"United Spirits Limited Q2 FY19 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the United Spirits Limited Q2 FY19 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Anand Kripalu – Chief Executive Officer and Mr. Sanjeev Churiwala – Chief Financial Officer from United Spirits Limited. Thank you and over to you.

Anand Kripalu: Thank you very much and very good day everyone and very warm welcome to the F19 Q2 and half year results call.

As I normally do before we open up the lines for Q&A, I just wanted to provide a perspective of our results which we announced yesterday evening. As you may have seen in the published results, net sales in the business grew 14% in the second quarter enabled by broad-based growth across both the Prestige and Above as well as the Popular segments; Prestige and Above specifically grew 19% on a strong base of (+12%) in the same quarter of the previous year. This brings the net sales growth of Prestige and Above to 19% for the first half and I am pleased to note that this is the third consecutive quarter of double-digit growth for P&A. The Popular segment grew 10% in this quarter after adjusting for the operating model changes. But importantly, I must call out that we lapped relatively low base for Popular specifically, which was more sharply impacted by the highway ban last year. Within that our priority states continue to show momentum with net sales of Popular growing by 11% in the current quarter and 9% in the first half enabled again by a low base due to the highway ban.

Now, during this quarter specifically, we delivered an underlying gross margin improvement of about 120 bps, fueled by the work that we have done on productivity, and this more than offset the impact of inflation. Our gross margin for the quarter as well as the first half of the year stood at 49.1% which is broadly in the zone where we want our gross margin to be. The gross profit improvement has allowed us to continue investing behind our brands and this quarter our marketing investment increased by 38% versus last year, albeit on a lower base and that compares favorably with a top line growth of 14%. The A&P reinvestment trade for the quarter was 9% and for the first half 9.7% and this is broadly what we have been sharing with you about the zone of 9-10% as our targeted A&P spend. The gross margin improvement coupled with operating leverage helped us achieve an underlying EBITDA margin improvement of 300 bps versus last year and you will recall that last year we had a pretty strong EBITDA performance, and this is despite a significantly higher A&P reinvestment rate. The EBITDA margin stood at 19.4% for the quarter and was 14.7% for H1. While we reassert that one quarter does not make a trend and importantly we do not run this business on quarter to quarter basis but on a full year basis, I must say that this does give us confidence in our ability to deliver the medium-term margin guidance that we have provided to you. We continue to stay focused on financing cost efficiencies; the interest cost for the quarter was down 37% which also included a one-time benefit from a prior period reversal. If I were to remove that, our interest cost were still down by a strong 22% versus the previous year. Profit after tax for the quarter was Rs.259 crores, up

69%, mainly as a result of improved operating performance combined with the lower interest cost.

On the balance sheet side as well, I am pleased with our performance; our net debt reduced by 24% during the first half of the year as we utilized operating profit to repay some of our short-term debt. As you can see the financial performance of the company has been steadily improving as the operating environment has stabilized over the past few quarters and I must say that we have, after a long time seen about a year now of regulatory stability and you can see what this industry is capable of delivering when you do have some level of regulatory stability. Therefore, I must say that overall I am pleased with the progress we have been making in our journey towards premiumization and productivity so as to deliver consistent and sustainable profitable growth.

Looking ahead, we will continue to execute against our strategic priorities and to invest behind our brands so as to be able to capture the long-term opportunity that the spirits industry and market in India presents. I would like to use this opportunity to reiterate our medium-term ambition to grow the top line consistently by double-digit and improve our EBITDA margin to mid-to-high teen and to do that consistently not just one quarter but year-on-year.

With that, I am going to open it up for questions. I will be joined by Sanjeev Churiwala – our CFO and we will together try and respond to the queries you have. Over to you, operator.

Moderator: Sure, thank you very much. We will now begin the question-and-answer session. We will take the first question from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy: Sir, my first question is, is there a seasonality in terms of your margins? Last year also in second quarter it was 16% EBITDA margin and next three quarters there was a sharp fall and again in Q2 we are seeing a very good come back. So, that was the first question. The extended question is salary cost especially is down 11% YoY and 16% QoQ when I remove even the restructuring cost which was there. So, why should salary cost is so volatile?

Anand Kripalu: I will take the first question and then I will hand it over to Sanjeev for the salary point. So, as far as seasonality is concerned, Abneesh, it is important that you recognize that we run this business on a full year basis, right, not on QoQ basis. Now obviously the Diwali quarter and the winter quarter is a bigger quarter for consumption, we tend to invest a lot more in gifting and support behind our brand and we tend to do a little less in summer periods of the year. So, I think it is really hard to talk of seasonality in margin. There is seasonality in demand however and seasonality in the top line for the reasons I just mentioned, people tend to enjoy our brands more during winter months and festive season and little less in the summer period. So, I would say what you have seen in terms of the quarter-to-quarter movement is not so much to do with the seasonality but how we plan and it is about management decision of how to plan your spends and that is the reason why you are seeing some of those variation in the margin. Sanjeev?

