“United Spirits Limited Q2 FY20 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day. And welcome to the United Spirits Limited Q2 FY20 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 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 – Executive Director and Chief Financial Officer, United Spirits Limited. Thank you and over to you, sir.

Anand Kripalu: Thank you very much. And good day, everyone. And a warm welcome to the F20 Q2 and H1 results call. As we normally do before we open the lines for Q&A, I am just going to give you a brief summary of our results that we announced last evening.

As you have seen, our revenue growth in the quarter was soft. The performance has been adversely impacted by both external as well as some one-off internal operating challenges. External challenges, of course, as you know, include the broad-based consumption slowdown, and that is also leading to some liquidity challenges with the trade in some specific states. In addition, we also faced some specific operational challenges in a couple of states, and this affected our overall business in both states to an extent as well as the sales of Scotch whiskey. Consequently, as a result of these challenges, net sales for the second quarter grew 3%, including the sale of bulk Scotch inventory. Net of that, our underlying net sales for the quarter was pretty much flat.

Within this overall net sales growth, the Prestige & Above segment was also flat, lapping a high comparative of 19% growth last year. In addition to the broader consumption slowdown, the segment was particularly impacted by a temporary supply chain disruption in our luxury Scotch portfolio, which has, of course, since been resolved. Also, liquidity challenges in certain key markets impacted the performance of premium Scotch, which is our bottled in India Scotch whiskey, where we consciously adhere to our policy of prioritizing credit risk over achieving sales. And therefore, we treaded cautiously in extending credit to private parties in these states. Additionally, while the P&A's volume grew over 3% in the quarter due to the adverse price mix, the value growth was flat. The Popular segment declined 1% in the second quarter and that too was lapping a high base of 10% growth in the same quarter of the previous year.

Moving on to profitability. There has been significant inflation in our raw material costs, particularly ENA, which impacted the gross margin for the quarter. Despite the gross margin compression as a result of that, we have delivered a like-for-like underlying EBITDA margin of 17.5% for the quarter, net of the onetime benefit from the sale of bulk Scotch. More importantly, this EBITDA performance was a result of discipline and efficiencies in our operating cost, and it's not just about phasing of our A&P. This actually compared favorably with last year's full year underlying EBITDA margin of 14.9%, so both in Q1 and Q2 we are ahead of last year's full year delivered EBITDA margin. We believe, as a management, team that with this we have demonstrated our ability to mitigate gross margin pressure at the EBITDA margin level. And while we assert that a couple of quarters don't make a trend, this does, in some ways, underscore our progress towards our medium-term margin ambition.

Investing behind our brands continues to be an area of strategic priority for us, and the reinvestment rate for the quarter was 7.8%, after adjusting for the sale of bulk Scotch. Given that most of our A&P is directed towards our ENA portfolio, the effective reinvestment rate on that part of the portfolio is in double-digits, which we believe is extremely competitive. The PAT margin for the quarter came in at 9.8% as the benefit from corporate tax cut was offset by some onetime write-off of deferred tax assets. The lower corporate tax rate will start to benefit the EPS from next quarter onwards.

We have resolved the internal operational issues that we experienced in the last quarter and are investing behind all growth drivers with the onset of the festive season. Additionally, while the commodity space is volatile, with the upcoming harvest, we are hopeful of seeing some respite in ENA costs. At the macroeconomic level, we do hope that the good monsoon, coupled with the various measures recently announced by the government as well as some improved liquidity will help stimulate the economy and bring back consumption.

Overall, I would like to reiterate that we don't run this business on a quarter-to-quarter basis. And while the current context has presented some challenges, we are committed to making consistent progress towards our medium-term ambition of growing our top-line by double digit and improving the EBITDA margin from mid- to high-teens.

With that, I am going to open up the line for questions.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the questions-and-answer session. The first question is from the line of Abneesh Roy from Edelweiss.

Abneesh Roy: My first question is in terms of price hike. So, last one year, 15 states have given the price hike, but when I see gross margin it is at a 10 quarter low, and 411 bps down. I understand ENA has moved up sharply in Q2. So, question is, now that 15 states already having given price hike, is it now difficult or because of the gross margin, there will be reception from the government on that fact?

And second is, in Q3, do you see further erosion? Because my sense is in Q3 some more inflation has happened in the key raw materials, so could you disclose that?

Anand Kripalu: Abneesh, thank you for the question. So, first and foremost, we will see price increases in 17 states, so it's fairly broad-based. Yes, there are one or two states which have been more difficult and we haven't got the price increase, and our efforts continue to make that happen. The reason why you have seen the gross margin erosion in the quarter is because of two things. One is the glass price increase, which we absolutely knew and that was not a surprise, because we had agreed to certain glass price increases a couple of quarters ago, and we have spoken about that earlier. And unprecedented ENA prices this quarter. So, while we got fairly broad-based price increases, this only covered a fraction of the cost increases. And therefore, you have seen the erosion in gross margin. We also had a poor quarter on mix, specifically because of what I spoke about. And we believe that the mix part of it, we will be able to recover in the fullness of time, specifically to do with Scotch. So, that's the reason why the gross margin has got eroded to the extent that it has.

