"United Spirits Limited Q1 FY2021 Results Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the United Spirits Limited Q1 FY2021 Results Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the opening remarks 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, Chief Executive Officer and Mr. Sanjeev Churiwala, Chief Financial Officer from United Spirits Limited. Thank you and over to you!

Anand Kripalu: Thank you very much and very good afternoon everyone, and a warm welcome to the Q1 F2021 Results Call. First and foremost, I just hope that you and your families are all staying safe.

Before we open the lines for Q&A, I want to provide some context for the results that we announced last evening. This was indeed a quarter like no other and I do hope we never have to experience another quarter like this ever again. For the period between March 24, 2020 and May 3, 2020 lockdown 1.0 and 2.0 Alcobev Manufacturing and sales were completely banned in all states in India. From May 4, 2020 onwards several states began allowing the sale of alcohol. Off-trade outlets began to open in May and subsequently over the course of the next two months about 80% to 85% of the off-trade outlets gradually opened including some that were doing only home delivery so they were not opened for over-the-counter sales only for home delivery in places like Mumbai.

On-trade outlets, an important channel for our P&A brands continued to stay closed pretty much throughout the quarter. Our manufacturing operations also followed a sequential process with factories being allowed to operate based on the zoning criteria in line with the easing of the lockdown starting from May 4, 2020. By the end of June all our units became fully operational. Having said that what we have witnessed subsequently in July is that retail outlets in a few cities and a few of our plants had to again shut down temporarily in line with the second wave of localized lockdown announced by various states. So in many ways this will be a process of two steps forward and one step back till the pandemic comes more under control.

During this period, a positive development on the distribution side for our industry has been that several states have allowed home delivery and online ordering of alcohol something that we have been trying to unlock for a very long time. While this is still very nascent and the model is still evolving we do believe that once states see the merit of the model especially in terms of added revenue and improved compliance while enabling social distancing, there will be a stronger argument for this to sustain. On the other hand, what we also saw in the immediate aftermath of the opening of the industry was across-the-board tax increases in most states. Some of the tax increases were exorbitant going up to 70% to 75% of the MRP, but the good news is that a few of the states have since rolled it back including Delhi and Odisha and we are hopeful that a few more will follow.

Since these factors were external, what we did as a management team was to focus on what was within our circle of influence and within our circle of control, and I am particularly pleased about a few things in particular that we have achieved during this quarter -

First is supply chain readiness. The team planned ahead and made sure that the startups and shutdowns were quick. This was despite having to navigate a very complex state-level manufacturing footprint and having to procure several permissions to operate, in fact, several new permissions to operate. The team simultaneously overcame any logistics-related hurdle including labor shortage and ensured that ramp-ups were faster than usual. This despite putting several safety measures in place to protect our employees, be it thermal scanning, multi-point hand sanitation, frequent sanitization of equipment and facilities and all while maintaining the appropriate social distancing in our factories.

Second, we continued with the rollout of renovated mixes for two of our largest brands, McDowell's No. 1 and Royal Challenge whiskey in more markets and supported them with the right levels of investment. We have had an encouraging response to these relaunches and are eager to ensure that consumers across the country experience these new mixes as fast as possible.

Third, we redirected our sales force to work more effectively in a virtual world, be it in terms of equipping them with appropriate training or exchanging best practices during the lockdown or indeed even having virtual connects with our customers.

Fourth, we also continued to work with state governments to minimize collateral damage to our industry including obtaining necessary permissions for production and keeping the route to market open.

In parallel to all this, we have been ruthless about discretionary costs, but at the same time what is important is that we have not shied away from doing the right thing, from investing and supporting our customers, our consumers and communities as per need. We have also supported our TMUs and franchisees as well as our vendors to ensure that our ecosystem remains healthy during this very tough time. In service of that, we recently launched Raising the Bar programme to support the revival and recovery of the on-trade channel. This clearly exemplifies our commitment towards growing the category in the longer term and supporting our communities at the same time. Since we have already talked at length about this program on a separate call earlier, I am not going to repeat that now.

In terms of financial performance, you must have seen the quarterly numbers from our published results and obviously we will take whatever questions you have, but I think this quarter is full of aberrations and comparing these numbers year-on-year is not really an apples-to-apples comparison. I would just like to put a few things like aging-based provisions and COVID-led obsolete inventory provisions have exerted further pressure on our profitability in addition to the negative impact of the operating leverage due to significantly lower volumes in the quarter. We believe that a part of these provisions should reverse over the course of the coming year.

Looking ahead, we will have to navigate several unknowns over the course of this year. As the pandemic continues to surge in India, the containment strategy being adopted by state governments in ways of localized lockdowns could lead to temporary closure of manufacturing sites and retail stores in phases. This is likely to be the environment within which we will have to operate in the next few months or quarters and therefore maximizing the opportunities presented to us each day while being agile to move from one day to the next will determine how successful we really are.

Additionally, the real impact of recent tax-related price increases on demand will also become fully known and much clearer over the next few months especially given the fragile state of the economy as well. Another variable to watch out for and plan for is the change in consumer behavior in the aftermath of the crisis particularly the change in the ways of socializing and shopping. Having said all of this, we do continue to see some improvement with each passing month. Given the nature of this new reality, however, we must be cautious about extrapolating this into the future and therefore we will continue to closely monitor the situation and constantly evolve while staying committed to investing in our business and in our brands for the long-term success of the company. With that I am going to throw this open to your questions.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta: Sir, I just wanted to take a comment from the press release that you have mentioned about there being a month-on-month improvement in July despite the lockdown, which is very heartening to read would it be possible to share how the July sales have been or try to get some sense given this uncertain environment any visibility would be very helpful?

Anand Kripalu: So as you would imagine, anything specific is not possible for me to...

