"United Spirits Limited Q1 FY-19 Results Conference Call"

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**Moderator:** Ladies and gentlemen, good day and welcome to the United Spirits Limited Q1 FY19 Results Conference Call. Today we have on the call, Mr. Anand Kripalu – Managing Director and Chief Executive Officer; and Mr. Sanjeev Churiwala – Executive Director and Chief Financial Officer from United Spirits Limited.

As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Anand Kripalu MD and CEO. Thank you and over to you sir.

**Anand Kripalu:** Thank you very much. And hello everyone and welcome to the FY19 Quarter 1 Results Call. As we normally do before we open up the lines for Q&A, I wanted to provide a perspective of our results that we announced last evening. I would like to remind you that we don't run this business on a quarter-to-quarter basis but on a full year basis. So please do look at our results from that perspective.

As you may have seen in the published results our net sales grow 13% in the first quarter helped by strong momentum in the prestige above segment which grew at 19%. Despite benefiting from lapping the impact of the highway ban in the same quarter last year we do believe that these numbers were testimony to the strength or our underlying business and the fact that the business has started recovering after the many shocks that we have seen and faced over the last year. Our premiumization strategy continues to show results with the prestige and above segment now accounting for 65% of our net sales and that is up 4% versus last year. Our fit for purpose model for the popular segment is also delivering as planned and our franchise income this quarter was in-line with our expectations. Net sales of the popular segment in priority states grew by 7% even as the overall net sales of popular remained flat after adjusting for the operating model changes.

During the quarter we have delivered underlying gross margin improvement of 266 bps, fueled by productivity savings, pricing and better mix. And that has enabled us to more than offset the adverse impact of inflation and GST. In fact, the continuing improvement in gross margin and that journey is something that we are particularly pleased about. The gross profit improvement has allowed us to continue to accelerate investment behind our brands and you would have seen that this quarter we continued this journey of enhancing our marketing investment which was up by 30%. And specifically, in this quarter we invested aggressively behind two big opportunities that presented themselves this quarter IPL and the FIFA World Cup.

Despite the increased marketing investment and the investments that we have made in improving our factories in the current quarter, we have seen underlying EBITDA margin improvement of

127 bps versus the previous year. We continue to bring in financing cost efficiencies through lower debt, improved mix and better rates. And our interest cost therefore for the quarter were down 20%. The profit after tax for the quarter was 81 Crores up 29%, primarily as a result of improving operating performance combined with lower interest cost during the quarter.

I would also like to touch upon our recent decision to acquire a 26% stake in Hip Bar. Hip Bar is a technology startup and you all know how important this space is for the future. So it is a technology start up in the Alco-Bev space that aims to solve some of the logistical issues faced by consumers and our industry and that is to do with accessibility. It offers them home delivery, store pickup and a digital wallet, depending on the area in which they live and it also enables online age verification thereby improving compliance which is a plus for the regulators. Currently Hip Bar operates in Bangalore and Chennai and we want to support their ambition to expand in other states. And I would encourage actually each of you to check out the Hip Bar app if you are based in these cities or when it launches somewhere near where you live.

I also want to take this opportunity today to touch upon some rumors and unsubstantiated claims that have been plaguing our industry as well as United Spirits over the last couple of weeks. And this has impacted our stock price more recently. The first one is the possibility of ENA coming under GST. Now it was interesting that there was so much speculation on this, but there was not even a reference to the matter during the most recent GST council meeting of the 21st of July and in fact it was not even on the agenda. Now, while we cannot control the final decision I have to say that the industry has continued to work with key state governments to provide them the relevant data-based arguments against the inclusion of ENA in GST and I can tell you that there are several states and very-very senior minsters in states who are favorably disposed to opposing the inclusion of ENA in the GST.

Similar to this last week there was another media article that one of the incumbents in our larger industry was liable to pay GST on the surplus profit received from his contract manufacturing. And this was something passed by the Authority of Advance Ruling, AAR in Karnataka. It not only was interpreted to also extend to us but its potential impact was also grossly overestimated. I want to clarify that this ruling is not binding on us. There are multiple rulings by the tax tribunal in the past including ruling by the Supreme Court which clearly upheld that the surplus is not taxable. Basis this and the legal opinions that we have received we remained confident so as to maintain that position.

I would like to reiterate that the financial performance of the company has stably improved over the last few years. Despite all the challenges that we have spoken about in the macro environment.

Looking ahead, we will continue to pursue our strategy and invest behind our brands as our P&L now allows us to do that. And get another step closer to our ambition of our medium-term ambition of double digit growth and delivering mid-to-high-teen margins. So, with that opening comments I am opening up the lines for questions.

