvest into process and systems and of course our manufacturing capabilities.

Manoj Menon: Okay, understood. Sir, just please allow a couple of follow-ups here. One from a medium-term of view what do we look at, so do we look at A&P as a percentage of revenue significantly trend up or is it just a function of your gross profits? So how are you looking at it either an absolute increase you are looking at it or will it actually be tactically depending on how the gross margins move, that is point number one. Second question was that given the fact that there has been P&L savings because of the related party transactions not being there that also should have resulted in some productivity improvements in A&P for you so that is a linkage to the question number one actually.

Sanjeev Churiwala: Okay. So question number one, in terms of our advertisement promotion spent we would see a slight trending up happening. What you really see is for this quarter we have spent 11% of NSV on advertisement and promotion and if you have seen the previous quarter that was about 9% to 10% so we do have trend which is slightly moving up.

Moderator: The next question is from the line of Nilesh Shah from Morgan Stanley. Please go ahead.

Nilesh Shah: Sir, my first question is on the underlying gross margin trends for the USL brands so two things out there first is ex out the impact the Diageo brands so how will the gross margins for that particular business look like only for the Diageo brands so EBITDA you said is about 10% to 11% or 11% to 12% but what is the gross margin out there to understand what the USL brands are doing?

Sanjeev Churiwala: Please hold on. So if you really see the overall average gross margins it is roughly about 40% to 41% so, without getting into the complete detailing of it we would say we would say that the gross margins coming out of the Diageo portfolio could be slightly above the USL portfolio. So let us say if the average is about 40% for Diageo we would like to keep it closely to about 50 odd percent.

Nilesh Shah: So sir, are you then manufacturing the brands for Diageo at this point of time or is it only a distribution agreement?

Sanjeev Churiwala: It is a combination of distribution agreement and importing so it is both BII and BIO.

Nilesh Shah: So in that case how do you get gross margin that much higher that means that the margins for USL brands on a Y-o-Y basis have actually come off.

Sanjeev Churiwala: No, I think we cannot draw a very straight line relationship the Diageo overall portfolios I already explained that in terms of the million cases it is a very small percentages over a volume. As part of our premiumization policy yes, the Diageo brand would fetch a better NSD has been in the market share as compared to Prestige and Above and as compare to the popular brand.

Nilesh Shah: Okay, sir. Can I ask you in different way who spends behind the input cost for the Diageo brands, is it Diageo or is it USL?

Sanjeev Churiwala: No, it is USL so USL as you have already seen we talked about 11% spend on advertisement and promotion so this encompasses the overall brand portfolio which includes Diageo as well as USL brands.

Nilesh Shah: Okay. So whatever you sell so for example for Smirnoff the manufacturing could be done with USL and anyways the input costs are also borne by USL would that be…

Sanjeev Churiwala: Absolutely correct.

Nilesh Shah: Okay. And this price mix of I think you have indicated about I think 453 crores for the nine months as a price mix impact of net sales. Would that roughly be flowing down to the EBITDA line largely speaking or will there be some cut between on account of that also. Any price or mix improvement should generally flow down to the EBITDA line, right?

Sanjeev Churiwala: Yes, so that is what we said, that yes, if you really look at the margin mix we said that on an annualized basis we are looking at 11% to 12% EBITDA margin coming from Diageo portfolio between the quarters this will slightly vary and we also said that whatever Bihar earnings we are trying to reinvestment back into the brand's portfolio for garnishing growth in the future. So if you see the quarter we have reinvested that…*

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Nilesh Shah: I am only talking about the gross margin, I am not talking about the EBITDA margins so would the 453 crores price mix impact positive impact flow down all the way to the gross profit line, it would right?

Sanjeev Churiwala: Not necessarily that the mix directly flow into the EBITDA line.

Nilesh Shah: Where could that go sir? Higher cost I mean I assume higher cost….

