



“United Breweries Limited Q3 FY15 Earnings
Conference Call”

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MODERATOR: **MR. HARIT KAPOOR – AVP RESEARCH, IDFC SECURITIES LTD**

Moderator Ladies and Gentlemen, Good Day and Welcome to the United Breweries Limited Q3FY'15 Earnings Conference Call hosted by IDFC Securities. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Harit Kapoor from IDFC Securities. Thank you. Over to you, Mr. Kapoor.

Harit Kapoor Thank you, Zaid. On behalf of IDFC Securities, we would like to welcome you all to the Q3 FY'15 Call of United Breweries. With us from the senior management we have Mr. Henricus P. van Zon – CFO, as well as Mr. Poonacha – Divisional Vice President - Finance. I will hand over to Mr. Henricus P. van Zon for his "Opening Remarks", post which we will open for "Q&A." Over to you sir.

Henricus P. van Zon Yes. Thank you very much. Good Afternoon, Ladies and Gentlemen. I understand that we have quite a high number of participants. So, I am looking forward to your questions. Normally, we begin with an introduction which I will do, but I will keep it very brief because all of you have certainly kind of seen our 'Press Release' and in particular, our figures that we have published on Saturday.

We just take rough outline of the Q3 in particular, then what we see is a market that did not give us an opportunities to grow, the market was flat, we consolidated our market share, we had some additional difficulties in Tamil Nadu where they have implemented or kept very strict to their policy with respect to giving us only one-third of the business or basically we were not even one-third, 30%, that is one. However, due to price increases that we have been able to further achieve, we still have shown or have been able to show revenue growth of 5% for the quarter. Then in addition to that, as you have seen, we have not been able to improve the bottom line, which in actual effect, says far more about last year's Q3 than about this year's Q3 and now I ask you all to go back into your memory. Last year, we started the fiscal year with very peculiar arrangement or rule that we were confronted with in the State of Maharashtra, which did not allow us for 6-months to use any returned bottles from the market in our breweries in Maharashtra. This had a pressure on the profitability in the first half year last year. However, as soon as this measure was over, we were of course able to use a lot of these returnable bottles that got stuck in the market in Q3, and therefore, we had abnormal good Q3 within the normal kind of pattern that we go

throughout the year. But again it says a lot about Q3 of last year. If this would not have occurred, I reckon that we had been able to show a slight, I must say, profit growth.

Because of another kind of pressure that we see on the cost side in particular that is a bit contrary to what one might expect, if I talk about freight, one might expect with the current price of oil in the world and therefore the effect on the price of diesel, that our freight cost would become lesser. However, this is not a case in contrary our freight costs are increasing amongst orders because there is shortage in the market of transport capacity. That is different of course for states and also different for a period in the year, but in general, this puts pressure on the development of transport tariffs. So, that is the thing that we are faced with as well.

If you look at our year-to-date results, we are showing good results. As you all know the first half year was very good, we did not lose out too much on that, we still have a good kind of increase in revenues of 17%, we had a good kind of fall in growth, so year-to-date, we are now still on a volume growth of 7 and a double-digit growth in EBITDA and profit after tax. That is basically I think what needs to be as an introduction. Having said that, I would like to open the floor for "Questions."

Moderator

Thank you very much. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. Our first question is from the line of Sonali Salgaonkar from Axis Capital. Please go ahead.

Sonali Salgaonkar

Sir, my first question is with reference to the volume decline in certain states like Tamil Nadu, Odisha, and Kerala. Are there any particular reasons why the industry volumes have declined in these states considering that the Southern states are key consumers of Beer? And secondly, would like to understand from you what is the ground situation and when is the recovery in volumes are we expecting?

Henricus P. van Zon

Let us say, starting with the last part of your question, we are not used to give indications about the future, as you know. So, that will be difficult to answer. If you look at the first part of the question with respect to Tamil Nadu, I think that market is suppressed because we see the effect of the government, let us say, the policy which is now witnessed already for more than a year on the development of Beer sales, because very often, let us say our products which have a very good image and our brands in the state, are not available for sale in the outlets. I understand from our sales people that when an outlet is being delivered with our products, they are most

often sold out in a couple of hours. We try to complete the deliverance to the outlet, so that at least our brands are available everyday but still not far from insufficient. In Kerala, we have had specific difficulties with respect to the licensing and renewal of licensing and the whole policy of, will there be yes or no prohibition in the state. Fortunately, that has now been more clear; the licenses have been renewed for buyers also with respect to Beer and Wine. So, that is a good development and we also see with that respect that in Kerala, the sales are again kind of coming up and getting on stream again. In Odisha, there has been a very and vigorous situation where the government was unclear about how they were going to renew the licensing policies for retail, and therefore, everybody actually have affected a little bit, because nobody wanted to have his money stuck as soon as something very kind of specific would change there.