Now coming on to quarter three. So, in quarter two, ENA actually peaked. It was unprecedented increase as a result of ethanol blending being pushed to its limit, and that was fueled by the fact that petroleum prices were reasonably hard and the rupee devalued, and there was also a big push from the government to improve ethanol blending. And that kind of destabilized our supply/demand equation on ENA. I suppose the silver lining is this, that since the peaks that we saw in Q2, at the end of Q2 it's come down a bit, so it's not going up any higher. So, in some ways we could believe that the worst of ENA happened in the quarter and we have to bear the brunt of the margin erosion, the gross margin erosion in the quarter. So, that's the overall situation, but I just want to say this, that despite this, and like I said, if anything did make it a tad better, right, I think what gives us confidence is the fact that we will have to maneuver the other line in the P&L without doing anything that can harm our growth opportunities when the tides turn and the markets improve. We have continued to do everything we have done in the past on productivity, on overheads management, and declined A&P appropriately to still deliver an EBITDA margin that we believe is reasonable given the current context of the business.

Abneesh Roy: Sir, just one small follow-up. So, the exit in Q2 in terms of the ENA, that's lower than the average ENA in Q2, is that correct?

Anand Kripalu: It is lower than the peak that is hitting our Q2. I am not in a position to tell you whether it is lower than the average right now. And I think the bulk of the inflation, the max inflation we experienced in Q2. One is, we have started seeing a little bit of this coming off, and second is, now with the post monsoon scenario and the harvest coming in, we believe there could be some improvement in the feedstock prices, which will also help ENA prices ultimately, and we have just to wait and watch for this to play out.

Abneesh Roy: Sir, that's quite helpful. My second and last question is again related to this. So, when I see ad spend that has come off significantly in first quarter and second quarter versus the number which you used to give earlier in terms of 9% to 10% of the sales. So, because the industry is also facing similar gross margin pressures, so has the entire industry also come down in terms of ad intensity?

Anand Kripalu: I can tell you this, that, first of all, our ad spend are very competitive, more than competitive. That's the first thing I will tell you. The second thing I will tell you is that, the bulk of our A&P growth behind our Prestige & Above portfolio. And therefore, in the Prestige & Above portfolio, we are spending double-digit A&P as a percentage of sales, which you will also accept is competitive, that's in the largest of consumer goods space. And the third thing is this, Abneesh, that there is a reality of the current context where the business environment is exceptional in terms of circumstances and it requires management prudence and management judgment on what is the right amount of spend. So, do I have confidence that we are still doing the right stuff for our brands? I absolutely do.

And one more thing we have done is, we have mounted a fresh effort on driving efficiency and productivity from our A&P spend. So, we actually have a comprehensive project in the business where we are really pruning down our A&P efficiencies to make sure that we retain the impact but with a lower outlay of costs and investment. So, I think, at the end of the day, as the management team, and on behalf of the management team, I do believe we are doing what is right by our brands in this context so that our brands continue to strengthen, so when the market improves we should be in a strong position to grab our share of that opportunity.

Abneesh Roy: Sir, why I asked this question was essentially, the other player has called out India as one of the top-three strategic markets. So, you are saying still the ad spends are competitive in spite of that, right?

Anand Kripalu: Very competitive.

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

Amit Sinha: My first question is on your overall sales growth. While you have highlighted, I mean, the main impact was mainly on account of the overall macro slowdown, I just wanted to basically understand from you in detail some of the extraneous factor which might be very, very specific for the quarter. For example, the competition called out major impact from floods in some of the key states. And also wanted to understand what was the impact for you, specifically in some of the southern states where there was some uncertainty on the route-to-market changes. So, the entire effort from my side is to understand that what could have been a normalized sales growth for the quarter.

Anand Kripalu: So, there are too many moving pieces, so it's hard for me to give you any specific view on what could have been the normal sales, if all this didn't happen. I can conjecture, but it is conjecture at the end of the day. First and foremost, even in the previous quarter, I will tell you, many investors told us why are you guys being very cautious? When we gave an outlook they say, listen, we are beginning to see the macroeconomic slowdown and there could be an impact in our outlook. Many people felt that the previous quarter was decent so why are we being pessimistic about it. I am just glad that we were able to see some of the dark clouds ahead of us coming.

Now, coming to our internal challenges, there have been many. I mean, floods could have impacted the movement of trucks and stuff like that, but we don't believe that flood was a big impact as far as we are concerned. Now we did have issues, for instance, P&A supply in certain states where we could not produce the full volume of some of the popular brands that we wanted to do. So, we gave that up because of shortage in ENA. And all we would have done is to push up the ENA prices even more, given how big a consumer we are. So, sometimes you just have to balance your portfolio and play the game out. So, that resulted in some lost sales.

