



‘United Spirits Limited F16 Half Year Results Conference Call’

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**MANAGEMENT: MR. ANAND KRIPALU – CHIEF EXECUTIVE OFFICER, UNITED SPIRITS LIMITED
MR. VINOD RAO – HEAD OF FINANCE, UNITED SPIRITS LIMITED**

Moderator: Ladies and gentlemen, good day and welcome to the United Spirits Limited F16 Half Year Results 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 during the call. Should you need assistance during the conference call, please signal an operator by pressing ‘*’ and then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Anand Kripalu – Chief Executive Officer. Thank you and over to you sir.

Anand Kripalu: Thank you and a very good morning everyone, really appreciate your taking the time to dial-in today and let me extend a very warm welcome to each one of you. I am Anand Kripalu and I have with me Vinod Rao, along with few of our team members.

Now the model that we have adopted after this quarter’s results is the kind of model we would like to pursue and put in place each quarter and two things that we aim to do, one is to give you the kind of press release that you would have seen which tries to give you as much clarity and transparency about what is happening in the company and then follow that up as we are doing today with an investor call so that we can take your questions and answer any queries that you may have.

Now we have more than 200 people who have dialed into this conference call this morning and my only request to each of you therefore is in order to keep it as democratic as we can and give everyone a chance to participate please keep your questions to as few as possible and as brief as possible. There is no further introduction or preamble that I am going to do because you have all the materials with you so without further ado we are going to throw this open for questions.

Moderator: Thank you. Ladies and gentleman, we will now begin the question and answer session. We will take our first question from the line of Latika Chopra of J.P. Morgan. Please go ahead.

Latika Chopra: On the margin front is it possible to share the EBITDA contribution coming from Diageo brands in the first half? And secondly it would be helpful if we could get some sense on gross and operating margin profile for various sub-segments prestige and above Popular and Diageo?

Anand Kripalu: We will work out the Diageo part for you. I really do not want to go into specifics of each segment but what I do want to say is that we obviously are trying to drive margin improvement in this business and clearly each segment in our portfolio makes a margin that is better than the margin of the segment below it. As you know we have a fairly large popular business and

what we are doing in the popular business is trying to make sure that we are very choiceful about where we drive that business. We choose our states carefully based on growth opportunity and margin opportunity, and it is in those states that we are investing and driving growth. So Popular, which otherwise could be seen to be margin dilutive to a business of our kind, is something that is getting special prioritization, so to speak. Above that each of the segments are margin accretive to the business, and we *are* seeing growth in the higher segments that are better than the segments below that.

Vinod Rao: Let me tell you that the Diageo brands would have contributed around 15%+ to the margins for the quarter.

Latika Chopra: So the share of EBITDA would be 15%, is that right?

Anand Kripalu: That is right.

Latika Chopra: Lastly, would be helpful to understand the underlying demand trends for the liquor space in the various sub-segments. And what would your expectations be on the medium-term volume growth rates for the same?

Anand Kripalu: Let me share our perspective. I think as far as our business is concerned we genuinely aspire to deliver sustained double-digit growth in this business. That would probably comprise of volume growth which is probably low single digit, with just a couple of percent really coming out of Popular, and a double-digit volume growth coming out of Prestige and above segment. So clearly on revenue we are looking at a double-digit growth ambition. Now I would say that demand is reasonably intact I would say in our business though it has waned a bit from the highs that we saw a couple of years ago. Many of our states continue to perform very strongly. Some of the states are challenged because of either local issues or regulatory issues and we are working hard to overcome that. Even in our previous periods, if I were to just kind of separate out the challenges that we have faced, we'd been delivering very clear underlined double-digit growth in the business, and that remains our aspiration. Just in terms of revenue and margin, I just want to make clear that we do along with a double-digit revenue growth aim to constantly improve margins but we are very watchful of the combination of growth and margin. While we improve margins we do not want to do it at such a rate that it starts affecting our topline so parts of our margin improvement program are being reinvested to drive revenue growth through our brands and to improve the capabilities for our people.

