



“United Spirits Limited Q4 and Full Year 2019  
Earnings Conference Call”

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**Moderator:** Ladies and gentlemen, good day. And welcome to the United Spirits Limited Q4 and Full Year 2019 Results Conference Call. As a reminder, all participant line 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 – Managing Director and Chief Executive Officer, and Mr. Sanjeev Churiwala – ED and Chief Financial Officer from United Spirits Limited. Thank you and over to you, sir.

**Anand Kripalu:** Thank you very much. Hi, everyone. And a very warm welcome to this call where we will discuss FY19 Q4 and full year results. I am joined by Sanjeev, and I am Anand Kripalu. Before we open up the lines for questions, I just wanted to use this opportunity, as we typically do, to provide a perspective of our results that we announced last evening.

As you may have seen in the published results, net sales in the quarter grew a modest 4%, with the Prestige & Above segment growing 8% on the back of a relatively high base of 16% growth in the same quarter in the previous year. In addition to the broad slowdown of the entire FMCG sector and other sectors as well are grappling with, for us specifically this quarter was also impacted by some excise policy changes in a couple of key states, specifically, Maharashtra and Karnataka.

Now, as many of you know, Maharashtra announced a change in excise duty with effect from the 1st of January 2019, and it took everyone in the industry a while to calibrate the pricing and get new stocks into the market. Karnataka, on the other hand, didn't announce an excise duty hike this year, unlike in previous years. And obviously, that is good news that there is no excise duty hike. But what happened is, because there was no excise duty hike from the 1st of April, we had an effect on demand specifically in the quarter and, more specifically in the month of March, where retailers did not bring forward purchases that they had typically done in previous years.

Now as you know, we run this business on a full year basis rather than on a quarter-to-quarter basis. And therefore, I would like to now share our full year financial results. In this case, net sales grew 10% with the Prestige & Above segment growing 15%, with Popular growing at 1%. So, while these numbers have come on a somewhat low comparative, it does illustrate the potential of this business to demonstrate and deliver growth when you have a relatively stable environment.

Our premiumization strategy continues to yield results with the Prestige & Above segment now accounting for 66% of our business, which is up from 58% just a couple of years ago. Our fit-for-purpose model for the Popular segment is also performing well, and we have franchised our Popular business in one additional state of Telangana during FY19. Overall, our Popular business in priority states grew 1% and the income from franchise states was in line with our expectations in the year.

In terms of profitability, we have delivered a gross margin improvement of 21 basis points this year, despite significant raw material inflation and despite part absorption of the excise duty hike in the State of Maharashtra, starting Jan 2019. We were able to deliver this improvement in gross margin, primarily because of our productivity led efforts. We continue to invest behind our brands with our marketing investments up 9% for the year. Our A&P reinvestment rate was 9.6% for the full year, very much in line with the range that we had shared with you.

Importantly, EBITDA margin for the year was 14.3%, an improvement of 175 basis points versus the previous year, delivered mainly through extracting further efficiencies in staff cost and other overhead lines. I am also pleased to report an 18% reduction in interest cost that resulted in interest cost savings of Rs. 48 crores for the full year. We made further progress in monetizing our non-core assets and simplifying and rationalizing our subsidiary structure. To this end, we sold some of our key properties, specifically four floors of our office in Bangalore, in UB Tower, and also our wine subsidiary, Four Seasons Wines Limited.

Our improved operating performance, sustained focus on reducing interest costs and further monetization of non-core assets have resulted in a PAT of Rs. 659 crores, which is an increase of 17% over the previous year. On the balance sheet front, we have continued to deleverage, and we reduced our total debt by 21%, partially as a result of better working capital management.

I would like to also share with you that, recently, USL has been assigned a Corporate Governance rating of CGR 2 by ICRA, reinforcing the quality of our corporate governance practices. Additionally, in line with the highest standards of corporate governance and transparency, we have proactively disclosed some potential irregularities when we announced the results of the last quarter. So, specifically, we had a note in the accounts related to certain irregularities in our manufacturing processes in certain plants, which we have proactively disclosed to the concerned authority. We have now appropriately dealt with these irregularities basis discussions and disclosures with the appropriate authorities, and we have also discharged or provided the amount of financial obligation, which is not considered to be material. Based on this, we have also strengthened our existing controls and processes so that we don't have an issue like this again.

So, in sum, after challenging FY18, we could see the underlying momentum return to our business this year, particularly in the Prestige & Above segment, which is in line with our strategy. We made further progress towards preimmunizing our portfolio, driving productivity and strengthening our core brands, while also investing in building the future of this organization. In fact, on a full year basis, we have delivered across all lines of the P&L, the top line, EBITDA margin improvement or A&P investment. And that was in line with our philosophy of running this business on a full year basis rather than on a quarter-to-quarter basis.