Sonali Salgaonkar Sir, you have mentioned in your opening remarks that your company could get price increases in some states. Would it be possible for you to name those states?

Henricus P. van Zon No, I do not think we were used to that, but you can say, we have gotten a fair number of price increases like we basically achieve on a yearly basis every year and that is not more or less than in the past.

Sonali Salgaonkar So, sir, out of these 3 states -- Tamil Nadu, Kerala and Orissa -- it would be fair to assume that the problems in Kerala and Odisha have been sorted out, right, during the quarter?

Henricus P. van Zon Yes.

Sonali Salgaonkar On the selling and ad cost, is there any scope for rationalization of these costs or considering that we understand that there are multiple launches in United Breweries and variants to be launched as well, so would it be fair to assume that it would stay nearly at these levels over the near future or is there any scope for rationalization in these costs?

Henricus P. van Zon If you would allow me to react in this manner, these costs are not kind of have not to be looked at as costs to per se be rationalized. We are a fast moving consumer goods company and we thrive on the basis of the health of our brands, which means that you have to support your brands to the utmost. It does not mean that you have to waste money, that might be clear but we see sales and promotional costs, advertising, etc., sponsoring promotions as an investment in our brands and with that an

investment in our future. So, let us say, of course, we look at these costs as well to make sure that we do not spend money that we do not need to spend and everything we procure in this context, we procure at the best prices and provisions, but in principle, I do not see these group of costs as cost that are open for rationalization, I rather see the most of it to grow into the future.

Sonali Salgaonkar Sir, on the working capital front, would it be fair to assume that the working capital would remain at similar levels considering your business at parastatal agencies. Sir, I am asking as a percentage to sales. Sir, of course, absolute would increase but relatively, as a percentage to your net sales, would it be fair to assume that it would remain the same?

Henricus P. van Zon We always try to do the best to keep it on that level. You will see probably that and you have seen if you take an analysis of our figures throughout the years that we have at the end of the fiscal year, most often, let us say, relatively, high level of working capital. That has to do with the season, and with the fact that we have a lot of clients that are state and government-related.

Sonali Salgaonkar The CAPEX in the previous concalls you had mentioned about 2.5 to 3 billion per year in the near future. Are we sticking to that?

Henricus P. van Zon So far, yes. Let us say, we would not have any growth in the coming 2-years than not. This year we might kind of end up maybe a little bit higher at the entity because we now let us say, are finishing of our project in Bihar, we are starting of the brewery in Rajasthan that we acquired recently, and we will increase the capacity of our Brewery in let us say New Andhra Pradesh.

Sonali Salgaonkar What is the capacity of the Brewery in Bihar that we are likely to commission from February?

Henricus P. van Zon 6,00,000 cases per month

Moderator Thank you. Our next question is from the line of Apurva Kumar from Jefferies. Please go ahead.

Apurva Kumar Sir, can you just help us understand the difference that you see on the cost of Used Bottle versus New One? And also on how are the other packaging costs associated with the product have moved?

- Henricus P. van Zon** As stated, Used Bottle cost depends a little bit on which take you are in and how it is recuperation order let us say that, supply chain back into the Brew is being organized but it is more or less New Bottles are 3x more expensive than used old bought back bottles.
- Apurva Kumar** And how much would be the percentage of Used Bottle versus New Bottles in your production right now or...?
- Henricus P. van Zon** This is a different per state but we are not used to comment on that.
- Apurva Kumar** And sir, amongst the other packaging costs, have you seen any easing in the prices of those materials?
- Henricus P. van Zon** No, not in particular.
- Moderator** Thank you. Our next question is from the line of Ashit Desai from Batlivala & Karani Securities. Please go ahead.
- Ashit Desai** I have a few questions: Firstly, if you exclude these 3 markets where you have seen a decline that is Tamil Nadu, Orissa, Kerala, what would be your volume growth in the other markets?
- Henricus P. van Zon** I can of course give that, but I do not know so by heart. But it is positive apparent, if the other ones are negative, then these must be positive. It is also there, as I will say, we have a portfolio of markets and some markets grow like the Tamil Nadu and Kerala one do not grow and the other ones are stable and the next one to grow and that can change over time, etc.
- Ashit Desai** You mentioned double-digit growth in AP Telangana, UP, these are value growth or volume growth?
- Henricus P. van Zon** Volume growth.
- Ashit Desai** Any color you can put on the growth in mainstream versus your discount brands, like the lower end brands like London Pilsner, Bullet, etc.?
- Henricus P. van Zon** We do not think that we comment on that specifically.

