"United Spirits Limited

Q3 FY2023 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the United Spirits Limited Third Quarter FY 2023 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Shweta Arora, Head of Investor Relations, United Spirits Limited. Thank you, and over to you, ma'am.

Shweta Arora: Good afternoon, everyone. And welcome to United Spirits third quarter and 9-months ended FY '23 earnings call. Today on the call, we have with us our Managing Director and CEO, Ms. Hina Nagarajan, and our CFO, Mr. Pradeep Jain. Hina will provide you an update on business performance, while Pradeep will run you through the financial performance during the period, post which we will open the floor for questions.

With this, I hand over the call to Hina for her opening remarks. Over to you, Hina.

Hina Nagarajan: Thanks, Shweta, and good afternoon, ladies and gentlemen. Thank you for joining us on the Q3 FY '23 earnings call of United Spirits Limited. It's always a delight to interact with all of you, and I wish you and your loved ones a very happy and healthy New Year. I will first give a brief update on macro and industry and will then discuss progress on our portfolio reshape strategy followed by some business context of the results that we have announced yesterday evening.

The consumption and the growth story of India continued in the October to December 2022 period with India safely being one of the bright spots, I would say, in an otherwise gloomy global economy. This was the first full festive season post-COVID where people celebrated both inside their homes and out of their homes with great fervor. I mean we saw that Dussehra, Pujo, Diwali, even Halloween, Christmas and New Year. Premiumization and aspiration-driven choices continued to be the key drivers of demand with greater growth coming from the middle and upper income segments in India. The lower income segments did feel a crunch in their wallets as inflation continues to be high and that reflects in the lower end of our portfolio.

Having said that, we would like to say hopeful of inflation coming down and a boost in income owing to strong winter harvest. I mean speaking of Alco-Bev in particular, we continue to witness good growth post-COVID, particularly at the mid-upper segments of the P&A portfolio, and that is reflective of the consumption revival in the broader economic context with the festive season adding further momentum as mentioned earlier.

Our premium Indian whiskeys and scotches continue to drive category expansion on the back of sustained trend of premiumization. Inflation and the larger global macroeconomic headwinds may act as a bit of a drag, but we believe that consumer demand will continue to be robust. Global data also suggests that the Indian consumer continues to be amongst the most resilient and optimistic in the world. Net-net, I would say, a larger growth story pegged on premiumization continues for our industry. In this context, we have delivered a good performance in the quarter despite headwinds from routes to market change and partial recovery of BIO. This was also the first pristine quarter post the slump sale and franchising of the strategically reviewed popular portfolio. Pradeep will reemphasize a couple of points that we have consistently communicated with regards to the divesture and the franchising in his section of opening comments.

During the quarter, we have also completed the merger of Pioneer Distilleries Limited and signed definitive agreements to divest the non-operative Sovereign Distilleries Limited that progresses us towards a simplified legal entity footprint. I'm also very happy to inform that the Board of Directors have approved a multiyear supply chain agility program, which aims to strengthen our end-to-end supply chain, making it future ready by improving its resilience and agility, driving efficiencies, delivering additional productivity savings and making our supply chains and operations more sustainable. This is in addition to our focus on everyday efficiency savings. Just to take you through a bit more on the rationale and economics of the program in more details.

As we have clearly articulated on several occasions that being a combination of acquisitions and mergers over a period of time, USL still has a fair amount of legacy costs stuck in the P&L. And we want to accelerate towards our near-end state manufacturing footprint. This is exactly what we're trying to achieve through the multi-year supply agility program. The total program cost will hover around INR 500 crores consisting of both cash and non-cash components in roughly a 60-40 ratio. Once completed, the program will generate INR 130 crores to INR 150 crores of annualized productivity benefits. Overall, the discounted payback would be about four, 4.5 years. There are also appropriate disclosures to this effect in our financials.

Coming back to the impact of Delhi route to market and policy change, that is clearly visible during the quarter, and there is unarguably a setback for companies like ours with this change. We are doubling up our efforts to make-up for this lost growth opportunity by sharpening portfolio execution, particularly on salient segments and brands like Black & White, Black Dog, Royal Challenge. We are harnessing the strong momentum of these offerings and also accelerating the reach of our innovations such as Royal Challenge American Pride and the renovation of Royal Challenge Whisky and Signature across other states in the country.

Overall, we remain very pleased with the response received on our renovated innovative offerings and new launches over the last few quarters and continued the sequential momentum of growth of the same in the October-December quarter. We also launched Johnnie Walker Blonde, the smooth bright and light-scotch variant from the house of Johnnie Walker. Blonde is priced position between Red and Black and will play the strategic role of recruiting the next-gen non-scotch consumer.

We have also launched a renovated new Royal Challenge in many other markets. The renovation launch was done with 'Choose Bold' video from Viral Kohli, which reached about 12 million-plus accounts. Complementing the same, we have created the 'Naya Sher' anthem, which was created in collaboration with Divine and Jonita Gandhi featuring Viral Kohli. The renovated

Royal Challenge has been rolled out in Assam, Rajasthan, UP, Haryana, Maharashtra, Goa, Daman and Diu, Chandigarh, and we are targeting a full national rollout completed by June 2023.

On McDowell's Number-1, we continued focused investments, pan-India launch of the new Yaari song in December, which basically was attributed to KK who was the original singer of that song, and this is one of our strongest brand assets, I would say. And that new song garnered 26 million-plus views. The song aims to build salience for the brand across the country and drive brand love amongst the youth with celebrity handle, digital as well as new age platform promotions.

On the digital side, we are continuing acceleration on consumer engagement, content and community building through our platform, in.thebar.com. And we are also driving precision marketing for effectiveness and efficiency of our marketing spend. We create this virtuous cycle, therefore, of everyday efficiency, smart investment, leading to topline growth.

