"United Breweries Q1FY13 Earnings Conference Call"

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MODERATOR:	**MS. SWATI NANGALIA – ANALYST, IDFC SECURITIES LIMITED**

Moderator Ladies and gentlemen, good day and welcome to the Q1FY13 Earnings Conference Call of United Breweries hosted by IDFC Securities Limited. As a reminder, for the duration of the conference, all participants' lines are in a 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 this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Ms. Swati Nangalia. Thank you. And over to you, ma'am.

Swati Nangalia: It is a pleasure to welcome you all to the Q1 FY13 earnings conference call of United Breweries. Today, we have with us representing the management team, Mr. Guido de Boer – the Chief Financial Officer and Mr. P.A. Poonacha from Investor Relations. I would hand over the call to Guido for the opening remarks, post which we can move on to the Q&A.

Guido de Boer: Thank you, Swati for hosting the investor call out of New York. Starting off with the results for the first quarter of fiscal 2013, on volumes, UBL achieved the volume of 45 million cases in the quarter against 39 million cases the corresponding quarter in the previous year, so a growth of 40%. A very good news and showing strong acceleration versus the growth of 6% in Q4 of FY12.

During the quarter the industry registered a growth of around 20% and UBL's growth was curtailed by a change in ordering policies in Tamil Nadu and Andhra Pradesh and I will go into that a little bit more later on the call. And excluding those markets, the industry grew by about 13% and UBL by 15%, still outgrowing the market there.

If you look on market share including Tamil Nadu and Andhra Pradesh, our share was down by about 3% and excluding those markets our market share was up 1% versus last year. And the positive on is that A.P. and Tamil Nadu are amongst the lowest profit markets while the high profit market states have shown a very good growth.

If we move to state-by-state analysis, we had double-digit growth in 12 out of our 15 largest markets with 7 markets even growing in excess of 20% which evidences that the growth was consistent across the country and not just one or two markets growing well. In the north, star performance was by Rajasthan and Uttar Pradesh, both growing by almost 20%. The other main market, Delhi was flat, like it was in previous quarters. If we move to the east, West Bengal showed excellent performance growing by more than 30% in Q1, largely reversing the decline in volumes that was witnessed in the previous year which witnessed a steep in increase in taxes and disruptions in supplies on account of election in the state in that quarter. So the low base and consumer acceptance of increase in duties has resulted in high growth. Orissa declined by about 7% in the quarter, largely on account of competitive gains largely due to our new canning line is still waiting approval and the demand for 'can' volumes could not be fully met. The other key state was Bihar where we grew more than 115% mainly due to restricted supplies last year, you might remember in the first quarter on account of differences with State Beverage Corporations on price increases.

Moving to the west, the markets posted impressive growth of 17% in Q1 fueled by growth of over 20% in Maharashtra where the market is now back to growth after the duty increases in Q1 of last year. If we move south, the important market of Karnataka grew by 10% in Q1 notwithstanding supply constraints in the peak season. Kerala was up by about 19% while in Andhra Pradesh, like mentioned earlier the ordering policy changed in September 2011 and therefore our volumes in Q1 was affected by the high base we had in the previous year. But still we were able to achieve a very healthy increase in volumes of more than 20%, largely due to government action enforcing retail sales at MRP which is really driving a step change in the size of the industry. So there the market grew extremely fast and a 20% growth meant that we maintained the market share of Q4 of the last fiscal. On Tamil Nadu, our volumes were flat as ordering by TASMAC, the State Beverage Corporation has now not gone on market demand, it has allocated large volumes to new breweries that have come in the State and this has significantly affected our market share which is expected to continue in the coming quarters. Especially in Q2, the volume impact will be seen as the general overstocks with new brands from those breweries are not selling on their own while our brands are largely out of stock. So, we hope that will reverse but for now there is not much clarity on that yet.

So moving to net sales revenue, net sales revenue for the quarter was 1226 crores versus 953 crores in the previous year, up 29% that is split between volume growth of 14%, price mix increase of about 4% and that has made it 11% on account of consolidation which has come in period after Q1 last year.

So we move to cost of goods, variable cost for the quarter were at 43.5% of net sales versus 49.4% in the last year, resulting in a drop of almost 6%. This is largely on account of lower intercompany purchases which includes an element of excise duty, due to the merger of the various companies. So, it therefore makes more sense to compare the full year ended March 2012 where the variable costs were at 44.9% of sales which is comparable to that of the current quarter, both these results include the result of the amalgamated entities. The impact of the merger will be seen in the next quarter also, so for comparison it is advisable to take the full year results of the previous year for an insight on margins. So if we do that you see a reduction of variable cost by about 140 basis points which is like-for-like improvement.