Sanjeev Churiwala: When we look at QoQ numbers, there would definitely be variations on the numbers and as you would all understand, it all depends when you are providing for the gratuities, bonuses, we do have the way plans on the basis of which we do provide for severance cost and we have been calling out many times the plant closure that we do and as a result we need to pay out the severances at the time of closing the plant and that is not time-bound or yearly-bound, it happens as per the quarterly programs. Best is to look at the CAGR growth of salary cost over the last three years. As we have always called out, our endeavor is to keep our salary cost almost flat because of the productivity work that we have done and the biggest organization restructuring that we have called out in the past and that is the best approach. And as we have also mentioned in the previous calls as well, while our endeavor is to continue to deliver salary cost which is flat, the whole idea is to enjoy the operating leverage, the economies of scale because we want to grow our top line double digit just to keep our salary cost almost flat. The whole idea is to ensure the benefit of that go into the EBITDA margin.

Abneesh Roy: One follow up here. In Q1 you had said salary cost will be around 8-9% of the sales for FY19, this quarter it is only 6.3%. So, is there some downside risk to that 8-9% number?

Sanjeev Churiwala: No, we do not look at it that way, because we look at the six months staff cost as a percentage is 8.2% and that is the guidance that we have given. Best is to look at the absolute staff cost YoY and how the progression is happening there because frankly speaking while our category growth is happening now, as you see in the numbers, great delivery in terms of the top line, that does not mean that our staff cost will also proportionately increase. So, just a guidance, to do the mathematical modeling, the best is to see where the staff cost remains kind of flattish as we move forward.

Abneesh Roy: Sir, my second and last question is on the P&A growth which has come back very strongly. So, now when I see Pernod's numbers on a two year basis also, they have grown 34% on a 2% base which means on a two year basis around 36%, you have also grown 19% which is a good number on a 10% base. So, on a two year basis, you have grown at 29%, Pernod has grown at 36%, so there is a gap of 700 bps, the gap should have been the other way round, right, because you had relaunched the brand while Pernod was already a stable business. So, could you explain why this gap should be there?

Sanjeev Churiwala: I am not really going to get into explaining gap with the competitor, Abneesh. I think you have to look at our performance which is 19% on a growth of 12%. So, to use your arithmetic, which is not precise but simple arithmetic is 31% over a two year period which is a CAGR of about 16%-odd, that is our growth. We are also driving significant margin improvement because our objective is to deliver sustainable profitable growth with improved margins, not just deliver double-digit growth but with improved margin and hopefully you are beginning to see this come through. The other thing I must say is that somebody may deliver spectacular growth in a quarter. The reality is the industry is growing at mid-teens kind of growth or mid-to-high teens kind of growth. That is the rate at which the industry is growing. All I want to say is that this is not a winner takes all market. India is about category growth and if I am able to deliver strong double-digit growth, right, and in this case 19% growth on a 12% base, with significant improvement in operating margin, then we actually believe that this is a strong performance in absolute. If somebody else also does well, I am not too concerned about that because there is a lot of opportunity in the Indian market for everyone to grow. As far as we are concerned, we want to grow and grow profitably and that is how we are holding ourselves accountable.

Abneesh Roy: Just one small follow up. The three relaunch brands, McDowell's, Royal Challenge and Signature, they would have grown faster than the 19% number?

Sanjeev Churiwala: So, we are not getting into specific brand wise performance. You have to look at our overall performance. But what I can tell you on performance and this is a message to everybody on the call, premiumization is happening, so brands higher up are growing faster than the brands lower down, right. If you start from #1 and go all the way up to Scotches and Johnny Walker as you go up the pyramid, every segment is typically growing faster than the segment below it, and that reflects that our premiumization strategy is working and that is helping us in terms of price mix, right, which is hugely valuable to our overall margin profile.

Moderator: Thank you. We will take the next question from the line of Avi Mehta from India Infoline. Please go ahead.

Avi Mehta: Sir, my question was essentially on the recent articles about ENA fuel blending norms changing. I just wanted to understand a) how do you look at those kind of input cost pressures and if you could also share what are the measures that you highlighted for example this quarter there was some productivity, what are the measures that you can do to offset any such input cost pressures?