**Moderator:** Thank you much sir. The first question is from the line of Abneesh Roy from Edelweiss Capital. Please go ahead.

**Abneesh Roy:** Sir my first question is on ad spend. So last three quarters it has been 11.5%, 10.2% and 10.5% percentage of the sales while it was 9.2% in FY18 so is this the new normal and what is the split between ATL and BTL in this?

**Anand Kripalu:** So BTL is completely separate and that is netted off sales. But as far as A&P is concern which is the number that you had seen here in the P&L so I agree that the A&P spend this quarter is probably towards the higher end of what we would like to spend and that was because there were opportunities to spend and you must have seen visibility of our brands on the two events that I spoke about. I have said earlier that it is unlikely that we will on a steady state basis do an A&P more than 10% right. So, 10% is the max and I do not think we will go lower than 9%. Having said all of this I feel that we are beginning to see recovery in our business. On the back of the investments that we have made, and I feel reassured that whatever decision we took to enhance ad spend has actually started paying back. Now we will suck and see this as you know this is about management judgment beyond the point whether we spend 100 bps more or 100 bps less, we do not want to over spend, we do not want to underspend. And if we feel that we can sustain the right momentum with slightly more trimmed A&P spend closer to 9 rather than closer to 10 then we will do that over time. But you should read this as this is probably the max cost, probably 10-20 bps more than the average for the year and because of the opportunity that were available in this quarter.

**Abneesh Roy:** But sir has competitive intensity in terms of advertising also increased because three successive quarters. I understand FIFA, etc but could you also discuss in terms or share of voice are you compelled to do this?

**Anand Kripalu:** Advertising is not a short-term delivery Abneesh. There have been years where our brands have been under supported and we are in some ways making up for lost time and seeing the value of doing that. So, I believe that our share of voice today is strong, and we want to improve that share of voice. Our competition has upped their spends to some extent but our understanding is not to the extent that we have. And I think we retain the rights to trim it as appropriate. But there is a lot of management judgment in what is the right amount of A&P, there has been so much of science done on this without anyone having a precise answer and I think we are watching this piece closely we don’t want to spend more than we need, but I will spend as long as I believe that it is giving us dividends and right now that is what we believe.

**Abneesh Roy:** Sir, my second question is on Hip Bar investment. So we also see different companies like Madhuloka which are also present here. So, will you work with them also and you also said it will be expanding in to more cities. How is the legal framework in this because what we understand is in terms of legal only Bangalore currently allows B2C but what is your sense in the next three years you expect maybe most of the top cities being covered by this.

**Anand Kripalu:** I will not talk about collaborations with anybody else because that is completely speculative let us talk about Hip Bar and the opportunity to expand Hip Bar. We actually believe that in terms of just unlocking of accessibility, now one of the biggest challenges in the Alco-Bev industry is that the number of stores where you can buy a drink or have a drink is very-very limited it is amongst the lowest in the world for a population that is this large. Now opening new retail stores and for the government to give license for new retail stores is a touchy one because it is highly charged subject whether to open more liquor stores or not. I think that with governments focus on supporting this digital economy, digital initiatives probably have a better probability to get approvals then the conventional industry and hence our partnership with Hip Bar. Now having got success and I want to make one thing very clear we are going to only do what is completely compliant. So, where we get regulatory approvals we will do it and once we start having data to support the positivity of the decision in a few states I think that will be the best campaign that we can have for other states to open up. The interesting thing is that there are other states also who are reasonably open to having the dialogue which means that if you give them right data they will be open enough to unlock this opportunity. And that is what we are playing for. So, this is not a short term quick fix or something of that kind. It is a strategic investment we made because we believe there is a longer term unlock and we want to put the might of our company in partnership with Hip Bar to try and make this happen.

**Abneesh Roy:** Sir one follow-up here. How is the response in Bangalore because their regulations are allowed but in the past, I have seen some of the other start-ups in other cities they have not scaled up in this. You said ecommerce in liquor is the next big disruption and in FMCG already 1 to 2% of sales is from ecommerce in Bangalore is it already hitting that kind of number or if not when do you see that number coming.

**Anand Kripalu:** So I would say the data is still encouraging we are not going to share numbers right now on what specifically we have got, but it is encouraging and it was encouraging enough for us to make this decision to invest. So I believe that there is no reason why Alco-Bev cannot throw up an opportunity in ecommerce as big if not bigger than FMCG, given that availability of FMCG is so much wider than Alco-Bev. And that is the game we are trying to play.