The second thing is that some of the competitors in the marketplace decided to increase credit in high-risk markets. We decided we won't do that. And this remains part of our philosophy, to not keep having provisions of bad debt because of you sell and then you just find it hard to collect, just to be prudent as far as that is concerned. And the third is we had a funny action really on one of our Scotch finishing centers in India where the customs license was withdrawn for a period of time inexplicably. That's obviously come back and we have sorted that problem out now in terms of making sure that our BII Scotch supply is uninterrupted, but that also impacted the quarter.

And then there were a few other issues as well. Honestly, the RTM change in Andhra Pradesh has not impacted the previous quarter materially, at all. We will see what happens now because it's not impacted from AP, so there is no real impact of that in the previous quarter. So, I would say those are the major issues that we have had. Each of these have contributed to some amount of the loss of NSV and the loss of mix. And I don't want to be specific about what this totals up to, but suffice to say that, yes, the revenue number would have been better than what we reported if these would not to have happened.

Amit Sinha: Just to follow up on here. While I completely understand Andhra may not be a big impact, it is not a very big market for you, but the uncertainty in Telangana, even that did not impact the primaries during the quarter?

Anand Kripalu: No. Because what happened is, there was a period of certainty, obviously, in the quarter. But it's not as if that stocks in the cooperation or the retail shelves have dried out completely or something of that kind, which affected a significant consumption loss. And because the issue got resolved with the announcement to say now the policy has extended for two years with no other change in RTM, that quickly sorted itself out. And the new licenses will now get operation from 1st of November. So, I would not say that there was any material loss in the quarter because of these uncertainty.

Amit Sinha: Sure, sir. My second question is on working capital. And you have mentioned that it's a very short-term kind of an issue, but just wanted to understand some details around there. And has anything changed on the payment side for some of these cooperation markets?

Sanjeev Churiwala: So, Sanjeev here, maybe I would like to take these questions. If you see the press release, the press release very clearly calls out that we had a negative working capital changes in the cash flow terms of roughly about Rs. 380-odd crores. But we are not really worried for a couple of reasons. As you all are aware that throughout September end we had banking holidays, and as a result of which some of the cooperation markets could not pay us to September end, which is reflected in the receivables now. That payment has come in through, largely it was two states, West Bengal and Telangana, roughly about Rs. 180 crores was stuck towards September end, but the money has come through, so that concern.

Second is something good. As you are aware that we have sold some from Scotch of Rs. 75-odd crores which kind of called out as some one-off items, that sale out happened towards September end, and that money is going to come to us in October, so that's about Rs. 75-odd crores over there. These three items or two items put together, it's about Rs. 250-odd crores. Towards September end, we had to also build out some finished goods inventory in bonds and warehouses to cater to hopefully higher demand that we would see in October and November coming in, and roughly about Rs. 100-odd crores are block over there. So, that's what it is.

I think what we are trying to really do is, as you are aware that there is a lot of liquidity pressure in the market, retailer, distributors, wholesalers, are in big time liquidity crunch. We want to really to play it out dynamically and see if we can really manage sales, at the same time manage credit risk. We want to be very prudent and judgment throughout as we move forward into subsequent quarters. And of course, in pockets, we will keep on releasing more liquidity as and when required. But as Anand has called out, we definitely want to ensure that in some of the pockets where we had some challenges, we want to prioritize credit risk over the sales growth. And that's way we are trying to work out and manage between our top-line aspirations and the working capital.

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

Harit Kapoor: Just two questions. Firstly, you have mentioned in your release that you are seeing a little bit of a pickup in the festive season on demand. So, could you just speak a little more about what you are seeing on ground probably towards end September or early October, any green shoots?

Anand Kripalu: So, let me put it this way. So, first of all, the festival season, the start of the festive season or the onset of the festive season starts with Dussehra normally. And I must say that Dussehra in Bengal was good, I won't say it was euphoric, but it was good. It didn't give you a sense of an economic slowdown. Now, historically, we have seen sometimes that's a precursor to the mood during the rest of the festive season with Diwali and Christmas and everything else thereafter. So, the start was good. The euphoria around Diwali is still not there. Now normally, a lot of sales happens in the last weekend before Diwali and we have got to see in the next four, five days whether there is an exceptional pickup that happens. And normally, it does happen. But having said this, I think that there is an overall, I would say, less than euphoric or even modest mood in the run up to Diwali overall. There is no buzz, the malls are not packed. The normal Diwali buzz, the parties, the taash, all the stuff that goes with it, there just seems to be less this year. And I don't know if you guys are noticing it in your own circles as well, but we are noticing that. And that's normally an important route for consumption of our kinds of brands. So, we really just have to wait and see over the next four, five days to a week how this kind of pans out.