Sanjeev Churiwala: So basically if you look at the two lines above the GM, there could be a change in the brand portfolio in north axis line and similarly change you will find in the COGS line and then but we are looking at this the GM margins is going up roughly by about 101…

Nilesh Shah: Okay, sir. If I get my calculations right and I ex out the impact of Diageo brands and I ex out the impact of price or mix and mix is because your Prestige and Above is growing much faster than the regular and below segment. So if I ex out these two impacts I am getting a gross margin compression to the tune of 300 basis points. In an environment where input costs are flat how our gross margins compressing by this big in amount is something I cannot understand.

Sanjeev Churiwala: We would not know your model what we see is when we are saying that our net sales is increasing by 22% at the same time the absolute gross margin if you see has gone up from 872 crores to 1,092 crores so that says that has an impact of roughly more than 200 crores. So I think it have to work backward to see the absolute impact on the gross profit.

Nilesh Shah: That is exactly what I have done, I have missed out the Diageo brands that is it.

Sanjeev Churiwala: So when you look at the price mix basically pricing is normally a challenge so we do not think that in your model it can really input some pricing challenge so that is largely negated through productivity and through mix so while the net sales would definitely grow the slow down impact on the GM and the GM margins particularly will not be very very high. So that is why we have said that our gross margin enhancement is 41.2% as compared to what we had in the previous quarter so that is an improvement that we see in terms of the GM improvement but not necessarily that you can split that into brands and then try to see the impact.

Nilesh Shah: Okay. So can I just ask you one last question is that if I ex out the impact of Diageo brand performance so if I only look at USL performance as a company how much as the gross margins gone up by?

Sanjeev Churiwala: I think I have said originally when we look at the USL mix the gross margins are roughly about 40 odd percent when we look at the Diageo mix the gross margins are roughly about

50% odd. The overall portfolio of Diageo is a very small percentage of the overall portfolio that is why when you see averaging they are looking close to about 41%.

Nilesh Shah: Okay. So the margins for USL is flat on a Y-o-Y basis despite you getting a big improvement on the Prestige and Above mix improvement, that is right?

Sanjeev Churiwala: Yes.

Moderator: Thank you. The next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

Arnab Mitra: Firstly, on the Diageo brand sales there has been a big jump in third quarter versus what you did in the second quarter so is the third quarter sales numbers of around 256 crores - 260 crores more representative of a quarterly run rate given that I think when the transition had happened we expected about 600 crores to be the annualized sale number from Diageo brands?

Sanjeev Churiwala: Yes, so basically this is again the seasonality impact because October, November, December is the peak season. Our annualized Diageo sales volume and going back what we said the earlier thing we are looking somewhere between 600 odd crores to 700 odd crores.

Arnab Mitra: Okay. And sir, on the price part growth part of it I am not specifically talking about Diageo brands have you got pricing growth in any of the major government markets in the last six months and overall within USL brands what would be the pricing component of growth that you are seeing in this quarter?

Sanjeev Churiwala: This is without splitting between Diageo and USL we have had challenges in terms of pricing increase the previous pricing cycle had not been good for us and we could almost say that our pricing has been flattish and this has just not been the USL challenge this has been the industry challenge overall what we are really planning to do is in the next pricing cycle we can work with the government to see we can get some price improvements.

Arnab Mitra: Sure. Just on your cost of raw material you spoke about the ENA prices any sense on how glass prices are moving and as you renegotiate next year's contracts given that gas prices have come off to you expect any reduction in glass prices next year?

Sanjeev Churiwala: At the moment what we see is the flattish trend both in terms of the ENA and the glass prices. I think the overall trend is may be that we are slightly increased but we are not able to directly link with the overall crude prices. I think for India perspective I would say that our commodity prices as of now is flattish and we have a slight increase going forward but the trend as of now is flattish.

Arnab Mitra: Sure. And just last question on the CAPEX side I see first nine months you have probably done something like 180 crores versus I think initially you had spoken about 500 crores of

CAPEX annualized so is it basically postponing of some plans or what should be the kind of CAPEX we should build in for next year?

Sanjeev Churiwala: So by in large we are sticking to the overall plans where we are trying to spend about 400 crores to 500 crores CAPEX largely about regarding our manufacturing units capability building. We have been able to spend close to about 200 crores as of now so we are going as per our plans.