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

**Arnav Mitra:** My first question is on your P&A growth. So in your initial comments you sounded quite reasonably comfortable with the growth that you have delivered this quarter, but I just wanted to question on the fact that we had a very-very low base and a base of -8 to -9% volume decline in P&A last year in the same quarter we have got a 13% growth, so if you look at 2 years basis it looks like a 2% -3% growth over maybe what you did in the June quarter of two years back. So how should we look at this situation and is it not actually a sign of a relatively weaker trend compared to what your aspiration is here.

**Anand Kripalu:** So, first of all I do not think it is a reflection of a weaker trend. The P&A number by the way is 19.5 to be precise it is not 13, 13 is the overall growth for the quarter. So, if you look at P&A specifically which is really the focus of your question. The previous two quarter we have started delivering a strong double-digit growth in fact mid-to-high teens growth on P&A. Now, yes you are right about the comparator being low and I accept that, I accept that in my opening comments as well but please do recognize that, this is not a tap that you open and shut so the impact of GST, the impact of the highway ban all I can say now is that so although while the base become slower it takes much longer for the things to come back. My current sense right, last quarter and this quarter is that the momentum is certainly coming back, I am feeling that on a day-to-day basis as we are running this business that the momentum is coming back, and I believe that we are going to continue to build on this in times to come. So yes, you can discount the comparator but just look at the trend if you look at sequential and just see how the sequential are coming back without only looking at the denominator and I think you will get a sense that the P&A volume which are now 65% of our business of our NSV is consistently moving forward quarter-on-quarter and that is the encouraging trend for us.

**Arnab Mitra:** Sure. On the popular business my question there is also pretty similar that you had a flat adjusted growth again on a pretty weak comparator. So, your sense earlier was that there will be a stage when popular will stop declining on a consistent basis and therefore there is some growth that starts coming in popular. So, if we start off this year on a very weak comparator just doing a flat number does it indicate that we are still in that decline phase and that stabilization of volume is still a little far away from where we are right now.

**Anand Kripalu:** I think we are close to the stabilization of volume. The good news is that our big priority states which is now becoming the lion share of our business have grown by 7% and that tells us that there is an opportunity to drive those focused states. And some or the other states where there were decline and part of it was to do with the fact that some of the states we wanted to franchise we could not get the right commercial partners, so we finally decided to retain those states. There were a few states in the middle and now we are just making sure that both are franchise partners or our own sales force is focused on driving this. You know that we have said that our overall popular growth is expected to be low single digit. And I think we are now coming into the zone where we are going to start doing that. So, while quarter may have had a softer comparator the priority states have grown strongly and as we move ahead with right comparators coming in I believe that we are going to be low single digit on popular as an aggregate between the priority states and the rest. And I am quite confident that is what is going to happen.

**Moderator:** Thank you. The next question is from the line of Bhavesh from CLSA. Please go ahead.

**Vivek Maheshwari:** Hi morning this is Vivek. Sorry, I have exactly the same question like Arnab. Two-year basis 1% so while you addressed, I don't understand why do you say GST had an impact on the business because GST was supposed to impact the profitability rather than the volumes, right so what exactly is the reason why the growth is just 1% on a two years basis in this quarter because sequentially also there is no improvement in performance and so is the case with two year CAGR at the prestige and above. And the growth is 13% right in volume terms and not 19%, 19 is I think value?

**Anand Kripalu:** 19 is value and 13 is volume so that is correct.

**Vivek Maheshwari:** Right. So 13% on a two year basis is just 1% so is there any issue from competition perspective or anything that you want to highlight?

**Anand Kripalu:** First of all, I want to say that we remain competitive and our understanding is that our shares are holding as well if not improving, so there is no loss because of the competitive environment. The competitive environment has been more challenging and of course that is the nature of the beast in many-many sectors in the larger consumer good space. Now coming to GST specifically your question, there were two parts the migration of GST and the mitigation of the impact of GST. Now the mitigation of the impact of GST was more to do with operating margin and profit and cost and ensuring that we don't have stranded taxes that impact the P&L. And that is something that we have spoken about, but please do understand that starting July there was a massive change which led to shorter term disruption of the business itself. Simple things like our operating model, fact that we give gifts to trade based on purchase and how those gifts had to be stored and invoiced all kinds of changes happened during that period. So, the reality is that there was a disruption in the way of working and therefore to stability of volume during that period. So, it is not only about cost it was also about stabilities of the migration having said that I do believe that we were among the fastest of the block to actually manage the migration of GST, but the fact that it was complicated for the Alco-Bev industry and that resulted in some short-term hiccups is something that actually happened.

**Vivek Maheshwari:** Okay. Second one on the staff cost there is a one-off restructuring so when do you think we will have all of this behind and there will not be any more adjustments.

