"United Spirits Limited Q4 FY2017 Earnings Conference Call"

May 31, 2017

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Moderator: Ladies and gentlemen, good day and welcome to the United Spirits Limited Q4 FY2017 earnings conference call. We have with us today Mr. Anand Kripalu, Chief Executive Officer and Mr. Sanjeev Churiwala, Chief Financial Officer from United Spirits Limited. 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 "*" and then "0" on your touchtone telephone. Please note this conference is being recorded. I now hand the conference over to Mr. Anand Kripalu. Thank you and over to you Sir!

Anand Kripalu: Thank you very much and very good morning everybody and a very warm welcome to this investor call, which comes just after we have announced Q4 and more importantly our FY2017 results. As we normally do before we open up the line for Q&A, I just wanted to provide a perspective of our full year performance for FY2017. First and foremost, I just want to say that I am pleased with the results that we delivered this year, which we have delivered as you all know in the face of a very subdued economic environment as well as several regulatory changes that we have faced during the course of the year. As you would have seen in the results, we reported a net sales growth of 4% for the full year and this of course was impacted in part by the prohibition in Bihar as well as some operating model changes that we have embarked on in the business. If you exclude the one off impact of these, our net sales grew by 8% in the full year. Although we have been impacted by the effects of demonetisation as well as the run up to the highway ban because the highway ban was announced by the Supreme Court in early December. We believe that we have been able to manage through these better than we originally expected and that is because of some of the interventions that we put in as a business and some of the proactive measures that our management team took and therefore in overall terms, these results I believe demonstrates that our strategy is effective and more importantly that we are also executing that strategy as per the plan. Now our overall Prestige & Above performance delivered what I would say is a robust 14% underlying net sales growth in the full year and that continues to be fuelled by the work we have done on renovation as well as premiumisation. Now the Prestige & Above segment actually represents about 60% of our overall business. Within that the key brands have shown good performance. McDowell's No. 1 and particularly the key variants of McDowell's No. 1 have grown net sales by 8%, Royal Challenge grew 16% and our most recent renovation, which is Signature grew by 29%. Our overall Scotch business grew net sales by 32%. With this momentum, we are confident that we have actually grown faster than the category, which should have resulted in improvement in market share. At the same time, our popular business and specifically the key brands in our priority states has grown net sales by 1% in the full year.

Now as we have outlined in the past, our strategy on popular is selective participation and as part of that we have continued to franchise parts of our business in select states and that journey actually continued in the last few months. The purpose of us doing this and I want to make this very clear is that we are not exiting the popular business, we are creating what we believe is the fit for purpose business model that allows us to do two things, first to extract the best value we can from the popular business and two to liberate our internal management to the extent possible so that we can focus on the bigger potential profit pools of the future, which we believe is in the Prestige & Above segment. So post completion of franchising in FY2018, the popular segment is expected to be about a third of our direct business and over time as Prestige & Above grows faster that contribution will come further successively. Now apart from growing our topline, we are actually pleased with the margin improvement that we delivered and our gross margin improved by 156 bps during the course of the year, this was enabled obviously by our journey on premiumisation. Importantly price increases that we got in some key states and the kind of persistent focus that we have kept on pulling cost out of the business, which is really our productivity initiative where we have again gone after every line of the P&L and look for opportunities to mitigate cost. Overall input cost inflation was in the range of 3% to 4% of the year and through our productivity efforts we believe that we have been able to mitigate a significant part of that. In parallel with all this, we have continued to make investments to understand our longer performance, so we have further enhanced our marketing investment this year and despite the fact that there was subdued demand because of all the environmental changes that I spoke about earlier we have still stepped up our A&P. We are also continuing to invest in new capabilities, building in general systems and processes, which we believe will create the platform for longer-term future growth.

As far as EBITDA is concerned, we have delivered a margin of 11.5% in the full year with a 75 bps improvement enabled obviously by the improvements in gross margins, but also some containment of our staff cost. If we exclude the one off impact, we have delivered an EBITDA margin of 12.4% and I would say that is more or less in line with our expectation. Our efforts do not stop at the EBITDA line. We are doing a lot of work below EBITDA as well both on debt reduction as well as interest rate reduction. As a consequence of that our total interest costs are lower by 17%. This together with lower tax partially offset the increase in exceptional items and all this put together has resulted in a PAT growth of 39% for the full year. As I look ahead, I do expect that the highway ban will continue to impact our performance for the next few quarters and also that the GST implementation, which now the government seems categoric about to happen from July 1, 2017 is likely to create operational disruption at a macro level in the market place and this too could impact our FY2018 shorter term performance, but despite these headwinds that we have faced in the previous year and we are likely to face for the next few quarters overall I must say that I do feel pleased that all the efforts that we are putting in driving improved performance and this does reinforce our philosophy that we have the right strategy in place. We are going to continue to persist and focus on these priorities so that we capture the real pot of gold that is there in the end of the rainbow in India. The long-term opportunity in India remains attractive and that is what we are really going after and pursuing and in doing that we will achieve our medium term ambition to grow topline by double digit and improve margins to mid to high teens. With that I am going to open this up to questions and I will be joined by Sanjeev Churiwala our CFO and we will jointly respond to the queries that you have.

