



“United Breweries Limited Q2FY14 Earnings Conference Call”

November 8, 2013



**MANAGEMENT: MR. HENRICUS P. VAN ZON – DIRECTOR & CFO, UNITED BREWERIES.
MR. PA POONACHA – HEAD, FINANCE & ACCOUNTS, UNITED BREWERIES.
MS. SWATI NANGALIA – ANALYST, IDFC SECURITIES LIMITED**

Moderator Ladies and gentlemen, good day and welcome to the United Breweries Limited's Q2-FY14 Earnings Conference Call hosted by IDFC Securities Limited. As a reminder all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand over the conference to Ms. Swati Nangalia of IDFC Securities Limited. Thank you over to you madam.

Swati Nangalia Thank you Bikram. It is a pleasure to welcome you all to the Q2-FY14 Earnings Conference Call of United Breweries. We have with us the senior management team of United Breweries represented by Mr. Hans van Zon – the Chief Financial Officer and Mr. Poonacha, Head of Finance and Accounts. I will hand over the call to Hans for the opening remarks, post which we can move on to the Q&A. Over to you Hans.

Hans van Zon Thank you very much Swati. Ladies & gentlemen welcome all on this Friday afternoon. We have presented our second quarter figures and half year figures yesterday together with a press release and if you look at the quarter 2 in itself then it is clear that we have had a challenging quarter for different reasons of which the important ones are in first instance are not taking it from kind of in sequence of importance but let me do very first which we of course are still influenced or our situation is still influenced by the measures taken in Tamil Nadu which is now one year ago. But it also had effect on our figures in the Q2 of this fiscal year because basically Q2 of last year was more or less the quarter during which this change in policy in Tamil Nadu has been implemented.

Two new additional factors that have been very challenging is in this Q2 as most of you know is the quarter in which in India we have monsoon, monsoon that is always there. This is also why the second quarter is always less kind of big for us compared to the first quarter of the year and for that matter the fourth quarter of the year, the fiscal year I speak about, not a calendar year. And this monsoon this year has been extraordinarily strong in India and not only in terms of its length because it started very well, very much in time and it ended even later than one might say normal. But also in its spread throughout the country it basically hit an influence on all of the states, I think with exception of one or two and also with respect to its intensity. That has had an effect on the industry volume throughout the country in quarter 2 and thus with us representing half of that industry also on our volumes.

Last but not least, specific issue and extraordinary issue introduced already in the course of the first quarter but really kind of having an effect also a complete effect on the figures and the results in the second quarter, the issue of not being able to use returnable bottles in Maharashtra which started basically in May of current year and has been with us until the beginning of October and we are very fortunate we can now kind of inform that this is over, that we have been allowed again to start using returnable bottles which we are doing of course.

And of which the effects we will see come through in the months in front of us because Maharashtra is a big state. The collection process and the usage of the bottles have become too sensitive and we have to kind of get that into process again. In let us say last but not least, still a bit difficult to identify exactly what and how big the effect is but we think that the quarter and the industry was also affected by the loss of momentum in the general economic growth in the Indian economy.

With having introduced that I think these are the major issues for quarter 2. I would like to hand over to Q&A.

Moderator

Thank you sir. Ladies & gentlemen we will now begin the question and answer session. First question comes from the line of Sonali Salgaonkar from Axis Capital. Please go ahead.

Sonali Salgaonkar

My first question is with respect to the volume growth. Now I got the reason why the volumes in Q2 were subdued but just wanted to understand from you what is your near-term outlook on the volume growth going forward from here? Say for FY14 as a whole and FY15, do you expect it to improve?