Anand Kripalu: I will just give you an overview and then hand it over to Sanjeev as well. So, the reality is that we have had a relatively benign commodity environment now, I would say over the last 18-24-months and everybody knows that commodities do not stay that way. So, we are beginning to see partly because of what is happening to oil, what is happening to foreign exchange and so on. Some hardening begin to start of glass and ENA. Now, all I can say is that as far as this fiscal is concerned, we have a very aggressive productivity program in place, we are looking at even putting in new projects into productivity. I am not getting into specific productivity project but suffice to say that it covers every aspect of cost in our P&L, not just material. So, we are looking at enhancing our portfolio of projects so as to mitigate as much as possible of whatever hardening we are seeing in ENA and glass, and we do believe that as far as this fiscal is concerned, it is not going to have a material impact on our total numbers and margins.

Sanjeev Churiwala: Maybe, Avi, just to build on to your question, the larger discussion point is yes, we will see some inflation coming through the input cost, whether ENA or the glass bottling prices, but the fact is how do we look at that through the lens of our GP margins and EBITDA margins, that is a larger question I suppose all of you would be very interested to understand. If you look at the current shape of the P&L the way it is panning out, GP margin profile is almost in the zone of 50% which is a very-very healthy margin point to begin with and absolutely you have also seen improvement in a GP margin and this improvement has now been very consistent over the last eight quarters. As Anand was pointing out, so a combination of various things, how do we look at our pricing increases, mix, premiumization journey, our productivity across various lines of manufacturing items and all of these have contributed to the margin enhancement. We are very confident with the various productivity work that we are doing. By and large we will be kind of tackling all the inflationary pressure that will happen, but there will be some pressure and we will have to kind of fight the battle as we move forward. What is very-very important for us, as we also kind of pointed out in the last call itself, if you draw your attention to the six months performance, not leaving it to just one quarter, we have 230 bps improvement in our gross profit margin and almost all of that have flown into the EBITDA margin, our EBITDA margin enhancement is 220 bps. What does it say? It very simply says that we are using the scale of economics now and the operating leverage is coming out as to how we manage our overall fixed cost portfolio. So, when we look at staff cost, we have called out our endeavor to keep it flattish. Other headlines stand up to large part of inflation is mitigated through that. Advertisement and sales promotion expenses last year we did reinvest lot of this margin portfolio back into but then we called out that the intent to keep our A&P investment in the zone of 9-10% which means as we move forward a large chunk of the GP margin improvement we see will flow back into the EBITDA margin which kind of tells you the story as we move forward. So, our endeavor is to kind of manage our EBITDA margin delivery, our stated ambition of mid-to-high-teen margins through all the lines of the P&L and just not purely one line of cost.

Avi Mehta: Sir, I was essentially looking for the numbers for inflation essentially if you have any, I do not know ENA if there is any number that you can share or any expectation, that is what I was trying to get through?

Anand Kripalu: It is, Avi, very difficult because we do keep on tracking that month-on-month but it is very difficult to put a number in terms of projections as we land up. Our whole idea is to kind of look across all the line items and collectively drive the productivity initiatives and the margin initiatives rather than just focus on one particular line of cost.

Avi Mehta: The second question was on the reduction in the debtor levels that we have seen, that has been a very healthy performance. If you could share what has driven that moderation and is that a steady state level to kind of take going forward?

Sanjeev Churiwala: Alright, let me first start with the various initiatives that we do to really manage our working capital. Of course, given the category we operate, this is a very intensive operation in terms of working capital for the industry and big amount of money is invested in the working capital but across the various activities we do over the last couple of years we have tried to really manage our working capital very intensively, as a result you have seen now across the last eight quarters, continuous reduction in the working capital and that has gone in releasing the debt. So, yes, working capital, our endeavor is to kind of keep flat or keep on managing it well. The whole idea is if we are improving our top line by 10%, we want to ensure that the increase in the working capital requirements to be bare minimum which means a better return on invested capital that we have. Most of this reduction in the working capital goes in terms of reduction on the debt. If you see our free cash flow, we have been having a healthy free cash flow, our CAPEX levels are bare minimum, it is kind of on a guided level of Rs.200 crores odd that we spend, working capital increase is very subdued and almost flattish or reduction. As a result, we do get good free cash flows, most of them kind of goes in reduction of debt. So, over the last one year when we speak now vis-à-vis last September, we have reduced our debt by Rs.900 crores as compared to March '18 itself we have reduced our debt by Rs.637 crores. Our endeavor is to yes, ensure that we keep on working towards improving our working capital every year and keep on reducing our debt level. Now if you are having a question as to what extent you want to reduce our debt? It is very difficult to decode that, as we speak now, we are sitting down on Rs.2600-odd crores of debt. Given the healthy cash flow, yes, we would endeavor to reduce our debt further in the next couple of years.

Avi Mehta: No sir, since you are talking about receivables, the decline has been very-very sharp and very healthy, it is a very good sign, I just wanted to understand what drove that, that was what I was coming to, that was what is the question?