Looking ahead in the next quarter, we do expect to see some impacts from the dry days caused by the recently concluded general election. And also, the fact that there is a consumption slowdown in the larger consumer goods space, it's something that we are also seeing a bit of in our industry. But with the election results having come, we are beginning to see the first signs of positive sentiment, and that's reflected by something that you guys monitor very closely which

is the stock market performance over the last few days. And therefore, we do expect sentiment to continue to turn positive, and that, normally, more than money and other things, leads to increased consumption. And we, therefore, do expect to see improved consumption in the fullness of time.

And therefore, I would like to use this opportunity to reiterate our medium-term ambition to grow our top line by double digits and to grow EBITDA margin consistently year-over-year towards mid to high-teens.

With that, I am opening up the line for questions.

**Moderator:** Thank you very much, sir. Ladies & gentlemen, we will now begin the question-and-answer session. The first question is from the line of Avi Mehta from IIFL.

**Avi Mehta:** Sir, I just wanted to kind of touch up on the demand side that you have indicated. If I look at the Prestige segment growth for the last, I look at as you said, on an annual basis for the last three years, you get an average of only about around a 9% even for the last two years. What do you think is giving you kind of, and given the demand environment also, what do you think would allow us to kind of grow at a stronger pace and this 15% odd growth momentum as we go forward into FY20? And correspondingly, even with the Popular segment you continue to see decline, is this now over or do you expect some quarters to be weak before the pickup comes in?

**Anand Kripalu:** Thank you, Avi, for your question. Let me just address Popular. We have always said Popular will grow at low single-digit, and it is at low single-digit. The previous year was a little negative, this year it's at low single-digit. And we expect Popular to stay around that level and nothing gives us an indication that it's likely to be any different. Now coming to the Prestige & Above segment, I think you are right in terms of the data for the last couple of years. And let's recognize the fact that in the last couple of years, there has been a significant discontinuity that has impacted the industry as a whole, and therefore, impacted our business as well within that.

Now, however, when we are able to see a bit of stability you will see that the Prestige & Above segment starts delivering better performance. Now, looking ahead, two things give me confidence that we should be in a better place in the fullness of time. The first is that the consumer opportunity for our industry is unquestionable. And on the back of GDP growth, which I think we should feel more positive about with the stability in the government, there is absolutely no question in my mind that the consumer opportunity is out there. Then the question is really, if the invitation is there, I would want to open the door and join the party. And there are things that we are doing on our brands in terms of the next phase of investment, and the next phase of activities on our key brands that actually gives me confidence that we are going to build momentum on whatever we have already seen.

Now these are really the two things that gives me confidence. What nobody can say is, specifically when exactly that turn will happen, but I do expect that it will certainly happen. We just don't know exactly when. And that is what I would say as far as this is concerned.

**Avi Mehta:** Sir, just continuing on that, the near term is you seeing, because you said some signs of improvement in sentiment. But would you believe that this translating in to revenues is probably going to take a couple of quarters? What is your sense, sir, I just wanted to kind of get a sense? Because almost two months are of in this quarter itself, you have got some idea about how should we kind of, I am just trying to peer through near-term. I take your point about the medium-term, and I completely appreciate it.

**Anand Kripalu:** See, as far as, I am not going to specifically tell you too much about this quarter and the next, right? But what I can tell you and what I have said already is, because we are not really going to give a forward guidance of any kind. But what I can tell you is that there has been impact of the election in this quarter. And in fact, most of the election impact happened in April and May. It didn't happen in the previous quarter, and that's why I have not called out any impact of the previous quarter, whatever was there is something we mitigated. Now in this quarter there has been an impact and therefore there has been impact in consumption, because obvious things like dry days and so on and so forth, with no mitigation plans to really compensate for. And then there is a larger softness in the consumable space, which we are seeing across the larger consumables industry. I am only saying that there is some positive sentiment beginning to emerge in the larger space, as reflected by the stock market. I expect that will translate to better consumption. And therefore, we should start seeing some kind of a positive movement there. And that's really all I can say at this stage.

**Avi Mehta:** Okay. That's helpful. The second bit, sir, was on the margin side. Now, I kind of appreciate that we have taken, the last quarter was impacted the margin as you said, there was an impact of part absorption of excise duties. But had there been pricing actions subsequent to that, which kind of gives us that this margin has seen a subsequent improvement or there is something else, what are the levers that should help us improve gross margins from here on? And related to that, if you believe that is not the case, would it be more focused on the operating costs? That was the other bit of it.

**Anand Kripalu:** Yes. So, first and foremost, I must say that the guidance we gave you is that we will show consistent improvement in operating margin on a year-to-year basis. And we use all lines of the P&L as appropriate, to deliver a margin improvement consistently on a full year basis, and you will recognize that we have actually done that now for the last few years. Now coming specifically to your question, yes, there has been significant inflation on cost and on the two key raw materials for our industry, which is glass and extra-neutral alcohol. There are also these specific actions that we have taken to absorb excise duty or correct pricing to stay competitive. And this is specifically in the state of Maharashtra and we can say that. Now, as far as the action on absorbing excise duty or correcting price in Maharashtra is concerned, I want to say this that despite whatever investments we have made in that, our margins in Maharashtra are accretive to national margins, and our growth in Maharashtra is faster than national average growth. So, despite these corrections, it is benefiting to the overall business. And I would like you to see it that way.