Arnab Mitra: But so therefore, this year below that 400 to 500 given that nine months you have just done about 200.

Sanjeev Churiwala: Yes, so we are citing to 400 crores to 500 crores possibly we will end up may be around 400 crores or little above that.

Vivek Maheshwari: Good afternoon, sir this is Vivek Maheshwari. My first quarter is on the excise duty, excise duty as a percentage of revenues has been kind of going down, is it just because of the change in the mix which is driving it both market as well the premium product, I would imagine in percentage terms premium would have lesser excise duty.

Sanjeev Churiwala: You are right, it is combination of the state and then the brand mix.

Vivek Maheshwari: Okay. Second on, coming back on the gross margins if we adjust as you articulated Diageo portfolio and the kind of flattish cost curve that we had your margins were broadly flat or whatever marginally up. Is not it a little disappointing given that I mean this is something that we have never at least have not seen for long-time in Spirits industry where cost is not an issue either on ENA or on glass and in this case it is on both the sides. Despite that if underlying margins are kind of flattish then what will take up the margins?

Sanjeev Churiwala: That is I think combination of few factors the price increases has been limited there have been industry challenges in getting the price increase. Second when we talk about the cost increase definitely there is a low-single digit inflation impact coming in and a large part of our savings we have tried to again reinvest in our capabilities so in terms of innovation that we did for RCW what we did for McDowell's No.1 is actually all going in that particular line. So that is why I think our productivity gains that has come through price and volume mix has actually landed up in the COGS line but in spite of that I think we have been able to increase our gross margins.

Vivek Maheshwari: Okay. And on the advertising, where do you think it will settle at if we take a medium-term view on ENP?

Sanjeev Churiwala: For this quarter it is about 11% and as we said that we are slightly changing upward trend in the medium-term. We would continue to reinvest our profit in the trade spent given that overall larger agenda we want to keep on reinvesting into the brands.

Vivek Maheshwari: Sure. But this quarter I think you did 11.4 would it be like as you say upward trend as in is it 11.5%, is it 12% is it 13% is there a number on an annualized basis that we should be looking at?

Sanjeev Churiwala: So I think it should be in the range of 11% to 12%.

Vivek Maheshwari: Okay. Just two more questions. One you mentioned about working with government and all but if we look at what Goa said yesterday about ban in public places and then what we saw in Orissa although I think Bihar which is still talking about country liquor perhaps IMFL from 1st of October or Tamil Nadu even talking about ahead of polls talking about partial ban or whatever it may be. I mean does government even care about talking to you or listening to your problems?

Sanjeev Churiwala: I think we have been facing this challenges across various states. Our CR team is in continuous dialog with the government to find amicable solution. So this is not the first time this is happening not this is last time I think as an industry we will keep on facing this challenges and we will be interacting with the government to find a solution for us. Prohibition is not the solution, we really trying to work out what are the reasonable ways of drinking so that at least there is some sense around it but then various states have taken various stands in the past there have been flip flops around that. So I do not think there is a particular strategy which is in place from the government perspective or from the industry perspective we are all working towards that.

Vivek Maheshwari: Okay. And in your interaction you think government is receptive of these points that you make?

Sanjeev Churiwala: Our dialog has been very productive so far.

Vivek Maheshwari: Okay. And last thing on the tax rate it has been yo-yo quite a bit quarter and I can imagine partially because of exceptionals but on a normalized basis what is the tax rate that we should be running with for this year as well as next year?

Sanjeev Churiwala: Going by the industry trend because we do not have last tax exceptions here so each year normally for the industry is close to almost about 34% to 35%.

Vivek Maheshwari: So 34% is what we should be taking at?

Sanjeev Churiwala: Full tax rate, Yes.

Moderator: Thank you. The next question is from the line of Rajasa K. from Jefferies. Please go ahead.

Rajasa Kakulalavapu: My first question again pertains to margins. I believe franchising out especially for Kerala and the popular brands in AP happened sometime this fiscal. So what would have been I mean I am guessing that gross margins could have slightly improved on that account as well just from an accounting perspective.

