"United Spirits Limited Q1 FY23 Earnings Conference Call"

July 28, 2022

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Moderator: Ladies and gentlemen, good day and welcome to the United Spirits Limited Q1 FY23 Earnings Conference Call. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Hina Nagarajan - Managing Director and Chief Executive Officer and Mr. Pradeep Jain - Chief Financial Officer from United Spirits Limited. Thank you and over to you.

Hina Nagarajan: Thank you very much. Good evening ladies and gentlemen, thank you for joining us on this Q1 earnings call of United Spirits Limited. As always, it is a pleasure to interact with all of you. I am joined by Richa, our Investor Relations Head and Pradeep, our CFO.

Let me provide a context on the results that we announced Tuesday evening and then we can open it up for Q&A. As a headline, we delivered a growth of 34% in the first quarter, lapping soft comparatives in prior year. Our price mix was 16.4%. The strategic focus on premiumization reflects in our numbers. On-trade saliency was back to pre-COVID levels, and we are seeing sequential gains in the innovation, renovation, best place in the market over the previous year. On EBITDA, double digit inflation, limitations in Scotch supplies in select markets as well as the one-time special grants to all employees in extremely challenging times impacted EBITDA margin delivery.

Let me take you through progress on the pillars of our strategy and I will come back to the financials. Our portfolio reshape strategy through innovation and renovation is on track. We have put a lot in the market, mostly in the second half of last year and are confident of ramping up the same in the current year based on the sequential gains we have seen in the launch market. To jog your memory once again, recent innovation and renovations are impactful, inclusive, and sustainable.

Godawan, India's first crossed single malt with sustainability credentials has already been launched in Rajasthan, Delhi, and the UAE. We have also showcased Godawan along with Epitome Reserve at the Cannes Film Festival in partnership with NFDC. The response from consumers has been heartwarming.

Black Dog renovation, we launched a new campaign, Savor the Pause with global icon, Keira Knightley and we have continued to scale up media reach on the campaign in this quarter helping reappraise the brand and dialing-up aspiration. The brand is performing extremely competitively in the market.

Black & White continues to see great traction amongst consumers and the quarter saw enhancement of the brands association with superstar Chef Heston Blumenthal on social media.

Royal Challenge American Price is now rolling out, already available in 7 states and along with the Signature brand end to end renovation of the consumer bundle, we are sequentially improving our position with these delightful liquids in the upper prestige segments. We are growing strong on Royal Challenge with accelerated momentum from states where we have renovated or had route to market unlock and the Yari Cheers and the purpose campaign on our flagship brand McDowell No. 1 reached over 65 million people during the IPL with the brand performing very competitively during the last 15 months or so, actually more than that since the time of renovation.

Touching upon the pillar of building and organization of the future, elaborating on our digital initiatives first, our website in.thebar.com is a one stop place to help people celebrate and create memorable moments of celebration. The bar is present as both the website as well as on social media on both Instagram and Facebook. The site has been in beta mode for the last few months, and I have got very good initial response with 1.1 million total visits to the site and very good organic traffic every month.

We also have precision factory, our powerful digital initiative that is focusing on media, data, analytics, and context helping us target consumers with the right context in the right occasion and improving the effectiveness and efficiency of our digital marketing spends. Both these are going to be continued to be scaled up as we progress in the year. We are continuously improving, investing in our tools, capability, and talent and as we improve we are creating a virtual circle that brings us closer to consumer towards more efficient and effective engagement and fuel growth.

On the third pillar, one of the most important pillars, Society 2030 goals, we continue to make progress in delivering our Society 2030 goals. We have been shaping drinking attitude towards moderation through sustained problematic intervention. Two of our flagship global programs continue to expand their reach in India, first one 'Wrong Side of the Road', our drink-drive program reaching 64,000 people while 'Act Smart India' educated 12,000 young people on dangers of underage drinking. We continued supporting customers and communities by conducting 'Learning for Life' and hospitality skills training program with 72% women participation. Under our water stewardship work, we created capacity to replenish almost 5 lakh cubic meters of water in stressed areas like Nanded and Nasik in Maharashtra and Kumbalgodu in Karnataka. We are working towards net-zero carbon by 2025. The Black & White Whiskey brand is using 100% biodegradable and recyclable hipster pack now and we will be rolling this to our other premium flagship portfolio over the next few months. We have also rolled out a blockchain-based track-n-trace system with Godawan, Signature and Royal Challenge Whiskey and we will scale it up for our other key brands. This now enables us to trace back the product journey from blends to finished goods, providing auditable sustainability data, again another significant step towards our commitments to sustainability.