Hans van Zon

Now as the figures say, as you know and used to we are always very reserved with respect to giving any outlook. The only thing I can say about that is if we look at volume development with respect to Tamil Nadu, of course the first effect of the measures taken for us as UBL will not be relevant anymore in the comparison of the figures of the future quarters than the quarters of a year before that because we have lived through all the cycle of one year now, that is one. And secondly I can say we would not have a monsoon anymore in the second quarter and the last one of this fiscal year, the next one will be next year and it is also a good or a bad monsoon cannot hurt us anymore in the coming half year. So with that in order coming three quarters of a year. With respect to the economy and the effect of the economy, first of all the state of the economy and how the economy will further develop into the months to come is for us difficult to say as also in general if you read the newspapers there are different kind of views on that. So it's difficult to comment and in second place what kind of effect that will have on our sales is also still difficult to predict. So there is an issue which we have to just kind of narrowly follow and basically the last thing I think what one can add I think we should take into consideration also that let us say election one can say season starts in India I think we have local elections in some four states coming in November and then after that in the new calendar year we will have, we will start living up to the general national elections for a couple of months later. What the effect of that will be is also still unclear but as you know there is specific kind of regulations in different states, different year round the elections which have a new influence on the availability of alcoholic beverages and there is also on the availability of Beer.

Sonali Salgaonkar

Okay. Sir my second question is pertaining to the cost front, now that the issue of bottles has been resolved in Maharashtra, how do you expect the packaging cost as a whole for the

company to go on from here onwards? Do you expect any rationalization in the same or do you expect it to be around stable or increased from the current levels?

Hans van Zon No, we will certainly be benefiting from the fact that we can again start using returnable bottles in Maharashtra or that we did start using returnable bottles in Maharashtra, so then it goes certainly a kind of very positive effect of our input costs. On the other side we have to kind of normal where one can stay inflationary effects on the input side of the business in which may be one should mention in particular with the fact that our “cans” have become a little bit more expensive with devaluation or the substantial devaluation of the rupee, what it is by now two months ago.

Sonali Salgaonkar Sir and what about the raw material cost because in the conference call you had mentioned that almost 70% to 80% of barley has already been procured, so do you expect the inflation to increase the raw material cost as well going on for year for the rest 20% of barley?

Hans van Zon No, not for this, for the rest of this fiscal year.

Sonali Salgaonkar Alright. Sir and my last question would be pertaining to the balance sheet. Now I can see from your half yearly balance sheet that there has been some rationalization in short term borrowings, trade payables etc. So just wanted to understand would we see an improvement in a working capital cycle going on from here or would it be stable or may be increased from current levels?

Hans van Zon We always aim for improvements, but so far I would rather expect it to remain stable.

Moderator Our next question comes from the line of Jasdeep Walia of Kotak Securities. Please go ahead.

Jasdeep Walia Sir in your press release you have mentioned that your EBITDA has been impacted due to some aberration in input cost. Could you elaborate on that front sir?

Hans van Zon Aberration in input cost is basically the whole issue in Maharashtra, with the non-ability to use returnable bottles.

Jasdeep Walia Sir as I recall in the first quarter’s call you had said that though state profitability in Maharashtra would be impacted on account of this change in bottling policy, but you would be able to use second hand bottles in a higher proportion in other states. So on the whole company would not be impacted in a major manner because of the change in bottling policy in Maharashtra.

Hans van Zon I would have hoped that it would have been that simple. It is not. Of course we have tried to do everything possible to kind of decrease the negative effect of this as much as possible. So we did use the bottles that we have collected in Maharashtra, also in other states but that of

course does not come without a cost because you have a longer way to transport and so on and so forth and you might not be required to use exactly the bottles that have collected in Maharashtra but the figure that we have mentioned in the press release which is exceptional, is also the figure of let us say the cost after kind of putting in all measures possible to keep them as limited as possible.

Jasdeep Walia

Could you quantify the impact?

Hans van Zon

The 46 crores that were mentioned in the press release.

P.A. Poonacha

What is it that you are looking for Jasdeep?

Jasdeep Walia

Sir you just explain that how the change in bottling policy in Maharashtra impacted your profits. So I just wanted you to quantify that if it is possible.

P.A. Poonacha

See therefore we have quantified, 46 crores is the impact after taking managerial action of reducing the impact.

Jasdeep Walia

Got it. And any price increases achieved during the quarter?

P.A. Poonacha

Price increase in revenue unit?

Jasdeep Walia

No, in various states, were you able to take price increases?

P.A. Poonacha

Yeah, that we did in the first quarter itself.

Jasdeep Walia

And what is the gross debt number?

