"United Spirits Ltd. Q3 FY19 Results Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the United Spirits Limited Q3 FY19 Results Conference Call.

I now hand the conference over to Mr. Anand Kripalu – Managing Director & Chief Executive Officer and Mr. Sanjeev Churiwala – Executive Director & Chief Financial Officer, United Spirits Limited. Thank you and over to you.

Anand Kripalu: Thank you very much and Good Afternoon everyone and Welcome to the FY19 Q3 Results Call. I am Anand Kripalu and I am joined by our CFO – Sanjeev Churiwala.

At the outset as I typically give and before we open up the lines for Q&A, I just wanted to provide a quick recap of our results that we announced last evening.

As you may have seen in the published results, after adjusting for operating model changes, net sales grew 11% in the third quarter driven by continuous momentum in the Prestige & Above segment while also benefiting from a weaker comparative in the previous year. Sale of P&A grew 16% during the quarter. This brings the net sales growth of the P&A segment to 18% for the first 9 months of the year. I would like to highlight that this is the fourth consecutive quarter of double-digit net sales growth for our P&A segment. After adjusting for operating model changes, the Popular segments declined 2% in the third quarter, and that brings the net sales growth of Popular to 2% for the first 9 months of the year.

During the quarter, we have managed to maintain our gross margin at 47.3% which is flat versus the last year despite adverse input cost and despite the abating flow of the effect of certain price increases from the previous year. For the first 9 months of the fiscal, our gross margin stands at 48.5%, an underlying improvement of 113 bps primarily achieved through our productivity program and mix that enabled us to more than offset the adverse impact of inflation. We have continued to accelerate investment behind our brands.

This quarter, our marketing investment grew by 3% versus the last year despite a higher base. The A&P reinvestment rate for the quarter was 10.7% in line with the seasonality of our business. Despite flat gross margins versus last year, a relentless focus on bringing down our operating costs has helped us to deliver underlying EBITDA margin improvement of 91bps during this quarter. The EBITDA margin was 13.9% for the quarter and 14.4% for the first 9 months of the year. While we reassert that our medium-term ambition is to deliver EBITDA margin in the mid-to-high teens on a consistent basis, this progress again gives us confidence that we are taking the right steps towards our ambition.

We continue to deliver financing cost efficiencies and repay our debt. Interest cost for the quarter was down 16% despite being in an environment in which interest costs are tightening. Profit after tax for the quarter was 192 crores, up 43%, mainly as a result of improved operating performance combined with monetization of our non-core assets as well as lower interest costs.

I am pleased to share that during the quarter, we have successfully monetized one of our key properties, i.e., UB Tower in Bengaluru from our portfolio of non-core assets. Additionally, during the quarter, we have made further progress towards simplification and structural rationalization of our business by disinvesting our stake in a 100% subsidiary, Four Seasons Wines Limited. The FSWL wine business was a niche and a small part of the overall Diageo portfolio and this sale will further enable us to focus on growing our core spirits business in India. While we have been in a relatively stable operating environment this year, looking ahead, we do expect the upcoming general elections to have an impact on our sales during the next quarter. Additionally, the input cost environment, after a couple of years of remaining benign, has continued to see a bit of upward pressure.

Having said that, these risks are near term and the long-term opportunity of the spirits market in India remains intact and we will continue to execute against our strategy to capture that opportunity. And therefore, I would like to reiterate our medium-term ambition to grow the top line by double digit and improve EBITDA margin to mid-to-high teens on a consistent basis. With those opening remarks, I am going to open up the floor for questions.

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 Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Just wanted to understand follow-up on this Maharashtra – there was a news of tax increase in Maharashtra. Could you help us quantify what is the price increase that tax increase kind of necessitates and have we already taken it, if you could share any details on that, Sir?

