"United Breweries Q4FY12 Earnings Conference Call"

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Moderator Ladies and gentlemen, good day and welcome to the United Breweries Limited Q4 FY12 Results conference call hosted by IDFC Securities Limited. As a reminder for the duration of this conference, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need any assistance during the 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 now like to hand the conference over to Ms. Swati Nangalia from IDFC Securities Ltd. Thank you and over to you madam.

Swati Nangalia Thanks Myron. It is a pleasure to welcome you all to the Q4 FY12 earnings conference call of United Breweries. We have with us representing the management team Mr. Guido De Boer- Chief Financial Officer and Mr. P. A. Poonacha- from investor relations. I will hand over the call to Guido for the opening remarks, post which we can move on to the Q&A. Over to you Guido.

Guido De Boer Thank you Swati for the introduction and for hosting this call and thank you all for joining the analyst call for the FY12 results.

So this morning we discussed another good results for the year, hopefully you have received all of them. If not then please inform Poonacha so we can add you to our mailing list.

So moving onto the results – in FY12 we saw 133 million cases representing 6% growth over the last year and as compared to an industry growth of around 4% for the year. So if you see the states that have driven key growth for the year were Rajasthan performing excellently, Andhra Pradesh continuing its strong growth, Uttar Pradesh was a combination of growth in the market and market share has helped us, Karnataka continues to perform well. Then if you see few markets where the trends were less positive West Bengal especially 1st Quarter of the year after elections and duty increases. Tamil Nadu where we went down a 9% in volumes for the year given the elections and the unpredictable ordering pattern during the course of the year, in Bihar we shrank our supplies until we received the price increase from the government and that has thereafter stabilized.

On the Brand wise, the main news for the year was that Kingfisher as a brand has crossed 100 millions a feat that we as a company reached a couple of years ago. And then if you note industry growth in that sense not another great year, industry growth was the lowest in 8 years where state likes Maharashtra one of the largest state went down 6% in volumes. Luckily we were able to maintain our volumes in the state by market share increases. Delhi was continuing to be weak, 10% down for the industry after the 11% decrease in the previous year. West Bengal like I mentioned went down 6% for the year due to duty increases as well as elections. And the star performance for the industries were Andhra Pradesh 15% up compared to already 20% increase in the previous year, Tamil Nadu has been growing by around 8% as well as

Karnataka, one of the key profit drivers was up 15%. The combination of these market growth as well as our market share movements led to the increase in market share from 54% in previous year to 54.5% for the current year, mainly driven by market share increases in Maharashtra, Karnataka, Rajasthan, Haryana as well as in UP.

So we move form volumes to revenues – You will see that our revenues have gone up from 3060 crores to 3628 crores growth of 19%. It's important to note that during the previous year we did significant number of consolidations so I will mention also the amounts on a like-for-like basis. On the revenue terms we increased almost 10% around 330 crores came from consolidations which means a like-for-like growth of about 10% out of which 6% was in volume growth leaving about 4% for price mix improvements. Majority coming from improved pricing in the states of Maharashtra, West Bengal, Karnataka as well as Goa.

Then if you look at cost of goods sold plus traded goods, cost of goods sold went up from 1423 crores to 1663 crores so an increase of 17%. So if you take the consolidated, the inorganic increase in cost of goods sold of 208 crores that means that the like-for-like increase in cost of goods sold is limit to something around 3% which is fairly limited for price, below inflation and so our gross margins on a like-for-like basis is up from 54% to 56%. And within our cost of goods sold there were material price increases in malts, cartons as well as in new bottles that we were able to off-set these to a large extent by the success of our secondhand bottle initiative where prices went down and now have reached the same level as they were four years ago. We expect a benefit from that to continue in the coming years.