Now as far as COGS is concerned, what are we doing to, at least in part, mitigate the impact of COGS. Now, in the last few months, we have got price increases in more than 10 states, some large states, some small states. And the price increases range from 1.5%-odd going in some states up to almost 5%. So, there is a series of price increases that we will see. Now, obviously, there are many more states that we need to target, but I want to use the confidence of the fact that we have got this in about 10-odd states to say that we are absolutely intent on working on this and unlocking this in other states. And there are still a few large stubborn states, if I can call it that, where we haven't got a price increase yet. Now our sense is that, as far as the pure COGS impact is concerned, pricing will be able to mitigate or the pricing what we got so far for them to mitigate about, somewhere around half of the COGS impact that we have had. And of course, we are going to continue to drive productivity aggressively in our business while looking for the balance states, to give us price increases. So, that's largely the construct. I am not going to get into any specific conversation on gross margin, gross margin guidance, because we don't give that. But this is how we are trying to deal with the COGS environment to make sure we can still use that and other lines of the P&L to deliver the operating margin improvement on a consistent basis that we have guided you on.

**Avi Mehta:** Perfect, sir. And with your permission, the last one, any comment on the recent news about Andhra Pradesh considering a provision? I will come back to the queue for the remaining, but just this one if you could.

**Anand Kripalu:** Well, it's obviously speculative. And you know what I know, because we have the same newspaper, right? So, listen, this is news out there. Just to that, you and the other people on the call understand, Andhra contributes somewhere between 3% and 4% of our top-line and bottom line. So, if it did go for full prohibition, then that would be the order of impact. Now we can speculate whether it will go to full prohibition, partial prohibition, or no prohibition. My view on this is, let's just watch this space, the Chief Minister in making has come out and made some statements, and I don't want to say anything to contradict that because I have no locus standi to do that. So, let's just wait for a couple of weeks and I think we will all get a bit more clarity on this. Suffice to say that Andhra is a state that need resources for development and that's a big priority, and we believe that we are a key contributor as an industry to fund for development. And we are hoping that the government will see this impact too.

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

**Abneesh Roy:** My first question is on the irregularity in the manufacturing, which has been concluded in terms of investigation. So, it took a few months for the investigation to be done. So, my question is, how many plants this issue was there? What and how much and where have we provided this provision? And what process changes you have done after those investigations came? And could there be more liabilities coming from the authorities or the regulator in the future or there is no opportunity on that?

**Anand Kripalu:** So, Sanjeev will answer that for you.

**Sanjeev Churiwala:** I think in the last December quarter when we had this qualification, all of these concerns were emerging out. Very happy to say that the qualification has now been taken away and we have appropriately dealt the implications of that in the financials. And as you can see in the SEBI results in Clause #11, it is kind of very detailed on the overall implications and what we have said. We have been dealing with the regulatory authorities, and I must tell you that last December when you saw that note, we just came to know about the irregularities. So, maintaining high standards of governance, we immediately disclosed to authorities, and we also agreed to take a qualification because we were not in that state at that time to really understand the implication of that. So, over the last few months we have been dealing with that. We have now already called out in the financials, so overall in terms of materiality it is not very significant now. We have disclosed with the regulatory authorities; the appropriate action has been taken as per the satisfaction of auditors. And I think there is nothing much at this moment to kind of speak about that. I think it is past now for us. We are dealing with this appropriately.

**Sanjeev Churiwala:** But sir still how many plants and why you are not quantifying it? And what are the process changes?

**Sanjeev Churiwala:** See, basically, certain manufacturing changes. This is something which is kind of, as I said, limited to certain plants, and a corrective action has been taken. It is not material in the scheme of things now.

**Anand Kripalu:** Yes. So, I don't think its value adding to get specific about which plant and so on and so forth. And like we had said, it's about intermediate, so it's just about tracking the process in a plant from input raw materials to output, and the steps in the middle, and just being more rigorous about how to track. And that's all it's about, Abneesh.

**Abneesh Roy:** Sir, that was helpful. My second question is on the ad spend. So, six quarter low and wanted to understand, yes, demand was weak, we do see always when demand is weak advertising being cut by many companies. So, how is the share of wallet? And any more brand relaunches being planned in FY20, because that will again determine how much will be the advertising?

**Anand Kripalu:** So, as far as relaunches in FY20 is concerned, you will have to wait and watch this space, Abneesh. But obviously, we are excited about some major initiatives that we are going to take on our brand. And one of the things that we have introduced, which is in the press release, which has just got into market is something which is a kind of a branded hip flask for scotch. And you would see that, the photograph of that, on the press release.

As far as ad spend is concerned, are we competitive? We haven't fully tracked it in terms of the previous quarters, but my sense is that we are competitive in terms of share spend. Now, our biggest quarter typically is October-December, festive season, winter, that's the biggest quarter. And typically, the demand is highest, because the conditions are for demand. And this happens the world over during the festive season, not just in India. So, therefore we end up spending more.