Harit Kapoor: Second thing was, you spoke about prioritizing credit over sales. I was just wondering, while we have done this earlier also in markets like Punjab, Haryana where we were expecting changes in distribution at that point. I was just wondering, when we do prioritize this and maybe some of the competition doesn't, and when things actually improve from a liquidity perspective, do you find it easy to gain back some of the lost share which has temporarily been lost? Or is that a fairly hard thing to do?

Anand Kripalu: It is a great question, honestly. And this is the ultimate dilemma as management, short-term versus long term and what choices do you make. We have seen that in the past, when we were not prudent on credit, it's easy to get the sale in states like that, and particularly in the wholesale markets, where it's private wholesale. This issue doesn't happen in government cooperation markets, it's really in private wholesale markets. But getting the money back is really tough. Now the current environment is different from the uncertainty of route-to-market change. The route-to-market change was that these guys will have no job vacancies, you won't be able to find them. That was the risk at that point in time. Now it is problem that we didn't have any turnaround. This time the reality is, there is real liquidity issues in the marketplace with the trading community today. There really is. So, if you supply, they will take the stock, but it's at your peril. This is managed and adjusted. Now somebody else may have more pressure on top-line, and say, "I will take the risk here, let me supply and deliver my quarter's numbers." And I am saying, No, I am not going to do that because I don't want sales if I am not going to deliver to our larger philosophy of profitable growth for this company. I want quality sales. And sometimes, this is our judgment.

Now in the fullness of time, the question is, you can have two kinds of situations. Somebody, is going to market with that, they have given the credit and collected the money, then you are able to strengthen their share position as a consequence of that. You can also have a situation where somebody does this, gets short-term share gains, but shoots themselves in the foot. Because then you are not going to be getting your money back. So, it's not as if we are not supplying at all. It is that extra push that you can get or volume that you get typically towards the last week or the last month of every quarter, which we are not doing because that will be required and further expansion of credit risk. So, it's not that we are stopping sales of something, it is the last push, and we are just being cautious about the last push. And time will tell whether this is smart or not smart. Historically, I must tell you, we have also burnt our fingers the other way around, to be honest, you can see some of the provision of bad debts in our books as well. So, I think this is just how we want to play this game.

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

Aditya Soman: So, my first question is on the channel inventories. Sir, you mentioned that there was a buildup in inventory at the company level prior to, sort of, the festive season. Do you think there's been a buildup in the channel inventory as well?

Anand Kripalu: No. Actually, there is some buildup there, but it is nothing that is exceptional compared to what we normally do at the end of particularly September quarter, and it only happens in September quarter because we know that you are running into both the winter season and the festive season, and consumption for our brands are high, and that's the most important quarter for our business. Sanjeev, is there anything else?

Sanjeev Churiwala: Absolutely. I think this is normal buildup that is happening. Of course, we just want to ensure that we don't lose our momentum as we step into the festive season. The world economy is sluggish. The worst thing that we can do is screenshot that there is no stock available. And we need to really move ahead. And the festive season, this time it is a little ahead, so very clearly with Durga Puja in West Bengal was almost like first week of October, so we had to build in inventories towards September end over there. So, just more timing and kind of being a little more prudent.

Anand Kripalu: And also it's an early Diwali this year. Actually, this is one of the areas where both Dussehra and Diwali are in the same month of October. So, it's early and kind of bunched together a bit. Last year, I think Diwali was on 8th of November. So, there's a bit of phasing there.

Aditya Soman: And some of the supply issues that you said you faced in the quarter. I mean, would you have anything of that sort into going into 3Q, especially both in terms of what you have already inventory in the system as well as demand for later in the quarter?

Anand Kripalu: So, first of all, in our industry, never say never. You never know if something is going to happen or not. Having said that, what we do know is that the bulk of the operational issues we had in the previous quarter are now kind of done and dusted. And as we are sitting today, there are none of those kinds of operational issues that we are dealing with. Now, unless something will happen, November, December, you never ever know. But we hope and pray that there isn't anything of that kind.

Aditya Soman: Fair enough. And lastly, this route to market change in Andhra Pradesh, you mentioned there is no impact in Q2, but anything to call out for 3Q or you don't expect it to be significant?

Anand Kripalu: So, first of all, I am not going to call out any risk as a result of the change, just to be crystal clear, from what we have seen thus far. The first fortnight of October was the first fortnight of the government retail stores opening up and so on, and the government articulating its philosophy and policy of how they will buy, how they will pay, etc., etc. And we actually were cautious about what we would get in the month of October from the state of AP because of this transition. Actually, the sales are a little bit better than that cautious estimate that we had. And that's why I am not seeing any material risk to AP of AP contributing to the actual numbers from where we are sitting right now.

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 on the competitive intensity in this kind of a slowdown, coupled with input cost inflation. So, I specifically wanted to understand, are you seeing competition getting more aggressive on pricing, especially in free pricing markets like Maharashtra where there could have been an opportunity to take up pricing more to make up for some of the gross margin pressures? Or is it proving to be difficult to do that even in the free pricing markets given the competitive intensity?