**Sanjeev Churiwala:** I think we have in the previous calls mentioned about kind of simplifying our manufacturing footprint, this kind of improves our overall productivity and cost to serve at the market front and that is what we are trying to address over the last three years. So, this particular quarter we are able to shut down four manufacturing plants leading to severance being paid out. Over the last three years in a row we have been able to close down almost 12 owned plants, so lot of work has already happened, will it absolutely go away, no absolutely we might still have some plants and we are working on that to keep on reducing our manufacturing footprint and optimize the cost but kind of overall this only adds to productivity and efficiency gains that is what we are looking at.

**Anand Kripalu:** And just in terms of our manufacturing footprint we started this journey four years ago with 94 plants. Today we are close to just over 50. So the journey is not complete yet, there are still plants that need to be trimmed because they are just legacy high cost plant and these are I would say good cost that we are taking into our P&L because they will all deliver returns over time so whether it is A&P and if you look at it the increase in A&P and whatever we have spent on restructuring I would say that they are both good investments that we have made and they are going to give us returns in the future.

**Sanjeev Churiwala:** And if I can add to what Anand said I do not think it will be wise for just to look at one particular line item. The fact is all of this restructuring plans that we have done in terms of optimizing the manufacturing footprint has added to lot of productivity efficiencies and most of them are reflected in the cogs line so while we do on a standalone basis look at one of the items that stands in the overheads, but the fact is the overall productivity gains are reflected in the way we look at our manufacturing cost and has reflected in our margin as well.

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

**Amit Sinha:** My question is on the other overheads line and you have mentioned that the spends have gone up on account of the investments in IT and the factory improvements. So just wanted to understand how much of this increase in spends are recurring in nature and how much of this is one off for the quarter.

**Anand Kripalu:** While we are looking at this particular quarter the fact is most of the expenses kind of would be might have bunched out in the particular quarter but eventually it will even out when we move to the full year kind of thing. So, the good part is at least we are spending in building our capability whether it will be IT infrastructure, whether we are looking at our manufacturing excellence program in improving infrastructure in a manufacturing plant and that is an ongoing journey. Again, we can start looking at in perspective of just one particular line item, but does it reflect into the overall efficiencies & productivity? It does.

**Amit Sinha:** Okay. So specifically, for the IT investments which you have done. Will it recur going forward or it is done for the quarter?

**Sanjeev Churiwala:** Well there will be some continuous recurring journey that will have in terms of improvement but overall kind of smaller amount we are not really concerned, we are not looking at big magnitudes anyway.

**Amit Sinha:** Sure. Secondly question on the UP market and before the first quarter after the route to market changes have taken place there. So, any comments on the volume uptake in the state and what is your experience there.

**Anand Kripalu:** Experience has been largely positive I have to say it is just becoming more open market economy and that is good for our business. There was an initial surge of volume for one or two months and then now it is kind of coming to a regular canter and that surge in volume in the beginning was because there were so many new customers and wholesalers who had empty godowns because they were just starting business. So a large part of it was just to do with pipeline thing. What I had to say is that, I believe that it is a big step in the right direction & we are getting a lot of support also from the UP-Excise Ministry on also doing responsible drinking campaigns and so on because I think the UP government believes that alcohol is here to stay, they have to do the right things to support the industry while educating consumers about the ill effects of alcohol abuse. So, I would say that I am feeling good about UP and I think UP should be a big contributor of growth given its size and population in the times to come.

**Amit Sinha:** Okay, sir. And lastly very quickly on the employee cost if I look at the adjusted number and broadly it is similar to last year same quarter. So, should we look at the full year employee cost number to be at a minor inflation number compared to last year?

**Sanjeev Churiwala:** If you look at the staff cost trajectory over the last few years if you look at '17 and '18 our staff cost has been kind of relatively benign it is about 8% of NSV. Of course, for a particular quarter when you look at staff cost we have severance and other cost, as a result the staff cost looks like on underlying basis 11% growth. But we feel overall for the full year kind of similar trajectory that we had in 17 and 18 and kind of looking at a staff cost in the range of about 8% of NSV.

**Amit Sinha:** Sir but in the last con call you had actually mentioned that you expect some operating leverage coming in.

**Sanjeev Churiwala:** That will happen. Absolutely, that is what I was saying if you look at our staff cost for the previous two years '17 and '18 has been kind of flattish which would mean that we have been able to mitigate a large part of inflation and our stated objective remains the same that even in the current year, our intention is all put together when everybody is looking at the staff cost kind of it would be benign and we should be able to kind of mitigate a large part of inflation.

**Moderator:** Thank You. The next question is from the line of Manoj Menon from Deutsche Bank. Please go ahead.

**Manoj Menon:** The first question on actually the gross margins when I look at last in a year or so the three drivers for gross margins on an underlying basis would have been favorable input cost, premiumization and pricing. How should I think about the trajectory of these three drivers over the medium-term?