But if you look at our full year basis on A&P, it's at 9.6%, it's very competitive. The growth of A&P is there. And we have always said that it's unlikely we will ever spend more than 10% and unlikely we will spend less than 9%. And I said this in a past call, so it's pretty much in that range. So, I think you should really believe that our spends are competitive. And I have also said in the past that A&P spend, how much you spend is not a precise track, it's a lot about management judgment. And sometimes you open the tap, you spend a bit more, then you see maybe I have spent a bit more than I need to, the ROI is not fully there. So, you trim it back. And these are things that you do as management, and this is how you will play different lines in the P&L as appropriate. But I think our brands are well funded, and that's the message I want to leave you with.

**Abneesh Roy:**

Sir, one last one follow-up in terms of book keeping. So, your debt is down Rs. 700 crores, but your interest cost is up quarter-on-quarter and YoY and your other income is down sharply, both quarter-on-quarter and YoY. So, if you could explain that.

**Sanjeev Churiwala:**

Definitely. Let me first explain the interest and the debt. I think it has already been called out when Anand spoke. This year we have seen an overall debt reduction of Rs. 676-odd crores, which is again significant. and it continues in the line of the reductions that we have seen in the previous years. Our debt reduction absolutely is about 21% reduction, our interest cost on an annualized basis is also down by 18% for the full year. I suppose, if you see some changes in the quarter-on-quarter number, that will depend upon the working capital intensity for that particular quarter for the kind of volume which is required. But I think the greater way of looking at is look at the full year trend and see the reduction in the debt and interest cost.

**Moderator:**

Thank you. The next question is from the line of Harit Kapoor from Investec. Please go ahead.

**Harit Kapoor:**

My first question was on the working capital side. Obviously, there has been a very substantial reduction in working capital this year. If you could just help us understand how much of this probably is a function of some of the relaxation in states? And how much of it would be internal? Obviously, the question is regarding how much of this can be even extrapolated into next year in terms of reduction?

**Sanjeev Churiwala:**

So, I think if you see our working capital evolution over the last couple of years, and way the management team measures the success is the average working capital. Our average working capital was to the tune of about 32%, 33% three years back, it's right now about 23%, 24%. So, we have been able to reduce about 1000 bps in the last three years, which is a significant reduction. In the initial years, yes, because of the franchisee changes that we did, we did some savings. But in the current year the savings that you see is purely because of internal efficiency, in the way we have managed our receivables outstanding in the market and the way we have looked at our state payables, optimizing state permit conditions. The way we look at inventories in our plant and the way we are looking at inventories in our corporations. So, it's an internal effort and I think it is all very-very sustainable efforts that we have put in.



**Anand Kripalu:** And if I can just add to what Sanjeev said, I will tell you, in the management team, which I attend every month, we run a cash committee where every line contributing to cash is questioned and challenged. And we focus on state-by-state issues and we resolve them. And we have our Chief Operating Officers from all the regions attending this. So, cash is a really critical focus for us as a company, and by the way, average working capital is also a key management metric for the management of this company.

**Harit Kapoor:** Very clear. So, just a follow-up on that, given that you have squeezed so much out of the working capital already, do we still expect that there is more that we can do on the efficiency side? Given the nature of the industry, do you still believe that we can have more space here going forward?

**Sanjeev Churiwala:** I think we do have some initiatives in terms of continuous improvement. But of course, the intensity will keep on coming down. I think what we are trying to do is benchmark and ensure that change best of class in terms of how working capital should be deployed in the business. And as Anand said, every month we look at opportunities in our executive committee meeting and we will continue to do that.

**Anand Kripalu:** So, I will give you an example of certain things that we are trying to do. For instance, increasing finished goods capacity in certain factories so that rather than keep duty-paid stock in corporation godowns, we can keep more stock in our factories. Now that would release significant working capital. We are trying to use our public relations efforts to try and work with government corporations to not have to pay excise duty while when we bid. And they recover the excise duty from retail. So, we can provide stock which is non-excise paid. Now, if that were to happen in any state, that could make a huge difference to our working capital. So, just efficiency unlocks may become less and less, because you have taken out the low-hanging fruit. But there are structural opportunities that may take different time, right, that we are still working on as a company.

**Harit Kapoor:** Very clear. My second question was on the margin side, again. So, if I understood your response correctly, you are saying that even for FY20 in spite of the headwinds on the cost, etc., you still believe that there is enough leeway to see some improvement on the operating margin side? Is that a fair takeaway?

**Anand Kripalu:** Yes, I think so. I mean we are saying that we are committed to consistent margin improvement year-on-year, and we are absolutely doing that. Now, obviously, there are challenges that we need to deal with. The cost environment has been adverse, and I talked already about the kinds of things that we are doing, increased intensity on getting pricing unlocked and increased intensity on productivity and extracting efficiency from other lines of the P&L as well. So, that's something we are doing.