And also related to that, you did mention a lot of the price hikes you have got, but it doesn't seem to reflect in the Popular. P&A I understand the negative is probably due to Scotch. But on the Popular side also the pricing and volume seems to be almost same, the value and volume growth. So, is there something negative in the mix there also which is impacting the pricing growth?

Anand Kripalu: So, first and foremost, competitive intensity. Of course, there is competitive intensity and different competitors have different way of competing and different competitors have different pressures on industrial volume or whatever. So, first of all, our philosophy is to go for quality growth. We don't believe that pricing is a tool to drove volume and revenue, is our philosophy. We believe that there is a category growth opportunity in India. And yes, there are short-term obstacles to that. But the long-term consumer fundamentals, hopefully, will bear out the fact that the opportunity is there. And therefore, it's not a winner-takes-all market, it's a category growth market. So, our philosophy, in line with driving profitable growth and quality growth is to consider to invest behind our brands, actually improve our product, improve our packaging, justify our premium, if anything, pick up our premium, and that's how you deliver quality growth.

Now, if that is our long-term philosophy and how we want to drive our business, it is possible that there are certain short-term moves in the marketplace that we may need to react tactically. And we will do that, we won't just sit right and do nothing at all, we will do that. But how we respond to that is really the million dollar question. And we are just watching and seeing how this space evolves. And I think our own strategy will become clear in the next few weeks against this. But I just want to say that this has happened earlier also in the state of Maharashtra. And I can tell you today we are sitting in a solid position in Maharashtra despite the moves that happened over the last 12 to 18 months in Maharashtra. I absolutely believe we did the right thing that we did at that point in time and therefore we are sitting in a solid position in Maharashtra. And therefore, how we respond to this is not to maniacally just do what other people have done, but to evolve our own model of what is in line with our philosophy and our business objective. And that is what we are really aiming to do.

On your second question on Popular, so there are two parts to it, obviously, one is pricing and so on and so forth. But the other is states mix. And what happened is there is a difference between states that kind of have made less margin, which have performed better, and states that delivered better margin that have performed not so well this quarter. And therefore, it's really the states mix that is making that difference there and nothing more than that.

Arnab Mitra: And just one question for Sanjeev, if I may. The other expense seems to be at a 16 quarter low at below Rs. 300 crores, and it's a substantial difference from the Rs. 350 crores, Rs. 400 crores which we have had in the seven, eight quarters. So, is there something specific in this quarter? Are these levels of other expenses sustainable? And even I look first half versus first half, if I want to even out some one-off effect here and there, it's almost a 12% decline year-on-year. So, again, just wanted to understand, is there something specifically on other expenses which is a big tailwind for this year and is that sustainable?

Sanjeev Churiwala: Yes. So, I think the other overheads on a very like-for-like basis is lower Rs. 80 crores. Now I am talking H1 because it doesn't make sense when looking at just the quarterly movements and other overhead items. There's an impact in the IndAs, the lease internal adjustments, about Rs. 31 crores is coming out of the other overhead and moving largely into the depreciation and debt line items, so that adjustment definitely should make in terms of our going forward outlook. The other part is largely related to the internal efficiencies. One of the big things that Anand and we have been speaking about in the last 30, 40 minutes of the call is managing credit risk over sales growth. As a result of which, our provisions for doubtful debt have significantly come down. And this time because of the IndAS requirement, we are very specifically in the balance sheet giving a breakup for these provisions. You will observe that in H1 of FY19, that is last year H1, we had a Rs. 44 crores of provisions. We did not have any provisions so far. So, that doesn't mean there will be nil provisions going forward as well. We are dynamically managing the situation, but it's a far-far improvement than what we see since last year. So, that definitely should give some benefit as we move forward for the full year.

Second is, all across the various overhead lines, we have been driving the efficiencies. Internally, we call it war-on-rest. So, we have a complete project team spread across various functions, we are trying to drive very clean efficiencies across various line items. But of course, because our volumes are down to that extent somewhere impact will happen on the other overhead, just to see kind of other overheads as a percentage of the NSV, and as these direction things are moving as a trend over the last couple of years, definitely moving in the overall right directions. F19 we closed at about 17.5% in terms of where we are standing right now, where H1 is 14.2%. Which means, if we can continue driving this efficiency good forward, we will definitely see some operating leverages coming forward. I would kind of just step back and look at kind of more on the macro level, and this is guiding towards how we look at H1, rather than just looking at one particular quarter. Because of our gross profit margin erosions, because of the reasons that we explained, mix issues and of course ENA and glass inflection coming in, our GP margin was lower on a like-for-like basis on underlying, but 228 bps. But when we look at all of the line items below that, which is the combination of staff tax cost, additional sales promotional expenses, other overheads, we have been able to recover 540 bps through various measures and efficiency coming in.