Avi Mehta: Sir, even a range would be useful, just to kind of get a sense how demand is...

Anand Kripalu: Yes. So I think you have to read the sentiment. I think what we are saying is the worst is clearly behind us. With each passing month we are seeing improvement, but given the nature of this beast two steps forward one step back, we had all our factories running and suddenly many factories closed in Karnataka and Assam because suddenly there were local lockdowns, now those have reopened again now, so this is a really, really dynamic situation Avi and it is not that I do not share, but I want to be very cautious about not misleading people and reading a trend when there is not enough data points for a trend, but just take it from me that things are getting better collectively, but I cannot say that they will stay better permanently because of the nature of the beast we are dealing with.

Avi Mehta: The second bit was essentially on the gross margin. Now we have seen some one-off impact, which is related to the inventory obsolescence if we kind of remove that would the gross margins have improved Q-o-Q versus fourth quarter levels and if they have if you could kind of help us what has helped that to kind of drive?

Anand Kripalu: I will pass it on to Sanjeev Avi for him to share as best as we can.

Sanjeev Churiwala: Absolutely as you can see that the gross profit margins, the underlying gross margins have kind of declined by 508 bps and of course I think there are a lot of factors, which are playing a big role out here. A couple of things which is worth noting for everyone, number one this particular quarter you will see our franchisee income has been badly impacted, it is quite soft, it is almost down by 40 odd Crores and just like us where we see our business decline close to 50% our franchisee business they have also seen their business badly impacted and on top of it because of smaller operations they had to face a lot of operating deleverages many of them have been making big losses, so we decided to kind of in a spirit of a win-win situation support our business partners there, so as a result our franchisee income is lower and that is impacting our gross profit margin almost close to 160 bps. Second is in line with the continuation and in line with our prudent policy accounting policy I will just mention about the loss, we have ensured that we continue to provide for slow and nonmoving inventories, which could be a combination of raw material, plant material, finished stocks within our own warehouses and of course finished stocks lying at the corporations, what you see in the cost line is everything to do with the inventory, which is owned by us besides the corporations that had a major impact. We had to take a hit of 21 Crores, which has impacted our gross profit margins by about 152 bps. Of course we also continued to have 2% on an average inflation, which is impacting the gross profit margin by another 150 bps, so all these three factors put together is about 460 bps barring other small items. Now how do we see this as compared sequentially I think the way I would like to decode is when I look at my ENA prices, which is a big component in my cost, have been flattish. I will not say benign, but at least as we said in the previous quarters that the peak is out now and hopefully we should see a softer environment as we move forward, so sequentially to that extent the ENA would definitely support in not pushing that inflation any further. Hopefully, as Anand said, if we see some gradual recovery happening in the market we might see a better utilization of the capacity and a better operating leverage coming through, which in this current quarter is really bad because what you see is 51% down in the industry, which means our manufacturing capacities have not been optimally utilized leading to a lot of inefficiencies. So hopefully yes this is where we are in terms of the current gross profit margin and some thinking as we move forward.

Avi Mehta: You said in the glass also if you kind of highlight that will be useful how is that doing?

Sanjeev Churiwala: Glass is the overall industry is in shambles the glass industry and over the last few quarters because of the lockdown situation, because of some other industries, the way this has played out, many of the glass industries have been under a lockdown situation and is gradually opening up. So to that extent we will see some inflation in glasses not that it will be flattish, there will be some inflation, but not the kind of inflation we saw a year back that is for sure. So yes I think it is good to kind of build in normal inflation happening in the glass.

Avi Mehta: Perfect. This is very intensive and extremely helpful. Just one last bit on inventory. We have been extremely prudent in our credit policies, I do not think there is a credit risk with the corporation sales, but I would love to understand your thoughts on how do we look at corporation sales and the credit that we kind of provide on such sales?

Sanjeev Churiwala: I think as compared to many other FMCG players we are very lucky in a way speaking that 70% plus sales is happening for corporations and as you are aware corporations are basically state government bodies and to that extent the credit risk completely secured this as a government sovereign debt as such there is no problem. Some states yes we did face delays in payment, which we have called out things are improving, but the provisions that you see is essentially not because an expected credit loss might happen it is just because the aging of the inventories lying with this corporations is not looking great why because we had a complete lockdown situation for 33 days, thereafter the economy opened slowly, it took time for the supply chain to ramp up, so as a result towards the year-end when we see towards June end you see a deteriorating aging situation. Of course because we are following a prudent policy we just provided the basis as aging, but as we move forward with some better depletion happening and some stages supplies happening, we should see the aging situation improving in the subsequent quarters and you see a part of that reversing. So yes it is not about any credit risk it is just about the prudent accounting policy.

Anand Kripalu: If I can just add a line to what Sanjeev said is that I do not think that credit coming in the way as we speak now of sales, we are not having to curtail credit because they are not at alarming level. At the time we used to in the past curtail even sales to make sure that credit does not go out of control, we are not in that situation, which actually coming out of the COVID crisis is not a bad situation to be in from a pure credit and cash standpoint.

Sanjeev Churiwala: Yes. Anand I would just add something more and I know this question will come up subsequently, Avi, so let me just finish this off. When we look at our overall debt situation on March 31, 2020 versus June 30, 2020 we are in a far better situation. There has been an aggressive drive on collections as a result we are comfortably placed, our overdues have come down significantly, we have also reduced our overall working capital as a result we have been able to repay debts also and this is a time when cash is the king. Our balance sheet is very, very healthy. Our working capital is right at a very, very optimal level. We have been able to reduce our receivables and take down the risk actually. So I think it is all to really serve the market well as and when the market opens up.

Avi Mehta: Okay good.