**Anand Kripalu:** I will just comment and then maybe Sanjeev will add. The first is on input cost, while we expect the future on input cost to not be as benign as the previous year, we do not believe that it is going to be disruptive in any kind. So, we do believe that with our own productivity initiative whatever is the inflation on the commodity environment it is something that we will be able to manage and possibly even mitigate. So that doesn't really concern us. As far as mix is concerned you should expect the mix journey to continue. It has continued pretty much in every quarter that we have announced results and you should expect the journey on mix to continue to move in the positive direction with P&A becoming a larger part of our total business. And as far as pricing is concerned now, we had a very good year on pricing last year. There are carry forward impact of that pricing into the current fiscal. There are couple of states where pricing has come and where we are still working on it happening which did not happen in the previous year. So, we do not expect that there will be states who will give pricing every single year. But if I can get to a rhythm through the work we have done on making states give ones in two years, right, I would think that is a reasonable place to get to. So, the states that did not give last year we are still working on them. Some of the big states like Karnataka for instance there has been big disruption in the political environment and therefore in the decision makers. But I am saying we are engaged, we are working on it and we remain hopeful that something will come out of that. So, I would say those are your three levers and I do not think that the three levers will get worse than what they were in previous year. Having said that I must tell you that gross margin is not something that you can keep on increasing into eternity. We are at 49%-odd now in terms of gross margins and I would say that we are now coming into the zone of gross margins reaching the kind of levels that we would like to remain competitive in the market place. And with that kind of gross margin I think we can afford the right kind of A&P, the trimmed overhead that Sanjeev spoke about and deliver an operating margin that overtime will get to the ambition that we have talked about.

**Manoj Menon:** Okay. That actually leads me to the second and last question. The construct for ad spend let say when you think about the next year or two for budgeting again there will be certain maintenance spends, etc., because that is just to be competitive. There would have been some spend in the past, I remember you alluding to this a couple of years back maybe that some of the legacy underspending either to be corrected, that is the second context is that still continuing? If yes, how long? And point number three the new activities, new brands Captain Morgan or any such new niches you are actually developing. So just trying to understand what are the constructs I should have in mind when thinking about the medium-term ad spends for you based on these three drivers and if there is anything more please add to that?

**Anand Kripalu:** It is very tough to talk about ad spends on a long-term perspective, we are going to suck and see like I was saying earlier on the call there is lot of management judgment in what is the right amount of ad spend. The fact that we are driving premiumization and the fundamental strategy means premiumization happens when you build imagery and imagery happens when you have the right kind of ad spend. Now, I have said in the past that it is unlikely that in a steady state, that on a full year basis we will get to more than 10. It is also unlikely that for the immediate future that we will go much below 9. So, I think you have to assume that our ad spend will be somewhere in that range. Sanjeev.

**Sanjeev Churiwala:** I can just add a bit more. Kind of Manoj linking back to both of your questions. If you see the previous two years and especially '18 over '17 our underlying gross profit margins kind of improved 295 bps point and to what Anand said as per the first year we kind of ramped up our

A&P reinvestment rates and our A&P reinvestment rates went up by 175 bps point. Do we see in subsequent years our A&P reinvestment is going up with a similar kind of bps improvement the answer is absolutely no. So, given that our gross profit margins coming to a decent level and going forward it will be more decent, we will not see this kind of spike increases of 300-400 bps point improvement. And given that our A&P reinvestment rate could be in the similar range between 9 to 10% at best you can say going forward you can see A&P reinvestment rate coming at 50 bps point or 100 bps point again depend upon the kind of market structure we will end up into. But absolutely it will be far lower as compared to the last year in terms of step-up improvement that we have with the A&P. And either way it is kind of little lesser GP margin enhancement because all the goodies will not come in one year getting a good price increase, premiumization, other benefits coming in through. But of course, still delivering our OP margin ambition that we have.

**Moderator:** Thank You. The next question is from the line of Avi Mehta from IIFL. Please go ahead.

**Avi Mehta:** Sir I just wanted to know last time the Prestige segment there has been a sharp improvement in the realization growth in this quarter over the fourth quarter levels. Is it any price increase impact that has come into now or if you could explain what is that?

**Anand Kripalu:** So when you say realization, so volume was 13, value was 19 so that is a 6% leverage that we have got through pricing as well as the fact the brand mix has also improved so I think brands above No.1 have grown, Scotch has grown faster, Signature has grown strongly, Royal Challenge has grown strongly and these brands have grown faster than No.1. Brand mix as well I think within that and that is what is contributing to the 6% leverage.