Sanjeev Churiwala: So we find a limited impact on that so we would say its margin neutral.

Rajasa Kakulalavapu: Margin neutral, okay. And sir, just a couple of observations from our Annual Report and again this pertains to margins. I see that USLs share of the tie-up unit revenues has gone down in fiscal 2015. Also you do have certain traded goods that sit on your P&L. On both these accounts the margin that USL gets has gone down in FY15. Is there some change in business strategy? Are you offering higher margins to your tie-up units?

Sanjeev Churiwala: So as a business strategy no, as I said our target is to be margin neutral on that. With your specific question on the FY Annual Report can I request if you can just drop us an e-mail on the Investor Relation e-mail we will get back to you with the specific answer on that.

Rajasa Kakulalavapu: Sure. Sir, just one last question on the Diageo brand sales what would be the year-on-year growth in the nine months to-date, I am guessing all of it has come into USLs P&L.

Sanjeev Churiwala: The Diageo brands are coming into the portfolio on the annual accounts for the first time so as such there is no like for like comparison with the previous year.

Rajasa Kakulalavapu: But sir, in general the brand the Diageo brands itself I mean they would be growing at certain rate. I just want to understand because you are now distributing through USLs channels has your growth rates gone up and what is that we can expect going forward for Diageo brands?

Sanjeev Churiwala: So I think the overall Diageo portfolio to the overall USL portfolio still a small amount but if you look at our Press Release what we are really talking about is direct sales for the Diageo brand portfolio added 256 crores for the quarter positively right and for the nine months it is about 439 crores and what we have said that we are looking at roughly about 600 crores to 700 crores on the annualized basis of the Diageo brands portfolio as part of the net sales.

Moderator: Thank you. The next question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: Sorry, to drag this point a bit further but again on gross margins, you mentioned that the gross margins were flat excluding the Diageo distribution. Now if you basically look at a situation where the mix has improved and the cost has actually remains flat and still your gross margins are flat. So could you elaborate which are the portions in popular segment where actually there has been some price erosions may be due to regulatory issues or otherwise. Could you just give us the pockets or brands or the regions where you actually have seen a price cut which is actually implying this?

Sanjeev Churiwala: So the way I would like to answer it is I did not say that the margins are flat. So if you really see our press release we have said that the gross margins for the quarter is up by 1.1 percentage points so as much have moved up. So now how do you relate that to the top-line into some net sales?

Kashyap Pujara: Yes, so I am saying that if you ex-out the gross margin on the Diageo distribution and then if you were to look at it then you said I mean basically it is more or less flat, right?

Sanjeev Churiwala: Yes, so…

Kashyap Pujara: So and the price mix and the product mix has been favorable from a Prestige perspective you grow ex-Diageo brands as well. So to that extent there should have been some benefit that would have flowed in on the mix front and your cost pressures are not very high so, there is there will be some pocket where there is a problem, right I mean so could you just…

Sanjeev Churiwala: Yes, you are right. So definitely there has been some benefit in terms of brand mix, state mix largely the pricing has been flattish so there has been some benefit coming out of there. The COGS, which is the cost line is not absolutely flattish, we have the mid-teen numbers coming in because there is a inflation factor also coming in. Besides that a part of this profits we have also reinvested back in terms of our investments as I mentioned in the renovation for RCW, in the renovation for McDowell brands besides we have also reinvestment into the people in the capability, process and systems so all those reinvestments has happened which is also sitting at the COGS line.

Kashyap Pujara: But I mean that is all below the gross margin level correct, right I mean technically I mean…

Sanjeev Churiwala: It is in the COGS line.

Kashyap Pujara: Yes. So, okay, I mean while I understand the strategy the company and the premiumization that is going to pan out et cetera. So I mean what is your or the management's perspective of gross margins three years down the line I mean let us say where do you think that we are headed I mean could you give us some sense there? You can put it, I mean let us put it a long with the Diageo distribution because that is very much part of the brand architecture now USL premiumizing over to Diageo so let us assume that if I take the entire brand architecture in place and then look at gross margins on an aggregate which is actually showing an upward trend as reported. So could you just give us sense as to where do you think we are headed I mean considering the momentum that you are seeing on the Prestige and Above and the distribution arrangement?