P.A. Poonacha

Gross debt about 950 crores.

Jasdeep Walia

And what is the reason of sequential increase in employee cost during the quarter?

P.A. Poonacha

Employee costs have gone up on account of a one-time bonus payout, annual bonus payout and on account of us taking gratuity provision because of a change in actuarial valuation based on the latest estimates of the funds, rate of income, coming below what it was previously.

Jasdeep Walia

So the run rate of employee cost for the remaining year will be as per the number in first quarter?

P.A. Poonacha

First quarter plus annual increments. The second quarter includes annual increments, one-time payout and a provision towards this enhanced gratuity. So you can take the previous year's increased percentage for the first quarter and then get your number.

Moderator Our next question is from the line of Avi Mehta from IIFL. Please go ahead.

Avi Mehta What is the volume growth ex-TN? Would you be able to share that?

P.A. Poonacha Are you talking about the quarter or are you talking about the half year?

Avi Mehta If you could give both because for the quarter I do not have the full number but I have for the first half minus 2%.

P.A. Poonacha Quarter will be difficult. Without Tamil Nadu it is +3.

Avi Mehta Plus three for the first half, right sir?

P.A. Poonacha Yeah

Avi Mehta And sir what would be the price hike on a YoY basis on a per bottle basis? Would you be able to guide us on that?

P.A. Poonacha We do not reveal what is the average price increase.

Hans van Zon That is also quite complicated because the price increases they happen in all states at different moments. They can be different for different products and it is a very mixed bag of all the states together so that is not a kind of easy to get.

Avi Mehta The reason may be you could give a qualitative comment or at least help me, because what I was trying to get to is the price hike.

P.A. Poonacha If you go to volume movement you will get the price hike from the financial results.

Avi Mehta No but the only reason why I was not doing that is because there would be an excise duty change as well which is why excise duty hike is there.

P.A. Poonacha Yeah financials in the clause 41 format is excluding excise.

Avi Mehta But sir you have tie up also, so in that case would you be able to say what is the growth in gross sales?

P.A. Poonacha What you will get there is about 95% accuracy, so I do not think it is a problem.

Avi Mehta Okay, so there is not much. And sir this Maharashtra excise notification, when exactly was it implemented? Was it there for the entire first quarter or was it there for part of the 1st quarter.

P.A. Poonacha Part of the first quarter and the entire second quarter.

- Avi Mehta** So probably half of the first quarter on a rule of thumb basis. Okay sir, because I just wanted to get an impact in that sense. Sir lastly on the sales promotion, what we see specifically on the promotions is on a YoY growth basis, there has been almost an 18% growth. Now this you have done I am assuming, given the fact that there has been a week sales in the raw material, we are trying to push sales. Now I just wanted to understand how easy with this kind of reduce this or do you think in this current environment it will be very difficult to reduce this? Because the base becomes less favorable going forward.
- P.A. Poonacha** I will take this question in a different manner. We are not trying to push sales. Majority of increase have come on brand building other than discounting. So if you see we have maintained 50% market share without having a great market share in Tamil Nadu for the reasons explained and with the competitive action with international brands like Budweiser, Carlsberg, Tuborg, doing whatever they are doing. So it is that we believe that just because the quarter is difficult that we would not stop in investing in our brands. And we have done exactly what a business needs to do looking at long term prospects of maintaining or growing our market share.
- Avi Mehta** Sir just one last question, would you be able to share the excise duty change on a YoY basis or no, even that is something that you would not have off hand?
- Hans van Zon** Also that is very different per state.
- Moderator** Our next question from the line of Prashant K from Emkay Global. Please go ahead.
- Pritesh Chheda** Sir just your comments on the market share, actually I missed it so, what is the market share and the changes if any?
- P.A. Poonacha** Market share is stable at 50%.
- Pritesh Chheda** And the press release gives out H114 volume slightly less than 2% type sequential. So it is basically 2% volume decline for H1?
- P.A. Poonacha** Perfect.
- Moderator** We have the next question from the line of Binoy Jariwala from Sunidhi Securities. Please go ahead.
- Binoy Jariwala** Just wanted to understand how is the industry volume growth for the state of Tamil Nadu and secondly if I have to look at our market share in Tamil Nadu, say about 2 years back versus today how does it look like?