**Avi Mehta:** Okay. Sir then coming to the next one on the margin front you did highlight that you have seen very healthy gross margin expansion. I was not very clear, you said that going forward it may not sustain the same level is that what you said as I probably missed that, is it because of input cost environment is that so?

**Anand Kripalu:** No. What we said is that the deltas that you have seen will not continue at this rate of 300-400 bps because at some point gross margin will start reaching a certain aspiration of gross margin and therefore while there will be some improvement it will not be at a galloping speed. Okay, the absolute gross margins are not going to go down, our intent is to more than manage any input cost inflations so that our cogs is contained through productivity so the gross margin is protected and bit-by-bit continues to increase but not by leaps and bounds that is what we have said.

**Avi Mehta:** Okay. And lastly sir the franchise income, we have seen a very good bump-up in this quarter it is almost about 74-75 Crores, is this the run rate that we should assume because you said it is in line so there is no one-off over here right sir, that understanding is correct?

**Sanjeev Churiwala:** Yes absolutely. But I think the better way to look at it on an annual basis because if you remember the franchising out kind of happened over various quarters, so you will see the flow through benefit of that coming in this quarter but as compared to the previous quarter we were just franchising out. So, I think it is better to look at annualized basis it is not that there is an additional bump up happening which reflected in this quarter will not recur in the subsequent quarters.

**Avi Mehta:** Okay. And no price hikes right sir in this quarter anything that we should be aware state related any price hikes in the first quarter that is last one? Thank you.

**Anand Kripalu:** One or two states which has come, they are carry forward as last year based on the phasing way it happened. So, there is some pricing that will into this quarter, but it may not be because of new approvals alone that has come in this quarter.

**Avi Mehta:** Sir sorry what does that mean, I did not understand sir. You are saying that there are some price increases that have got?

**Anand Kripalu:** There are couple of states that have given price increase in the quarter but the large part of it is really the carry forward of the previous year. So therefore, the pricing impact in the quarter is a carry forward to the previous as well as actions from the current. And as we look ahead there are few states where we are working hard to try and get price increases done which hopefully should benefit this fiscal.

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

**Harit Kapoor:** Sir just two questions. Firstly, follow up on the earlier participants questions. Given your franchise income royalty structure why should there be a significant increase in say one quarter which is Q1 versus some of the others or maybe I am not understanding that correctly? Because it seems like when we do a math this quarter has been strong so and if it is higher why should that not be extrapolated just wanted to understand that, that is the first question?

**Sanjeev Churiwala:** Okay. So let me answer this, I had said that there is a big number coming in if I look at my F18 and we have been franchising over the four quarters it is kind of my overall franchise income in the books would be in the range of about 150 odd Crores for F19 throughout the year we should be getting this similar kind of 150-odd Crores and kind of it could be a phasing impact but it is not that this is a bump up or additional franchise income coming in this particular quarter. So I think for the purpose of your working you can just pace it out over the quarters and it could be in the range of about 150-odd Crores.

**Harit Kapoor:** Understood, sir very helpful. The second question Mr. Kripalu already kind of addressed the AAR Article issue. Just wanted to understand your if you can have disclosed what is your proportion of surplus TMU income that you are still booking in your numbers historically. I remember this number probably three or four years back was in excess of 4 billion about 400

Crores I think with the franchise royalty business that would have come off but what would that number be do we talk about that?

**Sanjeev Churiwala:** So kind of this is not very relevant and it keeps on moving depending upon the kind of manufacturing footprint here we have. But I think it is kind of merged in all the line items of a P&L and we do not specifically call it out as a specific line item and that is because of the change in the accounting standard that happened about a year back. So earlier it was sitting out as a specific line item if you open that will report F16 or F15 and that is why I am saying it was more specific but now I think it is all scattered across all the revenue and cost line items.

**Harit Kapoor:** Okay. But would it be fair to assume that given your change at manufacturing as well as the change in the addition of the franchise strategy that component would be quite less now.

**Sanjeev Churiwala:** We have not tracked it and looked at from that angle and I don't think even they are quite relevant for our purposes because we would continue to have third party manufacturers producing and selling for us and we don't look at the specific line items on what is the economic surplus coming through them, but it is more about does that manufacturing footprint allows us to optimize the cost and improve our efficiencies.

**Moderator:** Thank You. The next question is from the line of Aditya Gupta from Goldman Sachs. Please go ahead.

**Aditya Soman:** Just not to belabor the point again but the question that was asked earlier on the volume growth this quarter so even if I look at five-year CAGR that is only about 3% volume growth. So is there a very strong seasonality that has changed because one would have expected that given the steps we have put in and given the investments we have made, the volume growth should have been stronger plus we have had the World Cup for a few days in this quarter which was not in the base which should have also sort of reflected in better on trade volumes?