I am pleased to share that our consumer activations have been significantly recognized by the industry for their innovative approaches and best in class leverage of Rich Media. To quote a few, the drone activation around Johnnie Walker, which we did in Goa, won a gold, both at the mobile marketing awards (MADDIES) in the media innovation category and at the ET Brand Equity Brand Strategy Award for tech-enabled media plan category.

Godawan, artisanal single malt whisky won its first international taste award for both its expression at the International Taste Institute Awards Brussels. And our renovated Black Dog packaging has won WorldStar Award, which is awarded by the World Packaging Organization as the highest award in the field of World Packaging.

All this is a reflection of the work of our extremely talented team underpinned by deep consumer insight and above everything else, our ability to adapt to the ever-changing marketing landscape. We will continue to invest in our brands by driving focused interventions. And over the coming months, we'll further build up mental availability for our P&A portfolio and equity of our Diageo brand.

To sum up, we remain optimistic about the prospects of our business and confident in the resilience of our well-established processes and overall in our ability to navigate headwinds. In the last few years, our teams have demonstrated their ability to overcome several significant challenges with renewed portfolio and razor-sharp focus on driving commercial excellence in store and on-premise, revenue growth management and everyday efficiency, we are confident in our ability to deliver sustainable long-term growth and stakeholder value.

With this, I hand over the call to Pradeep to take you a bit deeper into the financial update. Pradeep, over to you.

Pradeep Jain: Thank you, Hina, and a very warm welcome to all of you. I would like you to refer to the results press release posted on our website last evening. At the onset I would want to make two terminologies clear that have been used throughout the document. One is reinstated, wherein all numbers are adjusted for the Pioneer Distilleries merger as it is effective April 2021. So for the previous periods, these numbers are reinstated while current period reported numbers are already inclusive of PDL. That makes it comparable. The second term that we are using is rebased. This is eliminating the impact of the strategically reviewed popular portfolio from the base year to make comparisons meaningful and absolutely like-to-like. Hope this will provide all of you a better understanding of the performance and the numbers.

Now before I come to the retained portfolio, core operating performance, let me cover the impact of the slump sale and the franchising of the strategically reviewed popular portfolio. Since we have announced the deal in May 2022, we have consistently communicated that you will see two impacts of the transaction on a go-forward financials. A, divested perimeter will not provide any material pickup in margins as it is more or less makes portfolio margins.

And B, on fixed overheads, will lead to an operating deleverage for 12 to 18 months, and we will have to recoup the same through a combination of growth/leverage over the next four to six quarters. If you look at the numbers released for the quarter, these were exactly the two things that are playing out. And we have consciously called out the impact transparently exactly in the manner in which we have been conveying it to all of you over the last three quarters ever since we announced the deal.

Now let's come to the core operating performance of the retained business. Like-for-like, we have delivered a portfolio NSP growth of 9.7% during the quarter. Underlying growth stands at 11.5% after adjusting for the one-off bulk scotch sale in the prior year same quarter. Prestige and above growth stands at 11.7%, with double-digit growth in our scotch portfolio. The price mix during the quarter was 6.5%, reflecting the higher growth in more premium segments, as we move up the consumer price ladder. The continued brunt of inflation, which remained at double digits, approximately 11% for the quarter and partial BIO normalization adversely impacted gross margins.

Our marketing reinvestment rate during the quarter was 10% of net sales. As mentioned by Hina, we continue to drive customer-centric activation, strengthen our brand equity and premiumize the portfolio. EBITDA was INR 368 crores and EBITDA margin was 13.2%. Exceptional charge of INR 151 crores is on account of the supply agility program approved by the Board. Reported PAT for the quarter is at INR 111 crores, impacted by the supply agility onetime restructuring charge.

As we look ahead, input commodity inflation is expected to remain high. Having said this, our sustained efforts on pricing and productivity are also yielding results and will reflect higher run rates in the subsequent quarters. On A&P, we have done targeted calibrations earlier in the April to September period with full normalization of BIO supplies expected in Jan to March, we will invest in the brands to ramp-up equity and redeem the lost ground.

As always, our focus is on the circle of control rather than the circle of concern, and we continue to work towards expanding the pipeline of value chain productivity and revenue growth management initiatives. So I would like to hand over back to Hina for a very-very special update, which is hot off the press, and then we can open up for Q&A.

Hina Nagarajan: Yes. So hi, everyone. I just wanted to share -- this is right off the press as we speak. Very pleased to announce that our 100% subsidiary, Royal Challengers Bangalore, has acquired women's IPL team for Bangalore, just now. As the BCCI bid process closed over the last two hours. We are very delighted with this because, I mean, this is really taking forward the narrative of inclusion and diversity that we have led, particularly for our industry and in a broader context in India and globally. And it gives us -- it fits perfectly with our purpose of celebration. Cricket is big in this country for having this additional platform of women's IPL, fits hand in gloves our purpose and value. So delighted with that.

With this, Pradeep and I would be happy to answer all your questions.

Moderator: The first question is from the line of Jaykumar Doshi from Kotak.

Jaykumar Doshi: A couple of book-keeping questions. The first one, when I look at the bridge between INR 490 crores reported EBITDA last year and INR 420 crores rebased EBITDA, the impact is INR 70 crores. So our understanding at that point of time was that the EBITDA impact or EBITDA of the divested portfolio as slump sale as well as franchising portfolio of INR 195 crores ballpark in FY '22. And post this transaction, you were expecting certain royalty income So net impact of the business that was sold or franchise would have been somewhere in the range of INR 160 crores, INR 170 crores.