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

Abneesh Roy: Sir, good sales performance, given five weeks of lockdown and 25% sales coming from pubs was not there so wanted to understand some insights on two benefits, so one is of course duty-free shifts so have you seen a better performance in the mid and premium in the big cities I think wherein the bulk of the duty free shifts and second beer companies clearly are suffering because of the bulkiness of the purchase and refrigeration so any impact that you had versus beer industry how has the spirits industry done in the three months?

Anand Kripalu: Duty-free it is just too early to read this, so we are doing things as best as we can to woo people who would have bought duty-free stocks, to woo them through either direct contact or running promotions that are like duty-free promotions, but finally it is duty-paid and the prices are the prices that will be there in duty-paid versus duty-free and it is too early for me to see or read that those sales are actually shifting. Anecdotally I can tell you that some of it has to shift because if people are not traveling and you know that I have said this before in the past that people do not downtrade easily in this category. If you are used to drinking Johnnie Walker Black Label you do not easily downtrade to Johnnie Walker Red Label you will find that few thousand rupees extra so that you can continue to drink your brand of choice. So I think it will, but I do not have enough data points to tell you for sure that it is happening already, but I cannot believe that part of it will not move. All of it would not move because there is a price elasticity of demand as well. As far as beer is concerned again we do believe that there is a shift happening to spirits and spirits **(inaudible) 21:58** beer for all those reasons. There is an interview in the papers also today from one of the senior beer company leaders who has talked of the fact that beer is stressed because it is easier for people to just carry home spirits and consume spirits and because as long as the bars and the pubs are shut those tend to be more beer occasions when people go to those kinds of venues to drink. Now your option is to actually take something home and have that with a small group of friends because you are not having that in open spaces in large groups. Again the data is just too short, but anecdotally again I must say that is absolutely what we believe is happening and will happen on both these points. Let us wait so that is belief based on consumer trends and insights. Let us wait for data to corroborate that this is indeed the case.

Abneesh Roy: That was useful. My second and last question is on home delivery. So there are two subsets here, one is Mumbai kind of city wherein just home delivery was there so has the performance in Mumbai also been largely similar to your overall India performance given there will be more of bigger packs buying by consumers, second is in the 6, 7 states where home delivery has been allowed any impact you can share, there was a reversal in Jharkhand, but how is the performance in the rest of the states it is a short period, but any insights?

Anand Kripalu: It is a fact that it has started in a few places that is the big win and we need to just evolve this model. Now the contribution is still relatively small in places where over-the-counter sales is also being allowed, it is relatively small, but not immaterial, if I look at places like Odisha or West Bengal it is not immaterial, so it is picking up slowly, but if you look at Mumbai it is either home delivery or no sales, so everyone has found a way to contact their nearest store and get home delivery happening because over-the-counter sales are not being allowed so there it is material. Now I do not have the data off hand on whether Mumbai is selling in line with what it would have sold if retail stores had been fully opened, but I can tell you it is significant. The amount of home delivery sales happening in Mumbai is significant, so that is really what I can tell you, but I think on this the fact that the seeds are getting sown for an alternative route to market for the future and we have to sustain this because this can be the biggest unlock for an industry, which was constrained by accessibility.

Abneesh Roy: So why is Bengal, Odisha doing better?

Anand Kripalu: No, it is not about doing better. There are national players that have already they are operating there, so the Swiggys and the Zomatos and the HipBars are all operating in Odisha and Bengal and even Amazon and Flipkart and so on have got permission Big Bazaar I think they have got permissions to start in West Bengal and they are all perfecting their model. So I think just more scale players versus a retailer doing the home delivery on his own and there also the ordering can be done more efficiently through online portals and stuff versus calling up the conventional call-up, it is like the kirana wala send Johnnie Walker or send McDowell's No. 1, all right, so that is what is happening, so it is a crude, it is not an organized home delivery model it is a local store-led home delivery model and the big bang comes when you have scale players coming in and doing this.

Abneesh Roy: Okay sir. That was helpful. Thank you.

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

Arnab Mitra: My first question was on the tax increase and price increase from states, so we know that there has been a lot of two steps forward one step back even on the tax, so if you could help us understand at a national level what is the approximate higher consumer price that all the set of tax hikes that have happened till now is leading to, so what is the range of higher prices that consumers will have to shell out and any price hikes you have got from the state governments in terms of your own realizations?

Anand Kripalu: So we have received actually price increases over the last few months in 7 or 8 states Modest, but it still means, we have got some price increase. So as far as I am not going to give you an average rate of increase, but let us put it this way. The big outliers were states who had done 70%, 75% increase or 38%, 40% increase those have corrected. Andhra Pradesh is not corrected, but our business in Andhra Pradesh is down to almost nothing because of the route to market changes and regulatory challenges that we are facing. Amongst the balance, Delhi and Odisha were amongst the highest states in terms of tax increases, which I believe the consumer will accept because it is more routine, the range of tax increases there. There are a few states that are still there in the 25% to 30% range where we are still trying our best in those states the tax comes down because those states are also seeing a sharp drop in revenue and unless revenue also grows it is a lose-lose model, no one plays for a lose-lose model in the business, everybody on the win-win model, and therefore we are still talking with those states with data to see whether they will temper it down and then there are lots of states that were more nominal up to 10% odd kind of increase or low double-digit decrease and I am saying unless we see a crash of excise revenues we are letting it be and there are also some states that have not taken any tax increase, which continue to operate like normal. By the way there are also some states that have taken a meaningful tax increase where volumes are doing extremely well. So again it is just not easy to read because it is kind of a mixed bag, but giving you an aggregate number is oversimplification of what is happening and almost misleading because the differences can be many. So the way I want you to think about this is to say if it is more nominal tax increases, which is up to kind of double-digit price increase for the consumer and the revenues are going up we will leave that as it is. Where the tax increases are in the 30% range **(audio cut) 29:16** drop in revenue we are aggressively going after those states with data to try and get it tempered. So there is some tax increases in most places in our country, but none of them are such that it is detrimental to the industry or detrimental to excise revenues so that is the way we are approaching this.