Sanjeev Churiwala: Sorry, I could not understand that, yes, so absolutely we work with our commercial team very closely across all the states and ensure that our debt levels are kind of completely under control, sometimes it happens that some of the states which are corporation market, do not pay up on time but again that is the nature of the business. But we do keep a very tight control on our receivables, that is managed on a day-to-day basis.

Anand Kripalu: If I could just add to what Sanjeev is saying, so we have a very-very clear policy at a state-to-state level, right, which we have put in place with the commercial team, right. We have a circuit breaker and at times we stop supply if that circuit breaker goes off. So, it is just a tight policy that we have implemented on a state-to-state basis, that has actually driven a lot of improvement as well as some hard calls we took a year ago even in Q3 last year when there were suspected route-to-market changes and we said, we are going to put credit risk on top of revenue risk and pull back credit. So, I think it is a culmination of many-many factors, Avi.

Avi Mehta: Hard decisions you took earlier is what is reaping benefits is how I should see?

Anand Kripalu: Ongoing decision, so it does not stop. Every month there is a challenge of whether you are going to continue to supply a particular customer or not, depending on where the outstanding are. So, it is an ongoing thing but we are I think trying to implement a policy as rigorously as possible.

Avi Mehta: Your medium-term guidance is still mid-to-high teens. I understand quarterly is not what we look at but I do not see any one-offs over here. Your business has clearly shown the ability to deliver about 19% margin. Are you being conservative by maintaining that guidance in mid-to-highs and that also medium-term, I am just trying to …?

Anand Kripalu: Let me just put it this way, okay, we have given a guidance and the jury is out and whether we have achieved that guidance consistently and sustainably or not. Let us first get to that guidance and deliver that to you guys and then we will talk about any change in guidance, right. And again I am saying this - one swallow does not make a summer, one quarter does not make a year, right. So, just watch the space but all I am saying is take confidence in what I said, above the fact that we are feeling a lot better about the margin profile of this business and our probability of delivering the guidance I think is strengthened by a quarter like this.

Moderator: Thank you. We will take the next question from the line of Latika Chopra from JP Morgan. Please go ahead.

Latika Chopra: My first question was on revenue growth trends. Would it be possible for you to elaborate if this revenue growth is pretty much broad-based across states or were there any specific benefits or increases that you saw on account of due to market changes in some of the states like UP?

Anand Kripalu: So, revenue is absolutely broad-based across states and broad-based across the portfolio, so brand as well as state, so both the vectors. But yes, states like UP have performed better than the overall average numbers that we have declared and some states would be a little less than that but I would say all regions and generally speaking all states have performed strongly. I think that really augurs well because it is not based on a flash in the pan performance of any particular state or any kind of exceptional performance from a particular brand or a particular state.

Latika Chopra: Does that give you confidence that mid-teens kind of a growth for the industry could probably sustain as we look forward over next couple of quarters?

Anand Kripalu: Thing about this industry, Latika, is that you never say never and you never quite know, right. Now we have had a year of regulatory stability and that has really helped, bring some normative trends to this business. So, if you have normative trends is this the kind of growth that this industry is capable of delivering? Absolutely and that is what we have been saying consistently. Now, as we move into H2, we will have the run up to general election, we have four states going into election as we speak now and sometimes election is a funny, sometimes it could be explosive in terms of opportunity for us or sometimes it could derail you for a month or two. Normally, there is no long-term impact of that. But what happens in the short-term and therefore in the next couple of quarters could be dependent on how the election plays out. But what I would say is from a longer-term perspective, we have to take confidence in the fact that this is what this industry is capable of delivering. And particularly, Prestige and above, right, which has been central to our strategy since we started this journey three, four, five years ago. We have been talking of Prestige and Above and over investing in Prestige and Above and that is where we are seeing the real growth. Popular still remains I would say low single digit which is what we have always said. But Prestige and Above and the whole premiumization story I think is intact and if things just stay without any funny is happening, then I think you should continue to see decent performance.

Moderator: Thank you. We will take the next question from the line of Harit Kapoor from IDFC Securities. Please go ahead.

Harit Kapoor: Just two questions: Firstly, on the Popular side. I know it is not your key growth focus category but this quarter the underlying volume growth trends are good. You kind of mentioned that it was also led by the base of the highway ban but that probably would have been true of 1Q as well. So, just wanted to understand more in terms of probably core brands or core markets that would have probably done better for you and whether your medium-term low single digit guidance still stands true?

Anand Kripalu: As of today, if you look at the data not just quarter-to-quarter but from just a volume trend perspective, in the states where we have retained the Popular business, we believe that the guidance of low single digit growth is correct. Now there are quarter-to-quarter funny that happen in some state or the other and then one state shows spectacular growth because the base was soft and so on and so forth. But I think we really do believe that that is where the guidance is the right guidance and you might have some variations to this guidance depending on how quarters and years progress, but on a long term basis I think we still believe that that is the outlook for Popular.