Then if you move to fixed cost, which amounted last year to around 1247 crores, they went up to 1553 crores, out of which around 99 crores came from consolidations. So the like-for-like increase in fixed cost is about 17% which is significant and with a relatively lower volume growth also led to less margin expansion as we would like. Significant drivers for this higher fixed cost were a number of strategic initiatives that we implemented and the cost of implementation and payment to consultants formed part of the fixed costs, while the benefits are expected to come-in in the current year and thereafter. It also included one-off costs in personal cost and higher expenditure towards repairs and maintenance. So all and all this led to an increase in EBITDA from 435 crores to 485 crores, out of which consolidations were 32 crores. So the like-for-like EBITDA is around 453 which is 4% increase in EBITDA. Depreciation went up significantly from 131 crores to 149, out of which 21 is from consolidations, actually if you take our consolidations our depreciation went down slightly and interest went up to 99 crores, out of which 9 is from consolidation. So if you take a like-for-like 90 crores that would imply 15% growth in interest. I think two important things to note in these results is, one the provision that we have taken for diminution in value of our investment in Maltex Malsters Limited, there have been delays in getting approval for the expansion of the maltery that is in the center of the city so that's why we decided to be on the prudent side and take a provision to write-down the value of investment to reflect the net value which is basically the value of land. We took a 20 crores a non cash provision. And the other item to note is on our tax rates as you see we have 91 crores of tax, out of that current tax was only 49 crores and the balance 42crores, deferred tax and MAT credit availed and in the last year we paid around 48 crores of current tax, actually the tax outflow for the year is of a similar rate.

So PAT is reported is down from 147 to 126, so if you exclude the exceptional being the provision for impairments as well as 3 crores of profit that was coming from consolidation, the like-for-like PAT would be 143 as compared to 147 of last year.

CAPEX for the year stood at around 350 crores so that's investments in capital as well as capital working in progress and net debt stood at 942 crores compared to 900 crores in the previous year. So I just gave some insight in the performance of UB for FY12 and I open the floor for any questions you might have.

Moderator Thank you very much sir. We will now begin the question and answer session. We have the first question from the line of Abneesh Roy from Edelweiss Securities, please go ahead.

Abneesh Roy My first question is on the volume growth, last four quarters we have seen low volume growth and in a way this is good for FY13 because the base is favorable. But on the other side GDP growth rates are now at the lowest levels in the last many years so how are you seeing FY13 volume growth taking both of these into account?

Guido De Boer So we don't give guidance on a one-year outlook exactly because the industry growth is in that sense is volatile on a year-to-year basis. But our outlook as it stated many times about 15% CAGR in volumes still stands. And like you say we have the benefit of relatively lower base, also better weather in these few months. And on top of that excise policies that have been announced till date seen more favorable than we have seen in the previous year or at least less detrimental than we have seen last year.

Abneesh Roy And any down-trading you are seeing between your portfolio brands?

Guido De Boer No if you look at last year actually this year of Kingfisher within our portfolio has continued to rise. Actually we don't see the trend.

Abneesh Roy Coming to the other state governments like UP and Andhra Pradesh, do you envisage any problems, issues in UP because of the change in state government going ahead?

Guido De Boer No, as far as I understand the excise policy has been existing for the past years was continued for throughout the year so I don't see any sign of changes in that for this financial year.

Abneesh Roy Coming to the Andhra Pradesh market you said you have done well. So what is the market share in that state and what is the market share nationally, especially after the policy change how have we managed the market share?

Guido De Boer Basically there we came from a market share on 35% and around the peak we have reached about 60% and now we are stabilizing 50% sale.

Abneesh Roy And you expect that to continue going ahead?

Guido De Boer That's right that's what we aimed for around those levels.

Abneesh Roy And what would be the national markets sir?

Guido De Boer 54.5%.

Abneesh Roy Sir could you commend on the raw material side, how are you seeing things in terms of the key raw material?

Guido De Boer Key raw materials if you look at the two most important ones, they are malted barley as well as bottles. On bottles the secondhand bottle price is being able to contain very well and that should improve over the year where new bottle costs have been increased a bit earlier in the calendar year. So the total impact of that would still be a lower bottle cost overall than in FY12. On malted barley we don't have full visibility yet, the harvest has been very good. Prices of wheat which are related to barley are also quite well. But quite a few of the traders are speculating with the barley prices as this can be higher levels than last year. So we still need to see how that plays out where normally we would have our full requirement for this financial year procured in June I think we will stretch it now a bit more and also import where required to break this speculation of the traders. So that's basically a long answer if you say that we don't know where the malt prices go on that for the year.