And over and above that, what I understand is the operating leverage impact that you're calling out is another INR 100 crores. Is it right to understand that if I look at your FY '22 EBITDA, the impact of the portfolio that has now been divested, I mean your EBITDA is going to be a full year level somewhere in the range of INR 250 crores to INR 270 crores? Or if you can tell me what the rebased number for FY '22 full year was standalone, the equivalent of INR 420 crores at a full year level?

Pradeep Jain: Okay, Jay. So let me take this. That's why I did want to cover this in my opening comments as well. We've always consistently said that there are going to be two comments. There are going to be two impacts. One is the EBITDA of the divested business that it makes after a full loading of overheads. I mean it's a very-very convenient living room view, that the marginal contribution can be taken as the EBITDA of the business. That's not right. I mean to run a sustained portfolio and a business even of INR 1,500 crores, you require corporate functions. So therefore, those corporate functions on a fully loaded basis is the INR 42 crores that you are seeing.

And then the second thing we've always said is that those central corporate functions obviously don't go with it. And very loosely, I have to take the joke of my own salary. My own salary doesn't come down. Once I divest the portfolio. So there is a deleverage on account of that, which we have consistently maintained. We will take about anything from four to six quarters through a combination of growth and obviously our continued discipline on discretionary overhead. I think we've established a fairly good track record over the last four to five years of maintaining a fairly disciplined organization on discretionary overheads. So that's the way one will really have to look at it. Yes. So I don't know whether that answers or not. So basically, what I'm saying is what you see the INR 42 crores in the quarter, that's the core fully loaded basis, EBITDA that is losing. Rest is timing, we will recoup it over the next four to five quarters as we grow the business back to the origin. Does that answer, Jay?

Jaykumar Doshi: And it sounds we didn't anticipate or at least I didn't anticipate INR 110 crores, INR 112 crores annual de-operating leverage impact. So my understanding of the underlying EBITDA was higher than what the reported numbers are.

Pradeep Jain: No, absolutely, and since you raised this, I would want to clarify that we have been very-very clear in articulating that there will not be any mathematical pickup of the margin. But if you look at the numbers, there is a mathematical pickup, purely due to the dilutive part of the portfolio going away. So if you combine the two impacts, the net impact on the EBITDA margin is roughly about 40 to 60 basis points, which is playing out whether you look at the quarter numbers or whether you look at the 9-months number. So I just wanted to kind of balance that picture also.

Jaykumar Doshi: Second question is can you explain a little bit more about this program, supply chain program that you've initiated? And what will that look on INR 500 crores, 60% cash impact, it's like INR 300 crores of cash costs. So what is the nature of this cost? Is it entirely going to be severance? Is it going to be INR 300 crores of severance that you will have to pay in the next maybe three to five years?

Pradeep Jain: Yes. So Jay, again, by and large, we have a very-very detailed descriptor in our financials that will give you a good sense, but we just wanted to share the highlights. And again, we are being consistent with what we have communicated to you, over the last three, four quarters that this is something that we are working on.

And we will want to accelerate now, towards our end-state manufacturing footprint and it is becoming extremely difficult to do them on a piece-by-piece basis. So therefore, we did want to announce this multi-year program. And yes, I mean, you can make reasonable guesses on where the costs would be? The costs are largely on account of severances and on account of the write-down of the asset value of the asset set that we'll probably close towards our progress to the end state footprint.

Jaykumar Doshi: Lastly, could you comment on the inflationary trends in case of ENA and glass bottle? And what is your outlook on the gross margin front? Where does it go from the current levels over the next one or two quarters?

Pradeep Jain: Yes. So Jay, look, I mean, I think Hina has also covered it in the press release itself. The RMPM still continue to remain inflationary, though just to balance what I would want to say, certain smaller mix elements have started coming down also. Paper has started coming down. PET has started coming down.

But these were not the big drivers of our COGS portfolio. ENA is kind of flattish, I would say. But glass continues to be inflationary, largely driven by the natural gas inflation, etcetera. And the capacity is completely choked. I mean there is -- it's pretty much a seller's market right now.

So that -- but having said that, as we have mentioned, all the work that we have done in ramping up our productivity run rate and all the efforts of the last two, three quarters, etc. the higher pricing run rates and the higher productivity run rate will also start reflecting in the quarter. So therefore, net-net, to sum it up, we believe, even if you look at the gross margins of the rebased portfolio that you have mentioned we are pretty similar to the last quarter on a sequential basis. So we would right now want to believe that it seems to be bottoming out. And as our pricing and productivity run rates ramp-up, hopefully we can reverse the trend from next quarter onwards.

Moderator: The next question is from the line of Abneesh Roy from Nuvama Institutional Equities.

Abneesh Roy: Thanks & congrats on winning the women's IPL team for Bangalore. That was my first question. So what could be the medium long-term impact of this on your brands and revenue? It's a very interesting development. But the fact is that the rights have come obviously quite expensive. And I see that BCCI has received more money than what they received for the men's team in the first year. So obviously, a lot of time has gone, but RCB is paying around INR 900 crores for this. So what would be the revenue and the brand impact long term? And in near term, how do you see in terms of the impact on profitability because this is something which is currently going to be in the nascent stage?

Pradeep Jain: Yes. So Abneesh, thanks for this. So look, on profitability, I mean, it is a bit of a portfolio game. Yes, this is a long-term bet. I mean if I go back to the men's IPL also since we have the history, and we have seen it organically play out over the last 15 to 17 years now. It did not make money for the first 10 years. But the good thing about this investment is and all of you are aware, it kind of timed perfectly with the new cycle of the men's IPL and the new media auction cycles of the men's IPL. So we are fairly buoyant, that is going to provide a kicker into the men's IPL profitability. And a part of that will be consumed by the women's IPL. But longer term, genuinely, right from where the women's IPL cricket penetration, viewership penetration stands today, it can only grow by leaps and bounds. And therefore, it's a long-term jewel that we are picking up in our portfolio. And obviously, the three or four reasons that Hina mentioned at the outset, that kind of provides a kicker to our core alcohol businesses as well. Hina, do you want to add anything?