- P.A. Poonacha** Market share 2 years back was 70%, now it is only 30% and the volumes in the current half year have de-grown by 15-16%.
- Hans van Zon** So what is not good to see is what we see and notice is that the whole change in the policy in Tamil Nadu is clearly showing or is clearly having a negative effect on the industry development. So where a kind of brand loyal customers to us will not be able because of this measure to find their products at the end of the month any more in the stores, it is not a given that they buy the competitor's brands. I do not know what they buy or if they stop buying but we now know that the whole measure has started to have a negative effect on the development of the total market in Tamil Nadu.
- Binoy Jariwala** So if I am understanding it correctly, the overall volume growth industry in the State of Tamil Nadu was (-15%)?
- Hans van Zon** I think so yeah, we do not know exactly.
- P.A. Poonacha** For the half year, I will give you the exact number. For the half year it is 24% in Tamil Nadu.
- Binoy Jariwala** And how did we fair in terms of volumes?
- P.A. Poonacha** We would have got less than that because we have lost market share vis-à-vis the last year half quarter.
- Binoy Jariwala** Okay, so in such a hazy environment, how do you see clarity coming through? First of all, do you see clarity coming through in the near future or it is completely still hazy?
- P.A. Poonacha** At this point in time there are no indications of such a thing.
- Moderator** Our next question is from the line of Ashish Kalra from IDFC. Please go ahead.
- Ashish Kalra** Well I guess one of the reasons beer can be a lot less expensive here in India is because of the taxation structure where it is based on volume rather than alcohol content. And basically I think just from sort of strategic perspective one of the things may be is to actually look at how we can sort of help drive changes in the taxation structure to reduce the price of beer which will increase demand exponentially. So are there things that the company is doing from a medium to long-term perspective?
- Hans van Zon** Of course, we are always trying to when we speak with government to kind of build our case for beer in particularly also for beer over spirits wherein it is clear that the effect of drinking beer is a different one of drinking spirits and then it is also a far more healthier drink in that sense. So yes, we do but that as we continuously do lobby for our industry that has of course if it has any a long term effect.

- Moderator:** Our next question is from the line of Mr. Ashit Desai from B&K Securities. Please go ahead.
- Ashit Desai** Sir just one question on your volumes again, if I see your statements volume decline of 2% for the first half, is it right to say that the volume decline in this quarter would be more than 5%-6%?
- Hans van Zon** Yeah, we reported an increase of 1.5% in the first quarter bearing in mind that the first quarter in itself is bigger than the second. You are right.
- Ashit Desai** And secondly, I mean if I look at your base quarter, second quarter last year you have already had the negative impact of Tamil Nadu and on top of that flat volumes in Andhra Pradesh. So besides the Tamil Nadu scenario which is driving a volume decline, any other states you see having similar problems where volumes have declined or something?
- Hans van Zon** Yeah, what we see is that at this point in time Maharashtra was very severely hit by the monsoon and it looks as if also the economy or the loss of the momentum in economy is playing an extra role there. In addition to that we had an excise duty increase and with this also an increase in the MRP.
- P.A. Poonacha** Strong beer constitutes up to 85% of beer consumption in Maharashtra and the MRP on premium strong has gone up by 12% and on economy strong it went up by 25%. We have brands like London Pilsner Strong, one of the strong brands. We have the retail price of these economy strong brands have gone up by 25% as against premium strong beers like KF Strong it has gone up by 11-12%.
- Ashit Desai** Okay. And this excise was affected this quarter?
- P.A. Poonacha** No, even the first quarter but the effect of second quarter was higher because of the effect of monsoons and of course you need to add that to the economy. But when you compare this with the last year second quarter, it is a significant impact because the last year second quarter did not have such an impact.
- Ashit Desai** Can you quantify the impact on volumes?
- P.A. Poonacha** Volumes are high but the industry degrew by 24% in the quarter in Maharashtra and we degrew by only 20%. We have gained market share in Maharashtra.
- Ashit Desai** And could you also give any color on Andhra Pradesh volumes?
- P.A. Poonacha** Andhra volumes industry has degrown in the quarter but in the half year there has been growth. We have grown ahead of industry. We have gained market share. We are close to 50% in Andhra Pradesh.