Anand Kripalu: You are right, the tax increases in Maharashtra were announced, in fact, late into the evening of the 31st of December and it was effective from the morning of the 1st of January. So, that's the amount of notice we got to plan it out. What happened really is there was almost no increase at the bottom of the pyramid for Popular and large brands, and then there were fairly significant increase as we moved up the pyramid. So, the way it is panning out for the moment and I can share with you where we are, there is no impact on our Popular business and we are the leaders in Popular in Maharashtra, so the price will stay the same. There is no movement of price in lower Prestige and that's true for competition as well as us. So, we have had to absorb some excise impact in lower Prestige. As many of you know, we had taken a price correction while maintaining a premium to the average pricing in the segment for our #1 brands. We are maintaining that same premium post the price change which has meant we needed to absorb something. As you go up the pyramid, we have pretty much passed on the entire increase on our Premium brands like Smirnoff and Scotches. So, both have been announced and production has started. You will start seeing that in the market soon. There is no change in the bottled-in-origin segment for our brands like Johnnie Walker and so on. And we are still to take the calls on the mid and upper Prestige segment for brands like Royal Challenge, Signature and Antiquity and we are just waiting and watching on how this pans out. So, that's where we are. So, we have passed on a fairly significant amount already, we have absorbed some and we are watching the rest but things will become clear really in the next couple of days. I think what is important for us and what we have been guided by is Maharashtra is one of our most important states, as many of you know, and Maharashtra typically has been growing faster than our national average and our margins in Maharashtra are better than the national average. So, it is really important for us that our growth momentum in Maharashtra sustains because that is growth accretive and margin accretive for our total business. So, we may take certain hits in the short term but we really want to make sure that the long-term opportunity in Maharashtra is something that we absolutely capture and that is what is guiding our thinking and we are evolving our approach step by step towards making that happen.

Avi Mehta: Sir, just any quantum on the likely price increase or this numbers, would you be able to share any numbers on it? I am just trying to understand is there volume impact?

Anand Kripalu: The numbers is difficult to share but I can tell you that for instance in Scotch and so on, the price increase has been about 15%. That's the minimum price increase on bottled-in-India Scotch brands, and that has already been announced. There is no price change on the bottled-in-origin Scotch brands for instance. And like I said, there is no increase at the bottom segment in Popular and lower Prestige. So, it is now the mid and upper Prestige that is left. So, that is how it is panned out for the moment.

Avi Mehta: Okay, fair enough, Sir. The second part, Sir, was there is a note that you have mentioned, note #11, in your accounts. Would you be able to explain what exactly is this divergence all about, if you could help explain that?

Anand Kripalu: Yes, first and foremost, I really do want to say that we believe in the highest standards of governance and transparency as a company. That has been our philosophy ever since Diageo took control of this business and that's what guides Diageo globally as a company. We believe in being proactive, being preemptive and being transparent. That's our philosophy. Now, based on that, we have put these notes to account as note #11. Honestly, I am not in a position to say anything more than what has been written here. So, you will just have to wait and watch this space but what you can decode is the fact that the moment we can say more, in that same spirit of governance and transparency, we will.

Avi Mehta: Sir, what I was trying to understand is, as rightly you are saying that you need time, but is there a regulatory related kind of concern that might come because of this or no, it's more of a true-up which should hopefully get. We will wait and watch and the quantum will come out. I am just trying to kind of gauge, get some handle around it. That's why I was asking, Sir.

Anand Kripalu: Honestly, until the facts are established through the review that we are doing, it will be really speculative of me to say anything more, Avi. You will just have to honestly live with this question mark for the moment till we can provide you clarity and be sure that the moment we can, we will do that.

Avi Mehta: I just wanted to understand this gross margin you highlighted, these pressures. This quarter is a clear example of the cost initiatives that you have been able to drive. Would it be fair to say that something similar is how I should look at, at least in the near term or probably next year as well in terms of the drivers of margin expansion, not the quantum but at least the drivers? Is that how I should look at the business at least now and probably medium-term gross margin will play out?

Anand Kripalu: Yes, it is tough to say medium and longer-term, but what will I tell you is that there has been inflation, particularly on glass and to a lesser extent on the ENA. And like I said, we are absorbing some hits because of Maharashtra excise duty. So, really what's happening is the following: The benign environment we have had for almost 2 years on specific inflation to our industry, the first steps of hardening is something that we are seeing as we speak. We are preparing for that hardness even though ENA goes through a cycle and tends to soften again depending on the season for ENA. But, Yes, what we are doing is that we are planning that there is going to be some hardening of costs. We have had a very aggressive productivity program over the last 4 years that has more than mitigated costs and you have seen that in the way in which we have moved our gross margins from 42 up to 49. And that has been hugely driven by our productivity program. So, we are further accelerating our productivity program and looking for even more projects that we can bring in to mitigate any costs. The intensity for pushing for price increases with states is going up because this hardening is something is not just impacting us and that we are seeing, but the whole industry is seeing this because these are industry-wide commodities. So, the intensity of negotiating and pushing for price increases is also increasing, and finally I will say this that while selectively we may absorb some cost like we did in Maharashtra but as a general philosophy now, we are looking for more pricing-up opportunities in states where there is flexibility to jump a slab and take up the margins. We are absolutely going to do that and you will see us as market leaders beginning to lead the way in taking some of those chances. And I expect that in a market where costs are hardening that others will also follow. So, that is also something that you should expect to see.