- Moderator:** Thank you. We will take the next question from the line of Manish Poddar of Motilal Oswal Securities. Please go ahead.
- Manish Poddar:** Is it possible to share the volume performance. How much is the volume in cases let's say from the state of Tamil Nadu and by sub-segment let's say Popular and Prestige and above?
- Anand Kripalu:** Just to be clear Tamil Nadu is a franchise business for us. So we have no direct involvement in the state of Tamil Nadu, in the business. While I will try and share what I can I just want to make clear that we believe that in this business we must look more and more at revenue. I think traditionally everyone's looked at number of cases. It's the quality of the cases that is really important and we are seeing the value of driving the higher segments where the number of cases may be lower in terms of contribution driving those faster so that we improve mix, and that gives us a great benefit. In terms of just specific numbers that you asked for let us see what we can get you here.
- Manish Poddar:** Would we primarily be focused on the popular segment, would that be a right assumption?
- Anand Kripalu:** That is an incorrect assumption,. If you just heard what I was just explaining to Latika, there is absolutely no doubt about the fact that Popular is important but we are making choices about where to invest in Popular and where to drive Popular, and where we drive is based on growth propensity and margin propensity. So we will not chase volumes in Popular for the sake of volumes, unless it gives us profitable contribution to our overall business. So our overall volumes for Prestige and above was 7%, and for Popular in the previous quarter was actually -5%. Now I just want to point out that we had a specific issue in Karnataka on pricing which has since been resolved; a price move that we took... we had anticipated that it would be followed by the rest of the market, did not happen, so we have since corrected prices and we have seen volumes bouncing back. If I look at what is happening post the price correction in Karnataka we will be, like I said, back to positive low single digit growths on Popular.
- Manish Poddar:** On balance sheet, your working capital days have increased significantly in this six months so could you allude any reason to that?
- Vinod Rao:** A large part of the reason is as we have taken on the Diageo brands we have also taken on their working capital and cost, so that is the large part of the reason.
- Anand Kripalu:** Did you get the full response?

- Manish Poddar:** I got it. Primarily because of the transition to the Diageo agreement. I just had a question on the debt front actually, the last question if I may, primarily what is the debt outlook going forward and what is the transaction with the subsidiary Bouvet Laudubay? Can you give us some clarity on that front please?
- Vinod Rao:** We expect to continue our monetization of our non-core assets and just like we have reduced debt by about Rs. 1000 crores, in the next 12-18 months we are expecting to get to a similar reduction.
- Manish Poddar:** Is there any number which we are attaching to in the transaction which is in process?
- Vinod Rao:** I would like to just complete that transaction then we will give you a number, but this program is on Manish. We have non-core assets that we will be monetizing or divesting over the next maybe even two years.
- Moderator:** Thank you. Our next question is from the line of Avi Mehta of IIFL. Please go ahead.
- Avi Mehta:** Just taking up from the analysts meet that we had when we had met you, you had indicated that the focus is clearly towards mid to teen high EBITDA margin, you have achieved that. Trying to understand over here do you see this margin sustaining because this kind of implies... or is there any one-off over here? Secondly, just a part of it is the 220 basis points reduction through the related party. Could you share where are these reductions coming in?
- Vinod Rao:** In our investor meet what we had said is that in the near term we expect to improve our gross margins through productivity and premiumization, but invest all of that back in brand building, in our Route-to-Market as well as capability, as Anand had said. So in the near term we do not expect any margin increase. The mid-teens I think I had said is more in the medium term. That's what we had said earlier. Now coming back to this particular quarter where we seem to have achieved it, yes, there are a couple of reasons why this quarter is higher and probably not fully representative. One is, we have the RPT benefit about 200 basis points and the other is we have a one-off in it. If you have read the notes, the financials that went out yesterday we have settled receivables with one of the parties and we have written that provision back. That's about Rs. 28 crores, so this quarter is not truly representative in that way, both from an RPT point of view and a one-off point of view. To your next question of where the benefit of RPT is going ... about 75% of it is going in the A&P line and about 25% of the benefit is going in the overheads line.

- Avi Mehta:** A follow-up on that is if I look at the overhead expenses in F15 adjusted for the ad spends, the exchange loss and the provisions because those are one-off, it is about 12.5 billion and the first half we are at 5.3 billion only which either means that the second half should see a very sharp.. I mean it's almost double of what you saw in the first half or what am I missing, I am just trying to understand the numbers?
- Vinod Rao:** In the second half of last year RPT accrual had stopped. So this RPT benefit is largely only coming in the first half and a bit of Quarter 3, so that is the adjustment you will have to make.
- Avi Mehta:** So the fourth quarter did not have that so that's a one-off. So the base is a one-off is what you are saying?
- Vinod Rao:** Fourth quarter and a part of third quarter; the shareholders voted down the resolution on 29th November, so we probably have about four months of no RPT last year in the base.
- Avi Mehta:** But we have adjusted in the first and the second quarter, right, in the restated numbers? I am not still clear. I am just trying to understand the numbers in terms of the full year for the last year - its 12.5 billion which is considering the RPT benefits for four months and you are saying that this has the RPT benefits which will continue. So then why are you saying that is one-off because RPT benefit should continue?
- Vinod Rao:** Yes it continues only for part of the year; so it will continue for another two months and then since in quarter four of last year and a bit of quarter three we had stopped accruing the RPTs so we will not get that benefit for four months of this year.
- Avi Mehta:** But on a net basis this is there. Okay sir. Secondly, sir highlighted that the focus is clearly on improving the profitability on the regular segment, the popular segment or regular segment, just trying to understand in that so how is the McD No.1 relaunch coming through ...any numbers you could share or any kind of feedback there?
- Anand Kripalu:** First of all, we treat MCD or McDowell's Number One as part of our prestige segment and not our regular segment. The relaunch has just gone into the market and I have been travelling around parts of the country; I think it is looking very good in the market, the trade is positive but I think we just have to recognize that nothing is decided in the first few weeks of a launch. All I can say is the package has been well received by both our salesforce and the trade.