We have also been encouraged by mix, like Prestige & Above we are seeing good momentum in our Scotch business, and that is going to help also to mitigate some of the cost impact because it's margin-accretive. So, there are different levers that we are extracting in our business. But we are committed to improving our operating margin.

- Sanjeev Churiwala:** And if I could just add to what Anand said on a very lighter note, I think the similar question was asked to us a few years back, when would Diageo India deliver mid-teen margins? So, happy that as we are speaking today, that is not any part of the discussion, mid-teen margins we are already almost there, and now our margin aspiration is mid to high teens. So, I think we are moving in the right direction and we continue to do that. We also had significant headwinds from the last few years, and in spite of that we have been committed to grow to our mid-teen margins. So, very clear, the team is very, very confident in ensuring the margin progression continues to happen.
- Moderator:** Thank you. The next question is from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.
- Jamshed Dadabhoy:** Sir, two questions. So, when you look at the business over a two, three-year time frame, if you go back over the last couple of years, you will have got about Rs. 600 crores, Rs. 650 crores just through the price and mix effect, this is I am going through FY19 versus FY17. And roughly, one-third of that incremental number has gone in A&P. Would you agree that this is a sort of ratio which will broadly continue going forward?
- Anand Kripalu:** I don't know. We will examine this. You see, our A&P reinvestment, we have given the range where we need to be. And if anything, I think we are at the higher end of the range where we need to be in A&P, to be honest. And we need to be sensible about spending A&P so that we get effective ROI at all times. Now, whether this ratio of what we are getting is going to remain one-third and so on, I mean, Jamshed, honestly, I do not know. But now that you have asked this question, we will examine this definitely
- Jamshed Dadabhoy:** No, it was just an observation. So, I am wondering if it's just coincidence or you all think about it that way?
- Sanjeev Churiwala:** Jamshed, just to add to what Anand said. I think in the last couple of years we have gone out and very clearly stated that we would like to reinvest our profits behind the brands. So, if you are comparing F17 to F19, our reinvestment rate has gone up by about 250 basis points, right? And that was the specific intention that we want to step our investment of 7% to 8% to 9% to 10% now. So, I think what's important for you to know that, we would like to reiterate that our A&P reinvestment rate would continue at the rate of 9% to 10%. Now it's up to you to decode in your modeling as to how we look at it going forward.
- Jamshed Dadabhoy:** Okay. That's clear. Second question, again, two years ago you all had made this presentation where you set five-year outlook for all the brands, for the three big categories; Popular, Prestige and then Premium. You said Popular industry will grow at about 3% or so. Is that what the growth rate of the industry is today, which means you are sort of lagging a little behind industry on the Popular side? And the same would apply on the Prestige and Prestige Plus and the Super Premium?

**Anand Kripalu:** I don't know remember exactly. But the forward outlook on category growth is normally something that we take from IWSR. And there has been some tempering of the growth outlook on Popular and P&A as far as IWSR is concerned. Now that has predominantly happened in our judgment because there have been discontinuities in the intervening period, which has created a bit of a shock for the growth of the industry, which you are all aware of. And therefore, there is some tempering of that. But having said that, now with those things behind us, broadly, I think we are seeing Popular flattish to low single-digit, and that's what it's always been. And Prestige & Above, tempered down a little bit, but still allowing us to get to the range that we have talked about in terms of guidance for the growth of the industry. Now having said that, this is an outlook that IWSR gives, I think if we have regulatory stability, you will start seeing a turnaround again, because the consumer opportunity should give us higher growth than the projections that are there from IWSR.

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

**Arnab Mitra:** My first question was related to gross margins again. So, on input costs I just wanted a sense from you, do you think the full impact of the ENA and glass price increases is reflecting in the March quarter, or is the full impact likely to come in the subsequent quarters? And, secondly, you spoke about the 10 price hikes from 10 states. A very ballpark at a Pan-India level, given your state mix, how much would this translate to at the overall portfolio level?

**Anand Kripalu:** So, glass is, I would say, fully factored in. ENA is a dynamic market, it's a commodity that goes up and goes down. And while it has gone up in the last quarter, nothing says that it will evolve further, it may even come down a bit next year. But that's beyond the point, if I knew exactly what would happen I'd be a rich man. So, that's how you should see it. So, I don't think you should expect major adverse impact beyond what we have already seen on commodities.

Now, as far as pricing is concerned, I don't want to aggregate nationally, but what I did tell you is that about half of the COGS impact that we have seen, we have recovered on price. Now we have also invested back into Maharashtra and so on, on specific price corrections and excise duty absorption. But on pure pricing given by the regulator, we have got about half of the COGS impact back. Now we have not finished our journey of getting price increases from other states, and the intensity, if anything, is high in trying to unlock states that have not been unlocked until now. Now that's the only way really to look at it.