Moderator: The next question is from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: Good Afternoon. Two questions; first, on this gross margin bit. On a sequential basis, there is a decline. So, 1) can you highlight this issue, and Mr. Kripalu, you just mentioned about the opportunity to take up prices and you would want to explore that. If that is the case, why in Maharashtra you have not passed on the entire excise hike impact to the customers? I am just curious on that part.

Anand Kripalu: On gross margin, I pretty much answered that but again what has been significant this quarter in terms of costs is glass, that's been material, and some because of the ENA. So, this is the difference from the previous quarters that you have seen. Now, we have also not had any fresh pricing flow through in this quarter. And sometimes there is a phase lag between costs and our ability to push pricing, take pricing, or get pricing as the case may be, and this is a quarter where you are seeing a bit of that mismatch happening where costs have hardened and it hardened a bit more than we expected to be honest. And enhanced pricing hasn't yet started coming in. So, that's the situation on gross margin and that's why you are seeing the delta of let's say 180 bps versus Quarter-2. Now, as far as pricing is concerned, why did we not pass on Maharashtra. I am saying we have passed on where we believe that you are operating in area where it is reasonably inelastic and because we believe that a Scotch consumer is going to buy Scotch and buy that brand and a few hundred rupees is not going to make them downgrade or down trade. And where we have decided to absorb selectively is where we believe that we are operating in segments of price sensitivity, and we are waiting in the middle. Now, this is not necessarily the endgame. This is what we have done now and like I said at the stroke of the midnight hour, this announcement happened and we had to start implementing. I think we are going to wait and watch for a couple of months to see how volumes pan out. And we will see how different segments respond to these price changes, and Maharashtra is a free pricing state. So, we can do the pricing selectively as and when we choose, but the important thing is for us to maintain growth in Maharashtra because as I said earlier, its growth accretive, growing fasting than national average and margin accretive. So, protecting that contribution to our national numbers is critical. But this is not the endgame. I think you will have to watch this space.

Vivek Maheshwari: Sure. And as a follow-up to that, given what you mentioned about glass and ENA and a pause on pricing because Maharashtra thing will impact you from this quarter, is it fair to say that gross margins at least in the foreseeable future are capped and the best is like kind of there in the base already and there is a probability of it going down further as we head into the subsequent quarters?

Anand Kripalu: Really, we are not going to give an outlook on gross margin. We have given an outlook on EBITDA margin and please do recognize that there are many lines to the P&L and we can create those lines differently. And I have spoken about it in the past - we are aggressively investing in A&P and we are investing ahead of the curve, and these are the things that we can choose to kind of normalize as and when we choose to do that because there are different ways we can play. You have also seen our overheads and staff costs have improved over the last few years, and there is opportunity for leverage there as well. So, please follow our guidance on EBITDA margin as we are uncomfortable giving you a guidance on gross margins because the business is not solving only for gross margins, it is solving for delivering the EBITDA margin and the overall P&L.

Vivek Maheshwari: Okay, got it. Second question on note #11, the issue that you have highlighted about the mismatch or the discrepancy, is it something which is legacy coming in from pre-Diageo acquisition?

Anand Kripalu: Honestly, all this is speculative, Vivek. If I had known more, I would have shared more because we are absolutely committed to transparency but you will have to watch this space.

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

Abneesh Roy: Sir, my question is on the Popular on a 2% negative base, a decline has come while in the previous quarter there was a growth. Any particular states, is in Punjab there is some issue, is that the key reason?

Anand Kripalu: No, first of all, I am not going to get into states. And Punjab and so on, they make a very-very tiny for Popular, Abneesh. So, that’s not the point. I think what you have to recognize is that first of all, I said this many a times, we try and run this business on a full-year basis, not on a quarter-to-quarter basis. And if you read too much into every line in every quarter, you will just find it hard to see what's happening because it is a dynamic industry. I think, philosophically, what have we always said - We have said in our quest to get to double-digit growth, we expect Popular to grow low single digit. And if you look at our YTD numbers, we are +2% on a YTD basis which is exactly in line with what we have been saying. Bases change, quarters change, but roughly we are delivering Popular in the zone that we have been aiming. And that's what you should decode from the performance.

Abneesh Roy: Sir, next question is, in the comments you highlighted elections. Normally in elections, consumption goes up especially for the mid and lower end, and you have said it will impact next quarter. Is it because price hikes will be difficult or there is distribution changes, for example, in few states? What is the reason for highlighting?