If we move into the different cost items, Malt, one of our key costs was up due to higher barley prices and what we are currently consuming is the stock of last year, low growth in the previous year resulted in malt stock at the start of the current fiscal. Currently, we are procuring the remaining requirements for the year and during the Q2 results we will be able to inform you on the barley procurement cost for the year. The key driver for our improvement in variable costs is there UB logo bottles and it continues to help us to offset to very large extent, the other input price increases and the total increase on a per case basis is significantly below inflation.

Moving to fixed costs, our staff cost during the quarter was almost Rs. 49 crores compared to Rs. 32 crores in the previous year. A large extent of this is on account of the consolidation of the various entities and obviously, some salary increases and addition of manpower as well.

On advertising and sales promotion, that was 16.7% of NSR for the quarter as compared to 17% in the previous year. If you look at the full year FY12 it was also 16.7%, so broadly in line with previous comparatives.

Selling and distribution charges are up partly because of consolidations and also because of higher freight rates and halting charges.

That brings us to EBITDA at Rs. 204 crores for the quarter compared to Rs. 153 crores in the previous year, being 33% increase for the period.

If you look at the numbers they are not fully comparable because of consolidation. We estimate that the impact of consolidations would be about 22 crores so that would be like for like EBITDA of about 182 crores for the period.

Moving to interest cost, for the quarter we had an interest charge of 19 crores compared to 24 crores previous year. This is a result of higher interest from consolidations more than offset by lower interest expense from repaying expensive loans and also strong cash flows for the quarter.

So this results in a profit after tax of 99 crores. Unfortunately, we did not touch the 100 crores but I am sure we will do that next year quite comfortably, but still up 39% from the 71 crores in the previous year.

And the other good news is that our current tax payable was only Rs. 30 crores which is lower than last year's current tax payable due to the utilization of tax losses that were available as well as higher tax depreciation on our capital expense. So, this has driven very healthy operating cash flow for the period.

Moving to balance sheet – our ongoing expansion plan is well on track. The Greenfield in Nanjangud commences commercial production in this quarter and also the land acquisition for the Greenfield in Bihar is in its final stages. And apart from these Greenfield investments we are doing a number of Brownfield as well. The major one there would be in Aurangabad which we expect to complete ahead of the season. It you look at our overall expansion plan we are expecting to invest 1000 crores in the next three to four years to cater for the growth in the market.

On mergers we completed operating entities by March end 2012 and now we are only awaiting shareholder and regulatory approval for the merger of SNIPL which is just a holding company with no material P&L effect, and that merger would be with the effective date of 1st of April 2012**.**

The net debt of UBL – so that is including preference shares stands at Rs. 857 crores as of June '12 as against Rs. 942 crores in March and Rs. 886 crores in the corresponding quarter of last year. We have now received almost all the amounts advance to Star as well as the interest and during the first quarter interest accrued and part of the principal amounting to 112 crores was received and further 103 crores has been received in Q2 and the amounts have been deployed to reduce our working capital borrowings going forward.

So that is the highlights of this quarter and now we can open the floor to any questions you might have.

Moderator Thank you. We will now begin the question-and-answer session. The first question is from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy My question is on Delhi, specifically you said volumes continue to remain flat. So, wanted to understand when we will get growth back there? Second is on the broader growth, how much was the benefit from monsoon deficit because higher the temperature is obviously conducive to our sales so from the next nine months perspective, any numbers you can share on expected volume growth?

Guido de Boer Delhi, the performance has been a bit lackluster, actually the last quarter. We do not see really much sign of improvement. It would be likely single digit growth for the industry. On monsoon, I do not think that it will be making a very material impact. There is a little bit of low base bad summer of last year but now in the off-season still when temperatures are coming down now we do not expect major impact. I think if you look at the growth now has been a spurt to large extent by Andhra Pradesh, the industry we expect would be stabilizing and in Tamil Nadu also; we do not expect the industry growth there to continue. So, I think the 20% growth of the industry seen in Q1 does not seem that will continue throughout the year, as the growth is largely attributable to a low base. But still, it is an upward sign in growth compared to what we had in the previous year.

Abneesh Roy When does base effect catch up in Delhi and Andhra if you could give us more color, what is the current market share and why you feel that now it should stabilize in terms of your market share?

Guido de Boer If you look in Andhra historically, we used to have 30% market share, then when the ordering policy change some years ago we went up to 60% which we had until September last year when the policy was changed and then we reversed to a more natural level, somewhere below

50%, which started in September and our share tapered off from September say to November or so. So this base impact we will be seeing till November. I assume and from November onwards our markets will be more or less stable.

Abneesh Roy And when does base effect catch up in Delhi?

Guido de Boer Delhi the impact was largely because of that summer last year and also the duty increases starting with the Commonwealth Games. There it is more a function of how people respond to the economic situation. So there I do not see any near-term catalyst for improvement.