Coming now back to the financial performance and key highlights which you would have already seen in the press release, so let me again call out some of the salient points. Our reported revenue increased 34.3%, P&A grew almost 44%, while popular grew ~13%, lapping the soft prior year comparator, but growth also driven by resilient consumer demand in the off-trade and recovery of on-premises operating fully with footfalls back to pre-COVID levels. The P&A growth also reflect the ongoing premiumization trends. Growth has been partly offset by constraints in BIO supplies in select market on account of ongoing price deliberation with the government. Gross margin was 40.9%, down 366 basis points. This reflects the adverse impact of high commodity inflation. Continued management focus on favorable product mix and the culture of everybody efficiency has partially offset the inflation. Our marketing investment rate was 6.5%, up 128 bps. We continue to strengthen the equity of our brands and premiumize the portfolio. Staff cost includes one-time special recognition grant to employees for their outstanding contribution and commitment in an extraordinarily challenging operating environment for the last 2 years and now aggregated by massive volatility and high cost of living inflation. Our underlying EBITDA margin was 13.8% for the quarter, up 346 bps primarily driven by operating leverage and PAT was at Rs. 210 crores in the quarter, up 204%. We are on track to close the transaction with Inbrew Beverages as per schedule, we had mentioned that we will close this by end September, we are on track to do that. Our outlook on inflation, we are seeing inflationary pressure to continue in the near term. In our assessment, inflation is the combination of some permanent reset and some temporary pressure, however, in the near term the combination of material cost increases and external economic challenges will drive double digit inflation for our portfolio.

In conclusion, all I want to say is that we are confident of the resilience of our business and our ability to navigate headwinds as our team has demonstrated over the last couple of years. We remain focused on our strategy of reshaping the portfolio, driving commercial excellence in store and in on-trade, revenue growth management and everyday efficiency. We are confident in our ability to deliver sustainable long-term growth and stakeholder value. With this, we can now open the line for Q&A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: My first question is on marketing spend, so if I see quarter-on-quarter because Y-o-Y may not make too much of sense, quarter-on-quarter sales is down 10% while marketing spends are up 7%, I understand there is a seasonality in marketing investment, my question is because of the gross margin pressure of say 366 bps which must be there for you and the industry also, will the industry see much lower ad spend in the normative years, so in the normal years your ad spends have been more like 8 to 9%, correctly it is only 6.5%, so wanted to understand has the competition also cut down versus the normal year?

Hina Nagarajan: I am not in the position to say what industry will do, but at Diageo we believe that particularly in more difficult times, we should be investing behind our brands, we are playing the game for the longer term, we are a brand building company and we will not be pulling down our brand investments, but we will rather be using these more effectively, more efficiently to drive the topline growth objective that we have and we have very aggressive topline growth objective, so we would like to support that by investing into the brand equity.

Abneesh Roy: And one follow up on that, for FMCG companies, digital ad spend is around 25 to 35% of the total, so traditional is now only 65 to 75, what would be the number for you and any sense what it was say 5 years back?

Hina Nagarajan: We have been increasing Abneesh for very long time now for the last few years and I would say this differs from brand to brand. On some brand, nearly 65-70% of our spend is on digital whereas on others there is more focus on in-store etc., so overall I would say that more than 50% of our spend is on digital.

Pradeep Jain: About 50% would be the right weighted average number, Abneesh across the portfolio.

Abneesh Roy: My last question is, coming back to the sales number, so when I see historically quarter-on-quarter the dip is always there in Q1 in most of the years, but the 10 to 11% dip seen quarter-on-quarter this time seems to be slightly higher, is it because of the beer regaining some market share because very harsh summer was there or if you comment in spirit, how has been your sense in terms of market share, any sense you have got on how things would have changed, say quarter-on-quarter?

Hina Nagarajan: Abneesh, I would say that if I just break this down to P&A first right, so our performance has the book end of our portfolio, right, Scotch has performed extremely competitively despite the limitation on supplies. I would say number one, continue to perform extremely competitively for the second year in a row after renovation and in the middle, on Mid and Upper Prestige, basically our renovations and innovations, I was just calling that out that actually they started rolling out in the second half of last year and we are seeing sequential improvement in our position in these segments as well. There has been some impact of the limited Scotch supplies and that explains a little bit of delta that you are seeing here. Other than that, there is no unusual sort of impact on our sale.

Abneesh Roy: Could you elaborate on the cost supply constraint, when do you see fully resolving and how much was the impact in Q1 if it is possible to share?

Hina Nagarajan: So, basically, just to give everyone a perspective, Scotch as you know is a very scarce and limited commodity, right and this year Scotch is seeing a high level of inflation and we need pricing for sustained supplies. So, we have been proactively engaging to get the right pricing with a few state governments and we will commence supplies once we close the discussion. In the quarter, we have had an impact of about Rs. 60 to Rs. 70 crores and this would be about on a P&A portfolio about 6% points of growth. Now, we are hopeful that in this quarter, we will be able to come to the right closure on this and therefore we do see impact for this quarter, but we are quite hopeful that by the end of this quarter, we would have reached the right win-win situation for both sides.

Moderator: Thank you. The next question is from the line of Jaykumar Doshi from Kotak. Please go ahead.