Hina Nagarajan: Yes, I would just add that actually, we have taken a very conservative view over the next few years of what women's IPL could do. And even there, the business case made absolute sense. So we have gone through a proper due diligence process with the Board, and we believe the business case is very robust for it.

And like I said, Abneesh, I think the impact, I mean this is right up where Diageo Purpose & value stands. So I think our focus on inclusion and diversity, we have stood mix-gender, cricket in the past, and this is taking that narrative forward. So I would say, it's a very strong affirmation of what our business stands for. And we believe that this will only strengthen our overall equity as our business being a strong revenue case over the next few years.

Abneesh Roy: My second and last question is on the premiumization and the packaging. So in premiumization, we have delivered a good, consistent growth over the past few quarters. Could you be a bit worried because of the start-up job losses, IT net addition has been at a multi-month low? Would you be worried on that in terms of the outlook, not from a Q3 or Q4 and being more on the FY '24? And on the packaging bit, in terms of the innovation and cost savings which you are driving, next few years, could you talk about that, what exactly you'll be doing? And how much could the potential savings there?

Hina Nagarajan: So Abneesh, to answer your question first, I mean, we have seen this in India and globally actually. The premiumization story has remained quite strong. If you look at mid- to upper segments, as I said in my opening script. That basically, we don't see a slowdown there. We are seeing robust growth, and we expect that premiumization trends to continue. I mean in a sense, because we are not a daily frequency purchase items. And people only purchase a bottle every month or two or three months. We are not really comparable with the grocery items and the regular consumer FMCG.

So our story doesn't get as impacted by inflation as the daily consumables do. So we are not seeing a slowdown. Actually, the only little bit of slowdown that we see is towards the lower end of Prestige. And it is difficult to say conclusively whether that is there to last. I think there is some -- there might be some slowdown on upgrades from country liquor to popular business, which is the key source of growth for that segment.

But difficult to say, so we will continue to watch that segment over the next few quarters. But beyond that, I think we see the premiumization story and the growth quite robust. And we see that in global trends as well. Even pessimistic markets like the U.K. which is currently the more specialistic market on consumer sentiments, we are not experiencing a slowdown in alcohol sales and the premiumization. So I think we are quite confident that the fundamental growth trend will continue.

Abneesh Roy: And on the packaging bit? Packaging cost to that?

Hina Nagarajan: I mean, on packaging, look, I mean you are probably referring to the removal of IBCs , which we have started doing. So that was definitely both a sustainability and cost saving initiatives, of course, I mean it brings savings with it. So we have started that. I mean I will talk about our innovation as we go along. I can't really talk about it in advance. But there's a number of innovations that we are looking at, which are both to keep our growth momentum in Prestige and above. And also accelerate our sustainability journey because that's also a very critical pillar of our strategy. And whether it's alternate format or whether it is more innovative packaging, we are working on that. The technical team is working on that, and we will be announcing these at the appropriate time.

Moderator: The next question is from the line of Manoj Menon from ICICI Securities.

Manoj Menon: Just allow me one to follow up on the question on the profitability of the divested portfolio because that is one of the questions to many investors have been asking us since yesterday. If I look at the 9-months profit, so it's 110 plus 80. Am I supposed to add these to 190 divided by 983, which gives me a mathematical outcome of 19.2% EBITDA margin. Because cost is cost, whether it is corporate costs or the other variable costs, etcetera. To begin with, is that the right way to look at it that the divested portfolio actually had a 19% EBITDA margin, cash, noncash profitability included.

Pradeep Jain: So Manoj, that's not the right way to look at it. And that's why we have consciously split the numbers. And we have tied in with the consistent narrative that we have shared over the last seven, eight months ever since we have announced the deal. So the 110 is with the corporate overheads that portfolio was absorbing.

And even after we have sold that portfolio to Inbrew, etcetera, they have also had to set up the corporate organization. So that's the broad point that I made. And to run our INR 1,500 crore business, anyone will need a reasonable size corporate organization. Now we can dispute, we can debate whether it should be INR 28 crore per quarter organization or it should be INR 20 crore or it should be INR 35 crores. But the fact is that you need central support corporate organization functions to run that machinery. So that's the way.

But the second thing is we've always said that, look, when this happens, there will be an operating deleverage, which we will recoup. As our experience in other parts of the globe, when we have divested the tail end of our portfolio, etcetera, where we do not have a longer-term right to succeed, we believe that we will be able to accelerate on our P&A growth, etcetera, to be able to recoup this over the four to six quarter. So Manoj, that's pretty much the story. Consistent with what we have said from May onwards. Now that the first quarter has come in, I am equally transparently sharing the numbers as they are there.

Manoj Menon: The only follow-up, which comes here and I'll take it offline is that this INR 80 crore calculation for 9-months, is it volume indexed or volume linked. I mean that probably that's the reason it's a higher number than what many of us thought?

Pradeep Jain: No, okay. I mean the way we allocate corporate overhead is straight percentage NSV. All the direct overheads, etcetera, has anyway gone with it. So the people who are dedicatedly working for their portfolio, the plant, for example, owned manufacturing facility, all those have gone with the deals. So these are the big allocation percentage NSV basis. So if our full corporate organization has fixed overheads of 7% to 8% of NSV, we just load the 7% to 8% of NSV on all segments of the portfolio.

Manoj Menon: So just quickly, the second question on -- one on the actual pricing, which you would have got in 9-months this fiscal with geography, some granularity if you can? And one theoretical question I had is on initiatives like mono carton removal, etcetera, which I presume is an industry-wide practice, at least definitely in the top companies for sure. Can it redefine the industry profit pool higher? Or because you will do it on a like-for-like basis, it is likely to get expensed away?

