"United Spirits Limited Q1 FY-18 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the United Spirits Limited Q1 FY18 Results Conference Call. We have with us on the call today, Mr. Anand Kripalu – Chief Executive Officer; and Mr. Sanjeev Churiwala – Chief Financial Officer from United Spirits Limited. As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the opening remarks conclude. 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 for his opening remarks. Thank you, and over to you, sir.

Anand Kripalu: Thank you. Thank you very much and very good day everybody and a very warm welcome to the FY18 Q1 results call. As we normally do before we open up the lines for Q&A, I just wanted to provide a perspective of our results that we announced last evening.

Now, as you may have seen in the published quarterly results, our performance as expected was impacted by the highway ban, which has certainly created confusion and some concern across the trade and this has led to a reduction in the number of outlets that are currently open to service consumers. As a result of this, our underlying net sales declined by 7% if we also separate out the impact of the operating model changes.

In addition to the operating model changes, we have also seen a material down-stocking that has happened during this quarter. And our estimate of the value of the down-stocking is about 3% to 4%. So if we were to net that off, really our pure underlying result probably is about negative 3% to negative 4%, somewhere really in that range.

Specifically looking deeper into our revenue performance, if you look at prestige and above, there again, net sales were down 8% and again, this is partly impacted by the down-stocking that has taken place, but has also been materially impacted by the fact that the highway ban has been more prevalent on the on-trade channel, so really the bars and the restaurants and the hotels and that typically where our premium prestige and luxury brands are actually consumed.

We have continued our renovation journey this quarter. As you would recall, in the past we had renovated Royal Challenge, McDowell's and Signature. This quarter, we have now started rolling out the relaunch of Antiquity and what I can share at this point is that the early signs, both from the point of view of the consumer and the trade is positive. With the operating model changes, the prestige and above segment now accounts for more than 60% of our net revenue; in this quarter, 61% to be precise.

Moving on to gross margin, I must say that I am pleased that in a quarter of this kind, we have managed to deliver a material improvement in gross margin and while part of it is because of the business model change, there is a 116 bps underlying gross margin improvement. And I must say that we are quite pleased about the fact that we have been able to do that. This has been fuelled by our continued focus on productivity and cost saving, which we have continued to drive very aggressively as well as price increases that we have received in select states.

Overall, input cost inflation has remained around 3% during the quarter and as you would have seen, this has been largely mitigated by the efforts that we have taken on productivity. I think what is important is that despite having a difficult quarter on topline, we have continued to invest behind our brand to fuel future growth. And that is really our belief that the long-term growth story remains intact. And if you see the absolute numbers, our absolute A&P this quarter is almost the same as it was in the same quarter of the previous year. So we have more or less protected our A&P, the normal reaction would have been to trim A&P quite sharply with this kind of a drop in topline, but we have confidence that future growth will come and therefore, we have stayed invested behind our brand.

Employee costs were lowered by 8% and that included one-off restructuring costs of about 13 crores in the current quarter. Excluding the one-off impact, employee costs were lowered by 15%, benefit from the savings that came about because of the organizational changes that I had shared with you on previous calls.

The decline in net sales coupled with our continued investments in the business negatively impacted reported EBITDA and that was down by 26% and also adversely impacted EBITDA margin, right, which declined by 162 bps, down to 8.8%. If we exclude the one-off impacts, underlying EBITDA declined by about 20% and EBITDA margin declined by about 153 bps, to 10%. But just to reiterate, the reduction in EBITDA is purely a result of the change in topline, while most other lines have actually been held or become better.

We have continued to focus on reducing debt and interest costs and with the result, and I must say, we are again pleased about the fact that our interest costs are down by 32%. This coupled with lower exceptional items and tax compared to the previous year has resulted in a strong PAT growth of 44% during the quarter.

Now, I want to underscore the fact that we do not run this business on a quarter-to-quarter basis. We have said this earlier that at the minimum, you should look at our results on a full-year basis and that is what we did in the previous fiscal as well. So while there are short-term challenges that obviously have impacted our results this time, the overall results, we believe continue to demonstrate the fact that we are executing our strategy effectively. And I must be honest and say that while we have been a little shaken by the Supreme Court and the highway ban, our belief in the business because of the fundamentals of this business today are probably stronger than what they have been in the past. And that is because we have strengthened the fundamentals of this business over the last three years.

As we look forward, we do expect continuing impact of the highway ban for the next couple of quarters, but I must have to add that we expect the impact of that to happen to a lesser extent when it has happened in the previous quarter. In a couple of quarters, we are certainly going to see more reopening of stores because of the clarification that the Supreme Court has also given and where that does not happen, we do believe that consumption will shift to the stores that remain open and therefore, there will be minimal impact on ongoing demand thereafter.