Harit Kapoor: Second question was more book-keeping oriented. If we see last year there was a big difference between your consolidated and standalone EBITDA and part of it was due to a large VAT refund for one of your subsidiaries. Just wanted to get a sense about what could be the quantum of that differential even this year because the first quarter that subsidiary has not reported it. I could take this offline as well but if you have that number, it would be very helpful?

Sanjeev Churiwala: So, I think you have to take it offline because on quarter-to-quarter basis we just talk about the standalone, the consolidated discussions happens only on the March year-end because it is not wise for us to discuss sensitive numbers about subsidiaries when we are not supposed to disclose that on quarterly basis.

Harit Kapoor: I just wanted an annual thought process because I understand that part of that refund is supposed to come in this year, so just wanted that thought, but I will take that offline, no issues.

Sanjeev Churiwala: Yes, thank you.

Moderator: Thank you. We will take the next question from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

Jamshed Dadabhoy: Just a couple of questions from my side. First is on your other expenses. Last year you have had Rs.152 crores of bad debt provisioning and about Rs.184 crores for legal fees, almost 4% of sales on just those two item heads. Can you give us some sense in terms of how those are progressing this year?

Sanjeev Churiwala: Jamshed, I am not very–very clear on your question. If you kind of sensing that "Do we have a repeat of those kind of write-offs this year?" The answer is absolutely no. While yes, there have been some changes in the route-to-market last year because of which we took a conservative book provisioning. That does not mean that the money is not going to be recoverable. Our stated intention for this year is absolutely kind of ensuring that our overhead remains subdued and be able to mitigate a large part of inflation and the whole idea is we kind of get that operating leverage this year when you look at the P&L for the full year.

Jamshed Dadabhoy: So, actually where I was coming from was that if that inflated your other expenses last year, are you seeing a reversal of some of that bad debt provisioning this year which has already flown through the first half?

Sanjeev Churiwala: It is too early for us to really call that out. As we progress, we will see the recoveries happening. To that extent you will definitely try and get back but at the moment we are not able to give you a very definitive answer on that.

Jamshed Dadabhoy: Second question IPL brand franchise income has declined last year. How should we think about this going ahead into this year and the year ahead?

Sanjeev Churiwala: IPL brand franchise income will not be reflected in the standalone results. I suppose if you are referring to the last year numbers, you will have to wait for the March year-end to come and we look at the consolidated number, but there are not any surprises.

Jamshed Dadabhoy: No, I know that, but I was just thinking that since a lot of the agreements have been revised again on that side, I was just wondering if that at a consol level we could expect something bigger increase in terms of brand franchise income and if you all have any thoughts on that, that is where I was coming from?

Anand Kripalu: Whatever was revised in terms of agreement have flown into last year numbers and the last season of IPL. Now, there is no further revision that has happened recently in terms of the brand and the central promotion rights.

Moderator: Thank you. We will take the next question from the line of Prashant Poddar from ADIA. Please go ahead.

Prashant Poddar: Sir, obviously these numbers are fantastic but we just wanted to understand even if we look from the first half perspective underlying EBITDA margin of more than 15% and you said the second half you will probably see some more investments, but you will probably reach close to mid-teens and going back to the previous question that another analyst had asked, is the guidance the mid-to-high teens margin guidance looking conservative and also on gross margins when you say that 49%, 50% is where you see the gross margin stabilizing, given that you will continue to see some price increases in next year, whenever and the mix will continue to improve in the favor of premium brand, are both these guidance numbers looking conservative particularly given the other two players in the industry put together maybe as large as you are doing better than those margins?

Anand Kripalu: What others do, that is their strategy. I just want to say this that there is an appropriate gross margin to take away from a market like India, we want to drive overall volume growth and category growth. This is management judgment beyond a point. Now, if 49, 50 could, could it be 52, 53, could it be 45, I do not know precisely and these things you will suck and see. But all I am saying is this that in order to also have the right strategic pricing to drive volume growth, we might take decisions sometimes one-off, those will invest back into being competitive or in terms of driving segment and category growth. So, for now we are saying that this is the order of gross margin that we believe is appropriate for this business.

Sanjeev Churiwala: Anand, if I could add, what we are trying to be clear on this call here is our guidance is not on the gross profit margin piece, our margin is always on the EBITDA margin, right and when we say mid-to-high teen, we are actually talking in the range of 13 to 19, if you see last year's results we were exactly at 13, right, so I do not think we can really swing our guidance so early in the year. We will be very happy if tomorrow we are proven that we are conservative but absolutely we will be moving in the right direction between mid-to-high teens and we are somewhere in between now. So, please decode that way, do not kind of take away anything that we are giving a guidance on the GP margin, we want to deliver our EBITDA margin ambition through all the line of the P&L.