**Arnab Mitra:** Okay. And the second question on the Maharashtra absorption of excise. So, I mean, in this industry historically we have always felt that it's been price constrained, which constrains margins. But this is obviously a free pricing state where you have not fully passed on excise. So, is it, in your view, very specific situation in Maharashtra competitively, because of which, despite having no regulatory reason to not pass it, you have actually chosen not to pass it? Or is it a sign that there is generally high-competitive intensity in the P&A segment and, therefore, it's not going to be that easy to take pricing even it was available?

**Anand Kripalu:**

See, first of all, I'll tell you that if I we look at the excise impact, there was no excise impact on Popular, so Popular prices stayed the same. And in the Premium segment, particularly in bottled in India scotch, the full excise impact was passed on to consumers. And the bottled in origin segment, there was actually no excise increase, actually a small decrease. So, by and large, we have kept prices the same in BIO. Now coming into Prestige, there has been some absorption of excise duty across the three segments of Prestige: lower, middle and upper. And absolute, since this is a competitive industry, there is strong head-to-head competition. And sometimes, you have to stop and see and do the right thing.

Now in an ideal world, we would have liked to have passed on more of the excise increase to consumers, because that's what we should be doing in an industry like ours. But sometimes you wait and see what competitors do and you follow in segments where you may not be a leader in the segment. Now, having said that, I think on the positive side of this decision, so having absorbed the excise duty, on the positive side is that growth momentum is still strong in Maharashtra. And that is why Maharashtra is having now among the highest tax rate in the country and the highest consumer prices in the country, this growth momentum across segments in Maharashtra is robust and strong. So, it still gives us good margin and good growth. So, it is accretive nationally to us.

So, this is not ideal. If we were operating in a vacuum, that is in a space with no competition we may not have absorbed so much, to be honest. But we are operating in the real world. And in the hind sight, I mean, we are not completely disappointed because we have seen good growth momentum, and that's helping us. And I think it's accretive for the overall portfolio nationally, so that's not a problem. And premiumization is continuing to happen in the state of Maharashtra, despite the price increases in scotch and so on. So, on that's really the situation.

**Moderator:**

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

**Amit Sinha:**

Sir, firstly on the elections impact in the last two months. So, the question is, was the impact limited to the dry days during these two months or was there also a significant impact coming from the supply control availability at the store, etc, etc?

**Anand Kripalu:**

So, the more of impact was to do with dry days and so on, because supply side we tried to increase our stock levels and so on to compensate for that. But it wasn't just dry days, in some states there were different kinds of challenges that were there. So, for instance, in some states the store opening times were reduced, even on days other than dry days as part of the election code of conduct, so that had an impact. In some states, to make sure that there wasn't misuse of alcohol during the elections, quotas were given where we couldn't get a quota or an order which was higher than the sale in the same month of the previous year, to make sure there isn't explosion of demand which could have led to misuse during elections. So, there are multiple factors that have contributed in different ways in different states to the election impact. We had called this out three, four months ago, so it's not a surprise, honestly. And I have seen that other players have also called out that there would be election impact, or they are seeing significant election impact. Now I won't say it's significant, all the things put together, but there is an impact.

- Amit Sinha:** Sure, sir. And secondly, if you can help with the IPL franchise profitability for the year compared to the last year, it would be helpful?
- Anand Kripalu:** Let's go to Sanjeev who's Chairman of RCB.
- Sanjeev Churiwala:** Thank you, Anand. So, of course, if you are seeing the complete year numbers, for the full year, RCB had a revenue of Rs. 306-odd crores and our EBITDA of Rs. 146 crores. So, an EBITDA margin of close to 50%. But of course, the good part is because this year the season started early, in this year's financials you see the profitability and the revenue of the last season, which was Season 11, and part of that in the offseason, which is current, because some of the profits of March profits we could get here. So, we have to kind of decode that and take out the Season 12 revenues and profit from there. We are still hitting an overall revenue of Rs. 240-odd crores with an EBITDA of Rs. 130-odd crores. So, that's what came in F2019. And of course, it's significantly better than compared to the previous years, because not only we have sponsorship revenues gone up, I think all of across various line items we have been able to really ensure getting efficient base
- Anand Kripalu:** And in future we hope to win the prize money as well.
- Sanjeev Churiwala:** Yes.
- Amit Sinha:** Right. And this level of profitability we should expect going forward as well? I mean, given that the new regime of the sponsorship which should have kicked in from last year, right?
- Sanjeev Churiwala:** Normally what happens is every three to five years when the auction happens, you see a bump up, but there after the next three to five years it's significantly flat. So, the kind of profitability that you see now for this year, you can by and large kind of decode, that will remain in the similar kind of range-bound numbers.
- Moderator:** Thank you. The next question is from the line of Ashit Desai from Emkay Global. Please go ahead.
- Ashit Desai:** My question is on your realizations. You have mentioned that your Super Premium, Premium brands have grown faster than the Prestige. But if you look at the P&A realization growth, it's just 1%. And I believe out of the 10 states, some of the price hikes you had received during the course of the quarter and previous quarter also. So, if you can give some color on that, what's driving this? Is it lack of pricing, state mix, higher discounting or what is it?
- Sanjeev Churiwala:** I think it's very difficult for us to decode looking at realization perspective. But of course on the full year perspective our P&A has been growing 15%. And within that we see a good premiumization happening, our scotch portfolio is growing very, very healthy, above 20%. So, yes, I think it's a combination of various things, but the question is very, very specific and very technical. So, can I just request you to just drop a mail with exact requirement of yours and we can get back to you.