Abneesh Roy If you see in the rest of the discretionary spends modern retail, jewelry, paints and many other food categories also, in Q1 we saw a fair bit of slowdown happening and also if you see the spirit companies they have reported very muted volume growth and they have also been suffering the same state level issues. So, what is the difference apart from the seasonality temperatures related, are you also seeing signs of down trading within your own volumes and why is this difference between your growth and spirit industry growth?

Guido de Boer I think , because their season is when it gets colder and our season is when it is warmer. So an impact for spirits are probably be seen later than ours. And down trading we have not seen very major impact. In the beer industry the price-sensitivity is probably a little bit less because it is relative expensive form of alcohol anyway.

Abneesh Roy My last question is on your Premium product which was launched a few quarters back. What is the update on that?

Guido de Boer Our two premium brands in the portfolio; Heineken and Ultra are both performing very well. We are rolling out Ultra now to a number of additional markets and especially the new tetra, can that we have launched is getting a great reception and is driving for the share gains in the Super Premium segment. Having said that the Super Premium segment is a sub-segment of the mild beer market which is only 20% so, Super Premium is probably 10% of that. So it is only 2% of the market that was Super Premium.

Moderator Thank you. The next question is from the line of Ashit Desai from Batliwala & Karani Securities. Please go ahead.

Ashit Desai Just a little bit confused on the mild beer number. We earlier used to see lower digit growth rates in mild beer and much higher growth numbers in Strong Beer. But of late why is this segment declining and 9% rate seems a bit higher? Is there any specific market impact on these numbers?

Guido de Boer There is a number of factors that played. One, that you are seeing an increase this year. So last year Mild Beer was growing but still slower than Strong Beer. But if you look in previous years Mild Beer had similar rates of decline. What plays also here is the healthy growth in the northern markets which the higher proportion of Strong Beer. So, the state mix has a bit of an impact but apart from that it is a trend that we have seen basically over the last five years happening already.

Ashit Desai But we have been launching new super premium brands which are in the Mild segment. Your competitors are also launching new brands which are in the Mild segment. But this segment does not seem to be growing?

Guido de Boer No, it is a high value segment which is very valuable for brand building and it is more profitable but it is again still relatively smaller segment of the market.

Ashit Desai What will be your mix in Strong and Mild now?

Guido de Boer It would be about 80/20.

Ashit Desai That is the same as market?

Guido de Boer Yes, the more down market regional players are probably fully strong so we will have our share in mild beer is a bit higher. So, we have a little bit more mild beer than industry, but in the end we are half of the industry, so, we count that much of.

Ashit Desai But it is not that we are losing more market share in mild than the southern markets of Tamil Nadu and Andhra Pradesh?

Guido de Boer Absolutely not. In Tamil Nadu it is just based on 1-odd percentages and there is no difference between mild or strong share developments.

Ashit Desai Lastly, I missed your comments on Andhra Pradesh. If you could give us the market share and growth numbers over there?

Guido de Boer In Andhra Pradesh the market grew by a bit over 20% and we grew by about 20%.

Ashit Desai And your market share?

Guido de Boer The market share is still slightly below 50% where last year it was slightly below 60%. And therefore, in Q2 also you will still see this because of the high base.

Ashit Desai So this has been a similar level from November as you said?

Guido de Boer Yes, from November we have been very stable in the market.

Moderator Thank you. We have a follow-up question from the line of Abneesh Roy from Edelweiss. Please go ahead.

Abneesh Roy Coming back to Andhra, we have seen flip-flop happened now almost every two, three years. Will it be fair to say that in the next one year it will be again back to our favor? Are you working on those lines?

Guido de Boer If I would have a crystal ball then I would be able to tell you but I cannot look into the minds of the government and predict that. I would not know.

Abneesh Roy And what is really happening in Tamil Nadu market wanted to understand? You spoke on that TASMAC but where exactly is the market share shifting, some insight into that?

Guido de Boer Two years ago, six new breweries received their license, which have now come into operation and those are breweries which do not have established brands, but now with this new policy there is scope for them to sell on their own. So the government has decided to award them certain volumes which they get allocated in orders and that basically do not reflect the market demands.

Abneesh Roy On the margins if you could give us more color, raw materials side there could be pressure going forward. So wanted to understand in terms of price hike, are there any more states left where you can get price hikes and where do you see margins stabilizing in the coming quarters?

Guido de Boer On price increases we are still working on the few states and we will update you on that when we can. On cost of goods sold, the barley cost I can inform you on that when we publish the Q2 results, apart from that there is some impact obviously from the exchange rate movement for any materials that have a dollar-related impact, like for example, new bottles & cans, but the benefits coming out of the old bottle projects are largely offsetting all those increases. So, we expect an increase in cost of goods sold which will be comfortably below inflation.

Abneesh Roy And the bottling project, all the positives are there in the margins or is there something more available there?