Sanjeev Churiwala: Hi everyone good morning Sanjeev here.

Anand Kripalu: So back to the operator then to take the Q&A.

Moderator: Thank you very much Sir! Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Hi Sir congratulations on a great performance. Essentially you have shown a very healthy EBITDA margin by looking at cost control across all the line items. I wanted to understand if you could give us a sense about the run rate on employee cost that we should look at from an annual basis and whether the other expenses kind of run rate that we saw in the fourth quarter that is the level that we should continue going forward that was the first question and should I give you the second question right now?

Anand Kripalu: So let me give you an overall direction of what we are doing on both employee staff and non-staff after that Sanjeev can share some of the details with you. I had shared last time around that we have been through significant organizational restructuring in terms of not just trimming the organization, but I would say redirecting the organization so that we have a business model that is more efficient and that has helped us to in some ways start containing the staff cost itself right and some of that you have started seeing in the previous quarter when the action got implemented. I must also add that we are doing a lot of aggressive work on non staff cost to make sure that a lot of expenses are trimmed, so you should continue to see tight management of staff and non staff cost from us as a company and that is what I would expect that we will be able to show, but for some more specific details I am just going to hand over to Sanjeev.

Sanjeev Churiwala: Avi a good question on the staff. If you really look at the press release and the numbers you will see the staff cost have actually just marginally come up by 3.7% as compared to 16% and this is against normal staff inflation about 10%. We just show that we put in a lot of mitigation plan, which Anand also explained. The current year if you see the run rate is standing about close to Rs.667 Crores, which is about 8% of the NsV. We feel this is closer to the industry benchmark and of course we will keep on working towards the inflation mitigation on that, so I suppose you will see a similar kind of run rate in terms of a partial inflation mitigation also going forward.

Avi Mehta: What I meant is Sir the fourth quarter run rate suggests a much lower number almost of Rs.480 Crores that is where I wanted your clarity?

Anand Kripalu: I think it is better to look at the full year number than looking at a quarter-to-quarter numbers because quarter-to-quarter numbers normally get impacted by all the adjustments that we do in terms of accounting largely gratuity, leave encashment, and the better approach is to look at a full year number.

Avi Mehta: Sir my second question is you highlighted towards two headwinds or two concerns if I may say, one is the highway ban and the GST. A if you could quantify on the GST what is the likely in fact because of higher costs from packing and services and B why are you saying highway ban is an impact because most of it should be logically visible and please correct if I am wrong and why should sustain over longer time you said more than one quarter if you could just help us understand those two that is all from my side? Thank you.

Sanjeev Churiwala: Absolutely Avi. I think many of the analysts on the call would also have similar questions I suppose we will answer them altogether now. Let me start first with the question on the GST. I think our initial assessment of GST suggests that while alcohol for human consumption is normally say ENA is excluded from GST and many of you have pointed that out, but the fact is there have been additional tax on input materials and services, which will result in further taxes and would impact margins. We shall of course continue to work with the central government in terms of advocacy to minimize this impact and also approach the state governments for appropriate price increases. You will also appreciate that the GST rate may further undergo changes when the final notification comes in and we are just waiting for the formal notification the rules to play in. The fact is it could impact our short-term performance and we will put it together all the mitigation plan that is possible, but we do see some impact in abetting on that.

Avi Mehta: Sir on the GST bit how much is the impact of the rate, given the rates right now, and I assume it is not out and how much would that the number right now increasing tax rate for us?

Sanjeev Churiwala: We would just want all the advocacy work in terms of approaching the central government for release and wherever we need to do that to happen that and of course like all of the industry they already think they are unmitigated risks in terms of higher cost input cost we will then try and approach the state government for price increase. So of course we will have to really see and watch out for the next few quarters how things pans out. Anand would you want to add something?

Anand Kripalu: No, I am just going to say that we would share a number if we could honestly and the reality is that clarity of how the rates are going to be applied specifically are not fully cleared yet and that is going to be cleared probably over the next three to four weeks, so that is when we will have a hard number. What I do want to say is that there is an impact of GST. Let see what we anticipated. Now is all of that going to impact our results no because we are embarking on our effort to get advocacy and corrections at the centers as well as price increases from the states for any residual impact that we may have, but net of all this will there be some residual impact that we believe is going to impact FY2018 as of now yes. We believe there is going to be a residual impact despite our efforts to mitigate.

Avi Mehta: Sir just the highway part if you could cover why you highlight that?