Pradeep Jain: So maybe I'll take the first question. Yes. So on the pricing, Manoj, I mean here are the broad headlines. So if you talk of the quarter, we've got good pricing, price increases from -- I mean, you just call out four states definitely. West Bengal, Delhi, Odisha, Karnataka. Those are the four states. And obviously, our long-pending application with CSD, we've also managed to get some price increases and in CSD, which is very-very difficult to get, but we have managed that also. And a couple of other small states, I know that Daman and Diu we got some pricing, etcetera.

But overall, at a slightly elevated level, I do want to say that if you look at the July-June performance year of Diageo, I mean that's the way I mean we -- Hina and I do have a schizophrenic life, April, March and July, June.

But if you look at July, June, we are trending towards probably one of our best year on pricing. And broadly, we right now have a line of five to about 2% of our NSV, and 2% pricing we've never got in the last five to seven years. I would probably say, its the highest since the acquisition. Now having said that, it is still only a fraction of our inflation. Always focus on mix and product. So I hope that answers the pricing question.

Now your second question, maybe I'll request Hina to build after what I have shared, which is, will it redefine the profit pools. The entire mono carton removal and packaging. See, Manoj, the conditions in which it is happening, like I said, it was a sustainable initiative. In the current inflationary conditions where your COGS is inflating by 11% and you are getting probably pricing in terms of percentage terms only at 20%, even at 2%, it's only about 20% of, etcetera.

I think it's just kind of helping counter inflation to my mind. But once the inflation normalizes a little bit and we see some sanity coming back, etcetera, yes, absolutely, that comes into the profit pool. And then it's up to each individual player to make the choices that they want to do with that profit. So I don't know Hina, whether you want to add something?

Hina Nagarajan: So I don't think there's anything to add. Absolutely in this current environment, I think it is just going towards offsetting the cost and of course, it is helping on sustainability. At the moment, sustainability is the bigger driver. So I think it's a wait and watch area. Very difficult to tell you whether this will change anything because the environment still looks quite tough.

Pradeep Jain: Does that answer your question, Manoj?

Moderator: The next question is from the line of Avi Mehta from Macquarie.

Avi Mehta: Just a small clarification on this EBITDA margin bit. Now the way I just wanted to get it clear, the way you are -- we would be right in kind of looking at this, the 15% 9-month number, which I think from a full year basis should be probably a similar percentage on a full year basis, that is the level which you would look to reach back in the next four to six quarters on the back of scale benefits? That's the way it would be apt to look at that, right?

Hina Nagarajan: Absolutely.

Pradeep Jain: Absolutely, Avi. That's the right way because that is the middle block of the bridge is our retained portfolio, now. And that's what we need to focus on. That's what you guys need to look at. That's what we are maniacally focused on. And you're right, and yes, so...

Hina Nagarajan: Yes, Absolutely, that's right.

Pradeep Jain: You've got it absolutely right.

Avi Mehta: That number, what would be on a full year because you don't have that benefit? That's what I would -- it's just to get us clear on what is the target that you internally are looking at, we are also aligned on that. Could you give us a sense of what that target is for FY '22, which went by when you do this adjustment?

Pradeep Jain: No, FY '22 or FY '23? So Avi ...

Avi Mehta: So I mean, what the actual was. 15 is the 9-month number, is it the same for FY '22? And hence -- because the quarterly things remain volatile?

Pradeep Jain: We haven't done that, Avi, because there was so much of work this time. We haven't yet done that. But when we come to you and maybe we will anyway we will have that number. So I mean the way I'm seeing it, they'll till we start lapping the divestiture of the popular portfolio till September 30th, we will pretty much continue with these bridges. So you'll get a sense, it will not dramatically differ, I would say.

Avi Mehta: And just clarifying on that, the inflation aspect that you are witnessing is just something that will probably be impacting the time it takes to achieve it, which might be -- this is why the four to five month range that you are rates that you're looking at, is that the right metric that you are also kind of believing it, right?

Pradeep Jain: That's right. Absolutely, right.

Avi Mehta: Just two clarifications, book-keeping, if I out? But one is this women's IPL, congratulations on that, any sense on the likely near-term impact that I should build in? Would it be more like INR 900 divide by 10-plus some numbers, so we should be around INR 60 crores or so? Or any sense of that number or what your math is, A? And b, is there to be one-off or in the subsidiaries this time because of which the sales when I do just console minus standalone, the sales comes out to be negative, those are the two clarifications.

Pradeep Jain: Okay. So on the first one, I mean, obviously, the INR 900 crores will be amortized over a period of 10 years. Now, we don't know how the rest of the IPL math will work? I mean we've done some modeling based on our learnings of having handled/seeing the men's IPL progression. So we have to wait for -- I mean the good thing is the tournament will happen in March. So whatever local sponsorships, this/that etcetera, we will want to wait for one cycle to complete before we can provide.

But as I mentioned at the outset to Abneesh's question, the good thing is that this bump of investment is happening in the year in which the men's IPL media auction cycle is changing. It's going. So therefore, that should provide a profitability kicker, which will, hopefully, and the impact of this, the INR 90 crore amortization of the INR 900 crores should be consumed by that sticker on the men's IPL profitability. So that's a very-very broad model in our mind right now. But obviously, we need to wait for things to emerge over the next three to four months.

Avi Mehta: And the subsidiary bit, is there any one-off over there?

Pradeep Jain: Subsidiary bit, I'm just quickly jogging. No, there's nothing on the subsidiary base. I mean since there have a lot of action in this quarter, I'm assuming that you have read about our signing the definitive agreements on the sovereign distillery. That was a 12-year idle non-operative assets that we have finally managed to dispose. So we are happy with that, that will lighten the balance sheet. We haven't taken any charges on account of that, that was fully provided for over the last seven, eight years. That's one. And the second thing is you would have seen our announcement on the follow-on funding of – in our beverages. So apart from that, nothing around the subsidiaries.