The implementation of GST has happened effective 1st July and this has resulted in additional taxes on our input materials and services, and that will result in some stranded taxes which will impact margins. We are working with state governments to seek clarity on some of these specific taxes and also approaching them for price increases where appropriate. Additionally, we continue to work internally to minimize the impact of GST. However on a positive note, I must say that the migration to GST effective 1st July has been smooth, right and we have seen no business disruption as a result of that migration.

So net-net, despite the short-term regulatory challenges that we have seen, we remain confident about the long-term consumer opportunity on the business and the demand for alco-bev and spirits. We continue to focus on our strategic priorities to capture this opportunity in what we believe is a very, very attractive market in the long term. And we continue to do that so as to achieve our medium-term ambition to grow topline by double digit and improve margins to mid-to-high teens.

So with that, I am going to open it up for questions.

Moderator: Sure. Thank you very much. We will now begin with the question-and-answer session. We have the first question from the line of Manoj Menon from Deutsche Bank. Please go ahead.

Manoj Menon: Just one question on the highway ban. Would it be possible to give some quantification in terms of, let's say, how many states have actually done this de-notification which Supreme Court has recently allowed or put it differently, how much of volumes are actually still exposed to let's say, places where the state governments cannot really help out?

Anand Kripalu: So just to give you a perceptive Manoj, so we have seen a shrinkage of about 30% of outlets after the highway ban came into existence. Out of that 30%, we have seen about another 10% of stores reopening thereafter. Now many states have still not actioned the recent Supreme Court clarification. And as we have seen from this morning's paper, the Karnataka government has actually written to the Ministry of Road Transport and Highways, asking them to denotify the national highways that goes through the large urban center in Karnataka and the Ministry of Road Transport and Highways has sought clarification from the Supreme Court. Now what we do know is from whatever we have seen, is that the supreme court has to an extent, if I can use the word softened its stand when they have given the clarification that they are not against de-notification of State and National Highways within urban centers. So I would say as of today, I think there are still about 15,000 odd stores that are closed and out of that, about two-thirds are on-trades of bars and restaurants and about one-third are off trade. But with each successive week or month, we see either the stores beginning to reopen, some fresh licenses being issued by State Governments as Karnataka has just done to make sure that their revenue does not get impacted, right, or ultimately consumption moving to the stores that exists. And hence, when we had our investor call last time, we said two to three quarters, we expect the impact of the highway ban. One quarter is done and therefore, we expect to a decreasing extent, an impact over the next two quarters. But by the end of the next two quarters, I mean, we actually see that consumption should come back. So that is really the perspective we can offer you at this point.

Manoj Menon: Understood and thank you so much for that. And secondly on the GST and these stranded taxes point, if you could just provide some sort of quantification on how much would be let's say the value loss or rather stranded taxes impact for you, the way you see it currently?

Anand Kripalu: So I am going to hand over to Sanjeev Churiwala – our CFO, to deal with the question on GST.

Sanjeev Churiwala: Thank you, Anand. I think what is important for us to know that as Anand mentioned in the opening speech, we were ensuring that we start off 1st of July with respect to our systems and processes geared up for the GST changes, that has happened. We have ensured that we have not lost any hours in terms of GST hiccups and we have gone smooth the entire ecosystem for United Spirits Diageo India has been working perfectly fine now. While the GST rates are now clear has been notified and we have an understanding with respect to the various input costs going up, the fact is, while we speak to you, we are also engaging with the various state governments to clearly understand on the ground executions of the GST's notification, and of course, while some of the states have upfront de-notified some of the local taxations, we are still engaging with many state governments to really understand the overall implications. We are presently working through the mitigations and since that time we have a full implementation of this in the ground, we will not be able to really quantify the exact amount to you, but we do expect margins impact from the GST in F18, we will have definitely a better clarity in the next few months as we work on the various measures to mitigate the overall GST impact.

Anand Kripalu: And if I can just add to Sanjeev and say that, we would be very keen also to share with you as soon as we have clarity, the impact, but the reality is that the interpretation and the application of many of the announcements under GST are still moving parts, and what we do not want to do is to give numbers that are inaccurate and then have to go back and re-track and change it. So that's the real position.

Manoj Menon: Understood. So let me put it slightly differently. See, one is the timing mismatch which is probably a short-term and a slightly less relevant one. The other one is a permanent, if I can use the word impairment of margins, I can't think of a better word that size, so excuse me for that. So I am just trying to understand, the way you see it currently, is it more of a temporary issue in terms of the GST impact, the way you see it currently or is it going to be some sort of even without a quantification, some part of your margin which will have to now make good with your other measures, whether it is cost being lower or whether it is a bit of portfolio, or you know, something you will have to actually earn yourself?