Anand Kripalu: So the highway ban, so the reality is that there has been impact even in the last few months because you would imagine that when the Supreme Court made the announcement of its judgement in early December, there was uncertainty created in the market place. Retail stores nobody knew whether those stores will exist or did not exist and what the mitigation opportunities were and therefore distributors and so on started pulling back credit and that reduce the overall stock pipeline. Where are we sitting today? Where are we sitting today is that there are many stores that are closed and have not yet been relocated in many states. Distributors are still going tight on credit for many of these stores. Some of the states particularly in the South, the impact is going to be seen only now after July 1, 2017 because they were allowed to just retain status quo till the end of June. So this is the reality. Now longer term I believe that consumption will ultimately move to where product is available and therefore it will get mitigated, but I think there is an intervening period where the number of stores available for people to have a drink or buy a drink is going to be constrained and we all know that access constraints demand and that is what we are going to see. Many hotels have still have not got their licenses. Many restaurants have still not reopened their bars because of this issue. The good news however is that hotel associations, retail associations, restaurant associations, and state governments are all on the same side of the table and are working hard to mitigate the impact, but the impact is there as we speak right, but we believe it will get neutralized in the coming quarter.

Avi Mehta: Thank you very much Sir! I will come back in the queue for the remaining questions. Thank you.

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

Abneesh Roy: Sir congrats on a good set of numbers. My first question in Prestige & Above you continue to do well. You also said market share has expanded, so my question is with the other player what is the gap now and in your sense there is no hard data I agree, but in your sense what is the gain in the market share in the last one year?

Anand Kripalu: So I do not have a specific number on market share and I do not want to comment on anyone else's performance, but I am sure you can decode it if you want it to. Let me just say this that when I look at our overall P&A performance, we are confident that our P&A performance is a category beating performance. So the category has grown slower than our own numbers that I spoke to you about, which is 14% growth. Second thing is that when I look at brands that have been renovated in every case, brands have bounced back on shares and started stealing shares in the segment that they are operating, so when I aggregate all of that together and tie that up with our total NSV performance right I am confident that it is a category beating performance Abneesh.

Abneesh Roy: Sir one follow up here you had given the McDowell's core portfolio number last quarter. This quarter I want to get that number and McDowell's has slowed down sequentially, so is the relaunch now petering out?

Anand Kripalu: Let me put this in perspective first of all and we will see if we have the McDowell's core numbers, but what I have given you is all the three variants of McDowell's that operate in that segment and I said McDowell's has grown net sales by 8%. Now sequentials may have slowed. You checked the numbers. The reality is that the last two quarters have been quite different in terms of the environmental impact compared to the previous two quarters, so this slowing of sequentials is not necessarily scrabble to McDowell's itself, but two very different market conditions. Now if McDowell's continue grow shares in whatever fair data we are able to see yes it is and that is what I want to say now.

Sanjeev Churiwala: I will try and pull that out for you Abneesh. So McDowell's has grown core variants. It has grown 10% in Q4 Abneesh.

Abneesh Roy: That was around 19% in the previous quarter?

Anand Kripalu: I have explained to you already the perspective. The last couple of quarters have been funny quarters right for all the reasons I have explained.

Abneesh Roy: Sir my second question is on the highway you spoke a lot on that, so I wanted to understand in terms of numbers, so some of the beer companies have said it is almost 15% dip in April they have seen, so my question is if you could give us some numbers as to what kind of a decline you have seen in April and May and is May much lesser impact than April because lot of the shops might have shifted and within the bars on highway how much is the in-store dining, so in in-store dining are you going to see much larger impact some clarity on what is the percentage of bar consumption within those highways?

Anand Kripalu: It is very hard for me to give you such specific details because it is a very dynamic environment out there and how many of them are highways and how many are open and how many are closed it is really hard. All I can say is that and I cannot obviously give you too much about the period after April 1, 2017, but suffice to say that there was impact in April. Right across the industry we have seen impact in April. My own sense is that the impact in May is lower than in April, but the impact is still there. So I would say the worst was in April because as you would imagine the people who were waiting for the Supreme Court judgement till the evening of March 31, 2017 when the clarification came in the Supreme Court, so obviously there was chaos on April 1, 2017 and through the month of April. So I would say that it is a little better in May, but the impact is still there and we believe it is going to take a couple of quarters Abneesh for it to completely stabilize and for demand to come back to normal.

Abneesh Roy: I think it is largely done Sir! I will come back in the queue.

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

Aditya Soman: Good afternoon. Actually I had a question following up on the highway ban again. The question was will this lead to an adverse mix because I suspect that some of the stores it is easier to relocate than say a restaurant or a bar where your mix might actually be significantly better?