Jaykumar Doshi: My question is somewhat connected to what Abneesh asked earlier, see when I looked at 2017, 2018, 2019 calendar years, the usual seasonality was that from March quarter to June quarter, you would see about 0.2 million cases of decline in P&A volumes, this year March was impacted by Omicron wave and June was a normal quarter and yet we are seeing 0.9 million cases of decline, so is there some change in seasonality or if you could comment on broadly and again when I look at June 22 versus June 19, P&A volumes have declined, now I am aware about route to market change of P&A, but adjusted for that also it must be modest growth whereas in the previous two quarters versus respective quarters of 2019, you were tracking at the significantly higher volume growth number, I am unable to understand this, at least to me it seems like this quarter is weaker than what I would have expected at the beginning of the fiscal year or quarter, if you could comment on this, please?

Pradeep Jain: So, Jay, let me take that, so two points, you asked a seasonality question, I think the way I will look at it is that when COVID wave one happened, there was a bit of an inflection point there, right, so if you look at the last 3 years, I think there is absolutely no change in the quarter-on-quarter seasonality barring a little bit here and there, right, but if you compare the Q4, the April-June seasonality versus pre-COVID, yes, you would see a little bit of a shift, right, so that was the bit of an inflection point to answer your question that the seasonality have changed a little bit, right. So, there was a one-time inventory correction that all of us did when COVID wave one happened etc., and then we have just stuck to that. It just helped us, right to kind of, so that is the first part of your question. And second part if you look at it, one is you have answered it yourself, there is an Andhra adjustment that was a large business for us, large business not just in topline, even in bottomline from the franchise part, so excluding that we are in the positive zone on 3-year basis and as Hina has already responded to Abneesh's question earlier, we have lost about Rs. 70 crores of NSV in the top end of our P&A segment. So, once you factor that in, I think we are by and large in the same zone. That is broadly what our assessment is.

Jaykumar Doshi: Second question is, you had articulated your aspiration for double digit sales growth last year and then now with popular business being divested, I am assuming that aspiration should have moved up an inch given popular was anyway not growing, so if you could share your revised aspirations for the business and more importantly what is the growth construct that we should think of in terms of contribution of volume and contribution of pricing plus mix in this 10% or 10% plus growth aspiration?

Hina Nagarajan: So, as we have said since the time of launch of strategy that in one way we had already factored the going away of popular, when we said we want to target strong double digit topline growth and we are still sticking with that aspiration of double digit topline growth, so basically that said, I think in a year which is so volatile, etc., we are not in a position to change that guidance right away, it is a very difficult macroeconomic environment and we will stay with the guidance that we have given.

Jaykumar Doshi: My question is different Hina, I understand, I am not asking about near term, it is essentially in the medium term or may be next year if things are normal if you were to sort of pencil in 10% revenue growth, will it be 5% volume in?

Hina Nagarajan: Yes, I am answering to that, so I am coming through the price mix and the volume question, so look on the price mix, we have had because of the COVID base effects, so our price mix and our Scotch growth we have had price mix which is quite high, and we have said that on a normalized basis, we would see about 7 to 8% price mix on a steady state basis.

Pradeep Jain: So, just building on that Jay, broadly if you are saying that as a portfolio if you are looking at double digit growth, our price mix would be in the 7 to 8% range driven by the consistent premiumization of the portfolio and volume will be in the 3 to 4%. That is the broad math's.

Jaykumar Doshi: Final book keeping Pradeep if I may, this quarter, employee cost is ballpark Rs. 25-Rs. 26 crores of one-time grant, so what should be the normalized employee cost that we should sort of model going forward and if you can give us an idea of how it would be once the divestment of popular business is complete?

Pradeep Jain: So, Jay, I don't want to comment on the post divestment, we will come back, I mean you will pretty much start seeing the P&L once we close the transaction on September 30th, right, you will start seeing the excluded P&L, but I think the staff cost is about Rs. 167 crores currently. You knock off 26 out of that. That is broadly the organic run rate that we can look at.

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

Percy Panthaki: My first question is on the P&A growth, so while some people have looked at it sequentially, what I am looking at is on a 3-year CAGR basis, after adjusting this Rs. 65 crores of Scotch issue which has happened this quarter and even after adjusting that the 3-year value CAGR is only 4%, this is a completely normal quarter after adjusting the Rs. 65 crores, the base quarter which is Q1 FY20 is also a completely normal quarter and therefore whatever happened in COVID times or didn't happen plus minus is really irrelevant on this 3 year sort of comparison, so what is the reason that the growth is so low, only 4% and our target is double digit, so what really will need to change for the growth to accelerate from 4 to 10, 11, whatever that number is?

Pradeep Jain: Percy, you are right, adjusted to that, but I think what you probably not excluded is the Andhra sitting in the three year ago base, right, now is the large P&A business and that was the large franchise royalty business, so I am not talking about the bottomline here, we have brought all that, we have recouped all that, etc., and our margins are kind of come back to the pre-COVID levels. On the topline, if you adjust for Andhra, that 4% move to 6.5% [1] broadly and then if you look at our P&A performance, Jay don't look at one quarter, look at on a four-quarter basis, have we picked up momentum versus historical run rate, the answer is emphatic yes. Yes, one quarter, maybe we are a little short of the double digit etc., but if you look at our four-quarter rolling number, etc., we are significantly ahead of the double digit.