As a result, on a like-for-like basis, our EBITDA margins have kind of still significantly improved at 65 bps. And our H1 EBITDA margin on like-for-like basis is still 16.8%, which is still significantly better than the underlying EBITDA margin that we had for the full year of F19, which is 14.9%. So, my request is to kind of look at the overall thing rather than just specifically looking at one particular line item. The fact is, this is exactly what we called out when we had this long call at the end of F19, that we do see the benign interest rate environment behind us, which means that GP margins impact will really be called out, and that's what we feel right now. But I think everything that we do is in service so delivering a better OT and delivering a better EBITDA margin, and that's what is exactly playing out. So, we will continue to drive this cost savings across all the line items as well as we move forward to the H2 and for the full year.

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

Nillai Shah: Sir, my question is actually on the pricing that you got in the 17 states. Arnab also alluded to it. So, essentially, when you look at the numbers, we don't see it. There are different reasons for it, there is state mix, there is also the price cut which you had taken in Maharashtra in 3Q of last year and then the tax increase in Maharashtra in 4Q of last year, so it also is getting offset by it. But just how do I think about pricing going forward in the second half of the current fiscal, given that some of these things will be lapped up in the base now?

Anand Kripalu: So, you are right. So, Maharashtra was negating almost all the pricing that we got in these 17 states, because these were big states are it was a big decision to take. A large part of it is that now we have lapped, because it happened in September last year. And a bit more of it will lap in January, so it's all around the corner now. So, at least the Maharashtra stuff will disappear. So, the pricing that we have got should start flowing through because we also believe that the mix will also sort itself out because the mix was predominantly because of short-term issues right now. So, that should happen. So, you should absolutely start seeing net pricing from quarter four, because quarter three there will still be a bit of the Maharashtra stuff in that.

But I think I want you to look at pricing on this that, listen, with this kind of a commodity environment, and there is no way that we are buying worse than anyone else in this market. Everybody is reeling from a tough commodity environment, unlike FMCG which is having a relatively benign commodity environment. The industry today has come together, and I can tell you there is a lot more intensity to push price. Now within that, some competitors may choose to still play price at a time when cogs are going up, and that's I suppose a business call that people may take. But the broader industry is pushing much harder, and also lobbying now in states to say that you have given us a price increase, the normal model is really you will do it once in a few years, but these are exceptional cogs situations. And therefore, bringing it back on the table for a more urgent one more round of price conversation and hopefully pricing decisions. So, that's how we are approaching it. And I think that's how you have got to look at pricing as well.

Nillai Shah: I think from a slightly longer-term perspective, how does the ownership of, let's say, a Pioneer Distilleries, for instance, help mitigate, if at all, ENA costs going forward?

Anand Kripalu: So, absolutely, something like Pioneer should help. Pioneer has had some challenges and that has been reported in the results of Pioneer as well a listed company, right, and they will solve those. So, it will give us some advantage at a time when unit prices are as high as it is, because it is a bit of captive ENA capacity. Now long-term, the decision is different because it's a commodity and it goes up and down. So, you might have a period where it is really good to have captive capacity, there may be a time when it is not so good to have your own captive capacity. And we have seen both these scenarios play out in the past. So, I think given where we are today, it seems topical to think about it as an advantage, and it is during this period of time. And Pioneer will deliver a bit more as we improve the operating efficiency of our plant in Pioneer.

Sanjeev Churiwala: And just to add to what Anand said. While we are looking at Pioneer as a separately listed entity, it's largely a captive unit. And given the overall consumption that we have on **(Inaudible) 43:21.9** supplies from PDL, or Pioneer Distilleries is really immaterial to the overall scheme of things. So, it might bring in little more efficiencies. But again, on the larger scheme, it's still increases, not very material.

Nillai Shah: Sir, I just wanted to understand that is there optionality in the future to think about greater capacities coming in from captive, given the fact that ethanol blending is not going to go away as a strategy for the government?

Sanjeev Churiwala: So, absolutely, you are absolutely right. Going forward in the long-term, I think the larger thinking is now towards having an integrated unit rather than having stand-alone bottling and separate distilleries.

Anand Kripalu: So, the long-term footprint will move more towards co-location of distillation and bottling, so captive distillation and bottling in the same plant. That's the direction which we will move, philosophically at least.

Nillai Shah: And final question is, on green versus molasses-based ENA, what is the split right now for consumption?

Sanjeev Churiwala: About 70:30.

Moderator: Thank you. The next question is from the line of Binoy Jariwala from Sunidhi Securities. Please go ahead.

Binoy Jariwala: Just a quick one on the advertising and sales promotional expense, that's about 7.6% versus 9%. And likewise, it has been lower for this first half as well. So, just wanted to understand how much of this is alluded to the Diageo's catalyst tool? And how much is the actual reduction for managing profitability?