Anand Kripalu: So you are absolutely right. It is not so easy to relocate a restaurant, much easier to relocate a store and also even in some of the star hotels. Some of the star hotels have still not been able to open their bar, but having said that I think there are opportunities for people to get the approvals done and to still comply with the Supreme Court judgement. So many star hotels now have reopened right, so not all of them, but many star hotels have reopened because they also have to support the tourism industry and they have done things that are going to comply with the law, but will still allow them to keep their bars open. So there could be some residual impact, but I would say that the larger part of the bars, restaurants, and hotels I think will reopen in these couple of quarters that we are talking about. I suppose the other thing is this, which is at the end of the day strong brands, which are invested in are going to do better and company has actually have stronger footprint of retail distributions from the relationships with key accounts and say are going to do better because we will be able to work jointly with those accounts to help them to mitigate the damage better than somebody else will be able to do and I believe that United Spirits is in that position to be able to do that. So one way of looking at it is there could be an issue with overall demand in some of these stores, but there could be an opportunity in market share right where we could actually mitigate some of these better than some of our other competitors put and that is how we are looking at this and hoping to still protect our business.

Aditya Soman: Understand that is very useful and my second question is in terms of the franchising model wherein you franchised out volumes in eight new states. Sir in the past you had given out in the last quarter that it was about Rs.25 Crores turnover that you are looking from the previous franchising deals per quarter, could you throw some more light on the new contracts?

Anand Kripalu: I think Sanjeev will give some numbers, but just before that I just want to just explain again because there have been lot of questions on franchising, so like I said popular remains an integral part of our total business. There are some states where we believe it was not viable even now or in the longer term to do business and we have exited those states. There are many states where we are crystal clear that there is long-term profitable growth opportunity and those states remain strategic right and we will do that business ourselves and then there are set of states in the middle and that is where the journey of franchising is happening. I would say we have franchised many of those states, but not all those states because if we are not able to find the right partner or get the right commercial term then we will continue to do it ourselves till we find the right partner, so there is a bit of a journey and I would say we have made good progress on this journey, but we have not reached the station yet right. We are still on that journey of migrating the business to the franchising model that we plan to do. Now specifically in terms of numbers Sanjeev what can we share?

Sanjeev Churiwala: So let me take you through. I think I will first want to set the context clear because I did read some of the reports, which suggested that perhaps we are moving out of the popular business that was the fact. In the past as well as we have been very, very clear to that. If you really look at our overall popular profile and let us say I take a number on annualized basis of Rs.3500 odd Crores, 60% to 65% of that is the retained popular business that will continue to do going forward as well and we have called out those states especially Karnataka, Maharashtra, West Bengal, and that has been our position for the last several years. I read in the press release with the new ones and the existing ones as of now about 13 states we have franchised that could be about close to 15% to 20% of our popular business, which means we still have about 15% odd business that we might intend to franchise out in the future depending upon the kind of partners we get and depending upon the ecosystem prevailing in those particular states. Does that answer your overall understanding on the breakup of the popular business?

Aditya Soman: Yes. I think the other thing we just wanted to understand was you said can you throw some more light on what franchise, income or fee you will make from these incremental ones that you franchised Sir?

Anand Kripalu: We are not calling out specific royalty incomes that we get because it is part of the commitments that we have with our franchised partners, but our intention has been to ensure that the kind of royalty we get ensures the profit protection.

Aditya Soman: So this should be in line with some of the EBITDA margins you would make if you could run it on a statistic basis would that be a right way to look at it?

Sanjeev Churiwala: We would not like to really equate with the existing profits. The idea is as we have called out we have moved into this agreement, which almost like a fixed franchise fee, there are guaranteed volumes that the franchise part that we supposed to sell and on the larger equation we are ensuring that the absolute full of royalty that we give ensures that we protect our current profits coming out, but of course will depend from state to state and various other things would come in, but that is a going forward position.

Anand Kripalu: Just to be clear. In some states may be positive and some states may be negative, but our intent with franchising is that we should protect our overall gross profit and from a trend of the past that where there was a declining gross profit in many of these states, we at least believe that we will be now be able to hold it. The other unlock of course is working capital because in many of these states there was significant working capital locked up in the popular business and that will now get liberated.

Aditya Soman: Understand. It is very clear and congrats again on a great set of results.

Moderator: Thank you. Next question is from the line of Arnav Mitra from Credit Suisse. Please go ahead.

Arnav Mitra: Hi thanks for taking my question. Firstly, I wanted to check on the margins. You have reported a 13.1 EBITDA in this quarter and you have said the underlying margin is 15.1, so if you could help me understand this 200 bps difference and what is driving this 160 bps move in gross margin, which has happened between the third and the fourth quarter, is there additional pricing you have got from states or are there other elements playing out here?

Sanjeev Churiwala: Thank you. May be I will try and explain this EBITDA margin best to all of you. If I really look at the underlying performance, we have called out in the press release as well. There are a couple of things that we have actually taking out to really report the underlying performance. One is when we look at gross profit enhancement we did have some funnies in the last year, which we have now taken it up in the current quarter. If you remember we have mentioned amount of Rs.50 odd Crores in Q4 for the corresponding period in 2016 whereas part of the largest settlement we have agreed into a settlement with a party is that we did not go up to certain parties that has come in. In the current year if you really see the press release we have also called out that we are in the process of settling with a customer and part of the claim pertains to the current year, which is about close to Rs.46 Crores, it is also part of the SEBI result that has been taken out from the underlying days. The larger impact that we have in terms of the one of impact, so when you see the reported EBITDA, the reported EBITDA for the quarter is 13.1% as compared to 5.7% in the previous corresponding quarter, which is a margin enhancement of 740 bps point. When we look at like-to-like EBITDA margins the current margin stands at 15% as compared to 8.1%, which is a margin expansion of 690 bps points.