Avi Mehta: I wasn't able to understand why the subsidiary console sales were lower than the standalone sales, that's what I was asking, but that's okay I can take it offline.

Pradeep Jain: Maybe, Shweta will probably get back to you, right? I will also understand the query a little more.

Moderator: The next question is from the line of Percy Panthaki from IIFL.

Percy Panthaki: So my question is on the P&A sales. So last quarter, we had done a 22%, 23% P&A sales, the three-year CAGR since Y-o-Y growth can be disrupted by COVID, we are looking at three-year CAGR. So that was around 14%. And in the concall last time around, you had mentioned there are pluses and minuses affecting this number. But overall, they cancel out each other, and there is no one-off at an overall level in this 22%, 23% topline growth. Now this quarter, we have fallen to a 12% topline growth on P&A and the three-year CAGR has decelerated from 14% to a 10% a level. So just wanted to understand what really has changed for the demand outlook to suddenly change so materially in one quarter and if 10% is a three-year CAGR now. And now this quarter has been absolutely normal in terms of demand, is this an indicator of what the P&A portfolio can grow at in future?

Pradeep Jain: Okay. Super, Percy, great question, and we were mentally prepared for this. So I'd just say that I don't think we ever said that the pluses and the minuses are cancelling each other. I thought what we said was that this 23% is clearly not sustainable. So I tell you what is happening on a sequential basis, if you look at it, Delhi is the big joker in the pack. I mean for the last four quarters, up till July, September quarter from October, December of last year, Delhi was adding about four to five points of growth, to our national portfolio.

And with Delhi reversing completely, that positive kicker has become a negative kicker. So Delhi was adding, I would say, probably three to four points of growth. And it will still stabilize further in terms of the negative direction over the next two quarters. So essentially, the swing is Delhi. Delhi, the plus 3%, 4% has become a negative 1%, 2% from October, December onwards. So that's broadly the five to six points of swing. That's one.

Second thing is around the same time when the Delhi bump up was coming, West Bengal had also favorably changed its RTM after the industry has continued one year advocacy with them. If you remember, post-COVID, they have taken some 45%-50% consumer price increases, etcetera. So that benefit now we have started lapping. It had opened sometime in October '21. So huge growth for four quarters. And therefore, now we have started lapping. So that's adds two to three percentage points. So that broadly explains the 23% coming down to the 12-13%. I mean that's broadly the math.

Now third thing, I mean, it's just that last year with Delhi, BIO being so salient there, etcetera, we had an absolute cracker of a quarter last year on BIO sales. And this time, BIO, as we have said, Hina mentioned in her opening comments, it's not fully normalized. So hopefully, it will fully normalize in January.

Hina Nagarajan: But a large part of has now come in towards the end.

Pradeep Jain: Towards the end. So the whole quarter did not see a full normalization. So therefore, lapping a very high base on BIO. And obviously, we couldn't repeat that in October, December. So those are broadly the three reasons.

Hina Nagarajan: Percy, I would like to though say one thing. I think for our industry, where we have route-to-market changes quite often, as you are aware, you follow the industry. I think it is probably not right to look at one quarter in isolation. We've got to look at rolling four quarter performance to understand the performance of the business. Because there are these ups and downs that happen in every state. And we know how to navigate that. But in a particular quarter, they can all disrupt the picture.

So I would say that if you look at the rolling four quarters, you're right, the growth has been that 14%, 15%. And I think that is our aspiration. This is exactly what we told you that we want to continue the momentum to that. So I think that's what the team works on. So I would really request you to look at a rolling four quarter performance rather than an individual quarter and try and take a trend out of that because that doesn't really work for our industry.

Percy Panthaki: Absolutely Hina, But also given that bases are a little skewed on account of COVID, I would look at a four-quarter rolling number, but on a three-year CAGR basis.

Hina Nagarajan: Sure, sure. What I mean is that, I mean, going forward now that COVID is out of the way and we will start -- we have normalized the base. So going forward, we will it would be appropriate to look at the four quarter rolling thing. Of course, you do your CAGR analysis, etcetera. And the other thing I wanted to add is that growth, obviously, the team is working on, looking at how to recoup whatever part of that growth from other states and driving the momentum with the fantastic launches that we've had and where we are seeing so much momentum on innovation and renovation. So we will continue to aspire to deliver the kinds of growth that we have spoken about in our strategy and we have delivered.

Pradeep Jain: And maybe just one build, I'm kind of responding to your remark, Percy, the three-year CAGR, you get into 2019-20, so just be conscious, right? Andhra Pradesh is also the big animal there, right? So you've got -- and if you want those numbers separately, these are hard actuals, etcetera. I mean, Shweta will probably end up sharing with you, right? But there's a lot of noise in that 3-year CAGR because Andhra is in the base in 2019-20.

Percy Panthaki: Secondly, quickly on the margin. So this quarter, you have done 13.2%. Even if I adjust for the operating deleverage, it's around 14.2%. So let's take 14.2% as a starting point because that 100 basis points you want to anyway recoup in the next four to six quarters. So let's look at the longer term. So 14.2% as a starting point, over the next three to four quarters from that 14.2% starting point, what are the margin tailwinds that you see? And what quantum of those tailwinds do you expect, over the next four quarters?

Pradeep Jain: So Percy, I mean very difficult to call out. This is -- like I said, we continue to influence the levers. So we are happy with what we are seeing on pricing, even after December, there was a fair amount of pricing versus prior year same quarter that has flown in, but we also expect the run rate to ramp up.