**Anand Kripalu:** I am not sure how you are reading it. But the thing is when you are looking at a longer-term period. This period has had a lot of funnies in the previous years. So I think that really did have an impact on the industry because we had more things than what anybody would normally handle with the demonetization, the highway ban, GST and so on and so forth. I think when I look at it post the regulatory hurdles moving away, long-term whatever the data is it is, but I feel that certainly over the last couple of quarter and months-to-months as we are running this business I am seeing improved momentum coming in and that improved momentum is what the data shows that we have seen versus the previous quarter. So, if you look at the long-term perspective I think there are many drivers and hurdles to what has happened to the category performance. We have stepped up A&P by the way over the last few quarters because we started seeing the regulatory issues getting behind us and the future becoming better so we said let's start investing and that is again like I said about management judgment. So, I really do believe that it is moving forward, premiumization is moving, Prestige and Above is getting stronger, Popular is now coming into the zone where we expected it to be. And at the end of the day we are selling much more from our Premium portfolio which is better, so I do not look so much at volumes as you guys do, we look at value part more because the mix is preimmunizing. But I do believe that the momentum is coming and hopefully it will stay.

**Aditya Soman:** Understand. And just in terms of seasonality, is there any sharp sort of seasonality because of the changes and regulations over the past few quarters it is really hard to discern but is there a sharp is seasonality in 1Q say versus 3Q and 4Q?

**Anand Kripalu:** October, November, December, January tend to be stronger because of winter. So, beer tends to become much bigger in summer months and spirits become bigger in winter month so there is in year seasonality, particularly we look at moving annual totals and stuff like that I think it smoothens out the impact of seasonality, so you can understand real growth and real momentum from that. But yes, there is seasonality in this industry, Rum for instance sells only after monsoon and into winters and so on. So yes, there is some seasonality.

**Aditya Soman:** Alright. And lastly in terms of within the quarter was there a sharp change towards the end of the quarter or at the beginning of the quarter in terms of your sales growth or volume growth whichever way you look at it?

**Anand Kripalu:** You mean during April, May, June?

**Aditya Soman:** Yes. Given that lot of the sports activities were towards the end like IPL in May and World Cup in June.

**Anand Kripalu:** We don't want you get into month-to-month numbers because we don't really disclose the month-to-month numbers. So please read the quarter as it was but all I can say is that, the momentum is continuing. We are not seeing any slowdown in momentum and I think that augers well for us.

**Moderator:** Thank You. The next question is from the line of Nillai Shah from Morgan Stanley. Please go ahead.

**Nillai Shah:** My question is actually in the margins if I look at longer-term trend take four, six, eight quarters you are operating profit margins have been in this 12% ballpark average range. And this is when you have got big price increases, you franchised out your business & so optically the margins are looking much better, you have rationalized a lot of your manufacturing footprints so hopefully employee cost, etc., have also been rationalized and yet you are seeing this sort of trend. I understand only counter ad spend, etc., have moved up and you articulated very clearly on this call that you are expecting ad spends to be in a very narrow range gross margins to move in a reasonably narrow range and even the employee cost will be in that 8% of NSV ballpark. So, the question really is that over the medium-term which are the levers that we should be really focused on in terms of trying to extract this EBITDA margin expansion to reach to this mid-to high-teen sort of EBITDA margin ambition that you have?

**Anand Kripalu:** You have to believe that there will be some improvement in gross margin every year but not in the leaps and bounds of the past. There will be some tapering of A&P spends, not significant but please understand these 150 bps positive, negative they all kind of add up to be material and we have already said that overheads are intended to mitigate inflation so operating leverage as our top line starts becoming double-digit will become very significant in terms of just basis points improvement. Now if you just step back and talk of these just look at gross margin improving by some amount, A&P trimming by some amount and operating leverage coming on overheads you can do the math. We are not a million miles away from what we are talking about. And it is actually within graph. Now we have chosen to put high A&P for the moment, we have chosen to spend on overheads to continue to restructure our business and contain cost. We have chosen to invest in IT and other capability areas for long-term benefit. These are management choices that have been made but if you look at the P&L today and the most important part of having the right P&L by the way is the right gross margin in this business. That is the only thing that gives you the license to finally deliver the right operating margin. I think we are now getting into the zone, so you can do the math but if you just add it up it will not be a million mile away.

**Nilesh Shah:** Sure. And in this number that you are looking at, this ambition you are looking at have you factored any sort of price increase is coming through from the states where let's say today your margins are very different from what your blended margins would be for the company. So basically, in the underperforming or the weaker states for margins.