Arnav Mitra: Sir if I heard you right, essentially that Rs.46 Crores, which you have booked in this quarter on the topline itself that is causing the 200 bps kind of swing in the underlying, but that is the main item there?

Anand Kripalu: That is one of the major items absolutely.

Arnav Mitra: Sure and the gross margin I was referring to was more between December quarter and March quarter, so there is almost I think 120 bps movement between December quarter and March quarter this time, so is there additional pricing, which has come in between then and now or other elements there?

Anand Kripalu: So absolutely the fourth quarter is always the period when you do get some additional pricing happening, but between December and between March if you really want to have an exact bridge we can come back to you separately on that, we can drop a mail to investor relations we will do, but it is always a combination of the state mix of the premiumisation journey that we are going through and as well as the pricing that we get through.

Arnav Mitra: Sure and the last question is on again this highway ban so your numbers in the fourth quarter see much better than some of the other companies, so you spoke about something you did to mitigate the impact, so if you could help us understand what those are and can you quantify at least in terms of the fourth quarter how much of down stocking would have happen, in terms how much would be a primary sales lower than probably the secondary sales in the market?

Anand Kripalu: Overall primary sales are not lower than secondary sales, but there has been a change in the mix of where the closing stocks are, so the closing stocks were dipped in some states, but got picked up. Overall I would say there has not been a reduction in stock level. Now in terms of what are the things that we did to mitigate this. Well we are just trying to make sure that we are working with our distributors to make sure that impacted outlets can be relocated in helping to accelerate approvals, trying to understand where consumption is going to move and make sure that those outlets where we believe consumption will move are well stocked and we run special activities in those stores, so that we are able to pickup the demand and really working with state governments to make sure they really move fast and to be honest some state governments have moved fast, some state governments have not moved fast, but in order to make sure that the stores had to move then fresh licenses can be issued and those can be accelerated, so I would say it is a bit of mixed bag honestly in terms of and that is why I am saying that it is not just everything is mitigated yet, but this is what we have, the kind of stuff that we have done and I still believe there is impact in the business and we have lost a couple of points in growth without a doubt because of demonetisation and supreme court ban and some of that is going to continue.

Arnav Mitra: Thanks. That is it from my side and all the best.

Moderator: Thank you. Our next question is from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah: Sir the first question is on the guidance, which you have given, given that you are franchising out parts of the business in the popular segment, EBITDA margins really becomes a less relevant metric to look at, so how would you communicate higher performing versus your medium term guidance in the future, will it be EBITDA growth, what is the better way of looking at the business now and how would you be communicating that?

Anand Kripalu: I believe that EBITDA margin will still be an important measure and that is the longer term goal that we are looking at, would a small part of that margin delta happen because of the franchising out of the popular business yes, right, but the lion's share of the EBITDA margin improvement that we are put in terms of a longer term guidance will have to happen through the management of the total P&L of the rest of the business.

Nillai Shah: For instance this quarter is 15% margins, so would you say that this is much higher than what your near-term guidance or medium-term part is going to be, I would imagine a large part of this 15% number is on account of this franchising that you have done?

Anand Kripalu: There is some impact of the franchising, but not the last part of it. Having said that I really do not want to, we are not running the business like I have said earlier on quarter-to-quarter basis that one quarter you may see a bump up in some lines and the other quarter you may not, so I would really say look at the full year because that is how we are driving this business. Sanjeev has already explained a little bit of the bridge of what has bumped up the quarter for margin, but that is what really I would say.

Nillai Shah: Got it. The second question is on this 13 states, which you have franchised out, Sanjeev mentioned it is 15% to 20% of the popular segment, but 13 states is only 15% to 20% and three states of Karnataka, Maharashtra and West Bengal be 60% to 65% of the business?

Anand Kripalu: That is actually correct, so it is the way it is, so those three states are huge right, Karnataka is by far the bigger followed by Maharashtra followed by West Bengal and that is the nature of the list. Karnataka is THE biggest because as you know Karnataka also there is no country liquor, so that is what has made the whole popular segment as large as it is and you know that when you say 13 states in India there are states that are also tiny in terms of population, union territory, stuffs like that right.

Nillai Shah: Sure.

Anand Kripalu: So yes that is just the way it is and that is how the numbers are.

Nillai Shah: And final question without getting into the numbers per se, but the impact in April, which you highlighted would that be worse often what you have seen leading up to the highway ban?