Sanjeev Churiwala: Let me divide our answer in two parts. First is trying to understand what is the cost implication and that would mean having a complete clarity around various taxes on the input materials, looking at the exact slab, looking at what the state governments are also doing in terms of de-notifying various taxes which could have an implication on the GST. Now having done that, we still find various moving pieces across various state governments, which we are trying to put in together into place. Once we have the complete clarity around that and the clarity is still emerging, we would think that we will be in a position to mitigate this entire GST over a period of two to three years. Definitely the mitigation work will start upfront in F18 itself. We are already bringing those internal measures in terms of looking at our business models, what needs to change in terms of mitigating this GST impact. We are also engaging with our large vendors to understand their cost implications and how best we can work together with them to really mitigate many of these tax implications. A big mitigation would also be understanding what kind of price increases we can negotiate across the various states governments, which you are aware is presently controlled and that is not something that we will be able to put upfront in the table. So I think combination of all these is yes, we will be able to mitigate the GST over the next two to three years. There will be an impact in F18 as we move forward.

Anand Kripalu: Yes, but in two to three years, we do not believe that there will be any permanent margin impairments to use your words again, that we will find ways to mitigate that.

Manoj Menon: Okay. If I understood correctly, you're basically saying over the two to three years, everything will be normal actually.

Sanjeev Churiwala: I must add here that this is our current position, but as I said, we are still evaluating the exact impact on the ground and maybe, in the next quarter when we get into a call, we will have a better clarity around this.

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

Arnav Mitra: So Anand on your statement that you probably would expect the impact of the highway ban to get over by the third quarter-end. I just wanted to clarify, do you mean that the volume decline will stem or do you mean that you get back to your growth rate that you were delivering before this which was probably in P&A something like a high single-digit? And just connected to that, also if you could help us in terms of the states which went in for the ban on 1st April, you did mention on how many stores have closed down and reopened, but the volume trend, is it still significantly negative as we speak even at the end of the first quarter or did it improve significantly through the quarter?

Anand Kripalu: Yes. So to answer your first question, when I say that over two quarters, two further quarters, that the impact will happen to a lesser extent and go away, I mean, our current belief is that, we should get back to normative performance levels and growth levels that we had prior to the highway ban actually happening. So it is not just becoming zero, negative becoming zero, but it's getting back into the positive territory like you pointed out. Now you will understand that, that is our intent and belief and this is something that's not a 100% in our control, but that's our judgement. That's the management judgement call and we're going to do everything we can to make sure that we deliver to those levels of performance. Now, there is also a hearing coming up tomorrow, I understand at the Supreme Court, where there is a request from state governments to kind of allow things like clubs, five star hotels and so on and so forth, to not be impacted by the Supreme Court ban, and I think the Uttarakhand government has really asked for this. So I think that's something that should happen and I believe that in the trend of the Supreme Court, really saying that their intent was to protect truck drivers from drinking and driving on highways, right, and the intent was not to have bars closed on M.G. Road in Bangalore or in the city centers and I think directionally, it moved towards that. Now if I look at state patrol impacted from April, right, one of the bigger impacted states is Maharashtra actually where there is a material number of stores that are closed in Maharashtra. And Maharashtra happens to be a state, where there is a very significant on-trade as well, right, in addition to off-trade. So Maharashtra volumes are under pressure. Bombay city is fine by the way, just to be clear. But you know, up-country, there is still some problem but again in Maharashtra, we have seen stores beginning to open, either beginning to move or beginning to open, re-open and Maharashtra is one of the bigger impacted ones. So therefore, there is a volume impact in the state of Maharashtra. And that is what I would say to a lesser extent, there is an impact in the other states where this has got implemented. Some states have been very proactive to allow stores to get re-licensed by deciding how to measure the distance from the highway and so on and so forth or de-notifying because some states have actually very quickly gone ahead and de-notified the state highways whereas some states are taking longer. But I do not want to say anything beyond the fact that it will take the next two quarters or so for this whole thing to get mitigated.

Arnav Mitra: Sure. Thanks for the clarification and on and last question was on GST. So when you mentioned that some state specific taxes, are you referring to things like LBT and have any states actually de-notified LBT or other kind of taxes, which were applicable on alcohol earlier?

Sanjeev Churiwala: It is a combination of various taxes. So of course, some of those are very highlighted, if we're talking about LBT, but there could be entry tax, it could be OCTROI or it could be local, state taxes which have been de-notified. Some of the states also looking at increasing excise components. So as I said, it's a combination of various moving parts. Various state governments are also seeking in turn clarification on many of these state specific taxes. So far we are concerned, we are looking at this pan-India situation across all the states and then trying to pull together the overall impact.

Arnav Mitra: If I could just follow up, I actually thought that LBT on alcohol would be outside of GST, so states would continue. So is there a thought process that you cannot put LBT after GST?