Anand Kripalu: Elections in India are a funny and they are funny because you don't always know exactly how it is going to go. And whether consumption will go up or come down but what we are talking of is operational issues that could happen in the run-up to election. So, what will typically happen is the number of dry days will increase. That happens every time elections happen and on those dry days sometimes in some states even factories get shut. And this is because of the election code of conduct. Excise officials, many of them who are posted in our factories, are co-opted for election duty. So, sometimes you don't have the excise people there to open the factory and shut the factory and supervise the factory during the day. And what's happening this time is also that it is coinciding with the label registration cycle. So, I think we have been prudent, we do not know if demand will go up but we do know that there will be operational issue. Now, are we doing nothing about it also not correct, right? We are doing as much as we can to prepare. So, through February and March, we are going to do everything we can; to prepare, preempt and try and bring forward any of the issues that we have which will have an impact on our business, okay. We have a comprehensive plan internally of what we are doing in the run-up to the election. But I think it is only prudent for us to say this. Now, importantly, the India election schedule is not yet out, and once that becomes clear, then we will also make sure that our plans actually get firmed up.

Abneesh Roy: Sir, one small follow-up on McDowell's Platinum UP-Telangana launch and similar pricing to Royal Challenge. What is the strategy here, Sir? Why similar pricing and will it go to more states?

Anand Kripalu: Absolutely, it will go to more states and I must tell you that in McDowell's Platinum the first signs are encouraging. But we are not trying to push volumes hard or something. We want to do a quality launch wherever we are doing that launch and build the brand. The fact that it is priced same as Royal Challenge or some other competitive brand is immaterial. I mean, McDowell's and Royal Challenge are 2 different brands, it could well have come from 2 different companies and different kinds of consumers consume these brands. And that's how brands work. It is like BMW and Mercedes have the same price but very different kinds of consumers. So, that's the difference between McDowell's Platinum and the Royal Challenge – different consumers. And we believe that there is an opportunity for McDowell's consumers, who are loyal to the brand, to upgrade and drink better and drink something more premium. And therefore, if you see the McDowell's Platinum offer, it is a step forward in terms of bottle, liquid and everything else. It is also blended with a 5-year-old Scotch, so it gives a hook to consumers. So, wait and see how this evolves but clearly, we are encouraged by the initial response we have had.

Moderator: Thank you. The next question is from the line of Jamshed Dadabhoy from Citi Group. Please go ahead.

Jamshed Dadabhoy: Hi Sir. Two questions. If you just take a step back and look at the business over the last 3-4 years, could you give us a sense of how your proportion of on-trade sales have moved for current fiscal year versus say 3 years ago?

Anand Kripalu: I don't have the numbers on my fingertips for on-trade but I will tell you this – we have significantly enhanced our on-trade presence and our share of on-trade has improved and that is underscored by the fact that in our business, our Premium brands and Scotch are growing the fastest. That would not happen without a very significant on-trade effort. The other thing we have done is we have built a national structure within our commercial organization that deals with the on-trade - with weddings and banquets and those are the ideal places where Scotch and our Premium brands get consumed. We believe that on-trade is a great way to build equity in an otherwise media-dark market and to sample our liquids at scale. So, it is actually a great brand building opportunity and the benefits of what you do in the on-trade then start circulating down to the off-trade and that has been our philosophy and our approach.

Jamshed Dadabhoy: Okay. I know you don't have the exact numbers, Sir, but ballpark would it be in the region of about 20% of your net sales?

Anand Kripalu: Let me not speculate. We will find out and share with you. Nidhi will share with you the numbers that we can share as far as this is concerned.

Jamshed Dadabhoy: Okay Sir. Second question, you said your medium-term ambition is to grow top-line in double digits. Could you give us a sense in terms of what are your must-win battlegrounds or key states in that sort of template like when you think about the medium term, 3-5 years down the line, what states are really your key focus areas?

Anand Kripalu: I am not going to get into the state-wise prioritization on this, Prestige & Above segments have to grow mid-teen. And within Prestige & Above, each segment must grow faster than the segment below it. So, Scotch should grow the fastest followed by some of our Premium brands followed by our Prestige brands. And our more Premium Prestige brands growing faster than the lower-priced Prestige brands. Now actually, this strategy is currently in play. It is happening and we are seeing this happen consistently. In fact, what I have been most encouraged about in the last 6-9 months is Scotch, and you all know the import duties on Scotch in India, despite all that, duty-paid Scotch is actually performing very smartly and we have been hugely encouraged by the response to bottled-in-origin Scotch like Johnnie Walker as well as bottled-in-India