Sanjeev Churiwala: So I think we have been giving a good growth in terms of the top-line that will continue. We would remain to keep on reinvesting the growth in terms of our innovations, in terms of investments into the future that will continue to happen. A large part of this growth that is coming in terms of profitability we would continue to reinvest in terms of advertisements and sales promotion. So as a result as we have already indicated also in the past in terms of our EBITDA we would continue to look at about 10% to 11% in the immediate mid-term.*

For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document

Kashyap Pujara: Yes, I was looking more at as to what is the benchmark that you have three years or five years out I mean what is it that you are really driving towards in terms of growth but I mean you can choose not to answer that question but that was the question I had.

Sanjeev Churiwala: Yes, so I think joining the dots of previous question we do face this pricing challenge coming in as part of our strategy in the mid-teens in the mid-terms the company would look at an EBITDA margin of 10% to 11% coming in. It would also depend on how the industry gets the pricing power back so we will really look forward to the next quarter coming in where we engage with the government for the pricing increase.*

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

Avi Mehta: If I understand you correctly, you said the gross margins were flattish but there were some innovation-led investments also that are also in the gross margin line so would that be correct in the UNSP portfolio?

Sanjeev Churiwala: Yes, absolutely, that is absolutely correct. And I give you the examples for our RCW brand and McDowell's No.1 brand.

Avi Mehta: Okay. But would you be able to share what would the impact if I remove that one-off investment or whatever if just look at it on like-to-like basis sir?

Sanjeev Churiwala: We will not have this detailed break-up as of now so I would then request you to just drop us an e-mail and we will be able to revert back to you.

Avi Mehta: Okay, fair enough, sir. So sir, one last thing could you also share the third quarter break-up in terms of volume Prestige and Diageo?

Sanjeev Churiwala: Just hold on please. So the overall volumes for the quarter three is close to about 26 million cases we break it up, Popular it is about 16 million cases Prestige and Above would be roughly about 9.5 million cases out of that the Diageo portfolio would be roughly about half a million cases.

Avi Mehta: Okay. So 16, 9.5 out of which half is Diageo, okay.

Sanjeev Churiwala: Half a million is Diageo, Yes.

Avi Mehta: And sir, there has been this increase in loans and advances to subsidiaries which you have classified and there are provisions that have been created. Just want to understand is this related to Chennai unit and what is the subsidiary provision created for?

Sanjeev Churiwala: Okay. So there are two provisions, one is related to the Chennai unit there was a de-merger which happened on 31st of March, 2015, and there were some as part of between the effective date and appointment date there were some expenses which the company has incurred and there were some receivables which the party has been disputing and post discussion with the party there was doubt on the recoverability so as a matter of prudent the company has provided for it. However, the company is continuing to have his dialogs with the party for recovering of the money, so that is one. And second is there are some provisions for our subsidiaries which is more of a true-up because most of the subsidiaries largely non-operating has already been impaired in the books.

Moderator: Thank you. The next question is from the line of Ankit Panchmatia from ICICI Securities. Please go ahead.

Ankit Panchmatia: Sir, I just wanted to understand so for nine-month period for FY16 the total top-line from Diageo brands was 439 crores so, from that if I assume it correctly that would be generating an EBITDA of 11% to 12% if I am right you can correct me please.

Sanjeev Churiwala: Yes, so you are talking about the 11 months?

Ankit Panchmatia: Sorry, the nine months' distribution so if I see for Q2 we had posted 141 crores from Diageo distribution brands and for this nine month we have done 439 crores so, I want to understand what kind of EBITDA this is generating? Or what kind of cost has been sitting on P&L for the further distribution of this 431 crores?

Sanjeev Churiwala: So as I indicated on the gross margin level we are roughly looking at on annualized about roughly 50% margin coming up. On the EBITDA level for Diageo brands on an annualized basis we look at 10% to 12% of course this will vary from quarter-to-quarter depending on various mix but on an annualized basis it stands at about 11% to 12%.*

****For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document***

Ankit Panchmatia: Sir, actually what I was coming from is basically I want to understand is would it result that if we distribute higher amount of Diageo brands our margins would be pressured going ahead I just want to understand this.