- Moderator:** Thank you. We will take the next question from the line of Nillai Shah of Morgan Stanley. Please go ahead.
- Nillai Shah:** My question is in the gross margins. If I look at the gross margin expansion 150 basis points plus and when I then go back to the analysts meet we had you had spoken about certain issues you had in terms of mix within the states which was driving the gross margins lower in 1Q, and this question is in context of the fact that input cost to some extent have also come down, so how can we see gross margin trending near term, say over the next two quarters or so?
- Vinod Rao:** We expect the gross margin improvement that was evident in Q1, Q2 to continue. However, as we have said we are going to invest that back into our marketing spends, into capability building and into our route to consumer.
- Nillai Shah:** That is alright, but wanted to understand the extent of gross margin expansion in light of lower input costs. Are these input costs accruing to you at this point in time because you have seen a big mix improvement, a large part of the gross margin expansion this quarter is on account of mix improvement, not so much so in terms of lower input costs and we know that ENA prices are down, glass prices are probably flattish so when will the input cost start playing their part in the gross margin expansion?
- Vinod Rao:** So you are right, H2 we will get a little benefit from ENA, so the same level of gross margin improvement. May be slightly more, you will see in the next two quarters.
- Anand Kripalu:** But if I can just add to that, one is of course the cost side but the other thing in terms of gross margin is our portfolio upgradation. Now with the whole Diageo portfolio under one roof, I think we have genuine opportunities to upgrade our brand portfolio and thereby improve margin. We are continuing our focus on state prioritization, so driving states that give you better margin we are doing harder, and then finally we are driving a very aggressive productivity or fuel for growth program in the business which is also going to help us to pull out a lot of fat that still exists in the business, and all of these will contribute bit by bit to some kind of gross margin improvement. And finally, we have just rolled out a plan to embed a comprehensive S&OP program in our business. You will appreciate that in a company with nearly 90 factories with complex state borders and the kind of volumes we have, a robust planning process can also help us to extricate cost and also optimize working capital, so all that is part of the plan.

- Nillai Shah:** You have got specific plans to improve the gross margins in the regular segment because that would be more driven by price increases, etc. So prestige and above it's pretty clear in terms of how you are driving gross margins expansion out there with the mix improvement, etc., but more on the regular or the popular segment front what is the strategy for gross margin expansion out there?
- Anand Kripalu:** The strategy is, pricing has been hard to come by. Having said that, we are still pursuing pricing in states where the door is ajar and we are hopeful of getting some pricing in this fiscal itself and then we are beginning work for the next HY cycle to make sure that we are well placed, that we have got all the facts available so that we can have a fact based discussion with these states exchequer. So that is something that we are doing. The margin improvement in Popular will also be driven by how we are prioritizing our states, like I said earlier - and then the productivity program. So for instance, I do not know if I had shared it last time we met, but in many states now we have a common bottle across all our brands in the Popular segment. Just having one common bottle supported by market bottle recycling liberates a lot of cost, so there are a lot of productivity linked measures that are also being driven. So if we get the pricing, the state prioritization and the productivity measures, I think there are opportunities for us to start picking up some amount of margin even in the Popular segment.
- Nillai Shah:** In Tamil Nadu you had some issues with the preference for local distillers, etc., after the sale to Balaji has that been resolved partly at least?
- Anand Kripalu:** Well I am saying honestly we are not involved in the business in Tamil Nadu. We have sold that business. We get a royalty for the use of our brands. Whatever volumes are sold in Tamil Nadu we will get a royalty when our brands are sold.
- Nillai Shah:** But Tamil Nadu has a countrywide contribution of about 17% but for USL the contribution was only 5% so has that number basically gone up over the last few months or not really?
- Anand Kripalu:** No, most likely it has actually gone down because volumes in Tamil Nadu have been very subdued even after the sale to Balaji.
- Nillai Shah:** You mentioned some one-off in the other operating income, if I were to x that out the other operating income becomes negative, so can you explain that for the quarter?
- Vinod Rao:** As I said there are investments capability that are going in there so if you strip out the one-off it is just the investment we are making in our people capability.