Hina Nagarajan: And Percy, I would say that our strategy that we announced year ago is exactly about this. This is exactly what is changing. We are breaking out growth on luxury and strengthening our presence in Upper Prestige and reshaping our value proposition in Mid Prestige and Lower Prestige and all the renovation and innovation work that I have called out couple of time, all that has happened to strengthen our participation in these segments and it is giving us sequential gains and we are rolling this out and you know the innovations and renovations in our industry takes time because of the label registration state by state, etc., so we have confidence that these are working and that we will be able to scale them up in this year.

Percy Panthaki: I was also a little surprised on your volume guidance of about 3 to 4 in the medium term, 3 to 4% and this is now we are going to be only P&A company, so this would imply that the overall sort of industry volume growth which includes the regular segment which we will not participate, would be even lower than this 3-4%, so then are we saying that basically the spirits business which was likely to grow even below overall FMCG industry in volume terms that doesn't seem intuitively right?

Pradeep Jain: So, Percy, I think what I did respond to is on our as is portfolio which has a huge negative on account of popular, now once post divestiture, our portfolio will become 85% towards P&A. Obviously, this mix is going to change a little, so we will be as Hina mentioned in the last quarter, we want a little bit of peace time to revert before we come and discuss what are go forward guidance will be. Right now, in this extremely volatile condition, we don't want to discuss the guidance, but we will be happy to discuss that once little more stability is back.

Percy Panthaki: And my last question is on the margins, you have done 12.5% this quarter, even adjusted for these one-offs in the Scotch portfolio and the extra employee cost etc., you would be close to 13.5 or maximum 14% versus the last 3 quarter average of 17 and now this is very clear that it is because of higher input cost and you also mentioned that this double digit input cost inflation will last for a few quarters more, so in this kind of a scenario, there is adjusted margin of 13.5 to 14 that we are seeing right now, is there any reason that in the next 2 to 3 quarters, the margin will improve from that level and if so what would be the drivers for it to improve above the 14% mark?

Pradeep Jain: So, Percy, let me take the first part of your question, so I mean we have already stated in our press release, our underlying margin adjusted for the one-time employee grant is about 13.8%. Hina has already spoken about the range of the revenue loss that we have had, so that broadly would be another 70 to 80 bps probably right, so that is broadly where we are right now. Two things, all I can say is yes, inflationary trend will continue, so therefore margins will be under pressure in the current quarter as well as in the next quarter also, it will be under pressure and we continue to, some of the stronger actions that we have taken on the pricing front which we are talking about and we continue to advocate and we continue to build and expand our productivity pipeline which are the things under our influence and last but not the least the big one that we are banking on Percy is mix. What is reassuring is that our renovations and innovations that we kind of rolled out in the last year are beginning to pick up momentum in the markets, we are seeing sequential gains and if we can continue that momentum, I think mix will be a big driver of our, call it inflation mitigation or call it our margin holding strategy over the next 2-3 quarters.

Hina Nagarajan: No, the thing is that we are hopeful that we will hit pricing as we go along.

Pradeep Jain: Absolutely, right, and then the last thing, which is that Q4, I mean the April-June quarter that were lowest sales quarter, so we will get operating leverage also. We will be upwards of Rs. 2,500 crores hopefully in the next 3 quarters.

Percy Panthaki: So, what kind of pricing should we sort of pencil into our model over the next 4 to 6 quarters in total?

Pradeep Jain: Percy, that is very difficult for me to say. Honestly, if you ask me, had I been in a free pricing category, I am seeing enough CPG reports, etc., inflation becomes an opportunity to enhance margin actually because you price ahead of inflation and then inflation unwinds a little, you don't obviously price back. So, that is the difficult one for me to say in this category. Our desire will be that in a normal ongoing business, we should get at least two thirds from pricing, but this category is very different. So, all I can say is that Hina and my aspiration, the kind of efforts we are making is we are trying to beat what we have achieved in the last 5 years and if you can achieve that then we would want to build from thereon.

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

Avi Mehta: I wanted to just pick on the last, first on the pricing, have we received any hikes in this the pricing actions in this quarter or any company in large state or any state?

Hina Nagarajan: We have received pricing from UP and Haryana in the quarter gone by and prior to that we have had pricing from several other states, so we have had from states like MP, Rajasthan, Punjab, so yes, the answer is yes, we have received pricing and we have received fresh pricing from UP, Haryana.

Avi Mehta: And any rough quantum of what kind of ranges are these in? Is this like to offset in that particular geography, the double-digit inflation to some extent or how is typically….