**Sanjeev Churiwala:** Okay, I will do that. And secondly, these price hikes that you have announced, what will be the weighted average price hikes that you expect from these 10 states?

**Anand Kripalu:** So, primarily mentioned, I mean I am not going to give a specific aggregate number because that's not relevant I think even. So, the price hikes across more than 10 states is anywhere between 1.5% odd to about 5% odd in the best case. So, that's what happened. And it happened at different few times over the last five, six months, which should all help us in F20. Is there something specific you want more than this, which is something that we can't share.

**Sanjeev Churiwala:** Okay. These price hikes have happened in the last five, six months?

**Anand Kripalu:** Yes. Five, six months, most of them in the last two, three.

**Ashit Desai:** Okay. Got it. And just one last question on your working capital, it's good to see this reduction of Rs. 321 crores. I just want to know where is this coming from, because if you look at your trade receivables, inventory, payables, the numbers are more or less similar to last year?

**Sanjeev Churiwala:** The way you will have to decode is, our top-line is growing double-digit, right, and does warrant us to pumping the right quantity of working capital. The efficiency basically comes in terms of leveraging we are getting. So, our trade receivables kind of have improved overall, in spite of our top line growing faster, because the fact is for every Rs 1 of material we sell, we are actually blocking working capital of Rs. 4, because the excise component is quite big. So, that is kind of really helping us to drive down our working capital.

Our trade payables terms have absolutely increased in terms of renegotiations, we are trying to standardize our payment terms, that has happened. Anand also mentioned about all the initiatives that we have taken in terms of looking at inventory, inventory sitting at the corporation, inventory sitting at the plant. Most of them will not individually reflect in the overall numbers that you see, but given the backdrop that business is growing by 10%, this was a significant improvement.

**Ashit Desai:** Okay. So, there are other line items also which are reflecting these savings?

**Sanjeev Churiwala:** Yes. I think if you look at the inventory, trade receivables, trade payables, others, if you look at the balance sheet then you get the full one, you will find other line items as well. This kind of consists of all the advances, the excises we need to pay, the trade deposits that we need to pay. There is a significant reduction in that because we have standardized the excise amount that we kind of deposit across various plants and warehouses.

**Moderator:** Thank you. The next question is from the line of Mithun Soni from GeeCee Investments. Please go ahead.

**Mithun Soni:** Sir, is it possible if you can share how are we increasing our market share in the Prestige-mid and the Prestige-high category? We are lagging fairly behind the competition, so what are the things we are doing there?

**Anand Kripalu:** So, in the Prestige-mid and Prestige-high, I mean, I don't have specific market share numbers to share. Clearly, we are the challenger player in that segment, in both those segments. In the mid-Prestige, broadly speaking, I think Royal Challenge as a brand is holding or improving in most states, it's challenged in one or two states. Six months ago we introduced McDowell's Platinum, No. 1 Platinum in the same segment in the mid-prestige segment, and we are very encouraged by how Platinum is showing up. And the good news is that Platinum shares are accretive to the Royal Challenge shares as well. So, we have these two brands now, which are doing well.

As far as the upper Prestige is concerned, Signature Premier from our portfolio is growing really well and growing faster than the industry segment. And we are seeing many states across the country where Signature Premier is leading the growth in the segment. And that's really what I can share, I don't have any specific numbers as far as the market share is concerned.

**Mithun Soni:** Sir, an extension to this question, how are our products priced in terms of competition? We are more or less in line with the competition for both the mid and the high or we are price our product premium to the competition?

**Anand Kripalu:** I mean, its a mixed bag, it is different in different states. In some states we align price to the competitor brands, in some states we are at a premium to the competitor brands. In some states Royal Challenge and McDowell's Platinum are priced the same price, in some states they are priced differently. But broadly they play in the same segment, and that is the only way to look at it, and few percent up or down doesn't really matter, as they compete in the same segment.

**Mithun Soni:** Okay. Sir, my second question is with respect to advertising, wanted to reconfirm that most of the advertising is towards the P&A segment or we spend some dollars even on the Popular segment of the advertising budget?

**Anand Kripalu:** Spend small amounts on the Popular segment and small amount only in specific priority states, largely retained states.

**Mithun Soni:** So, we are basically spending about 15% to 16% on the Prestige and above segment as an advertising?

**Anand Kripalu:** I am not stating that. Yes, I just want to tell you that of our total spend a small amount goes behind Popular in the specific retail state on the key power brand in the Popular segment, and the rest goes in Prestige & Above.