Arnab Mitra: Very helpful Anand and just a last question. I know you answered to Avi's question that there are a lot of uncertainties and there is also restocking in the trade channel, so very difficult to read the near-term trends, but from whatever data you have seen the way I am coming from is you have that 25% on-trade, which is going to be literally 0 for some time do you get a sense that the off-trade or the outside on-premise business can actually make up for part of this based on whatever you have seen till now?

Anand Kripalu: So I am not going to say whether we can make it up because that is like telling you that we are selling equal to pre-COVID levels. I am not willing to make that statement today. Now some shift from the on-trade to off-trade is bound to happen it is obvious. Some sales of the beer consumption of the on-trade will move to the spirits consumption in the off-trade, all this is logical and it is going to happen. Now the question is how much and to what extent and will it compensate for the entire on-trade business and I think I would just be misleading you for instance that it is going to fully compensate for the on-trade business. Now having said that it will be our intent to activate the off-trade as best as we can to capture as much of that shift as we can while it is opened that is going to be the endeavor of management in our commercial and marketing team. That is what we are going to go after and hopefully the on-trade will selectively start opening as well as people get tired of these lockdowns and say we want to go out and have a drink somewhere, let us go to a place that is not crowded and let us go to a place that is safe, and that is where our Raising The Bar program comes in to create those safer environment for consumers to go out, but go out safely. So I think you will just have to wait and watch this space. As we get more data we will share it with you, but as you understand it is just so dynamic that I just do not want to give people the wrong message.

Arnab Mitra: Thank you very much and all the best.

Moderator: Thank you. The next question is from the line of Latika Chopra from JPMorgan. Please go ahead.

Latika Chopra: Anand and Sanjeev you did talk a lot about the supply side. There has been a lot of skepticism on how consumer attitude towards Alcobev consumption will be affected due to this pandemic I just wanted to check with you if you could tell us about any 2 to 3 key aspects of consumer behavior, which have surprised you either positively or negatively over the course of June and July month versus your expectations say two months ago this could be on mix trends, in the earlier call you had talked about worries on the downtrading aspect has something of that sort panned out, how has been Scotch sales, has there been supply disruptions which have weighed on that portfolio, large pack sizes versus small ones any certain state specifics and any of this which probably surprised you versus your expectations a few months ago?

Anand Kripalu: Yes. Thanks, Latika. There are obviously shifts that are happening I do not know about what has surprised us and what is not, but there are shifts that are happening. Obviously shifts away from large parties, large banquets, large weddings to smaller groups, socializing, absolute shifts to larger SKUs because of in-home consumption and in-home purchases and to store at home, which I think is actually a great attitudinal bust, which is going to be extensive, but it is a big attitudinal barrier that was there about alcohol at home and consuming at home for a lot of people and hopefully that would have broken down as one of the I would say latent benefit of this entire thing happening. Downtrading I cannot read yet, but I will say this and I cannot read because the data is too erratic. There is no massive trend of downtrading, it is kind of balanced. In some states you can see a bit of it, some states you do not see, so there is no massive absolute crash to the bottom of the pyramid kind of shift from Prestige & Above down to the bottom of the pyramid there is no rapid movement of that kind and what I do know in our category is that whenever there has been shocks in this category the basic category trend comes back, which is about people drinking best and not downtrading and once the shock is over I think that our longer-term strategy of focusing on premiumization, investing behind the more premium brands, I think that will absolutely continue because I think that strategy will be the right strategy when people come after this war period is actually over and then the other consumer change obviously is the shopping, so the way of socializing is changing, people are not going out, so there is so much more expectation on shopping from home and that is an opportunity that was a shock for us till now and that could open a change and maybe that has been one of the surprises about how permissions for home delivery and e-commerce in certain states started. In peace times my God we would have gone on and on and on lobbying with the state governments, we would not have gotten the permission I can tell you that and the fact that it started and hopefully other states will follow and that is our effort anyway. So those are the broad trends. Now I am surprised by the amount of shift that is at least we are reading from beer to spirits. I do not think we anticipated that because we do not also read beer as closely because we are not directly in that business and that shift and the function of both the on-trade, the bulk and the need for chilling in a fridge I do not think we read that much, so I will say that is a positive surprise. We do not know still the numerical impact of that, that is a positive surprise and a nice surprise, in crisis times it is good to have a few positive surprises as well rather than only negative surprises, which we are all getting used to, so those are the kinds of things, Latika, but I will tell you this that we have our insights team tracking consumer trends continuously to keep a finger on the pulse because it is very dynamic and we are redeploying resources in the business towards emerging opportunities in an absolutely agile way, so we said suddenly that key accounts is shut right now, on-trade is shut, let us move many of those people to focus on enabling home delivery and e-commerce to happen, so the way we are playing this game is to read consumer insights and trends, fix the ones that we believe are meaningful for the business and put resource behind them to exploit that opportunity and try and be the first off the block to make it happen so that is what I can tell you that we are doing. We have not just left it to fate we are actually doing it in a scientific way.

Latika Chopra: Sure and just on Scotch sales is there any supply disruption which is still there on Scotch imports or it is normalized now?

Anand Kripalu: Scotch imports supply disruption no, nothing material. Nothing that is coming in the way, nothing that is stopping us from doing what we need to do in terms of our business.

Latika Chopra: Sure, thank you so much.

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

Amit Sinha: My question was on the competitive intensity within the whiskey space, so just wanted to understand is it fair to assume that the larger players and the bigger brands would have done well in the last two months or so and any color on market share even if it is a very small period will be helpful?