Pradeep Jain: To some extent yes, Avi, right, but clearly, I mean the inflation of double digit, the pricing percent is much lower, so like I said earlier, we are really counting on mix, obviously we are not leaving any stone turned on pricing, but we would want to dial up the mix factor which is our intervention of Signature, Royal Challenge American Pride, and the renovation of Royal Challenge.

Avi Mehta: And just lastly on the input inflation or input cost environment, you had earlier highlighted that ENA is transient is what you felt, but in this comment, at least to start now asking that some of it is structural, some of it is transit, could you clarify what did you mean by that? And is it fair to extend what you said to argue that 1Q is probably the bottom on the gross margin because mix will steadily improve more or less inflation is behind us, is that the right way to look at things or no?

Pradeep Jain: Avi, inflation is probably not behind us, I mean we would want to be candid on that. We do expect if double digit inflation right to continue at least for the next 2 quarters which is July-September and October- December and once we start lapping probably the inflation versus prior year will reduce, so inflation will continue. What we meant by part of it is we believe that some part of the inflation is also on account of the geopolitical factors, let us say what is happening in Ukraine, big player in grain, etc., so that is impacting the sentiments, etc., so some part of that would hopefully unwind, right and some part of it is probably longer term. Whatever the Indian government is doing on account of the ethanol blending, etc., is probably more, so that is what we meant that it is a combination of two. We will have to wait for the next at least 4 to 6 months to see how much of it unwinds after that and how much of it stays in the P&L.

Moderator: Thank you. The next question is from the line of Bhakti Thacker from Investec. Please go ahead.

Harit Kapoor: This is Harit here Investec. So, I just had two questions, firstly on the pricing side, I think in the quarter 4 call, you mentioned that you are hopeful of getting of at least 2% kind of weighted average price hike, I just wanted to know what is your confidence level on that, is there probably an increased outlook given the multiple states where they are giving your pricing or you kind of still hold to that broad range?

Hina Nagarajan: I would just say that our pipeline of initiatives and the advocacy efforts are all to try and get that done and our pipeline is actually a little bit bigger than that, but basically we are pushing for this and we are hopeful that in the quarter we will be able to get BIO pricing, etc., realized and come close to that aspiration, so we know there is no guarantee in this, because it is not in our spear of direct control, but yes, I think there are enough and more conversations happening to try and get that.

Pradeep Jain: And also Harit, if you look again, if I look at the last 6 to 8 months, there are 9-10 states which have given us pricing, so that is reassuring, but what I do also say that there is a little bit of a negative carry-forward also when the BIO prices got adjusted last year in Maharashtra etc., the regulator did kind of also make the industry participate in the reduction of the consumer price, so right so there is a little bit of negative carry-forward also that we are carrying into the P&L in

FY23 and that is why it makes it little more challenging, but I think what is reassuring for us is that we are seeing a lot of fresh pricing coming from the states.

Harit Kapoor: And my second question is on the roll out for some of the initiatives which you have taken, could you give a sense on where you didn't mention the multiple states you have already rolled out some of the initiatives, would you give a sense on how long will it take for national roll out for some of these going forward over next 2-3 quarters?

Pradeep Jain: May be, Hina will be able to address this, but Royal Challenge American Pride, even 5 states.

Hina Nagarajan: Almost 7 states now, so another quarter or 2 we will be….

Pradeep Jain: Another 4 to 5 months, I think we should reach about 75% of NSV salience. Signature's rollout is pretty much national, Godawan is early and anyway that is a category that will take a little bit of time, it is a very high and premium category. We have launched in two states and the UAE, etc., so that will anyway that is a much longer gestation period.

Harit Kapoor: And just a follow-up on this, given that early volatile environments, is the focus on the current year it is kind of see through some of the things which you have done in the second half of last year and probably new initiatives would come post is that the way to think about it or am I getting it wrong?

Hina Nagarajan: Our first priority is definitely to start building up and scaling up what we rolled out in the second half of last year and that will be first priority, so that doesn't stop us from looking at new innovation and renovation initiative, but it will be fair to assume that in the first 5-6 months, we will be focusing on leveraging what we have done from the previous year.

Moderator: Thank you. The next question is from the line of Krishnan Sambamoorthy from Motilal Oswal Institutional Equities. Please go ahead.

Krishnan Sambamoorthy: In the last couple of years, you would have seen some benefit coming from duty paid sales rather than duty free sales which get booked as the part of Diageo's book, how significant was that and would that present a bit of a barrier particularly in FY23 over the FY21 and 22?

Hina Nagarajan: Actually, we find that there has been fundamental change in this COVID period where basically the duty free sale, because of the pricing of BIO coming down due to state positive developments on the sort of route to market changes that have come in Delhi, Maharashtra, etc., the prices of kind of evened out, so we don't see any fundamental shift back to duty free and any sort of incremental cannibalization of domestic sales because of that so far. We basically activate in our stores as fantastically as duty free stores activate in theirs, so at this point in time, we don't see a significant shift taking away sales from the domestic market.

Krishnan Sambamoorthy: This is too even as people have started travelling internationally and therefore even there, you have not seen any evidence of that slowing down?