Scotch. And the way in which our recent innovation which is Johnnie Walker White Walker based on the Game of Thrones series, how that has been lapped up by the market at a Premium to Johnnie Walker Black Label. So, I think that is how our strategy is going from a brand and a segment portfolio perspective, all in the quest of delivering a consistent kind of mid-teens growth for our Prestige & Above business and that's what we have been talking of earlier. As far as states are concerned, I will just say this – this is a very dynamic regulatory environment and state prioritizations tend to change if not every year, every couple of years, and you have to keep looking at the regulatory environment, what's happening on taxation and deciding whether the growth drivers could be some other states rather than the one we are focusing on and then a few years later, the cycle kind of comes back and these states come back and become priority. So, it's a dynamic prioritization approach and not something that is cast in stone.

Jamshed Dadabhoy: No, Sir. The reason why I asked was because Diageo in one of its presentations on the China business had gone into some detail where they talked about how they are planning to roll out the business there, just from a geographic perspective. So, I was hoping you could shed more light on India from that context especially because each state has its own dynamics. But anyway, thanks Sir.

Moderator: Thank you. The next question is from the line of Aditya Soman from Goldman Sachs. Please go ahead.

Aditya Soman: Two questions from my end. Firstly, you mentioned that you are striving for premiumization even within Prestige & Above brands which effectively means that your ASPs of each liter sold will keep rising but is there a point at which you cannot premiumize further or consumers will just find it a step too far or do you think we are a long way away from that? And the second question is on advertising through digital. Are the same restrictions that you have on, say television and print advertising applicable to digital and how are they enforced?

Anand Kripalu: It is not as if we are continuing to increase A&P without limit or exponentially, I have said that our ratio of A&P will be in the ballpark range of 9-10%, unlikely to be much more than 10, unlikely to be much less than 9, and we will live and learn because there is no perfect science as to what's the right amount of A&P to be spent. Now, as far as affordability is concerned, all I will say is this – the GDP is growing at 7 odd percent and will grow between 7% and 8%, this is what the economists say, and this thing about premiumization is not something that is a short-term thing. This is a trend that should continue for decades. And if you look at premiumization across other categories of consumer goods, you will see that the premiumization trend is intact across categories and has been continuing for decades. So, I don't think that we are suddenly going to hit a ceiling on premiumization where consumers will not be willing to pay more. There are enough consumers in India who are willing to pay more and that's what gives us the kind of volumes and premiumization strategy that we are pursuing. So, in fact if anything I must say that if anything a slight acceleration in premiumization rather than a deceleration of premiumization in recent times. So, premiumization is completely intact.

As far as digital and the regulations are concerned, we can find out specific details and let you know. We follow pretty much the same philosophy on digital that we follow on other mass channels. However, we through age-gating are able to go and do more brand-specific and product-specific communication. So, if you go to our sites like LiveInStyle (www.liveinstyle.com), you will get a lead into some of our brands. If you search, 'which are the best places to go and drink in?' you will see the best places to go and drink and then you see our brands being mentioned over there. So basically we follow whatever is the law of the land and it's no different as far as that is concerned but digital does give you the added advantage of age-gating that then allows you to then specifically target and speak about things when you know somebody is age-gated compared to and they are not on other mass channels.

Aditya Soman: I understand. Sir, in short, you can actually promote brands or products directly assuming that you are obviously age-gated. That's an advantage over something like a mass channel where you need to use surrogates or there are restrictions.

Anand Kripalu: We advertise brand extension. So, whenever we advertise, whatever be the medium, we advertise brand extension, and that's the philosophy we follow.

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

Arnab Mitra: My first question was on the revenue growth. In your commentary as well as in the release, you seem to be reasonably confident on the demand environment, but if I basically look at this quarter, the comparative was weak because of the RTM changes. If I look at 9 months also, we had the highway ban in 1Q, and 3Q has had a weak comparator. So, as you get into kind of normal territory where there are no such special situations in the base, is it not a worry that there could be a substantial slowdown from these levels? Or in a way what I am asking is should you not have been going much faster in this 9-month phase and how do you look at, therefore, the demand environment going ahead?

Anand Kripalu: I think the fact is that we are seeing a better industry growth than we have seen in the past. Yes, the comparatives have been a little soft because there have been regulatory issues and regulatory changes in the denominator. I think we will have to just watch this beyond a point. Regulatory stability has given momentum. We have to maneuver the general elections that I spoke about earlier which is the one big event that is going to happen over the next couple of months and we will have to see how that plays out but if I look at the fundamentals of growth, one quarter base and next quarter base, sometimes gets complicated. So, you should look at fundamentally how penetration is growing, how per capita consumption is growing, how barriers to alcohol consumption are breaking down, how the millennials and people who are over legal drinking age are consuming. Those are the fundamental drivers. So, sometimes it is hard to decode quarter to quarter but the fundamental drivers if anything I think are very attractive and absolutely intact. And I cannot get more micro than that because of the nature of the business we are in.