**Anand Kripalu:** We have a comprehensive plan for targeting price increase and it is a consistent effort because it does not happen with a simple input, output conversation. Now having said that in terms of what we build-in in terms of our internal management we take a conservative view on pricing so that we put much more aggressive focus on areas that we can control which is cost, which is within management's control. So, we always build in a conservative outlook on pricing, while having a very aggressive plan with the states but we take an aggressive view of cost control and that is why we have delivered so much of productivity over the last three years. And that is how we have internally planned and in our industry where pricing has to be given and not taken, I think that is the prudent way for us to operate. So that is what I would say.

**Moderator:** Thank You. The next question is from the line of Mayur Gathani from OHM Group. Please go ahead.

**Mayur Gathani:** Sir as you mentioned that you had some 90 plants and you now brought it down to just around 50 and we intend to reduce this further so is there any numbers that we are looking at and we can keep seeing this restructuring cost of course this will benefit us going forward but to take into numbers because that might dent your mid-teen margin kind of a number?

**Anand Kripalu:** Yes, I am not going to give you the number of factories in our destination footprint honestly but having said that you have seen the trend of what we have done over the last three to four years in terms of footprint optimization. Now, obviously you cannot have zero plants at some point this is going to slow down in terms of pace okay. But I can tell you there is more work to be done in this area and there is more work we are doing as we speak that there are conversations happening to close some plants. And basically, these are high cost plants that we are trying to exit and then try and monetize that assets as well. So, I think you will see a little bit of restructuring cost continuing to play out for the next I would say maybe year or two at most after that it will come down to trickle. So, I think that is what you should factor in the plan for.

**Mayur Gathani:** And that should be in this range what you reflected in this quarter.

**Anand Kripalu:** Should be in this range a little less.

**Sanjeev Churiwala:** Kind of I think range bound.

**Anand Kripalu:** Not likely to be more than this quarter.

**Sanjeev Churiwala:** If you see the trend over the last two years I think it is more or less the same trend, but I think it is important while you factor this cost thing, also see the kind of cost the inefficacies we are eliminating when we are taking out a very high cost.

**Moderator:** Thank You. The next question is from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

**Jamshed Dadabhoy:** Just one quick one, if you just take a step back and just look at your other expenses and how they have evolved over the last four, five years there seems to be a steady creep up in other expenses so I am not talking about ad spends and employees you have been very clear on those but just your other operating overheads have continued to spiral up much at a rate much faster than inflation despite you all are doing a lot of operational improvements in terms of plant rationalization, etc. So why is that happening, and could you just shed some light on that in terms of I think that is one piece I would just like to get some better understanding of?

**Sanjeev Churiwala:** So maybe I will try and throw some light on that. When we look at our other overheads there are two components to that, one is of course related to our selling and distribution expenses because with accounting requirement most of the things are kind of stuffed into one line. So of course, with new markets opening up and kind of a little better volumes that we have seen in the last two quarters there will be certain bump up in the S&D expenses. But on the other expenses of course we have been reinvesting back into capability building that we have said in terms of looking at infrastructure within the plant, the plant efficiency cost coming in, the kind of IT infrastructure we are putting into place. And all of this just cost money but at the end of the it its reflected in other efficiencies perhaps not in this line but in other lines. So to your point when we even look at like-for-like other expenses, other overheads last year '18 versus '17 it was about 11%-12% increase and we believe that we in '18 did a lot of transformation projects and we had spent quite some amount of money. Money will also be spent possibly this year but we do believe that the overall benefits which kind of get reflected in the EBITDA margin enhancement that we have been looking at.

**Jamshed Dadabhoy:** So, Sanjeev just to follow up on that, when we look at this line item and we think about modeling at three, five years out. Do we assume that it continues growing at 8%-10% kind of trajectory?

**Sanjeev Churiwala:** No. I don't think it will grow at 8% to 10% trajectory but kind of looking at the overall inflation this particular line item which is kind of 8%, we would be able to kind of mitigate a large chunk of it but I think for modeling we can still kind of play out with 4% to 5% what is important for us given the higher growth that we are looking at it. Do we get a leverage benefit on that. So, I think as a percentage when I look at the other overhead which is kind of around 17% my feeling is to be range bound, it should be better off in the sense that some of this should come down and help us improve our margins.

**Moderator:** Thank You. Ladies and gentlemen that was the last question. I now hand the conference over to Mr. Anand Kripalu for closing comments.

**Anand Kripalu:** I would just like to thank everyone for taking the time to join us on this call today and more importantly to be part of the journey. I just want to close by saying that as a management team I think we remain quite confident that we are making the right kind of progress and hopefully we will begin to see the results of that in times to come. Thank you very much for your time.

**Moderator:** Thank you very much sir. 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.