"United Breweries Q3FY12 Earnings Conference Call"

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MODERATORS: MR. GUIDO DE BOER – CFO, DIRECTOR
MR. RAVI NEDUNGADI – PRESIDENT & CFO, UB GROUP
MR. P. A. POONACHA – HEAD FINANCE & ACCOUNTS
MS. SUNITA SACHDEV – ANALYST, UBS SECURITIES INDIA PVT. LTD

Moderator Ladies and gentlemen, good day and welcome to the United Breweries Limited Q3FY12 Results Conference Call hosted by UBS Securities India Private 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 assistance during the conference please signal an operator by pressing * and then 0 on your touchtone telephone. Please note this conference is being recorded. At this time I would like to hand the conference over to Ms. Sunita Sachdev. Thank you and over to you madam.

Sunita Sachdev Welcome to the management of United Breweries and thank you so much for taking this time out to do the earnings call with us. We have with us Mr. Guido De Boer, the Director and CFO and Mr. Poonacha, AVP Finance from the company. I would like to just hand over the call to the management. Thank you so much Guido.

Guido De Boer Thank you very much for the introduction and welcome to the Q3 conference call of United Breweries. I assume you have all seen the results. I would like to start off with explaining a little bit about the results this quarter versus the previous ones, given that they are not comparable to previous quarters or previous years because in this quarter we completed significant number of the mergers that we had announced. So what has happened in the results for this quarter is that the 9-month results of the merged entities are consolidated into UBL. So that gives a bit of a distorted picture of the results. Later on in this call we will give you a breakdown of our impact of consolidations so that you can get a view of a like for like performance of the business. Let us first move onto the volume performance for the combined business.

In the quarter United Breweries achieved a primary sales volume of 29 million cases against 28 million cases in the corresponding quarter of last year, a growth of about 5%. If we look at the year to date, UBL achieved a volume of 98 million cases against 92 million in the previous year, a growth of around 6%. If you then look at secondary sales in the 9-months of this financial year we estimate the industry did a growth in 1% or 2% while we did secondary sales volume of around 5%, outperforming industry on a volume basis. Going into bit more detail on a market by market basis you see the northern markets have grown by 32% driven by good growth in key markets of Delhi, Rajasthan, UP and Haryana with a significant increase in strong beer sales in the respective markets. Especially Delhi was notable after being sluggish for over a year due to the impact of the excise increase on account of the Commonwealth Games. The market has now returned to healthy growth in Q3 and that excise impact seems to have been digested by the market. Moving to the eastern markets, they have declined in volume by 9% largely due to the de-growth in Bihar outstripping the growth realized in West Bengal and Orissa. West Bengal reversed a trend of de-growth in Q1 and Q2 and got back on track in Q3. Bihar continued its sluggish performance in Q3. The change in the corporations ordering pattern in the first half of the year, left the market deprived of popular beer brands thereby shrinking the industry. Slowly the trend is reversing and there could be positive signs on the horizons. In the South the volumes were largely flat, the healthy growth in Karnataka and Kerala was dampened by a moderate growth in AP, still on growth rate and de-growth in Tamil Nadu. Tamil Nadu degrew during the quarter mainly due to change in ordering pattern by the Corporation. The Western markets they grew by 5% in Q3, in fact there was a good growth in Goa, Daman, MP and moderate growth in Maharashtra. But the good news is that we realized a small growth in Mumbai and Maharashtra even though the industry was down after the steep increase in excise duties in April 2011, largely by market shares gains. The Heineken brand which we launched in Q2 in Maharashtra, Bangalore, Goa and Delhi we extended those launches and it is now also available in Kolkata and still sets you on a very encouraging trends throughout Q3 vice-verse of a low volume.