Anand Kripalu: We do not have data to share really, but I can say this that we would believe that companies with scale and with strong cash flows should be able to come out stronger from a situation like this I do not have data to bear it out, but that is the belief that we have the staying power, we have the cash, we have the relationships to leverage that to our advantage so that is what I would say. I obviously cannot tell you about shares and stuff like that, but what I will tell you this that our ability to start-up after the lockdowns were lifted has been better than what I would have expected particularly in terms of supply chain, ability to service the market. I think we were pleasantly surprised about; I was really worried, by the way. It is very easy to stop a supply chain, but to restart a supply chain, starting from your vendors, and raw material to the vendor, to the truck, to arrival in your factory, to making it in your factory then trucks to send to dealer, that whole thing had been stopped suddenly for six weeks or five-and-a-half weeks. I have been pleasantly surprised by how given the strategy that we pursued of keeping our TMUs and franchisees supported in the business making sure their employees were paid, minimize the impact of migrant labors on our supply. Those kinds of things I think we have been pleasantly surprised to what has happened and therefore I think in the opening up I think we have done well, in our ability to supply when things opened because in the beginning it is all about who can supply I think we have done well there I am pleased with how we have done there, but that is really all I can really share. I cannot share relatively small players, big players, what happened at this point.

Amit Sinha: In that context how would have your franchisee because you very clearly mentioned that the franchise income in the quarter was hit and so given that these guys are smaller with lesser resources, overall supply chain disruption would be much bigger is it fair to assume that in the near term, franchise income will continue to be hit?

Sanjeev Churiwala: That is absolutely right. Just like our business has been impacted this quarter our franchisee business has also been impacted even at the bigger scale. Like we said smaller operators as a result they do get into a lot of inefficiencies during this time. What we have done is just to ensure that we create a win-win situation and a good relations with our working partners here we have decided to share the pain also with them. So we have ensured that they do get their fair share of income and we have kind of worked together with them. This quarter as you would see our franchise income is about 40 odd Crores lower. When I look at on an annualized basis in a pre-COVID environment we earn about 160 odd Crores of franchise income our sense and it is too early to really give a number to it. We do not know how the thing will pan out, but of course the business will remain slow and their businesses will be getting impacted. We think that the franchise income should be about 40% probably lower going forward in the next two quarters, but we will keep on revisiting and recalibrating these numbers as we move every quarter because it is too difficult to say how exactly their business will recover from the crisis and the same situation for us. We have been kind of living and breathing every day, every quarter.

Amit Sinha: My second question was on your basically McDowell's No. 1 renovation and just wanted to ask in how many states have you relaunched the new bottle and how has been the consumer response to that?

Anand Kripalu: So we are in about one third of the country, but we are rapidly rolling it out during this period, so over July, August, September we will see a rapid rollout to at least two third or 75% of the nation in terms of the weighted contribution of the brand and I will say that I am very encouraged by the response from the marketplace. Obviously again the reading has been complicated because things started, things shut and so on, but I would say that by and large wherever we have gone in I think the response has been very encouraging and like I said I want more and more consumers throughout the country to experience this new bundle in terms of the new McDowell's No. 1. So we are continuing to roll out and that you only do if you feel that you have had your action standard kind of met in places where you started rolling it out so we are extending it now.

Amit Sinha: Just a very small bookkeeping question. So you mentioned that ageing-related provision impacted the other expenses this quarter, is it possible to share the number of this provision?

Sanjeev Churiwala: Yes, it is about 44 Crores.

Amit Sinha: Thanks a lot Sir. That is all from my side and all the best.

Moderator: Thank you. We take the next question from the line of Manoj Menon from ICICI Securities. Please go ahead. We seem to have lost the line for Mr. Manoj Menon. We move to the next question. The next question is from the line of Harit from Investec. Please go ahead.

Harit Kapoor: I just had two questions, one was on the franchise income again so when you say that you book 40 Crore lower number this quarter it would basically imply that the franchise income is next to nothing in this quarter in that context I also wanted to check that are these very temporary arrangements now with the franchisee to support them and once things get back to normal you will kind of get back to your normal run rates on the franchise income?

Sanjeev Churiwala: The franchise income for this quarter is about 10 Crores and for a similar I think the corresponding quarter you had about 50 odd Crores, so as compared to 50 Crores you see about 10 Crores now, hence is a decline of 40 Crores. Now this 40 Crores is basically true-up of impact that we had on the franchisee business and of course we saw a decline in business right from the beginning of the first quarter with the overall GDP and economic conditions were going down south and of course a much bigger impact during the current quarter where we saw a big lockdown. As a result when we discuss with the franchisee partners and we looked at the earnings of the operations we felt that it is quite prudent that we can share a part of the pain and hence we kind of about 40 odd Crores and as I said going forward looking at the current set of economy, the way things will move, the impact of the pandemic we do not really know how things will be, but our sense is the franchisee income would be about 40% lower. Now we will keep on revisiting that every quarter, but yes I think the business will be down and to that extent the franchisee income will get impacted by 40%.

Harit Kapoor: My second question was on the new launches for No. 1 and Royal Challenge. Is this change also to do with the mix in terms of the liquid and if so is this a more premium liquid mix that you have changed there or is it just a packaging and communication change?

Sanjeev Churiwala: It is an all new McDowell's and Royal Challenge. In McDowell's specifically pretty much all aspects of the mix have been improved including the liquid. Now whether it is more premium or not I do not know but consumers prefer it to the earlier mix based on market feedback that we have. Royal Challenge is also an improved liquid and again that is preferred by consumers based on test results, so it is not just "a packaging upgrade" which is more smoke and mirrors, it is not old wine in new bottle to put it literally, it is new wine in new bottle, so that is how I would like you to see it and it is therefore a comprehensive improvement in the product offer and the mix.