Sanjeev Churiwala: No, so basically the Diageo brands largely stands in our luxury segment but as I said if you look at the break-up we have just said we look at the quarter numbers just 0.5 million cases are coming from Diageo so, in terms of the mix though the Diageo brands would definitely give us a higher NSV but flowing down to the EBITDA we are looking at annualize still about 10% to 12%. *

For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document

Ankit Panchmatia: So apart from this Diageo brands is there any other expenses also which are being sitting on the purchase of traded goods cost item in our P&L?

Sanjeev Churiwala: You are referring to the Diageo brands or to the USL brands?

Ankit Panchmatia: Sir, both. So if I want to consolidate if I want to see the Q3 results, I am seeing higher amount of purchase of traded goods cost item so I just want to break-up that item into Diageo and the others.

Sanjeev Churiwala: Sir, basically all the cost would be sitting in the P&L line item so in terms of revenue the Diageo brand and the USL brand will be sitting on the net sales line and in the accounting term all cost pertaining to this particular brands whether it be purchase cost or overhead could be sitting in the respective P&L line items.

Ankit Panchmatia: Sir, actually I was just referring to one line-item from the cost item that is purchase of traded goods which has increased quite a bit. So basically my question was pertaining to that cost item purchase of traded goods, so I want to understand out of that purchase of traded goods what cost would be of Diageo brands and what would be the others?

Sanjeev Churiwala: So if you are really comparing with last year then possibly last year there was no Diageo brands so, all the portfolio purchases for Diageo brands would be sitting in this line.

Ankit Panchmatia: The incremental would be of Diageo brands if I want to assume it.

Sanjeev Churiwala: You can assume so, yes.

Ankit Panchmatia: Okay. And sir, apart from just understanding our strategy basically we have just pulled back from the ready-to-drink market which is growing quite a bit if I want to see how Bacardi is growing. So what were the investments for the same and would be looking out to write-off the investments, what were the investments we have blocked for the same?

Sanjeev Churiwala: As part of our larger strategy we are looking at to come back in this market but we cannot really spell out exactly when this will happen it is part of our larger strategy.

Ankit Panchmatia: Okay. And sir, apart from that is there any kind of distribution agreement signed in Nigeria with someone to distribute the United Spirits brand in Nigeria?

Sanjeev Churiwala: Yes, so I think the company is in the process of signing the distribution agreement with Nigeria.

Ankit Panchmatia: So sir how flavor of how big that market is and how are we going to go ahead with it?

Sanjeev Churiwala: The initial indication that we have is next couple of years' time we are looking at roughly two million cases from that market. But it is a very small percentage to the overall volume that we have.

Moderator: Thank you. The next question is from the line of V. P. Rajesh from Banyan Capital Advisors. Please go ahead.

V. P. Rajesh: Looking at Page #3 of your Press Releases the EBITDA waterfall that you have is a line item of 400 crores of COGS so, if you can just provide a comment on that and what was that number for quarter three?

Sanjeev Churiwala: Your voice was not very clear which Page number you are referring to?

V. P. Rajesh: Page number three of the Press Release has EBITDA waterfall and the COGS is 400 crores for the nine month. So my question is if you can just provide some color around that and share the Q3 number.

Sanjeev Churiwala: The overall COGS increase that you see is related to the overall volume and brand mix increase so I think that is what we have said when we look at the comparison purposes we set the part of the earnings so the price mix coming on the net sales is getting into the COGS line and this also includes the Diageo distribution agreement which you see in the same Page if you go up so part of that money is also sitting here.

V. P. Rajesh: So there is no one-time thing will believe 400 crores?

Sanjeev Churiwala: No, these are the regular operating cost.

V. P. Rajesh: Okay. And then what is the corresponding number for Q3?

Sanjeev Churiwala: The corresponding number for Q3 would be also be if you see the Press Statement the line number COGS line that you see overall for Q3 is about close to 1,558 for this quarter and close to 1,300 crores in the corresponding quarter.