Sanjeev Churiwala: I think it's a brilliant question. We have been talking globally as well as locally on a lot of productivity work that we are doing. Anand did mention about the procurement efficiency and the effectiveness that we are driving across our entire ENP spend, and that's again a big spend that we have over the years. First coming to your question on the A&P spend reinvestment rates, while on the books, reported basis you see 7.6, the fact it, it's about 7.9 and about 8 percentage. And if you look at the last three, four quarters, very consistently we have been spending around 18 percentage. We will step into a festive season which should mean our reinvestment rate will slightly go up. Possibly and on the full year basis we will still see our spend closer to 9ish percentage, and that's the guidance that we have been giving.

On top of that, definitely we want to build in a lot of efficiency and effectiveness this year, given that we have invested a lot behind the Catalyst tool, the NRM technology piece that is globally driven. And hopefully, that efficiency will also be built in and as we move forward for the year. We will not getting into a split saying how much of that is because of the productivity that we are gaining. But yes, we are moving head first into the direction that we already see lots of effectiveness and efficiency already seen as we have seen in the last few quarters.

Binoy Jariwala: Sure. I understand that. So, my follow-up on this is, with this efficiency coming in from Catalyst, do you still maintain that in the medium term you would like to hit about 9% to 10% of sales as a revenue and sales promotion expense?

Sanjeev Churiwala: So, I think there are two parts to it. If you really see, and on a comparative basis, we are definitely spending ahead of our competition, that's what we believe. So, our effectiveness is already in place. As of now, we are already double-digit for P&A, and I think we are very competitive in the market space. We had earlier kind of spoken about the guidance from 9% to 10%. This is still very dynamic. We will continue to drive efficiency. And just be around that range, maybe more above the 9ish range than the 10ish range. But I think this is about the managing judgment, this is about how we see the environment, and this is about our overall portfolio play. But I think the guidance that we have already mentioned in the past, kind of we are still staying closer to that.

Anand Kripalu: Yes. And if I could just add, I think the point Sanjeev made about management judgment, I mean, when you are in an environment where you are seeing double-digit volume growth, then you also fund it in a particular way. And it's a chicken and egg situation, you never know which comes first. But at least the economic environment needs to be positive for you to be able to do that. And in an environment, you see this with all companies at a time when consumption and demand is a little slower; you just have to be prudent. The question is, are we spending share of spend more than our share of market, and that we absolutely are. And that's the point about us being competitive. And that's how we maintain it. And we will just use management judgment and be dynamic about maneuvering our way to an environment that we did not expect six, nine months ago, honestly. So, we had to take different actions depending on the environment that we are in and that's what we are trying to do.

Binoy Jariwala: Understood. That's helpful. And last question is, what would be the normalized maintenance CAPEX?

Sanjeev Churiwala: Throughout the year over the last couple of years, we have been spending about Rs. 200-odd crores. And if I see the H1 trend, it's close to almost half of that. So, my sense is, yes, we kind of still stick to our overall guidance that we have been telling you previously, that we are looking at overall about Rs. 200-odd crores CAPEX.

Binoy Jariwala: And all of this would be maintenance CAPEX, is it?

Sanjeev Churiwala: It's largely maintenance, productivity-based, compliance and CAPEX, and environment, safety, other factors. We are not putting up greenfield projects per say, so it is largely around classifications and maintenance CAPEX.

Binoy Jariwala: Understood. And sorry, I couldn't get, you mentioned the split between grain ENA and molasses ENA was 70-30, is that right?

Sanjeev Churiwala: Yes

Moderator: Thank you. The next question is from the line of Nandlal Padhi, an individual investor. Please go ahead.

Nandlal Padhi: What percentage of revenue comes from export? And how fast it is growing?

Anand Kripalu: Well, I think we don't actually disclose this information specifically. It's a small part of our business. It is margin accretive, so it is good business to be in. And it is growing faster than the domestic business. So, all the levers are positive, but the materiality is still somewhat small for the business.

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

Avi Mehta: Sir, congratulations on a great performance, especially on the cost front. My question is on the sales side, I might be repeating on this because I missed the earlier part. But in the Prestige portfolio, while you have called out some factors that you have chosen to either do or the environment has forced it. Just wanted to understand, given that some of these factors have turned about, especially the one-off issues in BIO, how should I look at the recovery in sales trajectory? Are you expecting the double-digit more as a V shape or is going to take some time in your view? I know part of it is linked to macro, but based on whatever you have seen, if you can help us understand how to look at this? That was the first question.

Second is that, you highlighted that some of these working capital increases are more seasonal/one-off in nature. Is this corporate? Are you seeing or there is no linkage between working capital increase and the movement towards corporation model, would that be inaccurate to kind of link it? And how should I look at that? That were the only two questions that I had.