- Ashit Desai** Okay. So in your last concall I believe you had shown some positive signs of volumes improving because Tamil Nadu was coming into base from this quarter.
- P.A. Poonacha** This quarter meaning I am talking only of the Tamil Nadu base effect will go hopefully in the third quarter only, because it was only in September 2012 it came in. So the quarter base effect is there.
- Ashit Desai** Okay. And any change in the industry competitive activity or promotional discounting spends that you have seen?
- Hans van Zon** We are seeing of course competition is very active. To kind of point at something specific we would not be able to do.
- Ashit Desai** Sorry, I could not get you.
- P.A. Poonacha** What is the information you are looking for?
- Ashit Desai** I wanted to know if any increase in promotional or discounting activity of late that is same.
- P.A. Poonacha** No, we do not drive our volumes by discounting, that you well know. We prefer to do brand building than to do discounting.
- Ashit Desai** No, I am asking for the industry.
- P.A. Poonacha** Industry, we do not keep track what are the discounting that the brands are doing currently?
- Moderator** Our next question is from the line of Mr. Arjun Khanna from Principal Mutual Fund. Please go ahead.
- Arjun Khanna** First question is in the terms of the growth phase in terms of volumes how has it been between mild beer versus strong beer?
- Hans van Zon** Same as always.
- P.A. Poonacha** They fairly do not change.
- Arjun Khanna** Does the mix remain the same?
- P.A. Poonacha** It fairly do not change very much.
- Arjun Khanna** And sir just to understand the profitability, would the margins differ between the two?
- P.A. Poonacha** No, they are similar in the markets where they are sold.

- Arjun Khanna** And the evolution of the market given that strong beer is roughly more than 80% of the market, do you see mild beer growing from here or how do you see this mix going forward?
- Hans van Zon** I think if you look at let us say the mix going forward, it is difficult to predict or to project 80% or they had the strong shares already extremely high. If you look at the volumes themselves we think that the mild segment will show growth and I am now talking about mid-term. And the strong beer segment will show growth and probably the strong beer segment will show a higher growth in the mild beer.
- Arjun Khanna** Why is this because globally you see mild beer is the dominant segment or the predominant segment, why is it that in India the evolution has actually shifted so strongly versus strong beer?
- Hans van Zon** Well, there are different kinds of thoughts about it. One of them is that as Indian drinker is also certainly a spirits drinker and may be one could say from origin he is used to a stronger taste. That is certainly one of the theories behind it.
- Moderator** We have the next question from the line of Bhadresh Shah from A M Capital. Please go ahead.
- Bhadresh Shah** I understand from your press release that the impact of new bottles in the first half was Rs. 46 crores. Could you quantify what was your impact in Q2 specifically?
- P.A. Poonacha** No, from that you can derive what the Q1 quarter would have been. The reason why we have not chosen to publish the same in the Q1 was that we were in touch with the state government officials with respect to getting the notification through and hence until such time that the reversal came we did not want to quantify the number.
- Bhadresh Shah** And now the directive has been reversed, so we will go back to the earlier release of being able to use a returned bottle about it?
- P.A. Poonacha** Yes.
- Bhadresh Shah** And when we want this exactly done in the month of October, start of October or -
- P.A. Poonacha** Mid-October.
- Bhadresh Shah** Any outlook on CAPEX going forward in rest of FY15 next year?
- P.A. Poonacha** We normally do not give outlook but, we will not be in line with what was there last year.
- Bhadresh Shah** Okay. Will it be lower?