Guido de Boer What you see having appeared in this quarter will continue for the rest of the year as now all the major markets have the logo bottles in place and so there is price impact of lowering of the procurement cost of bottles. In addition we are now able to continue to reduce the percentage of new bottle injection. So, a combination of this will continue to deliver benefits in this fiscal.

Abneesh Roy And recently this media news flow was there that in Goa, the government is planning to ban tetra pack and pet bottle related sale. So, do we have exposure to that sales in Goa?

Guido de Boer No, we do not. We just have a glass and can.

Abneesh Roy And nowhere in country we have this pet?

Guido de Boer Some of our competitors do but we do not do that.

Abneesh Roy What is the reason? Is there any degradation in the quality or is it brand perception wise, what is the reason because it makes huge sense from affordability point of view?

Guido de Boer For us if you see the cost of recycled bottles it is first choice to pack beer and it is also the best way that beer should be in packed, i.e. in a glass bottle.

Abneesh Roy I was saying more from maybe the price point perspective or the image perspective pet bottle, maybe even the youngsters, I do not know in beer I do not know how much it applies but since some of your smaller competitors are doing. What are they seeing what we are missing, so wanted some insights into that?

Guido de Boer There is one is there is quality issue with PET in a sense that it is the shelf life is generally lower. So that is why we have not chosen to go that way.

Moderator Thank you. We have a next follow-up question from the line of Ashit Desai from Batliwala & Karani Securities. Please go ahead.

Ashit Desai Can you quantify the difference in bottle prices compared to last year, what has been the decline in your average bottle prices?

Guido de Boer So you need to split basically between old bottles and new bottles?

Ashit Desai Yes.

Guido de Boer And then also within that you need to look at the percentage of new bottles that we have used in that period. So, in a few markets we have still added the new bottle initiatives and we reduced the old bottle price from Rs. 3.5 to around Rs. 3.25 but in some markets the prices have gone up. So, on average, the old bottle price is at a similar level, but the percentage of new bottle injection which was around 25% before has now dropped significantly. So that is where this year the benefit is really coming from. The new bottle prices actually have gone up by around 10%.

Ashit Desai And this 25% new bottle mix would have dropped down to what levels?

Guido de Boer That we would not disclose, but it is a significant decrease.

Ashit Desai I believe there has been a price hike in Kerala. If you can quantify how much is that?

Guido de Boer There was only price increase for spirits in Kerala. Often they alternate it, one year they do spirits and then probably next year the beer industry will get a price hike. This year we did not get a price increase in Kerala.

Ashit Desai And are we expecting something in Andhra Pradesh or also you see this alternate process?

Guido de Boer I wish it would be alternate. There only every few years we get a price increase. We do not know. For now we have not seen any price increase. The government might still consider it.

Moderator Thank you. We have a next question from the line of Pankaj Chopra from Shanti Asset Management. Please go ahead.

Pankaj Chopra: I missed the first bit about the top-line growth. Could you give us the breakup in volumes and price on a like-to-like basis? How does that stack up?

Guido de Boer On a like-to-like basis 14% is group's volumes and price mix is around 4%.

Pankaj Chopra So that is about 18% on a like-to-like basis…?

Guido de Boer That is right.

Pankaj Chopra And this 14% as you gave us a sense of various states doing what they are. So, is that the market growth estimates for the next couple of years or do you think there was an extra one-off this time driven by hard because of temperatures, etc.?

Guido de Boer Our company guidance is CAGR of 15% for the coming five years. So that should be more or less in line with our long-term guidance.

Pankaj Chopra And my last area of questioning is with regards to what is the as business, does the company business like this, get the benefit of economies of scale as we grow, and what are the constraints for those economies of scale from flowing into the bottom-line? What could constraint that?

Guido de Boer The economies of scale are specifically in the size of breweries, where breweries in India tend to be relatively small, around 0.5 million hectare liter each, the economies of scale only come in around 1 million hectare liter size and above, so breweries that reach that particular size do enjoy economies of scale, a few our 18 breweries have reached such a scale, they will be able to operate at higher efficiencies, enhance lower cost per unit.

Pankaj Chopra How many of your 18 will be reaching that critical level of 1 million?

Guido de Boer I guess this year we probably have three, maybe four breweries in that category.

Pankaj Chopra And do you expect the others to join in or because….?

Guido de Boer Some yes, some are just structurally not able to expand.

Moderator Thank you. As there are no further questions, I would like to hand the conference over to Ms. Swati Nangalia for closing comments. Thank you.

Swati Nangalia Thank you. I would like to thank all the participants for joining us today. Also thank you Poonacha and Guido for removing time for this call. Wish you all the best for the future quarters.

Moderator On behalf of IDFC Securities Limited, that concludes this conference. Thank you for joining us.