- Ashit Desai** One more thing on gross margins: We have seen a sequential improvement; if I look at Q1 to now, your gross margins are up from 58% to 61% right now. How much of this is due to the geography mix and how much is through pricing and other cost efficiencies?
- Henricus P. van Zon** The first thing that I wanted to say there is that I think it is good to look at development of our gross margin on a Y-o-Y basis, because of the fact that as we put in our notes also, there is a certain seasonality in our business considering the fact that we are a kind of industry with relatively high fixed costs. The gross margins can also differ or very much also influence if you look on a quarter-for-quarter, month-for-month, day-per-day, week-per-week basis. All you know the sales pattern. So, I would rather advise you to look at it year-for-year basis and then see what the conclusions are.
- Ashit Desai** If I look at the 9-month data, it would be more or less representative of the year data, so, 9 month it says 140 bps expansion, if you can give a break up of that?
- P.A. Poonacha** You are trying to say the 9-month ended December '13 vis-à-vis the 9-month ended December '14, we are 1.4% higher in gross margins in the comparative 9 months, right? This is more to do with your top line, revenue rather than cost, because cost cushion anyway is there. So, revenue wise you want break down or what is mix and what is price increase, right? Mix wise, yes, markets like Kerala and Odisha are not high margins. So, their growth not in line with accounting for this increase.
- Ashit Desai** But you also had price increases in Tamil Nadu and Rajasthan in the last two quarters?
- P.A. Poonacha** It is a combination of both, no; you cannot split that 1.5% into what is mix and what is price.
- Ashit Desai** But, if I were to assume these margins would sustain considering that you recently received price increases in some of the markets or say is there a high seasonality, because if I look at...?
- P.A. Poonacha** If you are taking 9 months where seasonality is, it is almost gone, right. You are comparing 9 months; the seasonality is more or less gone. So, when if you compare it in March and similarity is gone all together.
- Ashit Desai** From June to this quarter, how does seasonality affect the gross margins?

- P.A. Poonacha** You have to go market wise.
- Ashit Desai** So, it is only the geography mix that changes basically.
- Henricus P. van Zon** Everything, just now that not even that, we have product mix changing as well continuously and we have sourcing mix changing. So, sometimes as you know we have in almost all important states our own Breweries, but still sometimes you have to move product through the country and we have to cross borders which very often triggers extra duties. So, this is a very mixed situation.
- Ashit Desai** On Rajasthan, you spent Rs.105 crores for the acquisition. Any further CAPEX from this brewery?
- Henricus P. van Zon** Not at this point in time.
- Ashit Desai** So, before you commence operations, there is no further CAPEX required in this Brewery?
- Henricus P. van Zon** Slight bit, that is what we are spending now to get it up and running.
- Moderator** Thank you. Our next question is from the line of Jasdeep Walia from Kotak. Please go ahead.
- Jasdeep Walia** Sir, I noticed there is seasonality in your realization per case. So, your realizations per case for your company are highest in the Q3 and this is the trend which has been there every year. What is the reason behind that, sir?
- P.A. Poonacha** This is more to do with the market mix there because other markets being little more profitable than the average do not become too cold like the northern markets in the Q3.
- Jasdeep Walia** So, it is higher sales from the Southern market which pushes that realization number higher in Q3?
- P.A. Poonacha** Salience wise.
- Jasdeep Walia** And sir, could you talk about this new brewery that you have acquired in Rajasthan -- what is the current capacity, what are the investments that you will have to do going further, and what could be the ultimate capacity?