Harit Kapoor: Perfect Sir. That is very helpful Sir. Thanks and all the best.

Moderator: Thank you. The next question is from the line of Vishal Biraia from Aviva Insurance. Please go ahead.

Vishal Biraia: Sir, a few questions. The first one is on what would be your capacity utilization for July if you could give us some perspective there?

Anand Kripalu: I cannot give you a capacity utilization number, I would only say this that we are not capacity constrained unless it is shut of course, which is also the case in a few places and therefore it is now demand-led production, so the capacity utilization is based on the demand and we are working as hard as we can to make sure that our factories are able to meet the demand and I would say by and large, it is demand-led now and not supply-led, so we can I just say this we can produce in all factories to pretty much pre-COVID levels of capacity so if the demand goes at pre-COVID levels we could produce at pre-COVID levels in our plants with all the new norms in place.

Vishal Biraia: Second question is pertaining to this for this quarter we would have seen higher sales in the hinterlands semi-urban markets and rural market as compared to the metro, which was shut due to lockdown so is there a shift that you would see that some of these customers who are in the semi-urban India or rural India are demanding a different kind of product or the premiumization that could have happened has not happened because of this geographical change in distribution or it is just because of COVID that people are downtrading?

Anand Kripalu: No, first of all I am not clear that people are downtrading like I said earlier and if they are then it is because of COVID. Also see most of our sales happen in urban and large towns. The consumption may happen as product finds its way through unconventional channels to consumers in smaller towns and rural so that is how it flows and I do not think they want a different product, but we have products that can service the bottom of the pyramid to the absolute top of the pyramid and they could move to any of our brands within that top to bottom of the pyramid, I do not think they want something different or new, they may choose something else from the portfolio, In the short run if they choose to downtrade because of economic challenges, job loss, whatever else it maybe then they will hopefully choose one of our brands that are there lower down and then hopefully come back when the sun shines again. Hopefully they would not stay unemployed hopefully they will come back and they will have the same aspiration when they come back that they had before and they will come back and then hopefully buy again. So I think any trends that we are seeing right now we have to believe they are shorter term and COVID related. Longer term trajectory we believe at least right now will go back to where it was pre-COVID. The only question I do not know is how long it will take. That is the only question I do not know the answer.

Vishal Biraia: Just one last question on the receivables could you give some perspective as to what is the increase if at all in the receivables from the states as of June 30, 2020?

Anand Kripalu: Increase in receivables, Sanjeev, are we sharing that?

Sanjeev Churiwala: Yes. I can give a general understanding of this. While for this quarter we do not report our balance sheet we will not give the numbers, but I think it is suffice to state that we are kind of in a much better situation when it comes to the overall receivables. Our overall receivables have come down, it is much better, and so is the health of the receivables. Our overdue receivables have also come down, so I think we have been very aggressive during these lockdown situations and also in May and June to ensure that we collect better and ensure that we are kind of ready to serve the market and the market is not constrained because of the credit and we have done quite well. This has also resulted in an overall reduction in working capital and overall reduction in our debt situation. While I am not reporting this quarter numbers to you when you see the H1 numbers you will see for yourselves.

Vishal Biraia: So when you say reduction this is from March 31, 2020 to June 30, 2020, these are the reference points?

Sanjeev Churiwala: Yes.

Vishal Biraia: Thank you very much.

Moderator: Thank you. The next question is from Pulkit Singhal from Motilal Oswal Asset Management. Please go ahead.

Anand Kripalu: If I can just announce to everybody because apparently there is still a large volume of questions in the queue and in order to accommodate as many as we can we are going to extend the call for 15 minutes till 1:15 because I do want to make sure people do not log off before that, so if you still have a question and you want us to answer it then we will stay until 1:15 to help you understand the situation as best as we can. Sorry, back to the question?

Pulkit Singhal: I just wanted to try to understand the mix impact during the quarter because we have shown a similar kind of declines in P&A and Popular at the same time we know that the on-trade channel is a higher margin one and has been impacted more, so I am not sure how the mix changed within P&A and why has there been similar declines in P&A and Popular?

Anand Kripalu: My advice is do not try and read into this, this is such an unstable quarter and what happened maybe a function of just which factory was opened there in which state and which outlets were open or which outlet is shut and we are trying to read a principle or a trend with that data, so my advice is do not look at it because we cannot read that at this point in time and we should just wait for a bit more data. Right now all I can tell you is this. There is no clear trend that there is downtrading from P&A downwards. There was some short-term scotch disruption and so on and so forth because family weddings and banquets and those went away, the off-trade shut, we have to see how much of that will shift to the off-trade, and people will take it home, let us just wait for a few more data points, but there is no clear trend by the way of downtrading within P&A or from P&A to Popular, the data does not bear that out, and there is too much of noise in the data like I said.

Pulkit Singhal: The second question is on gross margin impact. If I just add back the obsolescence impact as well as some part of the franchise income that is add back 20 Crores not 40 Crores entirely we are coming to almost 44.8% kind of gross margin for the quarter given that I think ENA prices are also a bit benign so is that the right gross margin number to look at going ahead because this is probably the worst quarter and I am just trying to understand how should I look at this line item going ahead?

Sanjeev Churiwala: It is very difficult to decode how the gross margins will look going forward, but I think some of the things that you see as you rightly said the ENA prices perhaps have stabilized. The gross prices would be kind of the inflationary zone moderate and not the kind of huge spike that you have seen in the past years. We also think that the SLOBs (slow moving & obsolete inventory) that we have seen this quarter is kind of massive because of our prudent policy, but with the market opening up and with the depletion happening the aging will improve and to that extent the SLOBs would be lesser, but we would not like to decode and try and extrapolate from these numbers how the gross profit margins would look like going forward?