Prashant Poddar: The other bit in terms of price increases last year was as you said good and this year we head into election year, but generally has the approach of the state governments changed, the voting patterns of India has also changed in terms of people who are voting more. It looks like people who are voting more for development, etc., So, are the governments more receptive than they were let us say three, four years back or two, three years back?

Anand Kripalu: I would say generally speaking the government is somewhat more receptive and the quality and the kind of engagement has significantly improved from the way engagement used to happen earlier. Now, pricing last year was good; good part of that has flown through and we have taken pricing or renewed pricing this year as well in certain states. There are one or two states that have been elusive, right, which we are still trying our best to go and crack. More importantly now we are getting ready for the next excise cycle which is where a lot of our work is happening today. The next excise cycle also coincides a bit with the general election. So, there is a bit of funny there on whether we will get some price increases before the general elections happen or whether it will happen soon after the next government start getting sworn in. So, there is bit of a period where we are not certain what is going to happen during the March-April-May period. But overall I would say that the realization and ability to get pricing is better and in fact we have cracked some of the toughest and most stubborn states on pricing in the last 12-months. States that have not given pricing for five years, six years, we have cracked. So, I really do believe that our formula is helping us to get more pricing and that is what we are building into our plan for the future in terms of how we are approaching this.

Moderator: Thank you. We will take the next question from the line of Aditya Soman from Goldman Sachs. Please go ahead.

Aditya Soman: First question is you mentioned on taxation. Is there a chance any of the states can take up excise duties sooner given that some of them have cut the duties on petrol and diesel?

Anand Kripalu: There is a risk always in our industry and particularly post GST Aditya, the one thing that a state completely control now is Alcobev and sometimes they need to play with waiver of farm loans or increasing or reducing taxation on petroleum, right to help the common man and they may try and make amends from our sector, so that risk always exist. I think however, there is a greater realization of the play between higher taxation and volumes and health of the industry and the trade-off because people know that if the taxation is too much, then it hurts volumes and does not really improve revenue and make the industry less healthy and that is not helpful to longer-term revenue for them. So, I would say that this risk is something that we always know is on the horizon, some may happen, some may not happen.

Sanjeev Churiwala: To just to add what Anand said, the beauty is we are a pan India player across brands and we are playing across a big portfolio, so we always see that, in some states it will go up, in some states it will go down but overall given a pan India player we are kind of well-equipped to manage these kinds of contingencies.

Aditya Soman: My question was have you heard any sort of increases and noise around this issue lately or it is just business as usual as far as you are concerned?

Anand Kripalu: There are always rumors, right. I do not want to give credence to rumors or talk about the rumors on this call. Of course, there are rumors you hear, we hear what you hear and vice versa. Okay. So, there are rumors. But there have been rumors earlier and that has not translated into any action either. So, I think you will have to just wait and see.

Aditya Soman: Secondly, in terms of this volume uplift especially in Prestige and Above, any specific initiatives that drove this uplift and any specific brands that you want to call out?

Anand Kripalu: I think it is broad-based as I answered earlier. I think we are particularly pleased about the top end of our portfolio and scotch particularly and now scotch is done, and that is helping to drive premiumization, helping to drive our price mix as well and that has done really well. I think it is enabled by some structural changes that we made within the company to ensure that the top end of our portfolio has a very focused team who are very focused on driving growth in that part of the business and I think it has got enabled by that.

Moderator: Thank you. We will take the next question from the line of Priyanka Khandelwal from ICICI Prudential. Please go ahead.

Priyanka Khandelwal: Sir, just wanted to check, how much of our revenues are from free states and how much from government controlled purchases?

Anand Kripalu: Roughly about 70% is corporation but I would not use the word free, so it is not as simple as that, many of the corporations state are quite free as well in terms of how business is done. So, they do just wholesaling in many places and that accounts for about 70% of our business.

Priyanka Khandelwal: So, when you say that raw material prices are always volatile and we have seen that crude already spiked and rupee also depreciated, so is it safe to assume that you will be able to take price hikes or it will happen the lag effect at least to take care of your margins?

Sanjeev Churiwala: I think it is important to clarify "Whether we can take care of our margins?" Answer is yes, we will be able to take care of our margins and stick to a guidance that we have given. As I said before, we are going to play around various line items and just not only one pure play on the cost and the productivity, it is a combination, as Anand has said in terms of if we look at our premiumization journey, we look at price, we look at how we manage our overheads, the whole idea is to kind of deliver our margin aspirations.

Anand Kripalu: Just to add to Sanjeev's point, the only guidance we have really given is on EBITDA margin, right, and we are now coming into the zone of the guidance at least for one quarter which really is we are getting there despite having a very significant step up in A&P, so there is space in our line and that should give you confidence about our ability to get to guidance and manage any volatility that might happen in commodity or the other areas.