Sanjeev Churiwala: At the moment, we are still in the execution mode and understanding mode. As you would appreciate, we have just started our billing. This is the first month. We are also understanding from the state government as to what their perspective. Sometimes within the state governments, we need to go down to the municipalities because it could be linked to the municipalities. So I think, we will wait for a few weeks since the time we get a clarification across the state governments in writing. We would like to have a stability across these various taxes before opening up and giving you a very specific answer on the particular state tax.

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

Avi Mehta: Sir, just wanted to kind of clarify, has there been any new price hikes that you have seen and has the moderation in gross margin expansion from 270 odd bps to 115 bps, is that largely because of price increases coming in the base?

Sanjeev Churiwala: This is Sanjeev here. Let me try and answer this. So I think for us, this is a good story of this quarter. In spite of seeing an underlying degrowth of 7.5% in the NSV, we do see a substantial step-up in our gross margin profile. The reported gross margin profile has improved by 265 bps points, but the underlying has improved by 116 bps points. And it is a combination largely around two factors this time. We have spoken earlier on the price increases that have started to happen in the previous year. We see some flow through of that price increase happening even in this quarter. That is close to about 150 bps point that we have gained because of the price improvement. Then we have been speaking about our productivity initiatives that the company has taken. And as you are aware, we have already called out that we generally expect an inflation of 3% to 4% on an annualized basis for this company. But because we have put together a complete productivity initiative, we are in a position to actually mitigate almost like 75% of the cost implications. So while our price improvement brings in 150 bps improvement in our GM margins net off inflations, the negative impact is also close to about 50 bps points. That gives us an overall gross margin improvement of 116 bps points in the current quarter.

Avi Mehta: Perfect and sir, the price increase questions around Telangana in particular, can you update?

Sanjeev Churiwala: We would not get into a specific state government, state specific price increases, but I think it's a combination of various states, many of the states, they have called out in the previous quarter. We have been able to get a positive price momentum happening especially in the states of Maharashtra, West Bengal, Karnataka that we have called out earlier.

Avi Mehta: Okay and the second question sir was, you have seen a Q-o-Q moderation in interest costs, that is recommendable. Is this being largely interest cost reduction or interest rate reduction, or you have seen a debt reduction probably on the back of and if there is debt reduction, what has driven that? Is it working capital and that is what I wanted to just or non core that's doing a part? That's all from my side.

Sanjeev Churiwala: So maybe, when it comes to debt and in sense the fact it is a combination of debt reduction as well as the interest reduction. We have been working on a capital structure for United Spirits for a 12-month period now. And we have seen a substantial movement in terms of annualized improvement in the interest, interest rates between Q1F17 and Q1 F18, our interest rate profile has improved or interest rate has come down close to 230 bps points. That is largely because we have moved into commercial papers. We have been able to renegotiate down the overall interest rate across our various banks. And that is bringing a very positive momentum in terms of the finance cost reduction that you see. In addition, yes we have been also been able to reduce our debt, but I would not like to speak on a quarter-to-quarter debt moment profile, but when I look at the last 12-months profile between what we started on quarter one of ' 17 vis-à-vis quarter one of '18, we've been able to reduce our debt close to about 500 odd crores, and that is also bringing the positive momentum in the finance cost reduction in the current quarter.

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

Vivek Maheshwari: My first question is to what Arnab asked about LBT, would not there be also savings from OCTROI also given that, let's say places like Mumbai don't have any OCTROI checkpoints and that will be a big one?

Sanjeev Churiwala: So as I mentioned Vivek, there are pluses and minuses. Some of them comes out in the newspaper, as such, we would be more aware. For example OCTROI or LBT, but the fact is across all the state governments, there would be local tax regimes and there are many changing parts at the moment as we speak. Some governments are still seeking clarification, de-notifying. So we would not like to get into a specific state subject here. But looking at the pan-India, overall implications of the various local taxations, which could be entry tax, which could be purchase tax, which could be OCTROI, a combination of all of these.

Vivek Maheshwari: So are you paying those taxes or you're not paying those taxes?

Sanjeev Churiwala: So we have just started billing, we have just started getting invoices from the vendors. We are also seeking clarity. In some of those states, there are positive momentum as we have been trying to say. In some of those states, we see some negative things also coming in. So there are pluses and minuses and till such time, we get a complete clarity in writing from the state governments, we are not calling out specific positive movements or negative movements. So I think you know, while we are getting into the first 25 days, in the next couple of weeks, we will have a complete clarity coming in. And when we get back to our Investors' call, somewhere in October, I think we will be in a situation where we can exactly call out the implications.

Vivek Maheshwari: Okay. And two small book-keeping. One, why is tax rate so low in this quarter?

Sanjeev Churiwala: So I think while we are looking at the quarter numbers, the best judges look at an annualized number because in some quarters, you will have positive movements, some allowance happening, ETR true up happening, some provisioning which are eligible for tax deduction, some not. So I think, this is largely timing difference. I would say, you will wait for the full year to look at that actually, ETR movements between year-on-year rather than looking at just quarterly numbers.