Abneesh Roy And regarding glass bottles, how much secondhand we are done in the system and do we plan to increase it further?

Guido De Boer No, last year where there was significant investment in building a bottle pool, last year on some states we were in building mode but largely will be now reaping the benefits and reducing the new bottle percentage.

Abneesh Roy Sir my last question on the canteen sales, what was the kind of impact, other FMCG companies have seen impact in Q4. What was the impact you felt?

P. A. Poonacha Abneesh CSD sales as a percentage of our overall sales is very miniscule and in a way it does not affect our business to a great extent.

Abneesh Roy It will be in a single digit?

P. A. Poonacha Low single digits.

Moderator Thank you. The next question is from the line of Adil D from Lombard. Please go ahead.

Adil D Good afternoon gentlemen thank you for the call. Could you maybe comeback on that you were saying about initiatives to reduce your cost base which was payout in previous year and next year and the following year and what kind of margin range you are expecting from that?

Guido De Boer Two key initiatives we have worked on this respect is improving our sourcing optimization, you can imagine that with having 18 breweries and 10 contract brewing facilities supplying to 29 states that's quite a complex affair so we are looking to optimize that. And next to that we have the whole host of improvements around sales execution around increased realization from auxiliary materials. So those are broadly the initiatives that we are doing. We don't have guidance on our profitability on what kind of benefits we should deliver. But overall we are working towards a steady improvement in our margins and this is something that will contribute towards.

Adil D And the benefit of these initiatives under all the heads, none of those have hit the P&L yet?

Guido De Boer No there was a minor start of those benefits in Q4 but really it starts showing up during the course of the year.

Adil D This financial year.

Guido De Boer Yes.

Adil D Could you say a word about the outlook for CAPEX in the next couple of years what capacity increase you are looking for excluding acquisition?

Guido De Boer So basically we expect to grow on an average 15% per year, which means that we will build capacity for the year thereafter. So every year we will build 15% of the next year as expected capacity.

Adil D And in terms of acquisition?

Guido De Boer We don't have an eye on acquisitions. I think we have a complete portfolio of brands. We have excellent distribution in every state where we need so we rather grow organically by building Greenfield or by Brownfield expansions rather than buying companies.

Swati Nangalia What is our market share differential with SAB Miller right now?

Guido De Boer Obviously it is an estimate from us what their market share exactly is. We estimate that they probably lost 0.5% or so and we gained 0.5%.

P. A. Poonacha 23%.

Swati Nangalia So Guido my question was in reference to the fact that the difference in market share is only widening…so do we see this having an affect on our ATL and BTL spends, where we can lower our trade spends and improve our profitability going forward?

Guido De Boer I think you have to look at it on a state-by-state basis because in the end the battle is done in the markets where SAB might have lost a bit in some states they are gaining. Other states Carlsberg and ABI are stepping up their efforts. So I think it is largely the effects were some markets we are able to step back a bit on our promotional spends and in the other markets which are markets that have tough competition, will require higher spends so I would not expect any major changes in that.

Swati Nangalia My second question is related to the depreciation cost in Q4. Now Q3 we had seen the merger impact of three brewery units but depreciation in Q4 also seems to be on the higher end. So is there any one-time impact which we have built-in in this quarter?

P. A. Poonacha Swati considering that we are having several Brownfields across the country. We are also modernizing most of our plants to gear up to bottling better quality beer and meaning that we are upgrading to bottle KF blue across the country. So some equipment which have been idle have been provided for in the particular quarter so you have a one-time depreciation write-off of idle assets to the tune of 6.5 crores.

Swati Nangalia And lastly, just wanted to get your sense on how the performance of Heineken has been? It has been a while we have launched it, could you throw some light on how is it doing?

Guido De Boer So now we have launched in five key metros and focus is on perfect execution. Making sure that the brand is always fresh, that the packaging is perfect, that it is presented in a cool and not warm beer. So our focus is rather selling it at premium outlets in a perfect way and getting consumers having the first good experience rather than pushing volume in the market. So it is growing as per expectation but that means that it won't show up materially in our volumes today. Our idea is to build this brand equity strongly so there can be a long term driver for growth. So don't expect huge selling from Heineken we now try to establish it in the super premium segment so price at around 170% versus Kingfisher premium.