- P.A. Poonacha** No, we are still analyzing, because when you take old Brewery, when you look at it, you do not know exactly what is needed, what is not needed. So, we are still in a situation where we are getting into shape. It will not be done in the financial year; it will not come into commercial production. When it does, it should give around 3 lakh cases per month.
- Jasdeep Walia** And what is the scalability of this asset -- can you put in more money and scale up the capacity significantly from here?
- Henricus P. van Zon** Yes, more money we can always put in if we have it and we do, and for the rest it depends on the demand, it depends of course, the size of the area that you have which suffices and then in particular in Rajasthan, this is an important issue is what kind of water levels you are, was it allowed to grant it to use.
- Moderator** Thank you. Our next question is from the line of Nitin Gosar from Religare Invesco. Please go ahead.
- Nitin Gosar** Sir, two questions from my side: One, pertaining to the other operating income, if you can help us understand the broader part of what is going into the other operating income?
- P.A. Poonacha** Other operating income is income which you get other than the main line sales; it can be a sale of your broken glass, it can be a sale of your spent grain and what was the other query.
- Nitin Gosar** You have two quarterly statement; you give your expenses especially in sales and promotion line; one is sales promotion expense and second one is selling and distribution expense. The split generally signifies what sir, on selling and distribution expense?
- P.A. Poonacha** Selling and promotion expenses have two expenses -- One is brand building and the other one is schemes or discounts offered to the trade. So, both are clubbed together. Selling and distribution expenses, it includes expenses like freight, forwarding, and any kind of cost incurred from our side from getting the product moved from the Brewery right up to the point of sale.
- Nitin Gosar** In the Annual Report, you have a different line item which generally talks about the freight-related expenses.

- P.A. Poonacha** Then you are giving your Schedule-6 accounts right, you are giving entire accounts right, but then, it is not under this.....
- Nitin Gosar** Since there is a trade scheme element which is involved into the sales promotional expenses, going forward, somewhere down the line, it should start getting rationalized. Should that be the assumption going for may be 2 years, 3 years down?
- P.A. Poonacha** We are not spending anything irrationally. The business demands this kind of spend. A large portion of it is towards brand building and we specifically do not give a break up of this because we are the least discounted brands in the country and you should see this as a percentage of top line remaining somewhere where it is or dropping slightly based on what competition is doing.
- Nitin Gosar** Internationally once the brand mature, I have not looked into it, but if you can help us understand what is the kind of sales and promotional expenses company are required to spend to maintain the top line?
- P.A. Poonacha** Internationally, the discount is normally removed from the top line but however, here since the discounts are not primary discounts, the discounts which are secondary in nature, we cannot set it off from the top line. So, you cannot compare what they do international to what we do here, internationally, what comes as only pure brand building.
- Moderator** Thank you. Our next question is a follow-up question from the line of Sonali Salgaonkar from Axis Capital. Please go ahead.
- Sonali Salgaonkar** Sir, I wanted to ask in particular about the other income of Rs.1195 lakhs. It has almost grown two-fold if you compare Y-o-Y. Sir, any particular reason for that?
- P.A. Poonacha:** Item #4, you have other income which is not regularly business in nature, it includes even reversal, for example, if you have a reversal of provision that comes in other income and the write-off comes in the cost. So it is inflating in excess, inflating in income. So you cannot really compare it and say that is growth in other income.
- Sonali Salgaonkar:** But was there any one-off this quarter for it to be boosted almost twice?
- P.A. Poonacha:** No, it is not one-off, if you have certain provisions in your books which are with respect to periods prior to what we are referring to, when you write-off the particular

expense vis-à-vis the provision, the provision comes as an income and the expense comes in your regular expenses.

Sonali Salgaonkar: What would be the pan India capacity utilization for us right now?

Henricus P. van Zon That is always a question very often being raised and very difficult to answer because that depends on many different factors and it is also Northern only kind of India figure, you can imagine that we have all capacity in Tamil Nadu to be a factor of arrangements there with the ordering pattern of the government, for the restructuring, we have I think we can say, good, healthy capacity utilization on one hand, and on the other hand, we are also able to supply the market in the coming two-three summer, let us say, high season summer months.

Moderator: Thank you. The next question is a follow up question from the line of Jasdeep Walia from Kotak. Please go ahead.