Anand Kripalu: So I could be obviously careful, but the simple answer is yes because the day looking crystally clear, uncertainty became certainty right, earlier it was speculated losses then it became actual losses because, on April 1, 2017 stores were shut, restaurants were shut, Five star hotels were shut, many of the key bars were shut, cyber city was shut, so it just happened, so absolutely yes.

Nillai Shah: Got it Sir! Thank you very much.

Moderator: Thank you. Next question is from the line of Latika Chopra from J.P. Morgan. Please go ahead.

Latika Chopra: Actually just on advertising and promotion spends based on the competitive activity that you are witnessing at present in the category and your own launch plan, what sort of inflation appears reasonable for this cost here in your view?

Anand Kripalu: So our estimate is that overall media the A&P inflation will be in the order of 5% to 6%, now that may not be the net inflation that we see because obviously every business and including ours we will be looking at ways to mitigate the inflation and make sure that any inflation spend is to really impact in how we spend our money rather than just inflation, so that is the simple answer to your question Latika.

Latika Chopra: Second is on divestment of non-core properties could you comment on the timeline and expected monetizable value from these?

Sanjeev Churiwala: Yes Latika. I will take this question on. Maybe I just take you back two years back if you remember in the year 2015 and 2016 we did a huge amount of non-core asset disposal, which include sale of Whyte & Mackay and UBL, which helped us reduce about Rs. 4,000 odd Crores of a debt in those years. F2017 has been a bit muted while we did have a line up of various properties that we want to sell. In F2017 we landed up with monetisation of about roughly close to Rs.50 odd Crores with a profit of Rs.34 Crores. Having said that we think in the next three to four years we will be able to sell about Rs.2000 odd Crores of non-core assets, which would include lot of residential commercial properties, industrial properties as well as some of the shares, which is locked into litigation with one of the banks.

Anand Kripalu: I will add to what Sanjeev just said, so I think F2017 was definitely muted on monetisation and actually lot of our plans got derailed by the demonetisation that happened in the Indian market and that as you know materially impacted property prices and we therefore either could not transact or did not want to transact at the price that which it could have been sold. Having said that I think we have already seen a little bit of an improvement in that in the last month or so, so we believe that the outlook as Sanjeev has said is something that is an absolute possibility.

Latika Chopra: Sir what the debt levels, you talked about halving the debt levels over a period of two to three years, so should we still expect that by FY2019 the debt levels may come down by half or it gets stretched?

Sanjeev Churiwala: Absolutely because if you look at the demonetisation program Rs.2000 odd Crores is almost roughly about 50% odd of debt level that we currently stand, so in that equation yes, we would see this reduction happening in the next three to four years time.

Latika Chopra: Two years, okay and just lastly on the exceptional item that we had in the quarter if you could elaborate a bit more on the nature of this or at least let us know is there a chance of this recurring in any form in coming quarters?

Sanjeev Churiwala: Absolutely if you also see the press release we have called out what is exceptional item is strictly this relates to a claim from a customer and these all arises out of the legacy commercial terms that we have with this customer and through a voluntary disclosure by the company with this customer and absolutely we have been dealing with this customer with all transparency for the last one year, it was also reported in a previous quarterly releases. We are in the process of now coming to a settlement with this customer wherein we want to ensure that we agreeing to an understanding that we settle all of his past claims and moving to doing a future business with the party in a manner that profit ambition.

Latika Chopra: So we should not expect any more losses or exceptional charges on account of this customer in coming quarters?

Sanjeev Churiwala: Not expect that. If you really see the numbers Rs.46 odd Crores has been netted off against the NsV during this year, which pertains to the current price differences and about Rs.265 odd Crores pertains to the previous year, both this put together is about Rs.311 odd Crores, which forms the large chunk of business.

Latika Chopra: Sure. Thank you.

Moderator: Thank you. Next question is from the line of Sonali Salgaonkar from HDFC Securities. Please go ahead.

Sonali Salgaonkar: Good afternoon Sir and thank you for the opportunity. Sir my first question is you mentioned that you would be retaining three states as far as your regular portfolio. Maharashtra, Karnataka and West Bengal, so what is the current growth in the popular segment that we are witnessing in these states and where could it sustain over say the near term or the medium term?

Anand Kripalu: I already said in my opening comments that it was 1% in our core states on a priority brand and our longer term perspective is that popular will grow in these markets, but will grow at a low single digit growth and that is what we are saying on popular business and that is what you should assume for these states as well.

Sonali Salgaonkar: Sir my second question is again on your royalty fee for your franchising agreement; so Sir could you help us understand whether it is a fixed or variable royalty fee?

Anand Kripalu: So it is largely a fixed fee arrangement that we have entered into.

Sonali Salgaonkar: What about the price escalations if any, if they happen in the states where you are franchising the popular segment?

Anand Kripalu: We are factored in all of those as part of the pricing arrangement, the royalty arrangement we have with the parties.

Sonali Salgaonkar: For the tenure of three to five years?