Hina Nagarajan: Not really.

Pradeep Jain: Krishnan, there would be some impact without doubt, right, but the reality is I think the larger point Hina is making is I don't think it will be material enough to change our aspiration from what we do in the domestic market. I think the lines are completely blurred driven by the combination of reduced-price arbitrage between duty free and duty paid, right, obviously driven by the reduction of taxes locally and the fact that all the industry players are doing a phenomenally good job of activating what we call the modern off-trade, let us say the top 2,500-3,000 stores out of that 65,000 base, etc., where the shopping experiences are delightful.

Krishnan Sambamoorthy: My next question is on the you have mentioned particularly on Godawan, Black & White you have a block-chain based tracking system, can you just elaborate a bit on that, how exactly does that benefit you particularly over the medium to longer term period?

Hina Nagarajan: I think the track-and-trace system is as we stated our ambition on sustainability, right, we have talked of sort of going net-zero on Scope 1 and 2 by 2025 and going net-zero on carbon footprint on Scope 3 by 2030. So basically, how it helps us is to track from green to end of lifecycle, our carbon footprint and we are getting more transparency of data and we are building this data base to be able to rigorously track as we take our carbon footprint reduction initiative. We are able to audit the data and measure it and then to report it very transparently, so the whole idea is across the value chain to have that visibility from the time of sourcing to making to the consumer, etc., and be able to keep ourselves firstly accountable and then reporting this transparently outside, so that is how the track-and-trade system helps us and it is actually first of a kind in the industry and I would say that first of a kind perhaps even amongst broader CPG and we are quite proud of the fact that we are taking this significant step to get to our goals.

Moderator: Thank you. The next question is from the line of Himanshu Shah from Dolat Capital. Please go ahead.

Himanshu Shah: Couple of questions, one, can you just elaborate more of this Scotch issue, basically are we looking for renegotiation of prices with the local government because of the inflationary pressure and therefore we have reduced our supply, or it has been more of an import issue of scotch because of this Russia-Ukraine?

Hina Nagarajan: The former, so we are asking for price increases from the governments in line with the inflation that is happening on Scotch and therefore we have reduced supplies.

Himanshu Shah: So, this has been more from our end, we have deliberately reduced the sales?

Hina Nagarajan: Yes, while we are doing the discussion with the government, we have had measured supply, so that we can get the price increases and get a more sustainable pricing and supply system established with the government.

Himashu Shah: Secondly, in our annual report, Pradeep if you can help the rates and taxes cost line item has gone down from Rs. 150 crores run rate to Rs. 40 crores in FY22, so what is driving this reduction and is this permanent one or it shall come back in FY23?

Pradeep Jain: I would request Richa to get back to you, if you could just be in touch with Richa, she will help you with that. I don’t have line wise annual report account recorded in my mind, but we will definitely answer that. She will provide a very comprehensive response to that.

Himanshu Shah: And sir, couple of more questions, can you help me with the share of volume of BII and BIO in FY22, what would be the volume share of BII and BIO of our total volumes?

Pradeep Jain: It is about 50:50 broadly.

Himanshu Shah: No, I am asking for BII plus BIO put together as percentage of total volumes of ours?

Pradeep Jain: The volume, I have the value mix blocked in my mind, BII plus BIO**,** it is about 23%. Volume will be significantly lesser because of the per unit value difference. I am taking a completely rough guess, again Richa could help you with that. I am assuming volume would be about 4-5%[1] probably.

Himanshu Shah: And just one more, if the BIO volumes grew at a much faster pace, then the overall company average, will that pull down our margin, can you confirm on that because of the distribution arrangement that we have with Diageo PLC?

Pradeep Jain: So, you know again, I think I would want to respond it other way, yes, first of all, mathematically if you say that BIO will continue to gain salience, it will mathematically reduce our margins, because we make a 10% EBITDA, but the 10% EBITDA is after a very healthy A&P spend and after a full absorption of entire overhead structure that we have put in place to kind of execute our BIO business, so that is one. I just want to provide that assurance to you. The second thing as I say is that all the renovation interventions that Hina has talked about for the last 2-3 quarters, this significantly uplift the USL mix advantage, so if you see the kind of interventions we have made in Upper Prestige and then Mid Prestige and the Godawan of the world and the investments that we have made in the Nao Spirits of the world, etc., they are all geared towards premiumizing the standalone USL portfolio also, so therefore our role as the USL management is twin fold. We have to work on our Diageo global brands also. That obviously is huge premiumization opportunity and simultaneously we are also ensuring that we are building the USL portfolio towards the premiumization. So, we will have to balance these multiple parts and that is why our guidance remains in the longer term, the mid to high teens and yes, we should be able to balance all that with these competing process.

Moderator: Thank you. The next question is from the line of Alok Shah from Ambit Capital. Please go ahead.