Moderator: Thank you. We will take the next question from the line of Nilesh Shah from Morgan Stanley. Please go ahead.

Nilesh Shah: My first question is just a clarification on the IPL question that was asked earlier. Is it not true that the change in the media rights happened for this season and hence for fiscal 2019 you will see any changes thereon being reflected in a consol numbers?

Sanjeev Churiwala: We will have to wait when we see the consol numbers for the March '19. As I said, this six month is for the standalone USL business and we are kind of focusing this IR call on the standalone business operations.

Nilesh Shah: Because you did say that there was unlikely to be any change on YoY basis and hence the question. I am not asking for a quantum or what it is going to be, but is it not true that any change in the media rights and the increase thereon will only come in through fiscal 2019?

Sanjeev Churiwala: It might be, but I do not think we can give you an affirmative answer on this call when this call is specifically about USL business.

Nilesh Shah: Second question is on the input costs, what percentage of our ENA is now grain-based versus molasses-based?

Anand Kripalu: About 70% is now grain and 30% is molasses and specifically there in some molasses rich state, but our Prestige and Above portfolio I must add is 100% grain-based.

Nilesh Shah: This 30% is for essentially the volumes that USL has in terms of its non-franchise business. Would that be right?

Anand Kripalu: Roughly yes.

Nilesh Shah: Is there any flexibility in changing this to grain-based if and when you see an opportunity based on the input cost movements or is it …?

Anand Kripalu: Absolutely is an opportunity and again these are commodities and we are going to keep watching this closely and automatically whether we do it or somebody else does it, there is an arbitrage then you know that investment will happen and changes will happen there. So, I think there is absolutely an opportunity to even in some cases modify existing plants from molasses to grain if that is the need of the hour.

Nilesh Shah: Finally, any update on the asset sales, I know it is a slightly long-term view that you have about, I think about Rs.1,500 to Rs.2,000 crores?

Sanjeev Churiwala: Absolutely, if you see the last couple of years we have as of now sold noncore assets worth about Rs.300-odd crores, we have another Rs.1,500 crores in the pipeline which do include some of the marquee properties which are under negotiation right now. Hopefully, as we move on to the subsequent quarters, you will start seeing those going through.

Nilesh Shah: We should hold on to a view that this may happen over the course of the next three years or …?

Sanjeev Churiwala: Yes, absolutely, our stated ambition is to kind of ensure that the sale happens in the next couple of years.

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

Amit Sinha: Firstly, request your commentary on the Scotch portfolio especially the activation part which you did in Johnny Walker and how it has impacted the mix for the quarter?

Anand Kripalu: I am not sure how much detail we can give you in a call like this, but obviously the brands are being consistently activated and that is why we are seeing strong growth in Scotch and I am not sure what more you really want in this call. There is a comprehensive list of support and marketing activities, specifically in terms of things you may have seen, you might have in the new film of Johnny Walker that has gone on air, there has been a new film of Black & White, in fact the first film that we had on Black & White when the brand was launched in India also going on air. So, we have stepped up above the line investment on the brand extensions of these brands, so that coupled with activity on the ground which includes wedding banquets and work that we do in the on-trade which is in the bars and restaurants that is really contributing to what we believe in the strong Scotch performance.

Amit Sinha: The second part of the question was, does it improve the mix significantly, I am talking from the perspective that our margins have gone up significantly in the overall P&A space, so now some of these Scotch brands do they help our mix?

Anand Kripalu: Of course, they have to, just sheer arithmetic numbers, they have higher revenue per case, they have higher gross margin in most cases, so it is margin increases to the business and price mix also by the way is a metric that we drive very hard in our business and that forces a culture of premiumization, not just here, but down the line including the sales force, so that is something we actively do.

Amit Sinha: Secondly on the UP market, it has been now six months since the route-to-market changes happen, just wanted some commentary from your side how has the market panned out and if you can help us basically has your realization in that particular state improved after the route-to-market changes?

Anand Kripalu: Realization by state, I do not think we are going to get into that conversation, but what I can tell you is that UP continues to grow faster than the national average post the route-to-market changes, but there has been some tempering of that growth rate, it was not as explosive in the quarter straight after the route-to-market where there was an empty pipeline and hundreds of new wholesalers who are buying up stock and putting into their godown. So, there has been some tempering of that growth, but in this quarter that we are talking of, growth in UP has continued to be significantly ahead of our national average growth in Prestige and Above. So, there is still momentum that is coming from that state.

Moderator: Thank you. The next question is from the line of Jaimin Shah from RWC Partners. Please go ahead.