Anand Kripalu: The way this model is just so that everybody has cleared the call, it is an eyes-on hands-off model okay and what that really means is that if we want the franchises to see it as their business, but we have the right checks and balances on brand and quality and those kinds of things that we will look at and by then believing it is their business right, we want them to feel that if they are able to push more volume and drive better growth in that portfolio that is through their advantage and then when we renegotiate the terms in the next contract we will take those into account, but we will certainly want them to feel that it is their business and they must therefore do the best they can and that is why we decided on a fixed fee model, which protects us in case they do not manage their business well, but also benefit them they actually do.

Sonali Salgaonkar: Sir my last question is any capex outlay in FY2018?

Sanjeev Churiwala: In F2017 we have roughly spend about close to 220 odd Crores and in the past it was in a range of 300 to 400 odd Crores. I think we have done with a large chunk of our capital spend on health, safety, environment measures and as such we would expect that from F2018 onwards our capex spend should be in the range of 200 to 300 odd Crores.

Sonali Salgaonkar: This is helpful. Thank you. That is it from my side.

Moderator: Thank you. Our next question is from the line of Sridhar Nishtala from T Rowe Price. Please go ahead.

Sridhar Nishtala: Thank you gentlemen. Thank you very much for the presentation and the discussion. I have two questions one on your ASP improvement, so could you give me margins, which are sort of linked, how much does the pricing of prestige vary from the popular segment and also if you can give a sense of how the gross margins differ for the two segments given the different directions in which the two businesses are going I wanted to get a sense of how much of the gross margin improvement has been driven purely by mix and how much has it been driven by pricing for example?

Anand Kripalu: Sir what we have been doing in the past giving you an overall understanding on how the margin evaluations have happened that we are not getting in to a breakup per se between Prestige & Above and popular. For us this is very important to give you an understanding on how the overall things have moved in. If I look at the full year of 2017 I just called out in our earlier discussions that we had a gross margin of 41.3% and that has moved into a range of 42.9% now, which is quite a healthy improvement of 160 basis points and that is largely coming through a very healthy mix between P&A and popular. This year we have also got some surprising features in some of the states and the good part is the normal inflation on the commodities and the imports, which is in range of 3% to 4%. We have been largely been able to mitigate as such most of the next gain and the pricing gain has flowed into the gross profit margin, which is 160 bps improvement for the entire year.

Sridhar Nishtala: My only question is that given the shift in volume and net sales value, which is moving towards prestige should not this improvement be much more?

Anand Kripalu: No, 160 bps improvement is a good improvement.

Sridhar Nishtala: If not why is it not?

Anand Kripalu: It is because the 160 bps improvement for the full year on a gross profit margin is a very good improvement.

Sridhar Nishtala: The second question I had was just on your leverage and your cash flow generation as well as how much can your organic free cash generation be on an ongoing basis. Obviously we have seen in the last few years your net debt levels are essentially sort of flattish because the free cash that you generate is going to pay down since pay interest actually and only a little bit of deleverage is happening, so we did talk about the non-core asset disposal, but on an ongoing basis now by when do you start generating free cash to wind on your debt at a faster pace?

Anand Kripalu: As I was referring to the non-core monetisation plan this year we did have a monetisation cash coming on a roughly 50 odd Crores and if do you look at the cash flow we have been able to reduce our debt by close to 133 odd Crores with our sale of non-core setting up next year with improvement in market condition you would definitely think in the next three to four years we should be able to use this entire surplus is coming through the sale of disposals into reduction of debt so which is essentially we are talking about reducing our debt to 50% in the next three to four years.

Sridhar Nishtala: No, the question as I was just looking at that movement of cash right, so if I look at that movement of cash, which you have in your presentation things like net capex, interest payment, tax and working capital movement, so I wanted to get a sense of capex you gave us a guidance, interest I can sort of figure out, tax okay it is there wherever it is there, now I wanted to get a sense of this working capital side for example that is the one thing, which is probably within your control, how do you expect that number to move over time do you think that can move to becoming a positive contributor ever to your cash flows or do you think that will be a drag just given the nature of your business?

Anand Kripalu: We do not think that working capital would be a drag on the business and even in the current year you see a negative movement of working capital of 90 odd Crores it is happening because we have some challenges in some of the states, but by and large we have been able to really manage our inventory very well, we have been able to manage the core accounts payable very well. Going forward we have already put in lot of tests to ensure that we have a clear visibility on a working capital track and the productivity across that. Of course FY2018 we need to really watch out what impact GST could have on the working capital because many of this VAT and tax could move upfront leading into an upfront payment that is something that we need to work out, but we assume that, that impact could again normalize going forward so that is one big funny we need to really see how GST would impact our working capital for FY2018, but otherwise over our mid-term to a longer-term tenure we do not really think the working capital something, which will come in a way of not been able to reduce our debt levels.

Sridhar Nishtala: Just looking at the balance sheet that you disclosed say sundry debtors have gone up by about 650 Crores and debtors based on number of net sales days this is like up like 25 days why is that during this year and it has gone up like over the last two years by nearly 50% in terms of number of days why is that, why are receivable days going up so much?