Alok Shah: My first question was on the renovation and innovation, so at this time around are there any different initiatives that have been considered from a sales incentive or a distribution side, specifically through the on-trade channel especially now that on-trade is coming back after sort of a distress period, do you see that as an opportunity to outspend vis-a-vis competition in that channel, that is my first question?

Hina Nagarajan: On-trade is back and therefore our spend is now back in terms of the split of spend on on-trade activation and off-trade. So, during COVID it was only off-trade, so all our activations were being done in the off-trade. Now that on-trade is back, traditionally our split of on-trade and off-trade is about 30-70, so 30 on-trade and 70 off-trade and we are back with the bang activating with on-trade in that split of spends and we have taken the opportunity as on-trade has opened up. I talked a few couple of quarters ago of our Johnnie Walker, Revive the Night, which is a very big initiative on Johnnie Walker in the on-trade welcoming people back and celebrating the afterhours and Black & White has a table for all, sharing and food bearing activation that we do. So, certainly, as on-trade has opened we have taken that opportunity and we are back very strong on the activation in on-trade.

Alok Shah: My question was, do you believe this is your internal data point that you could be outspending competition, or it is broadly in line with your shares, etc.?

Pradeep Jain: We don't track that, I mean honestly we don't track the channel-by-channel spending of competition, etc., we have a commercial calendar that we create at the beginning of the year, and we try and speak to our commercial calendar.

Hina Nagarajan: And we do what is right for the brand activation, right for the brand activations and the consumers, so we take the consumer-backed lens of what make sense and spend, and we think we are well spend in the on-trade.

Moderator: Thank you. The next question is from the line of Tejas Shah from Spark Capital. Please go ahead.

Tejas Shah: Couple of questions, first, while Hina you spoke about in earlier calls that Vodka and White Spirit will be your focus area in the coming years, so any update on the same?

Hina Nagarajan: So, on Gin, we see Whites as a full category, so we don't see it separately and on the Whites we have been activating our two brands, Tanqueray and Gordon which have been growing very healthily, strong double-digit growth there and then our investment in Nao Spirits which is working well, Nao has done extremely well in the quarter gone by, I think they tripled their volumes vis-a-vis the same period last year. So, our activations remained very strong in White and Smirnoff we launched, our Vodka brand we launched the pocket scotch format, the same hipster format, we launched in Smirnoff, which is doing very well, so remain committed to strong activations in these categories and we continue to see growth in these categories.

Thejas Shah: And second question pertains to the overall guidance that we have given, now you spoke about that you need some stable environment for us to actually follow up on that guidance, now stability has been elusive in global economy and local economy for a while now and looking at geopolitical scenario, nothing points out that situation and go back to stability and in coming years also, so keeping that as a backdrop, double digit guidance is the current quarter just an aberration or you believe that many more things need to fall in place at the macro level for us to follow up on that guidance?

Hina Nagarajan: No, I would say that we have factored the macro instability and volatility in our plans, and we are still committed to the double digit growth guidance and we are fundamentally working on the strategic pillars which we think are validated and are working for our business, so we will continue to invest behind these and continue to drive to that aspiration and ambition. Now look, I can't predict the future, if something goes absolutely wrong in the macroeconomic environment and we never imagined war, nobody could have imagined a war scenario after so many years, now if something again happens like that, we will have to review it, but at the moment, I think we are still committed to that guidance.

Moderator: Thank you. The next question is from the line of Prakash Kapadia from Anived Portfolio Managers. Please go ahead.

Prakash Kapadia: I had two questions, if I look at the last few years, 5-6 years, around 38% of our raw material cost have been packaging related cost, as we move towards more premiumization, how will these packaging costs shape up and also if you could give some color, the current gross margin fall of 370 bps how much of it is packaging related, how much of it is crude based derivatives or some color on that, that will be helpful?

Pradeep Jain: I don’t know whether I will answer your question completely or not, broadly if you look at our material costs, glass is the big one that gets counted as packaging cost and the neutral alcohol spirit is counted as the raw material, so between these two materials, 65 to 70% of our cost is covered and the rest is largely the crude-based derivative which is the PET, the carton, the paper etc. So that is broadly what landscape of our cost portfolio and to answer the later part of your question, both the critical commodity, which is the neutral alcohol, spirit as well as glass is inflating close to double digit, more than double digit right now for that is what has led to the gross margin valuation.

Hina Nagarajan: But I would make a slightly separate point, as we premiumized our portfolio I think I would say as we premiumise our portfolio and worked towards more sustainability. I think we are going to look at what we can do on packaging, not just on the cost point of view, but from the alternate format point of view. You may be aware, we have already announced that on our premium portfolio, we are going to remove the outer cartons in a phased manner over the next year and this is primarily on account of sustainability, but it helps us on cost as well. Similarly, on glass, we have been working on light weighting glass because of the carbon footprint that glass contributes to. So, we are looking at tramlining initiative, market bottle use, so where it make sense. So, we would probably see light weighting of packaging for sustainability and therefore some benefits on cost as we go forward.