Pulkit Singhal: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Abhishek Joshi from CGS-CIMB. Please go ahead.

Abhishek Joshi: So a few weeks back, Diageo had announced that they would be selling Johnnie Walker in paper bottle so would we be doing the same for McDowell's brand next year like any thoughts behind this and if yes then how does it impact gross margins compared to No. 1?

Anand Kripalu: First of all the Johnnie Walker has to come in that packaging to just get distributed and then we will see that comes. There is no plan to move McDowell's No. 1 with that kind of packaging, but also remember that in India you have something called tetra pak and a large part of our volumes were in tetra pak, and that is a paper-based packaging at the end of the day, there is an aluminum foil, but that was paper-based packaging, and we have introduced No. 1 in tetra pak in the state of Karnataka and it is doing very well. The very small SKUs only, 90 ml and so on, we have actually done that, and it is doing very well. Now things at all of this, we are constantly looking at packaging innovation, which on our brand, which will upgrade the image of the brand, which will aid functionality, reduce spurious and counterfeit, and it will also lower cost so there is a constant endeavor to look at different kinds of packaging formats and we will continue to do that.

Abhishek Joshi: So what would be the contribution of our sell from tetra pak in the normal times?

Anand Kripalu: If you look at our total business, Popular plus Prestige & Above, Prestige & Above is negligible by the way in tetra pak almost zero, very, very low, but if you look at our total business a quarter of our business is in tetra pak. All our Popular in Karnataka is in tetra pak. Some of our volumes of Popular is in tetra pak in West Bengal, and some of it is there through franchisees in certain states like UP, so tetra pak is a very big contributor to the packaging for our Popular business.

Abhishek Joshi: Thank you, that is all from me.

Moderator: Thank you. The next question is from the line of Aditya Soman from Goldman Sachs. Please go ahead.

Aditya Soman: Sir, first question is on digital spending, given that in-store marketing spend is a little bit lower I am assuming this quarter has there been any sort of thought or increased spending on digital spending and do you see any differences in reaching out to consumers using digital?

Anand Kripalu: So absolutely the intent is to move more and more media towards digital and particularly given the digital explosion that has happened and the data consumption explosion that happened with COVID absolutely that is the place to be. However Diageo globally and we in India believe in doing the right thing and as you may have read Diageo is amongst several other companies who have decided to stop paid advertising on certain global digital platforms, so therefore we are absolutely honoring that commitment that has been made, but we are looking at alternative ways to still create the recent impact that we want through digital, so absolutely that is our intent and that is our work with our agency partners to make that happen and particularly to support our renovation I would say it is digital-first in terms of the media choice that we are making, how best will we make an impact starting with digital event following others rather than necessarily the other way around because in this environment I think that is what really works.

Aditya Soman: I understand. That is very useful context and in terms of the cost of digital is there any sort of way to measure the efficiency versus say your traditional in-store advertising?

Anand Kripalu: So there are many ways to measure it and I do not have it on my fingertips now, but there are obviously many ways to measure and digital by the way is far more measurable than conventional media, in terms of the impact, the number of people who viewed or viewed part of it, viewed all of the content, etc., etc., but it is not only about viewership, it is also about engagement and involvement that we are able to generate and that comes back to how creative is your digital work because it is not only about reach, it is about impact and engagement of the consumer and there are ways to measure a lot of this stuff and we do and we have very robust tools by the way in our business to measure the ROI of our advertising, a very robust tool. In fact there are global Diageo tools, which we also use in India and we use that constantly to prune and tweak our media plan and that is what we will continue to do.

Aditya Soman: Lastly just a followup on the franchisee economics. Has there been sort of any fundamental change or could you see any of the franchisees sort of stop doing the business with you in that situation or would you have to appoint new franchisees or take back that business any situation of that sort at your end?

Anand Kripalu: Let me just say that, I will take this Sanjeev because it is just about, so philosophically there has been no franchisees come in and thrown the towel and said I cannot do business with you anymore. Now we are constantly looking at how to improve our franchisee model. So for instance one of the things we have said is we are going to institute a principle of doing joint business plan with our franchisees to support them in areas of pain that they may have where we can bring some expertise to the table, so whether it is on brands or whether it is about sales or even if it is about efficiency, what can we do to help them support them because it is our business also at the end of the day, not only their business, so we are doing that. Equally we will constantly keep looking at whether franchisees are delivering effectively for this business that they are supposed to be doing and everyone is up for scrutiny on performance, we are and so are the franchisees and if people do not deliver then we will look at ways to improve them or split with them if we have to, but there is no plan as of now.

Moderator: Thank you. The next question is from Bharat Shah from ASK Investment Managers. Please go ahead.

Bharat Shah: We all understand what happened to the sales and given the situation what this could have been done in terms of managing debt was done, but what I wanted to understand was how did we internally deal with probably given that the things with the expenses and managing the profitability is the challenge, so what I am surprised by the losses at operating profit level was not sustainable, but operating losses is something that surprises me and I want to understand what kind of fixed cost and variable cost and what kind of efforts have been made to contain the impact?

Anand Kripalu: So Sanjeev, he wants to really understand what is being done on our cost levers during this period and he is surprised by the losses at an operating level that is the question so maybe I will hand it over to Sanjeev.

Sanjeev Churiwala: Yes. So maybe first on the philosophical level we all knew that because of this COVID the last quarter, the quarter end in June would be a complete washout and to that extent when I look at the analyst consensus as to what they felt, how the profitability will look like and how the P&L will look like, just to share the number, most of you in your consensus said that the topline is declined by close to 50%, 51% and we say the real number is close to that in terms of the EBITDA and this is your question on what could have been done better, the consensus was close to about 11 odd Crores of positive EBITDA whereas for tactical purpose we will end it up at close to over 80 Crores of losses so there is a deviation of about 90 Crores.