Vivek Maheshwari: Full year, basically tax rate should be similar to what it was last year?

Sanjeev Churiwala: It all depends, but by enlarge, we are into a tax profile, which would range between 30% to 34%.

Vivek Maheshwari: Okay. And one small clarification. And this is full year, you report your consol. When I take full year consol and reduce full year standalone, what is the difference right now over there? Let's say at PBT level, I get a 50 crore loss at the subsidiary level, what are the main subsidiary other than IPL now for you?

Sanjeev Churiwala: So we have a combination of about 19 subsidiaries which we consol. So besides RCB, which is an operating company, we also have Pioneer Distilleries, which is an operating company. We have a small wine company called Four Seasons Wines. These are the operating companies plus we would have 16, 17 non-operating companies. But I think this quarter, it's around the standalone USL numbers, if you need more clarity around the last March numbers, which is a console number, we can get back to you separately.

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

Aditya Soman: Sir, first question is on market share. Can you throw more light on market share especially in the prestige plus segments given the movements post the highway ban?

Anand Kripalu: So, well, we can share Nielsen information with you. On Nielsen, I would say that for prestige and above, we have had an improvement in market share, both in the last quarter, but also over the last year also. So we have seen an improvement in market shares on prestige and above. {*Share within spirits industry*}

Aditya Soman: Alright. Thank you. And just on a follow-up on that, over the past two years, we noticed that Royal Challenge in particular was growing very fast, but this quarter you specifically called out that, that saw also an 11% decline. Can you highlight whether this was something specific to the category or was this because consumers traded up to something like the Signature?

Anand Kripalu: You are talking about this quarter right?

Aditya Soman: Yes, this quarter.

Anand Kripalu: So, this quarter it's really tough to read brand wise performance because the overall underlying performance has been significantly impacted by the regulatory changes. Now having said that, yes Signature has performed well and actually grown despite a quarter of this kind and that's because of the relaunch of Signature and therefore, the new news on Signature is more recent, right, that's the only reason. Now do we expect Royal Challenge to continue to grow, not just in line with market, but grow share? Right, in coming periods, we absolutely do and we will be making investments both in terms of money and activities with the objective of delivering that kind of performance. So my own view is this quarter is a really funny quarter right because of the highway ban. So it's tough to really read a specific brand performance.

Aditya Soman: No. I understand that. And just a final question, if I were to just look at sales per case, that for prestige and above is up about 1.7% year-on-year. At the same time, obviously you have seen a significant mix worsening during the quarter, because you've called out a scotch, the decline was much more than the rest of the portfolio. What would have led to this 1, sort of a 2% increase in price per case?

Anand Kripalu: So it's probably, we can look at it a bit more closely, separately, but probably to do more with just the state mix, there is a big difference in the revenue per case depending on the state, right? Because overall, prestige and above is minus eight for the quarter and popular is also minus eight for the quarter. And that's how the numbers really stack up. So they are both almost similar; prestige and above and popular. So any change would probably be more to do with a bit of state mix rather than anything else really right now.

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

Nilesh Shah: Thanks. Sir, first question is on Telangana price increases. So a specific question, has a price increase come there or has not come through yet this quarter?

Anand Kripalu: No. It has not come through this quarter, just to be very clear.

Nilesh Shah: Yes. Okay. The second question is on the employee costs. Why they are up on a sequential basis and what should be the new normal for employee costs under the new franchisee regime?

Sanjeev Churiwala: Yes so I suppose, sequentially again when you look at quarter as compared to the previous quarter, because that's a year-end for March, there would be a lot of provisions around gratuity, superannuations and various things. And I think just looking at sequentially between the quarters may not be a right comparison. But when we look at this range over the last 4-5 quarters, I think we have been reporting that our staff costs have improved per se and I think that's the change we are looking at it, that started somewhere in the announcements in first quarter of '17, that we said that we are going for restructuring of our organization and as such, we said there would be a big project that we are taking and we have been now incurring severances costs quarter-on-quarter to bring down on staff costs. Even in a setting when we look at our staff cost actually includes about 13 crores of severance that we have to take, for severances happening largely around factories, around white collars and blue collars and that's the program that we initiated a year back. As a result, you see a staff cost overall improvement happening quarter-on-quarter as well.

Nilesh Shah: Okay. And the third question is basically on destocking. You called out destocking. What is destocking on account of, was it GST-related or was it just highway ban related?

Anand Kripalu: It was much more highway ban related, I would say, not so much GST related and that's because just with the instability with distributors, corporations, some corporations reduced the level of stock, many distributors and distributor markets reduced the level of stock. So it's just a pipeline correction that happened because as I said confusion and concern and the uncertainty around the future business model in terms of where retail outlets will be and not and so on. So it's more to do with that. But I thought it's important to call it out, because it explains part of the topline performance.