Sanjeev Churiwala: Yes, so we have some challenges in some of the states and largely corporation states wherein because of some challenges between the states treasury our payments have got delayed, but these are fully secured debt because the money lying with the state government. We think this stop position should normalize from the states. Besides that we do have challenges in some of the markets, which are open markets where we had frequent route to market changes and most of the route to market changes normally happens in the month of March, April and as a result some of the money gets to stuck up for a few month out there and we think these are more temporary nature rather than a permanent stuck up of the money in those markets.

Sridhar Nishtala: So I would take that as saying that the accounts receivable situation is sort of structural in nature.

Anand Kripalu: Certainly structural in the short-term and we have seen a significant increase in like Sanjeev said in a couple of days right it is structural and part of it is actually because reclassification of VAT as excise duty and excise needs to be paid upfront rather than VAT, which has paid later so I think part of it is structural to be honest and we might just see in the short-term we will see a GST implementation a bit more of that kind of stuff happening and we are cognizant that could be a bit of a challenge in the short run.

Sanjeev Churiwala: I would also just want to add one point here. I suppose this is quite peculiar in the last couple of years here if I really look at my topline and look at the gross sales because the net sales we are delivering, in FY2017 our gross sales have gone up by close to 9% and it would mean a large chunk of money is stuck, increase in taxation whereas that does not really impact our net sales per se so like-to-like basis for a similar kind of sales will have higher working capital stuck into those state government and that is one of the key reasons. A large chunk of those 670 odd Crores you said of 70% to 80% is because of the increase in VAT and taxes with the government.

Sridhar Nishtala: Thank you.

Anand Kripalu: Thank you. One last question and then we will close the call.

Moderator: Sure sir! It is from the line of Edward Mundy from Jefferies. Please go ahead.

Edward Mundy: Three questions please. First is just classification on GST and I appreciate you are still waiting for more clarification and are you able to confirm with the molasses i.e., extra neutral alcohol under the 28% bracket and green neutral spirit out of scope is the first question.

Sanjeev Churiwala: Yes, exactly what you said when you do spirit is out of it and Molasses as a raw material as an import into potable alcohol is at 28% and these are some of the exact things that we need to have dialogues the central government to make sure there is, if that is what intended or is it unintended and therefore we can get more consistency so yes you are right in the way you get.

Edward Mundy: And the second question is what portion of your portfolio was green based and what proportion is molasses based presumably you are more premium IMFLs will be grain in your cheaper brands would be or your more popular brands would be molasses based?

Sanjeev Churiwala: Our Prestige & Above business is completely grain and in popular some parts depending on the availability in different states there are some big sugar producing states there you tend to be more dependent on molasses compared to other states and we still need to really understand the impact and also what the mitigation we have because I do not know how it is going to play out, but it is possible that molasses may become more expensive than grain and that might turn the traditional table completely in favour of grain so we need to really work this things through. We still do not have a complete hang of what the impact is going to be.

Edward Mundy: Thank you and are you able to quantify of your popular which one I think is just under 60% to be our volume, what proportion is grain and what proportion is molasses if you have that in hand?

Anand Kripalu: I do not have that in hand. I do not have that exact mix, so at the end of the day you buy ENA as a commodity irrespective of what the source is for your popular business and wherever there is arbitrage that is how he plays his game so it is not that something will have only molasses or something will have only grain particularly in popular you will buy whatever is available off the shell at the best price so it is a dynamic environment so we will see if it is something that we can share with you.

Edward Mundy: And just one final question a bigger picture maybe a three year view how do you think about the mix between illicit country liquor versus Indian made foreign liquor as price increases comes through on GST do you see the country liquor will gain share or do you think you should be at a maintain IMFL share versus country liquor?

Anand Kripalu: That is a really tough one to answer honestly. I think there are two things that can happen, one is as state government gets more conscious about not providing cheap liquor to lower income consumers I think they could do one or two things increase the rate of tax on country liquor and therefore not let it to be discounted versus IMFL in terms of the tax incidence or go to the extreme like the four southern states have done about abolishing country liquor. Now in both these cases there will be a benefit through the IMFL category, but this is regulatory change from year-to-year. Last year Maharashtra increased excise duty on country liquor disproportionately compared to IMFL, so I really do not want to comment about this in terms of a longer-term trend, it is a very long-term trend I think is so if I go 20 years from now will there be a big country liquor market in India I think it will be small and IMFL be much bigger. Now between now and then I think we are going to have a bit of a sawtooth trend based on the short-term regulatory policy.

Edward Mundy: Thank you very much.

Moderator: Thank you. Sir that was the last question would you like to add a few closing comments?

Anand Kripalu: I just want to thank everyone for dialing in for your questions and for your engagement on United Spirits. I hope we have been able to answer questions that you had to the best of to what you expected and more importantly we will have an opportunity to meet many of you next week when we come for the annual road show to Mumbai, so till then all the very best.

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