- Hans van Zon** Let us say that of course the main part of our investments are related to capacity development. We see changes in the market. At this point of time we are confronted with that. We do not know exactly what it will be in the period to come, so we do not invest any money in either capacity so we will hold our horses there until we see new requirements and opportunities come along.
- Moderator** We have the next question from Swati Nangalia from IDFC. Please go ahead.
- Swati Nangalia** I just had one question which is more of a longer term perspective on the industry. If we look at the global markets, beer companies have been more profitable than liquor companies in their respective geographies. But in India we do see the trend being reverse. And this is when liquor and beer companies are operating in the same regulatory environment where distribution and pricing is majorly controlled. So, do you see the Indian market over the longer term reverting to the global trends and what could drive that?
- Hans van Zon** I am not sure, you are mentioning this. I am not sure but I also do not say it is not true that in most markets beer industry is more profitable than the liquor industry. Not sure about that and I would also be inclined to doubt if this is the case. How do we see that develop? I think that the social demographic trends would be skewed a little bit more in the direction of beer. It depends, however, very much on how and which kind of speed and speed is may be the wrong word. How long it takes for the governments, the specific local governments kind of to gradually change their policy in the direction of levying relatively spoken less tax on beer than on spirits. That will play an important role I presume.
- Moderator** We have the next question from the line of Jasdeep Walia of Kotak Securities. Please go ahead.
- Jasdeep Walia** Sir what has been the volume trend in Karnataka? I am interested because I believe the excise duties will increase on liquor but not on beer in Karnataka in August. So what has been the impact on that?
- Hans van Zon** All impact has been positive.
- Jasdeep Walia** But could you quantify on a YoY basis?
- Hans van Zon** No, we normally do not do that.
- P.A. Poonacha** Yeah we normally do not, but it is in high-single digits.
- Jasdeep Walia** So has the impact of increasing duties on liquor, has that boosted consumption of beer in Karnataka?

- P.A. Poonacha** I think that is the question one could only answer if one would know the effect on liquor and that I cannot comment on that.
- Jasdeep Walia** Just wanted to clarify this 46 crore impact on account of change in bottling policy in Maharashtra was for the first half.
- P.A. Poonacha** Yes.
- Jasdeep Walia** And I did not get your comments on CAPEX clearly, could you repeat them?
- Hans van Zon** No, you ask me in particular what you want to know please.
- Jasdeep Walia** Sir I did not get your comments. I heard Mr. Poonacha saying that the CAPEX will be similar to last year.
- P.A. Poonacha** Yeah, the CAPEX outflow will not be in line with what it was in the last financial year.
- Hans van Zon** Yeah, and basically what I added to that is that of course our main part of the investments are related to capacity extension and that we are of course always very careful with spending our money and that we do only kind of invest when there is really kind of market opportunities for it which one can say state of the market is at this point in time, we do not short-term see any requirement to extend our capacity. We will of course proceed with our investment activities in Bihar so that will require a certain amount of money but it will so far as we can see this point in time not be in the extent of what we have spent over the previous two years.
- Jasdeep Walia** Sir there has been a significant change of stance with respect to CAPEX. I believe in the previous quarter you always had held to this view that you will always invest in India based on your long term growth of 15% in volumes. It seems like in this quarter that has changed.
- Hans van Zon** No, it has not changed. Basically what I said it is not a question of do we invest because we are very much prepared and we will certainly invest following the market opportunities but we also do a lot of fine tuning in that sense which means that we try to invest at a right place and at the right point in time.
- Moderator** Ladies & gentlemen that was the last question. I would now like to hand over the floor back to Ms. Swati Nangalia of IDFC Securities for closing comments. Over to madam.
- Swati Nangalia** Thank you Bikram. I would like to thank Hans and Poonacha for removing time for this call. Also thanks to all the participants for joining in today. Hans, would you like to make any closing comments?
- Hans van Zon** Yes. Thank you all for listening in, for the interest in our company. I think as a conclusion we had a very challenging quarter behind us. We think that this year will be a challenging one,

amongst others already said economy, elections, etc. We will do our very best as always to make the very best out of it. However we cannot complete the influence our environment or have to see how that develops into the coming half year. Thank you.

Swati Nangalia

Thank you Hans. Thank you Poonacha.

P.A. Poonacha

Thank you.

Moderator

Thank you madam. On behalf of IDFC Securities Limited, that concludes this conference. Thanks for joining us. You may now disconnect your lines.