Because we -- the price increases that we have got, they will ramp up. Productivity, I mean, the big one that you guys are aware, is a mono carton removal, etcetera, so all that will start flowing into the P&L. Inflation, honestly, very difficult to call right now. Till when will the Ukraine crisis continue and therefore, the natural gas prices will remain high, etcetera, so very difficult to call out.

But our first target is clearly, as I think one of your predecessors mentioned on the call, from this 13.2%, get to the 15%, first. And then we will probably take it from there. The supply agility program, I mean, that may not deliver too much in the first 12 to 18 months, because first, we have to execute the actions and only then the benefits of those, lower conversion costs, etcetera, will start coming into the P&L. So that's the way I would want to leave it. Our first aspiration is to get back to about 15%, and then we see how we take it from there.

Percy Panthaki: And how long do you think it will take for you to get back to that first milestone?

Pradeep Jain: Yes. I wouldn't want to call that out, Percy, right now, very difficult. Had it been a free pricing category, we would have been in a better position. But there are those constraints in this category. So we are giving it a best shot and we would want to get there as soon as possible.

Moderator: The next question is from the line of Harit Kapoor from Investec.

Harit Kapoor: So my question is really on pricing again. I mean you've seen a state of pricing over the last 12 months, you said it is probably the best phase that you've had. I'm just wondering as you go into the next policy season over the next few months, I just wanted to get your sense on the confidence level and probably going back to some of the states and saying, look, we may -- they're back and we may need some more going forward as well, how do you see that dynamic playing out? And do you believe your success rates will be similar to what you've seen in the last 12 months?

Hina Nagarajan: I can answer what we will do. I can't answer the question of whether the success rate may be the same or not, but we would obviously strive to have the same. So pricing is a continuous advocacy for us. So just because we've got this pricing. Clearly, inflation is still roaring ahead of the pricing. So we are definitely back with all the states on pricing advocacy, and we will continue to drive that quite hard. Both as an industry and as a company, we continue to do that. We are getting into the excise cycles now.

This is the time when the advocacy is at its highest. So the team is on it, we continue to advocate for it. I mean you may still see some media releases on price increases and inflation. And we advocate both for immediate price increases, and we are advocating with the government for a more fundamental restructuring of the way prices are handled for this industry. Will we be successful? We don't know. We know these things take time. And we continue to work closely with the government to try and reach some conclusion. So the answer is absolutely, we are going back to the government and asking for more pricing.

Harit Kapoor: And my second question is on the competitive environment, given that you're such a large entity, there is a very high ability to manage the cost structure. But certain smaller competitors that might be even harder, so are you seeing markets that given this inflation with competitive intensity media or otherwise has come off? Is that something you're seeing or its still at a fairly high level

Hina Nagarajan: I mean, I don't think the competitive intensity is coming off. So we've had a lot of new people come in to the markets and launch new offerings. And we have always said that actually competition is good for this category because of the low penetration levels in the country. And especially if you look at the Prestige and above category and especially as we go higher up pricing ladder, I mean, scotches are hardly three, four percentage points, penetration, Prestige also at the upper level is 25%, 30% penetration. So competition is good. It continues.

There are many new players, many new types of offers in the market. And the consumer is demanding that. So consumer is experimenting -- even the white spirit area is growing quite fast. So if you look at our performance on gin, on Smirnoff, we are seeing good growth, robust growth there. So I don't see intensity relenting, I just see different players coming in with new offers and more innovation happening actually. And we have intensified our innovations and renovations as you can see from our last few months. And we are continuing to keep attention on our innovation process, so that we can cater to the evolving needs of the consumer.

Moderator: The next question is from the line of Anil Shah from Aditya Birla Capital.

Anil Shah: I just wanted to go back to why really did we do the slump sales? Because if mathematically, when I look at it, not only was the slump sale products giving me margins, EBITDA margins positive of 42% for the quarter. Plus they were actually taking care of the fixed overheads of the other side. So if I look at it, it literally tells me that margins for the slump sale were higher than company average. So, A, please explain. Let's go back to the drawing board, but all the time we've been talking about, margins will improve because we will only do P&A. But it seems like margins were much better here, number one.

Two, if you want to recoup this INR 90 crores for 9-months I'm assuming INR 105 crores, INR 110 crores for the year. You've talked about recouping this in the next four to six quarters. So if we are currently around 13.2% margins. I'm assuming if I add back this in the next as you said four to six quarters, we'll be back at 14.5%-plus, 15%.

On top of that, can I then assume that the productivity gains that we talked about in which we are working out and the Board has approved will add another INR 130 crores to INR 150 crores productivity over the period of two to three years, not necessary in the next 18 months, the next 18 months, this will kick in. The rebasing part will kick in. So is that understanding right? Or is there certain things which are double counting here?

Pradeep Jain: Yes. So Anil, let me just go back to your first question. I think that's absolutely the bull's eye question. Even though we have answered it earlier. I don't think when we took the call to sell the portfolio, it was a mathematical equation for us, it wasn't.

Hina Nagarajan: And it was not better margin.

Pradeep Jain: And it was not better margin, so but we leave that. And that's why we have been very-very transparent in sharing. The numbers are still dilutive to the portfolio. But yes, I mean, I don't think that's the big driver. The big driver has always been -- do we have a long-term right to succeed in that segment? And very-very clearly, we had consciously after a lot of work and diligence genuinely landed to the conclusion that no, we do not have a long-term right to succeed. And in fact, we would say that we probably delayed the divesture for about two to three years. And we only were eroding value in the portfolio. But maybe let me just…

Hina Nagarajan: Yes, I think the other one, Anil, I would say is that there were two assessments. Which way is the market going? And if you look at the market segment development, well before even I came in, it was very clear that the popular segment is declining and what is taking off is prestige and above, and that is going to be the longer-term future trend for this market.