Arnab Mitra: The second question was on ethanol pricing. What I understand is that the new ethanol blending prices became applicable December onwards and this is also I think the first time when grain ethanol can be blended in. So, do you anticipate this having an incrementally substantial impact in the March quarter onwards versus what you have already seen or this, in your view or in your assessment, is not a very big change compared to what was the situation before the December quarter?

Anand Kripalu: I can't say for sure obviously because this is a commodity and that it is a dynamic environment and there is ethanol blending on one side, there are issues with ENA and molasses, there is supply-demand in some cases. Now, like I said earlier, we have seen some hardening of ENA. Typically, there is some softening every year that happens in the cycle. This year the softening may or may not be as much because of the MSP that is there for grain as well. So, we will just have to wait and see. I don't expect it to go through the roof, but I think some impact is likely. I think that's the way at least we are planning for it.

Moderator: Thank you. The next question is from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: Hi Sir. Just had 2 questions. Firstly, on the P&A segment. If you see the kind of volume growth, it has been about 13-14% in the first 9 months and revenue growth has been 18%. In your assessment, the year so far would you have grown ahead of industry especially in this category?

Anand Kripalu: I am just saying that total industry (and I am not going to do any comparisons with competition by segment and stuff), but our P&A business is growing faster and much faster than the total spirits industry without a doubt, which means our share of P&A within the total industry is improving. And that's really what I can say. The total industry is probably growing at kind of high-single digit and our P&A is growing at twice that in revenue terms or 1.5 of that in volume terms [as per proprietary syndicated industry data]. So, that's where it is.

Harit Kapoor: Got it Sir. And the second thing is if you look at this margin this quarter, the gross margin especially, would that be correctly reflecting the higher input costs? What I am trying to ask is the higher input cost that you have faced, would that impact have completely come into the gross margins in Q3 or as the quarter proceeded, the cost kept going up, so you could be on a higher cost index in Q4 as well. I am just talking from a cost perspective. I understand that you have several productivity things to mitigate that but this is from input cost perspective.

Anand Kripalu: The hit up has flown through into the gross margin and the P&L this quarter, I am not going to give a guidance for gross margin for the next quarter because I think it is just inappropriate to do that because it will be inaccurate. But we are seeing hardening of commodities which have impacted our quarter. Will it harden further next quarter? I don't know. I think we will just have to wait and see but like I said, we are committed to moving towards our EBITDA margin guidance that we have given you and we will have to play the lines within the P&L accordingly. We might also be able to improve gross margins and compensate for some of these through more pricing pressure which I have also said we are going to try and pursue irrespective of how difficult it is in the industry. Finally, when everyone comes under cost pressure, then far more alignment in terms of taking price and asking for price. And we should expect that to happen too.

Harit Kapoor: My last question is on the competitive environment. In an environment where input costs are moving up after a long time, do you believe that it provides a player of your scale some kind of a benefit as the competitive intensity from say smaller players, etc., might reduce. Is that a factor that could play out over the next few quarters which may help you also?

Anand Kripalu: I don't know. I think it is hard for me to say that. I think the advantage we definitely have is in an inflationary environment, we have the more comprehensive portfolio from the bottom of the pyramid to the top of the pyramid. So, if you see a pressure on certain growth of certain segment, then we will have brands below to capture anyone who falls off. So, I think we have the power of portfolio. Having said that, smaller players tend to have much lower margin ambitions and gross margin ambitions particularly. Therefore, they look at margin per case and then are quite happy if they get some margin per case. And they are willing to forego that sometimes. So, how this plays out is just hard to say but I think the advantage of portfolio is there for us. The rest, I think, just will be speculative.

Moderator: Thank you. The next question is from the line of Chanchal Khandelwal from Birla Mutual Fund. Please go ahead.

Chanchal Khandelwal: Hi, most of my questions have been answered, but one thing on the industry. I am talking about the share of wallet of consumer. You have seen beer industry in the last 5-6 quarters has been consistently doing well and spirits growing a tad lower than the beer. Maybe if you want to highlight what's the consumer trend while this is happening and what's your view on this?