Prakash Kapadia: And lastly, Pradeep on interest cost, it is a nondebt expense, what is that, can you explain that in the P&L?

Pradeep Jain: Principally, INDAS requires your leased assets and the lease rentals that you pay to be accounted for as interest, so that is the larger component of it and then there are some old litigations etc., on which we have to accrue interest, right, which we are accruing on a quarter-on-quarter basis, so that also comes and sits in this line.

Moderator: Thank you. The next question is from the line of Chinmay Gandre from Reliance Nippon Life Insurance. Please go ahead.

Chinmay Gandre: I just wanted to understand your comment on, you did mention that ex of AP maybe the sales pre-COVID on a 3-year basis with respect to Prestige and it has grown at 7.5%, but my understanding was AP used to contribute may be 4 to 5% in terms of our volume mix in the Prestige, so if I give that adjustment also, the CAGR has not increased more than 5%, so I just wanted to get this thing sorted?

Pradeep Jain: We haven't done the number so accurately, broadly if you say that if we layer on the BIO sales impact that Hina mentioned and Andhra, we will be upwards of 5%. That we are very sure of. Yes, it could be off a little bit here and there.

Chinmay Gandre: And secondly, just on the raw material, so we did see some kind of softening of crudes from the high levels to may be near 100ish now, so any of our raw materials are we seeing some kind of relief or specially with respect to our discussions with glass, can you throw some light on this?

Pradeep Jain: Typically, there is about a 2 to 3 months lag, I think the reassuring part is crude has come down much below 100 recently, so hopefully yes, even though it is a small part of our portfolio, but it should hopefully provide us the relief over the next 2-3 months, but I think what is very critical for us is the neutral alcohol spirit and the glass, right now both of them are kind of on a boil.

Moderator: Thank you. The next question is from the line of Latika Chopra from JP Morgan. Please go ahead.

Latika Chopra: I just have extension to the comments that you made on margins and another one on revenue, so just to start with margins because you just talked about it, could you give us some sense on both ENA and glass inflation, is that worsening as you exited the quarter and clearly we will see price and mix impact to increase sequentially, so is it fair to say that gross margins bottomed out in Q1 for you?

Pradeep Jain: Latika, like I said, right now both the commodities are on a boil, we are not seeing any respite. So, as Hina mentioned in our opening comments also we do expect inflation to continue and therefore the next two quarters are very critical, but yes we do expect the inflation to continue, but having said that as kind of months pass, the negative carry forward of the pricing that I mentioned to etc., with wear down and our fresh pricing will kind of start contributing to the P&L, one, and the second thing that will happen is that the sequential momentum that I talked about that Hina talked about on the innovation and renovation and the portfolio that would also start contributing in higher salience.

Hina Nagarajan: Latika, just to add to that I also think the productivity as mentioned that we are going for 2-5 times the productivity of the usual year, we also see some scaling up of initiatives as we go through the year, so we see the might of all these 2-3 things helping us on the growth margin.

Latika Chopra: The second one was on demand and I hope you have talked about various parts of supply disruption, you have talked about Andhra Pradesh, but I wanted to get a broader flavor on, in your assessment how has been consumer behavior towards the consumption and it is a broader inflationary pressure on consumer wallet, are you sensing that the lower prestige is facing some kind of demand concerns and another aspect I wanted to check with you was that during the whole pandemic period or stay at home, it seemed that spirit consumption definitely benefited, right, probably say versus beer, now with the whole reopening thing, do you sense there is some bit of pull back on off-trade even though on-trade has normalized any broad thoughts here?

Hina Nagarajan: So, on the broader demand question, I think let us see, that the top end and the premium end we are seeing absolutely no stoppage, so we are still seeing very strong demand at the top end and the upper end of the portfolio, so there is no demand gap there, I would say no slowdown and that is to be expected, I guess. At the lower end, Latika it is very difficult for me to say because even I look at the pre-COVID and the post COVID and if I look at the 2-year period actually the market has just about leveled off in terms of where we were at pre-COVID level if I look at the industry as a whole. Now, how this will grow, as we go forward it is very difficult to tell right now. I do not have a trend to tell me that. All I can say is that yes, on the popular and the lower end, we do see a little bit of slowdown. Again, I expect, that would be the case, so how much of a slowdown, it is very difficult for me to say, but we don't have enough consistent data without the funny effects of the basis of previous years to be able to say that I am actually seeing a big slowdown or a smaller slowdown. So, this is an area of watch for us.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. Please reach out to IR head, Richa for any other queries. I now hand the conference over to Mr. Hina Nagarajan for closing comments.

Hina Nagarajan: Thank you. I think I would just like to say again thank you very much for continuing to engage with us and discussing our business and your commitments to our business and I do want to leave by saying that we remain confident in the resilience of our business and industry, despite the short-term challenges and we are committed to delivering long-term value to our stakeholders and we are pressing on with our strategy. So, thanks again for joining us and I look forward to meet you again next quarter. Thank you. Good-bye.

Moderator: Thank you. 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.