Before we move on to net sales, will give you an overview of revenue gross margin and EBITDA on an organic basis. The revenue reported for the first nine months of FY12 was Rs. 2638 Cr., out of this 555 crores is on account of consolidation. So our organic revenue was Rs.2083 Cr. compared to similar period of the previous financial year of Rs.1939Cr., which means a 7% growth on a like for like basis. If you go to gross margin, the reported gross margin for the first 9 months of FY12 was Rs.1311 Cr. out of which the consolidations accounted for 220 crores and so the like for like gross margin was Rs. 1091Cr. against the previous year of Rs.965 Cr., which is a 2% improvement in gross margin percentage. If we move to EBITDA, we reported EBITDA of Rs. 352Cr. out of which a consolidation of Rs. 35 Cr. so the like for like EBITDA of Rs.317 Cr. against Rs. 306 Cr. EBITDA in the previous year. And if you go to profit after tax the reported PAT is Rs. 119 Cr., consolidations came at a loss of Rs.12 Cr. so the like for like organic performance is Rs. 131Cr. against reported PAT in the previous year of Rs. 128 Cr. I hope you got all these numbers. In the Q&A we can give this in more detail. But hope this gives some insight in organic performance of the business and please treat these numbers as indicative. We have tried to give an indication of the performance but it is still a management estimate given into company transactions etc as such there is always some degree of measurement error in there. So if you look at on the revenue basis, the growth has been partly driven by volumes and also by higher realizations largely driven by strong beer growth which has had a positive impact on the margins during the year.

If you look at cost of goods for the quarter that is at 46% of net sales compared to 52% versus the previous year but this is largely on account of the consolidations, as I mentioned in the like for like performance our gross margin has improved by around 2% largely by the positive impact of the patented bottle initiatives, which has brought our prices of second hand bottles back to where they were a few years ago. If you look at advertising and sales promotion expenses, you will see that in the results it has decreased to 16.5% of NSR while it was last year around 19%. This is also because the consolidation, brands under merged entities received less marketing support, with the majority of the advertising done on UBL beer brands. So if you look at EBITDA as reported for the quarter has increased significantly, has largely done so on account of the consolidations and if you look at it excluding the consolidations it went up from Rs.306 Cr to Rs. 317 Cr. Our ongoing CapEx plan is well on track. We are building two Greenfield Breweries – first one in Mysore which should be ready for commercial production in the first half of FY13 and in Bihar we are in the process of land acquisition and will start ordering equipment in the first part of this year.

Our CapEx we expect to be in line with what we indicated between Rs. 252Cr. to Rs.300Cr. crores for the year. Moving to mergers, we have completed all the mergers that we announced previously barring the one, UB Ajanta and that is to be cleared by the BIFR and we are confident to complete this before the end of the financial year, yesterday we also announced the merger of SNIPL (Scottish & New Castle India Pvt. Limited). SINPL is basically just a Investment Company that owns shares of United Breweries. Merger will result in the issue exactly the same number of shares of UBL to Heineken (100% owner of SNIPL), this more of a structural cleanup, with no P&L impact whatsoever. Debt stands at around Rs. 813 Cr. against Rs. 506 Cr. in corresponding quarter of the previous year, the impact of consolidations in that is around 105 crores. So hope I gave you proper insight in the business and if there are any further questions we can take them in the Q&A. This concludes my opening remarks, let us now move to the question and answer session.

Moderator Thank you very much. We will now begin the question and answer session. Our first question is from the line of Harsh Mehta from Edelweiss, please go ahead.

Abneesh Roy Hi sir, this is Abneesh Roy, thanks for the opportunity. My first question is on Bihar, we are seeing sluggish growth rate continuing, so wanted to understand when do you see growth coming back to healthy numbers and we are also doing CapEx out there, so is this a one-year phenomenon only and next year you believe that the things should be alright?

Guido De Boer Absolutely, we believe this is a more of a temporary issue and the markets actually will be back to growth. So volumes will be sufficient to build a brewery there and also having a brewery there will bring benefits by itself. If you have a local brewery, one the realization will go up because of the lower freight cost, lower duties due to local sourcing and you will see that where you tend to open a new brewery your market share also going up as well because of close to the chimney effect as we would call that.