Anand Kripalu: I think you are right, first of all. Yes, beer has grown a tad faster than spirits certainly in recent quarters. Now, whether that will stay that way forever or not, I think, is difficult to say. I think what has happened is that there have been a lot of new entrants into beer as well and therefore they have made the category, I would say, a bit cooler than it used to be in the past. Compared to the old fuddy-duddy communication, labels, brand names, you have kind of younger cooler brands supported by private equity and beginning to play in this space and I think that is kind of beginning to reposition the category in consumers' minds to an extent, particularly amongst the younger consumers. Now, the fact is that spirits continues to grow, spirits is advantaged from a cost per unit alcohol standpoint. And I believe that we have a role to play with innovation to make some of our brands in our category a bit cooler as well. And there is an opportunity here and we have been building an innovation machine and again you will have to watch this space but we are seized with this. And I can tell you internationally, spirits in most countries is doing better than beer in terms of growth and growth opportunities. And that's because spirits have innovated, created outstanding drinks and cocktails through innovation that appeals more to those consumers who would rather have that brilliant exciting cocktail rather than just an old standard beer. But I think it's a valid point and something for us to then think about and place it.

Chanchal Khandelwal: Taking the point further, what is stopping us to launch RTD? Is it the regulations? Because globally RTD as a space would be doing well and RTD in India is very small portion.

Anand Kripalu: Yes, nothing is stopping us to launch RTDs. In fact, we have an RTD that is in test market as we speak but having said that, if your question is linked to beer, is RTD the solution to get consumers from beer or are there other more interesting ways of doing it, I think that jury is still out.

Chanchal Khandelwal: Understood. To make spirits look more cool was what I was hinting at, Yes.

Anand Kripalu: Absolutely, and that is the objective. So, we will look at how best to do that.

Chanchal Khandelwal: Second thing is, on the margin front, you have guided for high teens margin, but if I look at the volatility of margin quarter on quarter, it is very highly volatile. Over medium term, what is the kind of margins you are looking at and will this volatility continue in this business?

Anand Kripalu: I can never say that volatility will not continue in an industry like ours, first of all, and I have said this very very consistently. And I have also said everytime when in one quarter we have a great margin, everyone gets excited and I have to tell all of you "Hey, it is only one quarter." And then in the next quarter, you see that dropping compared to the previous quarter and then you wonder what's happening. I have said very clearly there is a sawtooth wave. If you are going to plot margin on your Y-axis and quarters on your X-axis, you will see a sawtooth wave; one quarter up, one quarter down, one quarter up, one quarter down; but the direction will hopefully be a direction of progress. So, if you see our margins over the last few years, yes, we have had one quarter up, one quarter down, but directionally if you smoothen it out, we are moving in the right direction. And I just think that's the nature of this industry and that's the way it is going to be.

Chanchal Khandelwal: Sure, but the guidance when you say medium term mid teens guidance, this is next 3 years or you are talking about 5-7 years.

Anand Kripalu: I can't say more but I have said first of all its mid to high-teens and I do want to make sure that we decode that correctly and you can decode what mid to high-teens means. It is not high teens and it is not mid-teens. And we are working towards this and what I have said is we will make consistent progress towards that goal and by and large, each year we are making progress towards that goal. And that's what you should take confidence from.

Chanchal Khandelwal: Just lastly, on the Popular degrowth which continues in this quarter also, are we losing out on this segment? There are lot of mid players and smaller players who are growing and taking market share. Since we are not focusing on this segment, someone else is coming and taking up the market share and trying to become more profitable there. So, what will the strategy be going forward here?

Anand Kripalu: Ultimately strategy, to use your word, strategy the simplest definition I have heard about strategy is it is about choice; what are you choosing to do, what are you choosing not to do. Now, we have chosen to do Popular in certain states which we believe are important and chosen not to do

Popular ourselves in certain states where we think it doesn't make sense. So, that is part of our strategy and we have articulated that quite clearly. You might look at a few players who are doing well in Popular and there are some players. By the way, there are also lots of players not doing well in Popular. And if I look at the total Popular growth based on whatever syndicated data we have, it is almost scratch, it is almost nothing.

Chanchal Khandelwal: Sorry to interrupt you here. Correct me if I am wrong. If the Popular is not growing, if you are not getting consumers in the Popular, how will you migrate them to Prestige? The consumers have to be taken at Popular and slowly they will move to Prestige. Is my reading wrong or consumers directly come to Prestige?