Bharat Shah: Sorry to interrupt you for a second. Consensus numbers is a market game and that is not a cause of concern one, secondly if you look at scores of businesses the results which have come out so far in case of many of the companies where considering the kind of obvious savings there have been far more clear visible methods, which have been at work to create a financial intake much lower than what one would have thought or to actually improve and give a positive supply, so I am not coming from that context, in a market consensus numbers and all this is a popular sport, but I do not think we should pay much attention to that.

Sanjeev Churiwala: You are right. I was just setting the context and I was coming to exactly what you are thinking about. So yes for the time being let us project consensus and let us look at what it is. The fact is this business as compared to any other business was completely impacted as compared to many other FMCG players we were in the situation of a complete lockdown for 33 days and thereafter supply chain resumed normally and a lot of the effort was put in to kind of almost get to a pre-COVID level in terms of the readiness for the supply so that as and when the market recovers we could kind of completely look at that. What have we done internally to ensure that we can at least minimize the impact of it or minimize the losses, it is a question you have. I think we have put a complete break on all the discretionary cost. Today when you look at our overhead while on a pure reading of the reporting numbers it is about decline of 3%, but because of the onetime impact that we had if we have not had those prudent accounting policy this is more of a noncash charge than a cash charge, our total expenses would have been lower by about 22%, so that is a big impact in terms of effectiveness that we are trying to produce by having a complete control on the cost element. Now a lot of this prudent accounting policy, which is nothing but provisioning for the aging inventories, will do us as I said in the earlier question because as the market is opening up we will see more depletion happening and the aging of these stocks will improve leading to a substantial improvement in terms of this provisions. This quarter which is of course not also the right thing but we also realize that there is a complete shutdown does not make any sense for us to keep on doing it on the media advertisements and keep on spending money on the A&P, advertising and promotions, so as you can see there is a significant cut down on the A&P spend as well in this particular quarter. Now of course because we have a huge manufacturing footprint company with 47 locations in an environment where your sales are down by almost 50% your manufacturing fixed overheads do not get fully absorbed and large chunk of the manufacturing and absorbed fixed costs are also sitting in these numbers, which hopefully as and when the market improves you will see some operating leverages also coming in. What have we been trying to do we are trying to have a very clear policy on curtailing all sorts of discretionary spend, we are trying to really manage our A&P, and make it much more manageable in terms of effectiveness and efficiencies. We are trying to really cut down on all sorts of needs for based on work, we have really managed our receivables very well this time. We have really managed that cash situation very well. As I said that we have been able to reduce our overall working capital under this scenario, which was quite challenging, but we did that. We dramatically I am not giving the numbers, but there is a material reduction **(inaudible) (01:11:37)**. So all the steps that the company should have done in terms of protecting the P&L, the shape and size of the business, making the business much more healthier, having a much stronger balance sheet, is all being done. Everything that we are doing is only going to make us stronger and emerge stronger as and when we move into the next phase as and when the unlock happens and we are very confident that our performance will start improving as and when the market opens up and we are actually very confident on all the measures that the company has taken so far. It was an unprecedented environment for all of us, getting the consumer trends, the customers' requirement, trying to understand when the lockdown will unlock or another lockdown happens, it was very, very difficult and challenging for all of us, but we are very happy that as we speak to you we are in a complete readiness on our supply strategy, complete readiness in terms of serving the consumers and customer better. So I think we have come a long way and I suppose with this we are almost coming to an end of this session. So maybe Anand you are fine we just take the last question.

Anand Kripalu: Yes. So we will take one last question now before we close the call.

Moderator: Sure. Thank you. We take the last question from the line of Vishal Punmiya from Nirmal Bang Institutional Equities. Please go ahead.

Vishal Punmiya: Thank you. My question has been answered.

Anand Kripalu: Okay then we will take one more.

Moderator: Thank you. We take the next question from the line of Shirish Pardeshi from Centrum. Please go ahead.

Shirish Pardeshi: Just a followup question, you said that about 7 corporation markets you have got price increase is that right?

Anand Kripalu: I never said 7 corporation market I said 7 states.

Shirish Pardeshi: So in 7 States we have got the price increase?

Anand Kripalu: Noncorporation markets yes.

Shirish Pardeshi: What kind of price increase we have got?

Anand Kripalu: I am not getting into the specific percentages they are all modest.

Shirish Pardeshi: Give the range?

Anand Kripalu: I do not have the range handy here. It started with Telangana and then there were other states, but I would say ballpark they are about 4%, 5% kind of increases, but we can check that for you and get back, but it is a range plus/minus 4% to 5% in those states.

Shirish Pardeshi: Sure. Related to price increase we have launched two new products, RC and McDowell's No. 1 what kind of price premium you have revised in these two products?

Anand Kripalu: It is not that easy to take up the price in this industry. So you have to improve your product offering and just be more competitive. Now we have a strategic view of where our pricing should be, but you will find that because of history in some states you might be at a premium, some states you might be at par with the segment and so on and so forth. So I would say that do not think of this as the ability to take a premium, yes we will try and take a premium as and when we have the flexibility to do so, but has the opportunity to at least grow share and grow the segment and that would be I would say primary.

Shirish Pardeshi: Just last on CSD business if you can give some color on how the things are shaping up there?

Anand Kripalu: CSD business is fine. I think this is not under lockdown now. By and large I think the government CSD canteens and vessels and so on are operating as far as I know. The CSD business is fine. There is no real problem that I see with the CSD business as of now.

Shirish Pardeshi: Alright, thank you and all the best. That is it.

Anand Kripalu: Thank you everyone. I just want to thank everybody for staying on for this call and your continued interest in United Spirits.

Sanjeev Churiwala: Thank you very much.

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