- Nillai Shah:** You spoke about this 15% contribution to EBITDA from Diageo brands, is that right? 15% of the current quarter's EBITDA coming in because of the sale of the Diageo brands?
- Vinod Rao:** It is roughly that, yes.
- Nillai Shah:** But if I do the math on the revenue which you have provided for the quarter it works out to like a (+30%) margin?
- Vinod Rao:** Just so that I clarify once again, the Diageo brands give out about 15% EBITDA margin.
- Nillai Shah:** Okay, so the margin is 15% not the contribution to EBITDA?
- Vinod Rao:** Yes margin is 15%.
- Nillai Shah:** That was supposed to be 10%, so has there been a shift or is it just a one quarter phenomena because of the mix?
- Vinod Rao:** You could say that this is representative.
- Moderator:** Thank you. Our next question is the line of Rajasa K of Jeffries. Please go ahead.
- Rajasa K:** One more question on the Diageo contribution, so could you share what it is on the gross margin level?
- Vinod Rao:** We just said that you have the Diageo sales contribution and we make about a 15% margin on that.
- Rajasa K:** Just a clarification on the one-off that you mentioned that's 28 crores and you said that is a reversal of certain provisions so where does that 28 crores sit in the P&L?
- Vinod Rao:** The 28 crores sits in the Other Overheads.
- Rajasa K:** So your Other Overheads which you have reported as 251 crores is actually 279.
- Vinod Rao:** If you gross it up
- Rajasa K:** For the reversal of the provisions.
- Vinod Rao:** Alright, can we take the next question please?

- Rajasa K:** I did not get a clarification on that could you just confirm that?
- Vinod Rao:** Sorry I thought I had confirmed, yes if you gross it up.
- Rajasa K:** So basically the margin this quarter is 13.5% and not 14.8% as is reported, I just want to clarify that?
- Vinod Rao:** Two things, let me say this once again, this time's margin is impacted by two one-offs, so one is this one-off that we just talked about, the write back. The other is RPTs are not accrued this year and they were accrued last year and we still are in a position where we are seeking clarification from SEBI on how to go ahead with this. So if you want to do like-to-like you got to take out the RPTs and the one-off.
- Rajasa K:** The implied Other Expense run rate for the second half is significantly higher than what you did for the first half despite the fact that you did not have related party payments in the fourth quarter and partly for the third quarter so how should one look at these other expenses? Was there any one-off in the second half of last year and how should we forecast this going forward?
- Vinod Rao:** Yes there was a lot of noise in second half of last year because post the investigation report there was a lot of impairments done, there was lot of cleanups done. So there is a lot of noise in last year, so you should probably just take the run rates of this first half as something that we will continue into H2.
- Moderator:** Thank you. Our next question is the line of Arnav Mitra of Credit Suisse. Please go ahead.
- Arnav Mitra:** On advertising spends if I look between the first quarter and second quarter of this year there seems to be a 23% dip in the absolute spend and almost 300 basis points of sales. So given that first quarter was 10.9%, second quarter 7.9% is the average kind of representative or you have been lower than normal in the first half?
- Anand Kripalu:** I think we are lower than normal in the last quarter and we plan to therefore invest more as we look ahead. The reason for that is the investment that's being made on brands that are being renovated. So as I was saying earlier on the call, the McDowell's No. 1 relaunch is currently going into the market, and we are going to be supporting that aggressively and there will be others to follow during this fiscal itself and those will need to be aggressively

supported. So we genuinely see the marketing spends picking up to support the initiatives that we are driving in the market place.

Arnav Mitra: For the full year any sort of range that you would want your ad spends to be in on an average for the full year?

Anand Kripalu: I am not sure we will give you a number or a range for the full year. However, our status strategy is when you look at our underlying marketing spend and as you have seen in the note in the press release our underlying marketing spend was 18% above the first half of the previous year, so our philosophy as we have said is to improve margins through a variety of initiatives and put some of that back, so that we constantly invest in our brands. You would know that our brands have been under invested in for some years and we are aiming to correct that. We corrected that a bit last year and we are correcting that further this year. And that will be the trend till we believe that we are competitive enough in terms of the investments we are making.

Arnav Mitra: Second question on gross margins, could you kind of give a sense of how much ENA prices have come off in the last 6-8 months and despite that why on a QOQ basis between 1Q and 2Q the margins are actually down on gross margin?

Vinod Rao: Actually our margins are up.