Anand Kripalu: Yes, so I will take the first question, Avi, and then Sanjeev will comment on the second one. So, how do you look, what will be NSA be, will it be double-digit, will it get there in the short term or the kind of medium term? I mean, it is a bit of a million-dollar question. Obviously, it's our ambition, and everything that we are doing is in service of that ambition. I think that a significant part will be dependent on some improvement in the macro environment. And there will be smaller parts of it that are to do with some of the operational challenges and so on, that are now behind us, and the efforts that we are going to be putting in to just deploy the growth drivers that we have, invest behind those and consider to push our strategy forward. Now what that number is going to be, unfortunately, I shouldn't say and I cannot say what that number is likely to be or when it is likely to get there. Because given the current situation, it's really hard to comment beyond that point. I think what one does during times like this is…

Avi Mehta: Sorry, Anand, just one thing I wanted to kind of highlight. I was not looking at reaching the double-digits. What I want to do is try to wean out or try to associate a number for the one-offs which is kind of reversing, which is what you highlighted. Is there a way to kind of have any number to it? So, if, for example, the BIO issue was not there and the BIO issue was not there, both of which have been resolved, the growth rate would probably have been 200 bps higher. Is there any way to kind of get that is what I was trying to kind of understand.

Anand Kripalu: So, listen, the operational issues over the last quarter which are in our control, which we could have solved or should have solved or whatever on these one-off things. It would have contributed to a few percentage points of growth. Now I am not going to tell you that it's 1 or 5 or 10, but a few percentage points of growth, absolutely, I think we just lost because of some of those challenges, which are not there now as we go into the next quarter. But this is a dynamic market. This is a quarter where you have the festive season in your base as well. How the festive season plays out in this quarter is going to be a real important determinant of consumption. There are many moving pieces, not just that one. But that one is worth about that much, is what I just told you, that's all.

Avi Mehta: But you can't quantify it's say of 2%, 3%, that kind of number you would not be able to kind of share?

Anand Kripalu: No, I wouldn't like to. We obviously have some internal working on that, Avi, but I wouldn't like to honestly.

Avi Mehta: Fair enough. And the second bit of working capital, Sanjeev.

Sanjeev Churiwala: So, I think there are two parts to your question. Part of the working capital is towards the seasonal deployment and of course that's absolutely fine. And the other part we did mention about is the timing. But I think it's fair to say when I look at the timing, there are two parts to it. 70% of our sales are, as you are aware, to the cooperation market, and I did mention about some of the challenges that we had in terms of collections, which is, in a way, behind us. But yes, this is frequent in the cooperation market, also we from time to time feel challenges across collections, but that's true for the industry. And it happens in the cooperation market. At least the payments are all secured, at least the challenges are lesser than the challenges that we face in the open market.

Coming to the open market, as we have mentioned, we have definitely prioritized credit over the sales growth. As a result, we have kept some of these issues under control. But yes, I think we do have our challenges in some of the north markets precisely. And as you are aware, again, there is the overall liquidity crunch that is there in the market. To that extent, we will continue to face some challenges as we move forward also in the subsequent quarters, but we will have to really manage it very, very dynamically, and we have to really see how things play out.

Anand Kripalu: Operator, we will take the last question now.

Moderator: Thank you. The next question is from the line of Tanya Bajaj from Emkay Global. Please go ahead.

Ashit Desai: This is Ashit from Emkay. I have two questions, one on other expenses. You have done a great job cutting down expenses over here. So, if you look at last two, three years, other expenses in the second half have been largely higher than the first half run rate. Is that a trend that will continue or we should look at the first half expenses for that item?

And secondly, one of your key competitors has cut one of the premium brand prices in Maharashtra. Do you see a material impact from that? And how do you plan to address that?

Anand Kripalu: So, I will take the second question, and then hand over to Sanjeev on the first question. I have already answered our philosophy and our strategy. And what the impact of that will be, I mean, we are still assessing. And more importantly, the impact will be based on how we will respond, if we respond, given our longer-term philosophy and strategy. So, I think we will have to just see how this plays out. I think we have managed the situation effectively the last time around. And actually Maharashtra, our performance is really good and those brands are growing really well. So, it gives us confidence that we will be able to maneuver through the situation. Whether there will be a short-term impact or not, I think you will just have to watch this space, honestly, because we are trying to construct our response and our plan at this point in time.

Sanjeev Churiwala: I will now get into your first question which was, how do we decode the other expenses H1 and H2? The fact is, many of the costs are associated with the rate the industry operates. Many other cost, for examples, licensing, renewals, brand registrations happens along with the change in the cycle, which has followed the fiscal year to March. So, some of the costs will definitely be coming next year. But frankly speaking, do we see a trend? Very, very difficult for me to answer, but I will stick with it. That's just to see all other expenses on an annualized basis and see the trend around that. That's the best way you can do your modeling.

Anand Kripalu: Thank you very much. I would like to thank everyone for joining in to this call, and look forward to your support in the time to come.

Sanjeev Churiwala: And I wish you all a very Happy Diwali.

Moderator: Thank you. Ladies and gentlemen, on behalf of United Spirits, that concludes this conference call. Thank you for joining us. And you may now disconnect your lines.