Jasdeep Walia: What is the status of the prohibition policy that Kerala state government had come out with, could you just talk about the developments you have seen on the ground with regard to that? As far as my understanding is concerned, I think after the policy was released, the retailers association had filed a suit against that policy in the court...

P.A. Poonacha: Not the retailers, the bar owners, which have been upheld and license have now been issued.

Henricus P. van Zon I think I commented on that in the beginning.

Jasdeep Walia: So what about the usual retail counters there -- there the state government is reducing the distribution footprint at the retail level by 10% every year?

P.A. Poonacha: No, they have started though the originated was there because that would mean loss of jobs and I do not think the Kerala government in the current situation will do that.

Jasdeep Walia: So implementation has not started at all of that policy on the ground?

P.A. Poonacha: No.

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

- Harit Kapoor:** Just a few questions from my end: Firstly, in Q2, you had said that the primary volume growth was 24% and secondary volume growth was 18%. So, I just wanted to understand in this quarter have you seen a higher secondary volume growth vis-à-vis your flat primary volumes and how that has really moved in the quarter?
- Henricus P. van Zon** There is no big kind of development there.
- Harit Kapoor:** So is it fair to assume that it would be at similar level that you are flattish...?
- Henricus P. van Zon** Yes.
- Harit Kapoor:** Second thing really was on the freight cost that you spoke about. You said that because demand/supply rather issue you have not seen any benefit of the freight cost. Just wanted your understanding, do you see this thing going forward also especially if crude prices remain at these levels, eventually, will there be in your expectations some benefit moving into FY16 on the freight front from your end?
- Henricus P. van Zon** No.
- Harit Kapoor:** Third thing really was on price increases. There have been one major price increase in Tamil Nadu in Q3. Any other price increase that we can talk about in Q3 that we have received in any state or would that be the main one?
- P.A. Poonacha:** Price increases happen at the beginning of the fiscal year.
- Harit Kapoor:** On prices of Glass Bottles, I would assume that because of the lower crude as well as gas prices, there could be a possibility that the new bottles that we buy we could possibly negotiate lower price in the next round. So would that understanding be correct – is there a possibility that could happen?
- Henricus P. van Zon** There is a possibility.
- Harit Kapoor:** Any chance of quantifying what kind of lower price?
- Henricus P. van Zon** No.
- Moderator:** Thank you. The next question is a follow-up question from the line of Ashit Desai from Batlivala & Karani. Please go ahead.

- Ashit Desai:** You had this ban on the number of shifts you could operate in Mysore in the last and this quarter.
- Henricus P. van Zon** That is solved recently.
- Ashit Desai:** Can you quantify the impact you had in the second and third quarter?
- P.A. Poonacha:** It is only on freight, we are moving across, we have to go back through every sourcing, we do address state and then start quantifying that...
- Henricus P. van Zon** We do not give that kind of detailed information. That is for ourselves to manage.
- Ashit Desai:** Can you comment how big is the Premium Strong Beer here in India?
- Henricus P. van Zon** Strong Beer is 80% and it depends on how you want to define premium.
- Ashit Desai:** If you look at brands like Carlsberg, Elephant, Budweiser, Magnum?
- Henricus P. van Zon** Extremely small.
- Ashit Desai:** And growth rates would be similar or ...?
- Henricus P. van Zon** Also small.
- Ashit Desai:** When was the last price hike you received in Andhra Pradesh?
- P.A. Poonacha:** Five years back.
- Moderator:** Thank you. As there are no further questions I now hand the conference over to Mr. Harit Kapoor for closing comments. Over to you.
- Harit Kapoor:** Thanks, Zaid. On behalf of IDFC Securities, we would like to thank everyone on the call for joining in as well as the management of United Breweries for spending time out for this call. Sir, any closing remarks that you would like to make?
- Henricus P. van Zon** Yes, thanking all of you for your questions. As you have noticed, we are very much willing to answer all the questions except two things that we then not to do as I repeat more often -- one is we cannot give any kind of indication with respect to the future -- and secondly, if it becomes really very detailed, then also, as you have noticed very often want to withhold from any comments with this respect, because we think this is



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a very kind of managerial issue, one, and secondly, we have customers competition as well.

Moderator:

Thank you. Ladies and Gentlemen, on behalf of IDFC Securities Limited, that concludes the conference call. Thank you for joining us. You may now disconnect your lines.