Arnav Mitra: I am talking between 1Q and 2Q of this year.

Vinod Rao: It is probably just a play of mix. There is really no other reason so ENA has been pretty much flattish, so it's a play of mix.

Arnav Mitra: How much has ENA kind of come off now versus let's say 6-8 months back in terms of what you are seeing in the market?

Anand Kripalu: Not material. The ENA prices have not followed crude and stuff like that. It has remained flattish. I think the good news is that there has been no inflation in ENA but there has been no major benefit either.

Arnav Mitra: On the Working Capital side one question I had was Receivables are actually up almost 500 crores almost 28%. So I understand the Diageo part but why would this one element be up so much in the last six months?

- Vinod Rao:** Two things, one is the Diageo part as we spoke and the second is that if you look at the quarter... within the quarter our stronger performance or month was the month of September so that has just added on to the absolute value of the Receivables which should correct itself as the payments gets collected.
- Annav Mitra:** So there is no underlying change in the terms on Receivables, it is just the sales coming towards the end of the quarter?
- Anand Kripalu:** Yes, it is sales phasing, there is really no underlying.
- Annav Mitra:** One last clarification again on that 28 crore number actually in your Notes to Account you have said its actually adjusted under Other Operating Income, so that you are saying is not Other Operating Income but Other Expenses, that write back of that provision?
- Vinod Rao** Let me just check and revert to you.
- Anand Kripalu :** We will check and revert to you. If you don't mind just send a mail to our Investor Relations mailbox that query we will make sure that a reply comes to you.
- Moderator:** Thank you. Our next question is from the line of Jamshed Dadabhoy of Citigroup. Please go ahead.
- Jamshed Dadabhoy:** Could you give us the number of cases you have sold, I know you all give the year-on-year change but the number of cases you all have sold for both Prestige Plus and Regular below for this quarter and the base quarter for last year.
- Anand Kripalu:** The total volume is 44 million cases versus 44.7 in the previous year and this is volume excluding our royalty and our overseas business. Wherever we are getting royalty this volume excludes that, so wherever there has been a business model change this excludes that.
- Jamshed Dadabhoy:** This excludes Diageo brands is it, this 44?
- Anand Kripalu:** No it will include Diageo brands but it will exclude for instance Tamil Nadu which was historically part of the business, because now that business has been sold and we get only a franchise fee, and also a couple of other places in the country where we have franchised out the business.

Jamshed Dadabhoy: Could you give us this split for Prestige versus Regular for both this quarter and second quarter of last year?

Anand Kripalu: We have given you the growth rates already on Prestige and above and Popular, right? So roughly it is about in H1 16 million cases of ENA versus just under 15 million cases in the previous half and I am sure you can work out the difference.

Jamshed Dadabhoy: Just a clarification actually on the Diageo brand, I was under the impression it is a marketing arrangement but this also includes the absorption of the Working Capital, is that correct?

Anand Kripalu: Yes it does. You're right.

Jamshed Dadabhoy: The inflation in the receivables is that primarily on account of the Diageo brands?

Anand Kripalu: As I just said earlier Diageo brands and the phasing of sales where September was a much stronger month than prior.

Jamshed Dadabhoy: This Diageo business roughly annualizes at about Rs. 600 crores a year, is that a correct way to think about it?

Vinod Rao: Yes, it would roughly annualize at that. The thing to keep in mind is this year it's kind of only started more towards end of Q1 so this year we may not get that entire amount.

Jamshed Dadabhoy: Understood, so first quarter was 42 crores, second quarter is 140 but if you annualize it runs at around 1.4 billion a quarter.

Vinod Rao: Yes.

Moderator: Thank you. Our next question is from the line of Gautam Duggad of Motilal Oswal Securities. Please go ahead.

Gautam Duggad: You mentioned about the various productivity enhancing measures which are currently going on, can you give us some visibility on the kind of margin upside it will accrue on various line items like say Overheads or some other manufacturing related processes where you are pursuing this cost reduction of project. And secondly in one of the responses earlier the last question you mentioned that the volumes include the Diageo brands but exclude Tamil Nadu and some of the other places where you have franchised out. Can you also specify which are those states where it is again on a franchisee basis apart from Tamil Nadu?