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

Latika Chopra: Yes, hi, just had one question. Have you noticed any inflation in your ENA costs post GST? Any specific that you noticed?

Anand Kripalu: No. To the best of our understanding, ENA has outed GST, okay? And that's what whatever ENA we are buying, we are buying without GST.

Latika Chopra: Yes, but there was this expectation that because of higher taxes and molasses, there could be an effect on the ENA prices.

Anand Kripalu: So, nothing noticed yet, right? We have started getting ENA, molasses based ENA, in the last week actually. There was obviously some uncertainty in the beginning, but in the last week, but so far, nothing alarming is all I will say.

Latika Chopra: Alright. And secondly, just wanted to clarify the comment you made regarding mitigating the margin impact due to GST over next two to three years. If you could just clarify what do you imply by that? Does that mean that your margin progression story, which you called out from mid to high teens over the medium-term gets impacted due to this or is it just FY18 margins are going to be lower on account of GST?

Anand Kripalu: I would say this and then Sanjeev can add to it. So basically I think based on the final impact of GST, right, we are going to see some correction in the longer-term trend of margin progression that we have planned. And that will happen for the next, let's say two years or so and that's our current estimate, but please appreciate Latika that there were seriously moving parts, we don't have a precise handle on the exact impact of GST yet like we called out earlier. But our estimate is that it would take us two odd years to compensate for whatever is the GST impact and get back to the growth trajectory on margin that we have originally envisaged. Okay? Now, this may be two years, it may be two and half years, it may be less. This all depends on I think where things land over the next few weeks. So till then, I think this was just a bit of fluidity in our numbers.

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

Amit Sinha: Just wanted to confirm, in your initial remarks, you said that the destocking impact was 3% to 4% during the quarter?

Anand Kripalu: That is correct.

Amit Sinha: Okay and subsequently in second quarter of this financial year, do you see restocking happening because I am asking this question because the highway ban has happened in a phased manner?

Anand Kripalu: So you know, it's not something that we are going to force to make happen. If we feel that the stock has gone below normative levels in certain markets, then we will try and do that. But like I said, another two quarters is what we need to wait for and then, we may make a part of this non-stocking, we may not makeup part of it. Now, I think that will just be based on what is right for the business and how the model stabilizes post this. There are other moving pieces where there is a route to market change in some states, there is a change to corporation from a distributor markets in other states. So you know, there are many moving pieces in this, but like I said, it is a small part of the total puzzle and we will do whatever is necessary to keep it good and efficient for business.

Amit Sinha: Okay and lastly on the franchising out the entire process which you have been doing in the last two quarters, is there any further update in first quarter?

Anand Kripalu: Yes, Sanjeev will respond to that.

Sanjeev Churiwala: Yes, let me respond to the query. I think in the last quarter, we had this same question on our plans on the franchise. So let me put it on record that as of now, 13 states have been franchised largely for our popular business. When I look at the current quarter, about 142 crores of NSV which in the previous quarter was sitting in my sales have gone away now and that has been franchised and that has been replaced by royalty income. So in the current quarter, we would have a royalty income roughly about 25 odd crores coming from this new franchise operating model, which corresponds to an NSV of about 142 crores in the last corresponding quarter, which would mean a net impact of 117, which I also explained you the underline. How does this look like as compared to the full year NSV that we would have franchised? For the 13 states that we franchised in the last whole year, we had a corresponding net sales of about 640 odd crores. And that is what will get reflected in the subsequent quarters for a setting as we move forward.

Moderator: Thank you. The next question is from the line of Mehul Desai from IDFC Securities. Please go ahead.

Harit Kapoor: This is Harit from IDFC. Just on the franchising part, you mentioned the value number, the volume impact due to franchising is about 2 million cases in this quarter. So is that also a representative of how it is going to be every quarter in FY 18 or the full impact was not there in Q1?

Sanjeev Churiwala: So the corresponding full year volumes for F17 for the 13 states that we have franchised are about 10 million cases.

Harit Kapoor: Understood. And on the employee cost fund, just had one question. So this 13 crore restructuring cost that you did take, is there more to come in terms of the restructuring impact through the year or are we largely done with the higher restructuring costs?

Anand Kripalu: So one is, restructuring a business like ours is a continuous process and we will strike for continuous improvement. Will there be a big bang restructuring? Again, in the immediate future, no, there is no plan for that. Will there be continuous trimming and tightening which may require some restructuring redundancy costs? Yes, there may well be. Apart from this, in this particular quarter, the number you are talking about includes a significant impact because of factory closures. So one of the things we are going to continuously be doing is to see how many factories we can close which are legacy factories, which are high cost and which are not necessarily strategic from the point of view of a destination footprint. And you must continue to expect that selectively, we would look at exiting certain locations in terms of high cost factory and therefore, the factory closure costs will come into part of the results, but we believe it's the right thing for us to be doing from the point of view of managing the longer term cost of the business.