Abneesh Roy And when do these two factories start manufacturing –Bihar and Mysore, FY14?

Guido De Boer Yes, we expect in the early part of FY13 Mysore will be on track. The construction is on the way. Bihar we are now just doing the land procurement and will be probably start off the financial year after that. That would take at least another 15 months or so.

Abneesh Roy In Bengal, surprisingly beer companies have seen trend reversal and better growth, while if you see liquor companies they have seen issues. So why is there a difference and why are we seeing a trend reversal?

Guido De Boer The duty increase in spirits was far high than the duty increase in beer, so that is why the -

Abneesh Roy How much was the increase in beer?

Guido De Boer Beer was less than 20%. In liquor I do not know, but I am told it is pretty steep and that is why it is not picked up for three quarters. We have had in Q1 also decline in volumes in West Bengal by 17% but in Q3 it has reversed to about 15% growth.

Abneesh Roy Why such a sharp rise? Have you gained market share? Because such a sharp seeing within two quarters has not been seen in any of the other states (-17) to (+15).

P. A. Poonacha No, it is industry itself Abneesh. It is like the first quarter in addition to duties we had the elections, so there was no supply for almost three weeks in the main summer so that affected the industry and with the start of the second quarter once the new government came in, they first introduced increase in excise duty, then next month they introduced increase in sales tax. So this had a double effect in the second quarter and third quarter industry itself is correcting itself.

Guido De Boer And also if you go from the Q1 conference, that apart from the West Bengal elections it was also relatively cold in summer and it was again hard comparables after an excellent Q1 the year before and so that has also made the performance in West Bengal Q1 weak. Now it is back to very healthy double digit growth.

Abneesh Roy Coming to Andhra we have seen again trend reversal towards adverse so how much is it a market share issue, how much is it a gain tax issue?

Guido De Boer Andhra Pradesh is exactly like we mentioned in the previous call. It was logical that the 65% market share we enjoyed for sometime was not sustainable and that we expect to have around 50% market share going forward in Andhra.

Abneesh Roy So there is no tax issue as such out there?

Guido De Boer No, there is no tax. It was just what happens in Andhra is the change in government policy.

Abneesh Roy Sir in Tamil Nadu we cannot see a trend reversal like Bengal?

Guido De Boer Tamil Nadu is taking a bit more time to settle down although January looks relatively healthy, that is going to take bit more time.

Abneesh Roy Sir one last question, in terms of overall market share, where do we stand with respect to PAN India?

Guido De Boer PAN India right year to date we are at 54.5%.

P. A. Poonacha At the end of December we are at 54.5%.

Abneesh Roy No but Q3 was it different because Q3 volume growth has come down from 8 to 5.

Guido De Boer Yeah, Q3 was flat when you compare it to the previous year but on year to date we are above last year.

Abneesh Roy In Winter how is it impacting sir?

P. A. Poonacha I mean you cannot say it is hard, it is no different from the previous year so the effect of weather has not been large.

Abneesh Roy Not in Q3, January, how is it?

P. A. Poonacha January is pretty encouraging in most markets and we should close a good quarter.

Abneesh Roy Okay sir thanks and all the best.

Moderator Thank you very much. Our next question is from the line of Varun Lohchab from Religare Capital Markets, please go ahead.

Varun Lohchab Yeah, thanks for taking my question. The first question was now if I look at the consolidated entity with all these amalgamations complete, how does the working capital situation changes with these entities coming in and how would the consolidated ROCE look like and then over the next few years what is the scope and what are the key levers through which you would look for ROCE improvement of the combined business and how much scope exists out there?

P. A. Poonacha I could not get the question.

Varun Lohchab So now with the combined business because you know with all of these businesses now getting amalgamated I guess they would pull down the ROCE which UBL was reporting till now you know given the increase of their EBITDA profile. So one was that where would it stand today with all of these entities now being part of UBL and then from hereon what are the margin levers in some of these other entities and how would you look to improve the ROCE of the combined entity going forward? You know like working capital on UBL you have worked pretty well in the last 2 or 3 years and improved it. Now on a consolidated basis again, is there a huge scope for improvement on those parameters?