Anand Kripalu: First of all, consumers don't necessarily move step by step. Consumers leapfrog. In fact, people moved from no phone to mobile phone and never went through a landline. So, that is how things happen. There is no perfect science that people will upgrade step by step. But all I am saying is this: that first of all, people who are moving out of country liquor may come straight to lower Prestige. In many states, by the way, the difference in price between Popular and lower Prestige is small. It could be Rs. 10 or Rs. 15 a nip and that's not too much for people to just go and then buy a better brand. So, it is not a linear staircase model at all. Second is that people from Popular are upgrading as fast as they are coming into Popular and that's why you are not seeing growth in Popular. So, Popular is not sharply declining and falling off but people are dynamically moving to whichever segment above this they are moving to but people are moving out of Popular as fast as they are coming into Popular. That's the really what is happening.

Chanchal Khandelwal: Sure. So, in the midterm, you think 2-3% kind of a growth may come in this segment or a flat growth would be what you are looking at?

Anand Kripalu: That's what we feel, low single digit, and that's what it is. That's what we have been saying and saying quite consistently and not just over the last 1 or 2 quarters, for much longer than that, that's what we have been saying.

Moderator: The next question is from the line of Amit Sinha from Macqauire. Please go ahead.

Amit Sinha: Sir. #1 question is just a follow-up on the Maharashtra excise and just a clarification that in the lower Prestige segment, you said that there is no tax increase or you said that you will not take price increases and absorb the tax increase?

Anand Kripalu: The lower Prestige first of all is not one segment in terms of price point or excise duty. It is a collation of brands and price points in that segment. So, in some parts of that segment, there has been no adverse impact of duty. In some parts of that segment, there has been some impact of excise duty. Now, we have brands both in the segment where there has been no impact and in the segment where there has been some impact. What we have chosen to do is to not take price increase in lower Prestige because it's a critical growth driver for our national margins and our national performance. So, we are just playing that game and like I said earlier on this call, this is not the endgame. That's the call we have taken right now. We are watching this space very closely and we will then take any further calls that we believe are appropriate.

Amit Sinha: Sure Sir. Sir, while in your PPT, you have given some color on most of the luxury brands and the mid-tier P&A brands; however, there is no mention of McDowell No.1. Any color you want to share for the last 9-month performance of No.1 brand?

Anand Kripalu: All I can tell you is this. McDowell's No.1 is continuing to grow healthily. Both McDowell's No.1 is growing well and McDowell's Platinum which we have launched recently in a few states is encouraging. So, McDowell's No.1 is a critical brand for us and remains healthy in terms of its performance.

Amit Sinha: Okay. Sir, lastly, on the A&P spend in the last 2 quarters have come down as a percentage of sales compared to the previous quarters. Just a question here is does that indicate that the overall competitive intensity at least in the P&A segment is incrementally coming down?

Anand Kripalu: No, I wouldn't say that. I think it is very competitive, the environment, and it is competitive in terms of trade spends, it is competitive in terms of pricing and price points and competitive in terms of advertising space. Now, having said that, it is about what is appropriate spend for you and we have been saying that 9-10% is probably the range at which we want to spend A&P and some quarters we will spend more than that, some quarters will be a little less than that. But that's the ballpark range in which we are going to spend. And we will stay in that zone, and then depending on how top line moves, we will decide whether we want to trim back or increase that or whatever. But that's how you should do it. Don't read too much into this 50 bps, 100 bps change in one quarter versus the other quarter. Don't read too much into that with phasing of activities, phasing of innovation, phasing of seasons and things like that.

Moderator: Ladies and Gentlemen, we will take the last question from the line of Latika Chopra from J.P. Morgan. Please go ahead.

Latika Chopra: One is over the last 3 to 5 years, what kind of revenue share shift you have seen in the spirits category for yourself between whisky and other segments?

Anand Kripalu: Well, I don't have the number off-hand. All I say is there are no major shifts between whisky, rum, brandy and white spirits. India still remains a brown spirits market. Brandy, rum and rum is continuing to do very well I must say in India by the way and so is whisky. So, there are no major shifts that we have seen. Equally, there is no explosion of white spirits. White spirits still remains a very small part of the larger spirits industry.

Latika Chopra: Alright. And just second one, is any of your franchise agreements in the key states coming up for renewal anytime soon?

Sanjeev Churiwala: No. I think most of the franchise agreements that we concluded have been for 3 months to 24 months now. So definitely another, I would say, 1 to 1.5 years to go.

Anand Kripalu: Alright everybody. Thank you very much for joining this call. Hopefully we have been able to take and answer most of your questions to your satisfaction. Thank you for joining us.

Moderator: Thank you very much, Sir. Ladies and Gentlemen, on behalf of United Spirits, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.