Harit Kapoor: Understood. One last question was you did mention the sales impact due to franchising. Could you also just give a sense of what the royalty income would be? So this quarter you have done 25 crores. What would be the full year impact?

Sanjeev Churiwala: Yes, so let me give you all the three dimensions. The volume impact for the full year of the last year was about 10 million. I mentioned to you net sales was 650 odd crores, that the royalty depending upon the states and we're also looking at fine-tuning it post the GST, could be anything in the 140 crores to 160 crores.

Moderator: Thank you. The next question is from the line of Ashit Desai from SBICAP Securities. Please go ahead.

Ashit Desai: You talked about some states de-notifying some taxes like entry, OCTROI, LBT. Have you revised prices in these states, so you would rather not change prices and keep these gains with you?

Sanjeev Churiwala: I think it's a combination of various factors, A, we are looking at what does it mean to us. It's state specific when we look at the various input material that we buy in those states, presence of the vendors in those states, our factory footprint in those states, combined to what's happening in terms of the various notification, de-notification happening by the state governments. At the same time, you are also approaching the state governments to look at the price increases. So I think as we speak, there are a lot of moving parts and these moving parts would differ from state to state. Absolutely, wherever we have cost implications, our intention would be to approach the state governments to seek a price increase.

Ashit Desai: Okay, but in states where pricing is controlled and you have seen some reduction in taxes and the government tells you to reduce MRP or it's an increase in your invoice value price?

Sanjeev Churiwala: Again you know from the company perspective, it will be very difficult for us to really look at it as a state grade. We will have to go on a pan-India brand grade because finally what matters is a particular input cost for a particular brand and then just spread it out across various states. So at the moment, we are not really applying a very straight line.

Ashit Desai: And lastly on the franchising part again, are most of the cost rationalized measures post franchising in those specific states already there in this quarter, or you can expect more to come in the coming quarters?

Sanjeev Churiwala: Whatever we could franchise, 13 states the number that I have shared with you, we already franchised. To the extent whatever needs to be done in terms of the reduction on the factory footprints, most of them are already materialized. We might still look at many other states we want to franchise and that all it depends upon the economics in those states, the kind of partners we get. But that's a moving piece again. Our intention is not to stop, to get some more states into that.

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

Jamshed Dadabhoy: Just two quick questions. First is the renovation cycle for most of your key brands, are you behind it now, are you done with it, post Antiquity?

Anand Kripalu: Well, just to be clear, the best way to describe it is the fact that innovation is not a destination, but a journey. So innovation is never quite over, there is renovation and there is innovation. Every brand needs a renovation rhythm, something that we've renovated some years ago created excitement, may become still in a couple of years and will need to be refreshed again. And similarly innovation, which is about new product offers like Captain Morgan Rum, which we announced started extending and making national. So my view is that innovation has to be and renovation has to be a significant long-term sustainable contributor, to our growth aspiration and that's how we are looking at innovation.

Jamshed Dadabhoy: So I guess the question that I was leading up to is that will we see any uptick in A&P spend here as a percent of sales going into the next couple of years, since McDowell's range would have been refurbished meaningfully about two years ago? So if you go one year from now, it will be about three years.

Anand Kripalu: So, I would not do brand by brand, but our intent is depending on how obviously the rest of the P&L shapes up, our intent is to actually inch up our A&P, right, because that's our belief that brands and stronger brands will ultimately drive better growth and better margins for this business. So that is our intent. Now obviously, you have to manage the P&L and see how the other lines play out, but that is our strategic intent.

Jamshed Dadabhoy: Okay. Second question if I may, just housekeeping one. This 25 crores of royalty per quarter which will basically annualize out to about 100 crores, that's sitting right now in your sales line, right? Not in other operating income or anything?

Sanjeev Churiwala: That's absolutely correct.

Moderator: Thank you. We have the next question from the line of Mayur Gathani from OHM Portfolio. Please go ahead.

Mayur Gathani: Sir, just wanted to re-check the royalty income for the year you mentioned will be 140 or it will be 100?

Sanjeev Churiwala: No. I'll just mention again. As you just heard us speaking, for the quarter, the royalty income is 25 crores.

Mayur Gathani: Right sir.

Sanjeev Churiwala: Which is sitting in the NSV line. And of course, this doesn't represent a complete three months royalty because we have started franchising during the quarter. We did some franchising in January ' 17, something in April. We also did some franchising in May and something in June. Our annualized royalty income, as I said, could be in the range of 140 crores to 160 crores.

Mayur Gathani: And sir, a couple of questions on one-off. There was some provisioning of 7 crores and lapping cost. Can you just elaborate a little bit more on this?