Moderator Thank you very much. Our next question is from the line of Aniruddha Joshi from Anand Rathi, please go ahead.

Aniruddha Joshi Just wanted to know what are the price hikes in the last four quarters that we have seen?

Guido De Boer In fourth quarter we took price increases in Karnataka and Maharashtra that I know. We did some individual SKU adjustments in states like Rajasthan and Delhi. We must have done some in the smaller markets but these are the once that I recollect at top of mind.

Aniruddha Joshi If you have to give any average price hike number for the full year as well as for quarter?

P. A. Poonacha Average is if you see as Guido stated as he went on to remove the consolidation effect. If you see the growth in top-line is 10% without consolidation and the volume growth is 6%. So the differential 4% is on account of revenue on account of price increase. It is for the year. It is not only the last quarter.

Aniruddha Joshi And first remarks you mentioned that overall the situation in Tamil Nadu not doing great and volumes are down 9% over there. So has the situation improved now and what has been the off-take probably from two months now?

Guido De Boer The trend is definitely stabilized towards the end of the year so it has improved but still it is an ordering pattern that this still sometimes a little bit irrational. So we have to wait on that and regarding Q1 volumes we will update you at the next conference call.

Aniruddha Joshi Can you just share the overall beer sold in lets say cans as well as against the bottles, so many be the revenue share in two different SKUs and the last question is how many touch points we are having? We are having an excellent distribution network so what are the exact number of touch points through our products are sold?

Guido De Boer So the share of cans would be below 10% so the still differing quite largely across states and exact number of touch points I don’t know but I would say between 65,000 and 70,000.

Moderator: Thank you very much. Our next question is from the line of Abneesh Roy from Edelweiss, please go ahead.

Abneesh Roy Could you talk on the recent amalgamation which has happened what kind of synergy benefits we are expecting in the next two years.

Guido De Boer Basically we have now completed all of the consolidations. So now you will have full insight in what the result of the operations is including the subsidiaries that actually were doing more like contract brewing for us than having brands themselves. So the operational synergies of them are largely are limited because those benefits we already realized because we are managing them last year’s as part of the same group. And key benefits that you see now is one that has come in from lower duties from producing from one entity to supplying it to another with brand transfers. So that’s the amount lower than 10 crores. And the other one is on the tax side where we have significant tax benefits so that’s why you see that last year out of the tax of 79 crores we actually only pay 48 crores in current tax and this year out of 91 crores of tax we actually only paid 49 crores of tax. So it is limiting our tax outflow by utilizing the tax assets that the company still has.

Abneesh Roy Next question is on the regulatory side you said this year seems to be as of now better compared to last year in terms of harsh tax so is this because an alternate years so last year was harsh so this year be soft or is it because the state governments are realizing that harsh tax could be counterproductive to them from a medium-to-long terms perspective?

Guido De Boer I wish I could predict how government thinks because I think that's relatively unpredictable but definitely there is some impact of when government has hiked duties in one year it is generally less in the year thereafter. But it is would say impossible to predict what the governments would do.

Abneesh Roy And how do you see your advertising and marketing cost in FY13 and FY14 you see that increasing as a percentage of sales.

Guido De Boer That depends more on how sales grows and than how advertising and sales promotion grow. We will increase it in a moderate way. We will try to be efficient in that and reduce activities which don't contribute. So as percentage of sales it is hard to say but we are aiming to curtail as much as possible.

Abneesh Roy Sir lastly in the last two-three months we are seeing a lot of news flow at the promoter level entity between Heineken and non-Heineken promoters. I understand it is very difficult for you to comment anything on that but some clarity on that would be extremely useful as to what is the thought process of Heineken or the non-Heineken from the longer term perspective?

Guido De Boer I suggest you ask that question to the promoters because I cannot really answer that question like this.

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

Swati Nangalia Thanks Myron. I would like to thank Guido and Poonacha for removing time for this call. Also thanks to all the participants for joining today. Guido would you like to make any closing comments?

Guido De Boer Nothing**,** apart from thanking you for organizing this.

Moderator Thank you. On behalf of IDFC Securities and United Breweries, that concludes this conference call. Thank you for joining us and you may now disconnect your line.