Vinod Rao: In terms of the productivity measures honestly it cuts across pretty much every line item of our P&L, from cost that help us to re-engineer our offers in terms of products to optimizing media spent to optimizing our overheads and to also optimizing our manufacturing footprint in bringing down some of the cost at our high-cost side. So it is a fairly comprehensive productivity program. I cannot give you a number because obviously are many projects that we are pursuing each with a certain probability of success. But I think the expectation is that we will deliver material margin improvement through those productivity measures which will allow us to invest back into brands and into sales that we are planning to do and still hopefully leave something to improve underlying margin itself. Also I think it is important to understand that in a market where pricing is controlled there is inflation that happens and that this productivity program is also helping to compensate for lack of pricing in many places. So it may not just jump out so easily because it kind of goes to mitigate many line items but it is a major initiative that we are driving in the business. That is really on overheads, so short of giving you a specific number and that is not because we do not want to but because there are multiple projects with different probabilities of success.

As far as franchise volumes are concerned this includes the state of Tamil Nadu, the big ones are really Tamil Nadu, Kerala and Popular in Andhra Pradesh. I think the only perspective that I want to give is the fact that given the regulatory environment in India sometimes it is necessary to have different business models or different routes to market to do your business and I just want you to see franchise and royalty as different business models or different Routes to Market to doing the business.

Gautam Duggad: Are you pursuing more such states where you can look for franchisee operations or this is it for the moment?

Anand Kripalu: I think this is it for the moment. Having said that, it is something that we will constantly look at. If we find win-win opportunities which both liberate our own business and help us to keep our brands growing we will do that, but that depends on the opportunities that come on the horizon Gautam.

Gautam Duggad: On this relaunch strategy you have already done one, currently there is one more underway, how many brands to look at it from an FY 16 perspective, are you trying to relaunch this year and maybe if you could give some color for FY17 also, so next around 12-15 months how many brands are you planning to relaunch?

Anand Kripalu: If I give you that I will be giving you the entire strategy.

- Gautam Duggad:** Not the specific brands but say number of brands you are contemplating.
- Vinod Rao:** Obviously we have a program to renovate; renovate means update or even one step ahead of the evolving consumer; make sure our offers are modern and one step ahead of what consumers expect. We are taking one brand at a time, recognize that it is not how many brands you do it is how well you do each brand that really makes a difference in business. So each brand that we do needs its own window of time to make sure that we realize the potential of that renovation. So you will definitely see maybe one or two more in this fiscal.
- Moderator:** Thank you. Our next question is from the line of Vivek Maheshwari of CLSA. Please go ahead.
- Vivek Maheshwari:** My first question to your point about Karnataka where you took up prices and you have rolled it back. How disappointed you are because I would have imagined that if market leader takes a bold step like this competition should follow because the reality is that the margins are really low in this business, why did it that the competition did not take up prices when there was a good window of opportunity for them and that there were no legal implications given that it's the free pricing market?
- Anand Kripalu:** Well Vivek you will have to ask them really. You are absolutely right and that is the reason we took it as the market leader saying that if we do what we believe was right given the cost in this industry, then sensible competitors, rational competitors would see what we have done and use the opportunity to follow suit. I think the contra happened where they started discounting more to try and appropriate as much of the volumes as they could, so we rolled it back. Of course it is disappointing when you do something and then you got to roll it back, it is disappointing but having said that I think we are now really crawling back and getting a lot of the volume that we had lost in Quarter 2, we are getting that back and we have doubled the effort behind our productivity program to make sure that we are able to sustain and build on the margins that we make. We will wait for the next price increase, so that is how it is and that is how the game is played in this industry by the way.
- Vivek Maheshwari:** But does that change anything from your perspective in terms of what you were expecting or that does make you more nervous about the market in general because the competition is not going to give in so easily despite the fact that the market is much rationally placed right now compared to how it was two years back, does that change anything from your perspective?
- Anand Kripalu:** Actually it does not change anything, the reason is that, Karnataka is one of few states where technically there is free pricing, and you can take up pricing, I mean you give the lion share of

that price increase to the government any way and you get a small part only to keep. Historically in this industry people have not taken selective pricing, they have waited for the government to give an approval on pricing or in the case of Karnataka for instance to move the slabs itself based on the inflation rate. And we are doubling our efforts to have that conversation with each of the State governments. So what it does mean is that taking pricing on your own knowing that the benefits are small and the risks are high is something that you may not do. Even a state like Karnataka the advantage is that you have huge opportunities to grow the Prestige and above segments in the market which are margins accretive and therefore improves the overall profitability of the state.

Vivek Maheshwari: Just to confirm on this point the pricing impact is it significant to overall EBITDA or gross margins in this quarter or the rollback, should we be worried about it, or it will be a few basis points only?

Vinod Rao: No significant impact.

Vivek Maheshwari: At the time of acquisition while I know a participant had asked about it but when Diageo took over United Spirits the indication that we got on A&P at that point of time was more closer to, if I recall correctly, around 12 levels whereas you are currently running with much lower number of around 9,. Is that a number that we should be looking at more inching towards 12 or any indication would be helpful?