Jaimin Shah: I have two broad questions; first is Pernod internationally on their call mentioned that they are also kind of focused on growing the market than picking market share. Could you kind of elaborate how the competitive intensity has evolved over last two to three years since the time Diageo completely taken hold and how the two large players are kind of working alongside in terms of growing the market? And also, how you kind of see competitive intensity in next five years versus let us say last five or 10-years where it was a very different kind of thought process behind United Spirits versus Pernod? The other question I had is, in a country like India where the end distribution on the customer side is quite restricted due to license which is under state control, I am curious to know what is your view on online delivery and we have heard this Maharashtra government kind of allowing online delivery and you took a stake in Hipbar, how do you think this kind of segment evolves over the next three to five years and what is the potential there especially in the top 8 to 10-cities for example?

Anand Kripalu: First of all, I do not think competitors collaborate to grow the category, competitors combine to shape the regulatory environment so that the category can grow. So, a on a state-to-state basis, how do you shape the slab, how do you shape the pricing, so that the category can grow and certainly as part of the industry association all competitors sit together to make sure that the industry has favorable policy. Of course, the competitive environment is hot and has heated up since Diageo made its investment, but the positive outcome of aggressive competitiveness is that competitors invest more and that is what drive category growth, the category growth comes from saliency of the category and relevance of the category and everyone is investing more today, you will see even other players spending money, advertising and doing other things and hence everyone is contributing to growth of the category and that is what is actually happening, we are seeing category growth coming. So, I think there are certain areas where you compete head-to-head and there are certain areas where the whole is more than just some of the parts. As far as online delivery is concerned, so this is something that we believe in and I believe that to your point five years from today, "Will there be any category not available online?" Very unlikely the way India is moving. With everything India is trying to do to leapfrog and more recently pharma is now allowed online. So, it is highly regulated and constrained industries like pharma are getting permission to go online. I think there is little doubt about the fact that some years into the future, there is going to be online delivery of alcohol officially allowed, but we also know it is not easy to get there and that is why we made the investment in HipBar to bring that date forward when this whole thing can happen. Now we are beginning to see success, right, in some states and I think as we are able to prove that success and demonstrate that success to other states, more states will open up. Nobody wants to be left behind. It is like ease of doing business ranking. Nobody wants to be left behind in doing things that seem to be progressive. So, I think we have to believe that online delivery will happen and as a key company in this industry, we are actually trying to take the lead in making that happen.

Moderator: Thank you. Due to time constraints we will be able to take one last question. We take the last question from line of Chanchal Khandelwal from Birla Mutual Fund. Please go ahead.

Chanchal Khandelwal: Most of my questions have been answered, just one question on the ENA, which is the 30% molasses-based from the sugar. What is the inflation you are seeing in this because of ethanol policy changes has happened and what is the kind of percentage increase and does the ENA grain behave in a similar manner like the ENA from the sugar?

Anand Kripalu: First of all, the full play out of the change in ethanol blending policy has not played out yet. So, we do not know whether it is going to have a difference in grain whether grain will sympathetically move in line with molasses ENA and so on. We are seeing some hardening of ENA as a result of this and I do not want to get into specific percentages. We are largely protected as we said earlier for this fiscal, so therefore there is going to be no material impact, but we are watching this space closely and we might change our whole buying strategy and the mix between grain and molasses as well as the investments that happen in producing ENA on the ground depending on how this whole piece plays out. So, I think you just have to wait for another quarter or two to see how this plays out and what is the real inflation that comes into ENA. Now you have seen what has happened right. Crude has gone down from 85 plus to 76. So, therefore already the value of ethanol blending will start eroding for oil marketing companies. So, this is a very dynamic space and we just have to watch it step-by-step.

Chanchal Khandelwal: The second question is on the brands key launch, McDowell's No.1 at some states, you have reduced the prices if I am not wrong. So, after the reduction in the price what is the new positioning you are doing that and how is the response being from the market?

Anand Kripalu: First of all, generally speaking, we have not reduced prices on McDowell's No.1 anywhere. We have taken what I call a strategic price correction to a small extent still maintaining a premium to one of the brands in that segment in one state and that is because we wanted to get to the right strategic pricing. Just to put this in perspective, in that state McDowell's No.1 grew even more than 30% and yet we took a strategic price correction because we believed that two things; one is that this was one of the highest gross margin states for us in the business and for McDowell's No.1 is the brand. If this brand grew faster in that state, it will be margin-accretive nationally because the gross margins were higher and secondly, we believe that there was an opportunity for further growth of the lower Prestige segment even faster than what was growing before, and that is why we have done it. It is too soon because it is only week since the change went into the market, and all I can say right now is that the initial response is positive and we are encouraged by that as well.

Anand Kripalu: Really I just want to use this opportunity to thank all of you for your support in our company for taking the time to join our call today. Thank you very much.

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