Sanjeev Churiwala: Yes, so this was a very small provisioning of 7 crores. This is related to provisioning for receivable from one of our very old outstanding parties. And it is part of our business as usual. This was an old vendor advance that was given, while we are still discussing, negotiating with the vendor for the sake of accounting prudence we are provided for it.

Mayur Gathani: Lapping cost, something was lapping cost mentioned 6 crores.

Sanjeev Churiwala: Yes, so this was basically one off cost that we have incurred in terms of doing some of our consulting and restructuring work that we just spoke about, which is also helping us in terms of improving our overhead.

Mayur Gathani: Okay, and to reiterate that on the staff cost of 13 crores, there were some factory closures also a part of this?

Sanjeev Churiwala: Yes, the 13 crore that you see in the current quarter is largely to do with the factory closures debentures.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Invesco Mutual Fund. Please go ahead.

Nitin Gosar: Sir, my first question was, is there any way to understand how your A&P strategy is divided or split between prestige and popular in terms of percentage?

Anand Kripalu: Yes. So without giving specific on percentage, let me put it this way that on popular, we will spend A&P on retained popular, which are states that are strategic where we are retaining our popular business. By definition, our belief is that success in popular is more to do with cost leadership than with image leadership. And therefore, we would rather keep prices competitive and put smaller amounts into A&P rather then put large amounts into A&P and take the prices up. Okay? So therefore, philosophically, the percentage A&P that we will spend on popular will be much smaller than we would ever spend on P&A. So that's our philosophy.

Nitin Gosar: And another question was with regard to the press note, which talks about the strong performance of Haywards was offset by decline in rest of the brands. Any reason for the strong performance coming in from Haywards brand?

Anand Kripalu: So basically flat or a bit of a softer quarter of the previous year. And I don't know if you remember, but we experimented about a year and half or two years ago almost with taking up prices for Haywards where we expected the rest of the industry will follow. Industry did not follow. We lost market share at that point of time and lost volume. And then it took us many months to get the prices reduced again and get the approvals for them done. And then since then, there has been a kind of recovery trajectory that we have had on Haywards. The good news is that I think we are back on track in terms of market share, but because of that continuously improving trend, we are always lapping a little bit of a softer base.

Nitin Gosar: Okay, got it. Would you mind sharing the market share on Haywards right now?

Anand Kripalu: No, I am not sure we have that because that's corporation data. We don't really look at Nielsen for popular, because it's very inaccurate. So I don't have the numbers offhand really. But it is data that we get from the corporation, so actually it's available to most people.

Nitin Gosar: Right sir.

Moderator: Sure. Thank you very much. Due to time constraints, we will be able to take one last question. We will take the last question from the line of Vivek Maheshwari from CLSA. Please go ahead.

Vivek Maheshwari: Sir, couple of things. On the margin bit, I still don't understand. So what you are saying is the trajectory get impacted because of GST. So are you trying to say the margins that we have today is something that we should be looking for in FY 20 because it takes two years because of GST?

Anand Kripalu: It could happen that way, right. But see, it all depends on what the impact of GST is. Now, what I said is it will take us two years or thereabouts to get back to the original growth trajectory that we have envisaged. So if GST was not there and if we had expected some margin improvement between F18 and F20, then we should be able to compensate for GST and get back to the margin trajectory that we originally had. So that is what we anticipate as of now. But if you hold your horses for just a few weeks, I think things will become a lot clearer on this entire theme.

Vivek Maheshwari: Okay. And second one on Sanjeev, depreciation, the number that you have over here, a decline quarter-on-quarter, is there something that we should model in for rest of the year as well or there is anything because your depreciation moves up and down quite a bit quarter-to-quarter?

Sanjeev Churiwala: Yes, so as a trade, we have been investing 200 crores to 300 crores in CAPEX every year, so we should see a slight increase in the overall depreciation rate, but on a quarter-to-quarter, I think there would be a variation happening, and overall kind of a flattish trajectory that we have been showing so far.

Vivek Maheshwari: No, the reason I'm asking is fourth quarter you had, let's say, 418; this quarter, you had 321 . So there is quite a bit of a drop and before that, third quarter you had around 313. Sorry, if I maybe missing, but fourth was even exception then.

Sanjeev Churiwala: Vivek, maybe we can come back to you on this specific question. Let us look at sequentially last three and four quarters. Many times, the capitalization happening in a particular quarter, many times, we are selling off factories, disposing of assets, which could lead to change in the accounting for us, depreciation as well.

Vivek Maheshwari: I will touch with Richard in that case.

Sanjeev Churiwala: Yes, please.

Anand Kripalu: Okay, folks. It's just after 1 o'clock. I just wanted to thank you for logging in and for your interest and engagement on our performance on United Spirits performance. Look forward to staying in touch and connecting again over the next quarter. Thank you very much.

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