Vinod Rao: As we said a little while ago that Q2 was on the lower side and as we get into more renovation and launches H2 you will see a higher spend so yes, into the double-digits is what I would say right now.

Vivek Maheshwari: On the loan repayment can you specify at what point of time that loan was repaid, I want to build my interest cost based on that, whether it was 1.1 billion that represents the number that we should be looking at for the second half on a quarterly basis?

Vinod Rao: We have repaid the loan almost immediately in the first half of July sometime.

Vivek Maheshwari: You all alluded to the fact that you are looking at a similar level of deleveraging over the next 12 months so which will be ballpark around 1000 crores. What would be the non-core assets now that you would have other than Treasury and Cricket IPL?

Vinod Rao: I would just correct that to say 1 to 2 years, not exactly 12 months, but between 1 to 2 years. Non-core assets are some of the businesses one of which we have referred to in our notes to accounts post the quarter, some of the properties that we have; so those would contribute to it.

Vivek Maheshwari: Is it possible to get a quantification of what we are talking about the quantum from these?

Vinod Rao: Similar level I said over the next let's say 18 months as what we have already done which will go to reduce debt directly. So interest cost then will be a function of both reduction of debt as well as we have also brought down the rate of interest in this quarter. So it is both the reduction of debt as well as interest rate reduction that is causing the considerably lower interest cost.

Vivek Maheshwari: What will be the CAPEX for first half and full year if you can give some ballpark indication?

Vinod Rao: Full year we are expecting around Rs. 500-600 crores CAPEX.

Moderator: Thank you. Our next question from the line of Sonali Salgaonkar of Yes Securities. Please go ahead.

Sonali Salgaonkar: A question based on the industry level, could you throw some light on how are your key markets performing the underlying trends that you are seeing in that? And also if you could give a broader picture as to which states are higher in profitability for USL?

Anand Kripalu: I am not sure I will get into state-wise profitability Sonali. Having said that I would say that most of the states that we operate in are actually giving us good growth in line with our expectations. We have a few states that are underperforming largely in the North and in the East of India and some of those are because of local issues which we are trying to resolve and some of those are regulatory issues where we are in engagement with the government machinery to fix. Those are the ones where we are seeing some level of underperformance. But despite those states what we are finding is that our aggregate numbers are kind of in the ballpark where we want them to be. Specifically we are having regulatory challenges in Uttaranchal where we are almost selling nothing right now because they have changed their business model and we will only operate and I want to underscore this will only operate in a completely compliant manner as a business and we are also having some recent problems in Chhattisgarh. Those are the kinds of issues but in an industry like this you will always have a couple of these and we are resolving them as we move ahead.

- Moderator:** Thank you. Our next question from the line of Mayur Gathani of OHM Group. Please go ahead.
- Mayur Gathani:** Seems like the question was just asked previously. I just wanted to check you have been mentioning about transparency with the state governments, bureaucrats, etc., how much of that you think is impacting your business because you are the front leader, I mean the competition is also looking at you as to how you can make things transparent and they can follow or probably how better you can do things with the state governments and how is it impacting your business currently? Do you think it is impacting?
- Anand Kripalu:** It has impacted. I think there are some channels, last year I will just give you an example, we didn't do well at all in the CSD channel because we completely tightened our business and this year we are seeing great recovery in CSD as that model has stabilized. So there is this period of transition that we are going through. In many states I think we have crossed that period of transition and we are seeing great momentum. In some states we are still in that period of transition. I just want to say that there are certain things in our business which is no compromise and zero tolerance and this is one of them. Having said that, there are some states who are being very progressive and we are having dialogues with some states on creating a kind of win-win model. Because what the state is interested in is better revenue. What we are interested in is ease of doing business and what we are both collectively interested in is making sure that there is a responsible consumption of alcohol. And states who are, I would say, open-minded are beginning to see virtue in not having unnecessarily regulatory hurdles, making sure their revenue is intact but also we do the right thing for our consumers and for our citizens. So those are the kinds of dialogues we are starting. I think you will recognize that these are big bold objectives. None of these are going to happen overnight. But I must tell you I am encouraged by the reception that I have received from many of the state governments.
- Mayur Gathani:** You mentioned on the franchisee side you also mentioned Popular in Andhra Pradesh is part of the franchisee agreement?
- Anand Kripalu:** Yes Popular brands, it's a royalty model but basically it is being done by somebody else; manufactured and sold by somebody else.
- Mayur Gathani:** You have seen some rate of interest reduction, what is the quantum? Can you tell us what it was prior and what it is now?
- Vinod Rao:** Over the prior period you could say about 100 basis points interest rate reduction.