**Mithun Soni:** Okay. If you can allow me one last question on the Premium side. Sir, just wanted your view, of the sales what we are seeing in India, are we seeing that the customers still continue to -- a lot of it is coming as an import, people come from outside and these are all well traveled people, or most of the consumption or the shopping for the premium products happen in India also? How do you see the mix over there?

**Anand Kripalu:** So, first of all, I must tell you that duty free sales at Indian ports and airports is much higher than the amount we sell domestically and that's because of the big difference in duties. Now, having

said that, the fact is that our domestic portfolio is growing handsomely in the Premium segment in scotch, both bottled in India and bottled in Origin scotch. And the one thing about our industry is that people don't down trade down easily. When people have a tight budget they may downgrade the quality of rice grain, but once you start drinking a Premium brand, people don't downgrade what they drink and what they serve. And that's the good thing about the industry. Typically, it's a one-way industry where people move up, they don't move down. And therefore, we are seeing the growth, and once the growth comes, people stay.

**Mithun Soni:** And the profitability of the Premium would be higher than the company average, is that fair argument?

**Anand Kripalu:** Yes, it is a fair argument. I mean, premiumization means premiumization of hopefully margins as well, yes.

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

**Bhavesh:** Just one question. You mentioned about the price hike range of 1.5% to 5% and half of the cost inflation is taken care of with this price hikes. So, the fourth quarter gross margin of 46.5%, that is the run rate also of the margins if, let's say, input prices stays where these are? Or there can be an upside to this as we head into first quarter?

**Anand Kripalu:** I cannot tell you one way or the other what is going to happen on gross margin. But please recognize that there was cost inflation, there is pricing, there is also excise absorption and price correction. So, there are multiple levers that are contributing to the gross margin number. Now, I can't tell you how exactly the sums will correlate and coincide prospectively. So, as far as margin is concerned, please stick to what we are saying in terms of our guidance on operating margin.

**Bhavesh:** So, your comment about half of the cost inflation is taken care of by price hike is for the quarter as a whole? I mean this has played out in fourth quarter or this is yet to play out, the comment that you have made?

**Anand Kripalu:** No. See, pricing has happened at different times. So, there is a moving average and many of the prices have happened actually even after 1st April, okay, which not reflected at all in the previous quarter, whereas COGS is largely reflected fully in the previous quarter. So, I think you will find it hard to try and correlate all of this precisely. But I am thinking of broad-brush sense of the total pricing that we will receive and the total cost inflation that we experienced, how would it compare to your understanding.

**Moderator:** Thank you. The last question is from the line of Mayur Gathani from Ohm portfolio. Please go ahead.

**Mayur Gathani:** Sir, your P&A segment was contributing 57% two years back, then 63% and now 66%. Where do we see this? I mean is there a benchmark that you would like to take it to?



- Anand Kripalu:** So, it will keep increasing, I mean, logically, because P&A will grow faster. I think the structural changes, the impact of the structural changes will become less and less as you move forward, because while there are still smaller opportunities from franchising, they are small opportunities for franchising. So, if you think about P&A growing strongly, Popular growing modestly, I mean that's just now an arithmetic progression of the fact that P&A will continue to increase bit by bit by bit in terms of its contribution.
- Mayur Gathani:** Okay. And on the working capital, you did throw some numbers, like there was a percentage drop over the last few years and compared to this. I missed the number, can you just reiterate the number, please?
- Sanjeev Churiwala:** What we have said is our working capital is continuously improving. And the number that we called out was Rs. 321 crores. As a percentage the way we manage the working capital, it is a metric called average working capital, and they will not be exactly coinciding with the statutory numbers. This number used to be about 32%, 33%, three years back. Now that this year we are closing, we are kind of standing close to 24% or 23%. So, as a result, over the last three years the improved by about 1,000 basis point and we are kind of ensuring that with all the productivity pipelines we have on the working capital, this will keep on improving with price rise.
- Mayur Gathani:** Okay. And the last one, sir, how's the franchisee operation? I mean, you have seen some renegotiations happening or it's on a steady-state basis?
- Sanjeev Churiwala:** Franchisee, the majority of the franchisee we have already completed in 2018 and going quite steady state. We are now engaging with our partners to ensure that the business continues to grow and flourish, and that's what we are looking at currently.
- Anand Kripalu:** Yes. And we will renegotiate it when the time comes, when the contract needs to be renewed. But we have changed or enhanced the nature of engagement of how we are trying to support our franchisee, which is something that we have learned as we embarked on the franchising model. So, we need to provide them more innovation, upgradation of products, we need to provide them sometimes some creatives which they can use locally in their markets. So, we are trying to support them more than we had already envisaged when we targetted this entire market.
- 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:** No, that's it. Thank you very much, everyone, for taking the time to log in and for continuing to keep the faith and support our company. I hope we were able to address a lot of the questions that you have had. But I look forward to seeing many of you early next week when we do our Annual Investor Road Show. With that, thank you very much.
- Sanjeev Churiwala:** Thank you.
- Moderator:** Thank you very much, sir. Ladies and gentlemen, on behalf of United Spirits, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.