V. P. Rajesh: Okay, I was just looking for the incremental but that is okay. And then last question on the Page #4 there is an improvement of 184 bps which is labeled as Related Party Transactions Benefit. So is it Diageo brands or is it something else there?

Sanjeev Churiwala: Okay. So I get your question so this RPT has nothing to do with the Diageo brands. This is essentially the RPT which USL had signed up and this is sequentially related by the shareholder so we have started we stopped accruing this RPT last year in November 2014 so, this is the corresponding difference that you see between this nine month versus the corresponding last nine months.

Moderator: Certainly, sir. It is from the line of Latika Chopra from J. P. Morgan. Please go ahead.

Latika Chopra: Yes, actually two questions. Firstly, I just wanted to clarify your medium-term margin outlook you said 10% to 12% is it more near-term because in the last Earnings Call Mr. Kripalu mentioned mid-teens is what you are looking at the medium-term level this an aggregate basis for overall USL. And the second question is on margin profile for Diageo brands. 11% to 12% is on the annualized basis. For this fiscal do we see there is scope for improving these margins over the medium-term as well any comments?

Sanjeev Churiwala: Yes, so I think this is exactly what we all are trying to say that in the medium-term this is what we are looking mid-teens are 10% to 11% margins, future improvement would also depend on how the government and the various states interaction happens in terms of price increase. The current year has not been great enough. We had hardly had any price increase we are expecting to get into dialogs with the government soon across all the corporation markets and across all the open markets to see what kind of price increase we can get. So our target is definitely to improve beyond this but in the immediate medium-term we are really looking at 11%.*

For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document

Latika Chopra: Okay. And by medium-term I would assume you are talking about two years to three years?

Sanjeev Churiwala: Yes.

Latika Chopra: Okay. And any scope to increase the margins for the Diageo portfolio over next three to five or that looks difficult as well?

Sanjeev Churiwala: So the Diageo portfolio comes to us for the Diageo distribution agreement where we said that on annualized basis we are targeting again close to 10% to 12%.*

For further clarification on EBITDA margin quotation please refer to the Appendix at the end of this document

Moderator: Thank you. Ladies and gentlemen, due to time constraint that was the last question. I now hand the conference over to Mr. Sanjeev Churiwala for his closing comments.

Sanjeev Churiwala: Thank you, ladies and gentlemen my friends and on behalf of Vinod and entire team out here we really like to thank you for this engaging discussion. Our apologies in case we have kept you waiting and to those who have not been able to really put their question forward. We will possibly have more opportunities in our next investors call to take your questions. Thank you very much.

Moderator: Thank you very much members of the management. Ladies and gentlemen, on behalf of United Spirits Limited, that concludes this Conference Call. Thank you for joining us and you may now disconnect your lines.

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Appendix

United Spirits Limited (standalone only) EBITDA margin including the impact of the Diageo brand portfolio was 11.6% in the 9 months ended 31 December 2015.
The above reported EBITDA margin was positively impacted by the related party transaction benefits as outlined in the notes to the accounts. Excluding this related party transaction benefit, the EBITDA margin for the nine months ended 31 December 2015 would have been 9.8%.

For this financial year (F16) we expect the EBITDA margin to be broadly in line with the EBITDA margin for the nine months ended 31 December 2015 at cca.11% including the Diageo brand portfolio.

In the forward outlook period (beyond F16) we continue to expect to deliver steady margin progression. We remain committed to our medium term aspirations to deliver mid teens EBITDA margin from this business.

EBITDA margin of the Diageo brand portfolio is expected to normalize in the range of 10% to 12%. This range may, however, vary quarter by quarter due to state and brand mix and the relevant phasing of A&P investments in that quarter.

EBITDA margin summary:

	P9 YTD F16	**Q3 F16**	**H1 F16**	**Q2 F16**	**Q1 F16**
USL (including RPT benefit)	11.6%	10.2%	12.5%	14.8%	10.1%
USL (excluding RPT benefit)	9.8%	9.4%	9.6%	12.7%	7.8%