- Mayur Gathani:** What is the CSD channel contribution to the business?
- Anand Kripalu:** It's small, it's a low single digit. But I just used that model more as an example than anything else to say when you are going through a transition there is a period of pain and then once you have sorted that out, you have crossed that barrier then you start doing good business and regular business and I am very hopeful of our potential to grow in that channel for instance.
- Mayur Gathani:** Specifically can you point out what is the CAPEX for 500-600 crores that you have mentioned for FY16?
- Anand Kripalu:** A large part of the CAPEX is going towards upgrading our factories, those factories that we believe is going to be a key part of our destination factory footprint and bringing them up to not just regulatory standards but also basic standards that Diageo would like in its factory.
- Mayur Gathani:** From your point of view does UNSP have any discussions with the government on GST issue?
- Anand Kripalu:** There have been multiple conversations on GST with all levels of people in the government from senior ministers to bureaucrats to state governments to states chief ministers and so on and so forth. And I just want to say that irrespective what the media has been writing we have still not given up about the inclusion of alcohol in GST and we are still doing it, so let's see where it ends.
- Moderator:** Thank you. Our next question from the line of Prashant Poddar of Abu Dhabi Investment. Please go ahead.
- Prashant Poddar:** Just a classification on the related party transactions. Actually I am a bit confused about what it is. So basically the shareholders rejected that resolution or those transactions, so what is it that is reflecting in P&L which is giving you those savings really?
- Vinod Rao:** The shareholders rejected this set of contracts in November of 2014. Till that period so 8 months of last year we were paying and hence expensing those set of transactions. Now that the shareholders have rejected we have gone back to SEBI on a clarification, we are in discussions, we have not yet received a clarification so we have not accrued for those related party transactions since 29th November, 2014, so not accrued in this period when compared to a period that where it was accrued is a difference of about 200 basis points on your EBITDA line.

- Prashant Poddar:** So this basically every transaction that you do serves some purpose, it's an expense so it should be serving some business purpose or it should not have been there forever? So what is it really? What is it substituting in that sense?
- Vinod Rao:** These are contracts signed on advertising, on promotion, on facilities so it's a series of contracts that were signed, that have been in operation and running which the shareholders rejected.
- Prashant Poddar:** So you are not paying that amount now?
- Vinod Rao:** We are not paying that amount nor are we accruing it.
- Prashant Poddar:** You are not therefore receiving those services as well?
- Vinod Rao:** We are not receiving the services either.
- Prashant Poddar:** That would then be replaced by some expense which will have to meet that requirement of yours if it's a business requirement?
- Vinod Rao:** Yes but for the moment in these financials that is flowing through as savings.
- Prashant Poddar:** You think the business can continue without these expenses and you will not need to pay to those related parties legally?
- Vinod Rao:** We would be requiring an alternate way of getting those benefits or services. So because we are in this in-pass right now we are just holding till we get clarification and then we would move on.
- Anand Kripalu:** We are really out of time and it's been a very engaging set of questions. We will take one more question and then we will have to close this call.
- Moderator:** Sure. We will take our last question from the line of Vivek Veda of Societe Generale. Please go ahead.
- Vivek Veda:** Just two quick questions, one is on the GST impact if you can tell us what will be the impact if its included and what will be the impact if alcohol is excluded from it, both the positive and the negative side?

- Anand Kripalu:** First and foremost nobody knows exactly the frame and the specifics of how GST is going to come. Nobody even knows what the revenue neutral rate is. So I am not even going to hazard a guess on what that number is. Now if GST was included then we would have believed that a lot more governance would have come into the alcohol industry, there would have been a better trail from items that are taxed centrally to items that are taxed at the state level that we have far tighter trail and I think that would reduce spurious parallels and health hazards for consumers. So that is the larger point on which we have been pitching our proposal that alcohol should be included in GST. In terms of the numbers unfortunately I just don't want to hazard a guess.
- Vivek Veda:** Second question is with all these moving parts what kind of EBITDA margin guidance we should look for the medium to near term?
- Anand Kripalu:** I think in the near term we could look at between 10-11% with modest increases in the next year or so purely because as we have been saying repeatedly we are improving our gross margins but investing it back in the business.
- Vivek Veda:** Thanks a lot and best of luck.
- Anand Kripalu:** Thank you and on behalf of Vinod and my entire team here I really want to thank each of you for making the time. I do apologize for those of you who are waiting in queue and who couldn't get an opportunity to ask a question. But I am sure there will be more opportunities and more occasions when we will be able to engage. So thank you very much everybody.
- Moderator:** Thank you. Ladies and gentlemen on behalf of United Spirits Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.