So one was where are the future profit pools going to lie. And the second was where do we have the long-term rights to win. And when you marry the two, I mean this is active portfolio management, and it is absolutely proven that companies that do active portfolio managements to play to their strengths and core capabilities win in the long term.

So as a prudent active portfolio management exercise, it was absolutely the right thing to do for this business. And Pradeep has commented on the financials of the business. It was not accretive to the business, it was under -- it would have been under huge pressure with this macroeconomic environment. We do not play to this portfolio, but play to our rules in this portfolio, so therefore, the longer term right to succeed was very low.

Pradeep Jain: And Anil last thing is, right, and there is enough in the bridges that we have given you. You will also get a sense of what that portfolio delivers in the current environment. So if you look at the INR 53 crores on the INR 700 crores in the first six months, you see the pace at which, in the current inflationary environment, that part of the portfolio resonates.

Anil Shah: So are we counting the gains that we should expect going forward?

Pradeep Jain: No. So gains, look, I mean, like I said earlier, Anil, we have been very-very disciplined as a discretion, in terms of discretionary overheads management. And IndAS was a little complicated because it clubs the fixed variable fixed overhead along with the variable overheads. In IFRS, it gives a better sense. I can tell you that our fixed discretionary overheads, the corporate overheads are 20% below what they were five years ago. And this is after providing industry competitive annual increment cycles to our employees. So that's the level of rigor that we have maintained in our discretionary overheads management.

Now you're absolutely right that, that will be a lot of diminishing returns. So now we can't cut further because if you cut further, we start cutting into the muscle. So therefore, we have to grow out of it, we have to absolutely grow out of it. And that we believe we will recoup whatever we've lost. We've lost about INR 1,300 crores of NSV, we are very confident that we will be able to recoup this over the next four to six quarters. .

Anil Shah: I'm sorry to re-ask the question again. And I won't mind if I can get some numerical answers, please. I'm again saying, you said that we will recoup in the next four to six quarters or 12 to 18 months whatever we've lost out as far as the deal is concerned, the slump sale is concerned. That's about a INR 110, it's INR 90 crores for the first 9-months as per your chart or as per the table that you put in. I'm assuming it will be INR 105 crores, INR 110 crores or INR 120 crores max for the year. Hypothetically, we will recoup this. On top of that, we've talked about a new plan, which the Board has approved where we've talked about INR 130 crores to INR 150 crores productivity gains are kicking in after 18 months.

Pradeep Jain: No, Anil, that's not right. So let me clarify again. The first part, you're absolutely right. The operating deleverage, we should be able to be recoup. Basically, if I just put it another way, whatever NSV we have surrendered through the sale, right? We should recoup that NSV over the next four to six quarters by keeping our fixed overheads flat. That's the way I would want to dimensionalize it. And the moment that happens, we would have recouped it. That's one. So I hope that's clear.

The second one is supply agility is a three-year program. And initiatives would keep kicking in incrementally. The first set of initiatives will kick in after 12 to 18 months when the first set of actions are completed. It's a three-year program...

Anil Shah: It will deliver in the next 12 to 18 -- after the next 12 to 18 months?

Pradeep Jain: No, it will start delivering in the next 12 to 18 months. It's a three-year program. All our actions will hopefully be completed by 2026 January. And whatever actions we completed by 2026 January will only deliver in FY26-27. So once all is completed, we will see an annualized flow-through of anything between INR 130 crores to INR 150 crores. Not to say that the first set of savings will kick in from 2026. As we take the first set of actions, those savings – partial saving…

Hina Nagarajan: A safe saving program.

Pradeep Jain: It's a safe saving program.

Hina Nagarajan: And yes, it comes after 12, 18 months.

Anil Shah: There are two separate tracks as far as, getting back to the first one is the next 12 to 18 months, getting back in terms of the rebase and then the kicking in terms of the ...

Pradeep Jain: Yes. Absolutely, Anil.

Anil Shah: That's exactly the point. And this -- and on top of that, whatever we do as far as the mix is concerned, the product pricing from the various governments is concerned ...

Hina Nagarajan: Correct.

Pradeep Jain: Absolutely, Anil. That's the right way to take it. I mean that's a game of inflation, productivity, pricing, mix, etcetera.

Anil Shah: Yes, I understood this part. However, I would genuinely like to have a call offline to really go back into understanding in terms of -- while I understand the long term in terms of active portfolio, when a product is contributing even in terms of fixed cost, corporate overheads to sell that off, I'm still not able to, sorry.

Pradeep Jain: Happy to have that call, Anil. I mean Lathika can reach to you, Shweta, we'll be happy to answer.

Moderator: The next question is from the line of Alok Shah from AMBIT Capital.

Alok Shah: My question was just an extension of what Anil asked. Can you elaborate more on the supply agility program, firstly, what are you exactly planning to do over here with respect to timelines? And then, of course, the benefit is something that we already explained earlier? But wrt the actions, if you can sort of help us ...

Pradeep Jain: We've already shared everything that we had to share. Am I missing something? I didn't get your question. We've already shared everything in the response to Anil's question.

Alok Shah: No. So, one is with respect to the factory closure or severances is one thing. Apart from that, any other program that we are driving, which will help us with respect to the cost savings?

Pradeep Jain: So there will be a combination of -- there will be a few other programs. We don't want to get into that level of detail in this call. We will be happy to have that off-line call and talk about some of those things.

Moderator: Thank you. Ladies and gentlemen, this was the last question for today. I now hand the conference over to Mr. Shweta Arora for closing comments.

Shweta Arora Thank you. With this, I close today's call. For any follow-up questions or clarifications, please feel free to reach out to me. Thank you for joining.

Hina Nagarajan: Thank you very much. I really appreciate the interactions as always. Bye-bye.

Pradeep Jain: Thank you.

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