Guido De Boer Basically increasing our return on invested capital we largely look at 2 levers, one increasing our EBITDA margins and two, reducing our working capital. Our CapEx spends I believe we already do very efficient, and we need to invest for the whole growth. So if I take two things margin expansion and working capital on arm's length separately, working capital improvement that we have been doing, we have always been doing not only for UBL as a legal entity but also for the merged entities as well, from operational perspective, we have tried to optimize everything. We have done the low-hanging fruit in the past year. So now we are moving to more advanced ways of reducing it like managing stock to distributors so that you get build quicker and improved sales and operational planning processes which reduces stock levels in our breweries as well as in ongoing negotiation with our suppliers to lengthen the payment terms that we get from them. So that is a process where we would not see big jumps but a steady increase in the next few years to come.

Varun Lohchab Like just to ask that different let us say this year in the first 9 months how much improvement would you have got on the net working capital in terms of days or something like compared to previous year.

Guido De Boer I am sorry if you look at it our debtors has gone down by 2 days and our payables has actually worsened a little bit because of the transition of the of the patented bottle system but now that the introduction of patented bottle system is largely done we can revert back to old the terms so that has improved again. And physical levels inventory was actually down value seems high because of the high cost of barley that we procured.

Varun Lohchab Inventories are down you are saying. Inventory days are down or -

Guido De Boer No. in days at the same cost it is less but just we procure a large amount of barley to go for the full years requirement and prices went up by 20%, the actual value in rupees of our working capital has gone up faster.

Varun Lohchab And the overall debt number which you mentioned 813 crores, that is a net debt number or

Poonacha No, no, it is gross debt.

Varun Lohchab And what will be the cash on books, what would the net debt number look like?

P. A. Poonacha **Rs.** 54 Cr.

Varun Lohchab And you still have not received that money from the promoters of Chennai Breweries, what is the status on that?

Guido De Boer That is as per the agreement that should be repaid as of the 1st of March.

Varun Lohchab That is it from my side. Thanks a lot and all the best.

Moderator Thank you very much. Anyone who wishes to ask a question may press * and 1 on their touchtone telephone. We would also like to remind participants in order to ensure that the management is able to address questions from all participants in the conference, please limit your questions to two per participant. Our next question is from the line of Abhijeet Kundu from Antique Stock Broking, please go ahead.

Abhijeet Kundu Thank you for the opportunity. I just had one question – primarily how are you planning to expand EBITDA margin which is related to the previous question actually? Going ahead for the consolidated NPV as a whole.

Guido De Boer Firstly revenue optimization wherever possible. In markets where we can't take price increases, taken the matter up with the government, doing proper revenue management, in the sense, pushing more high value SKUs and limiting those that make less money, so that is on the revenue side. Then on the operational side there is a whole host of initiatives we work on**.** We work on the cost production initiatives in our breweries. Supply chain optimization in our freight cost so that is both on the revenue side where you can see faster benefits as well as on cost side we are working to reduce costs and thereby maximize our margins.

Abhijeet Kundu Okay sir, thank you.

Moderator: Thank you very much. Our next question is from the line of Ashith Desai from Batlivala & Karani Securities, please go ahead.

Ashith Desai Hi everyone. Just one or two questions, one again on the EBITDA margin. If I look at your selling and distribution spends they are close to 31% of sales. How much of this is linked to fuel cost and what kind of savings or did you see the spends going at a similar rate or we can expect some contraction in the expense?

V. A. Poonacha You are looking at year-to-date numbers or quarter numbers?

Ashith Desai For the quarter.

P A. Poonacha Quarter would not be the right thing because it is 9 months coming in so it will not be right indication. Looking at year-to-date number I will just….

Ashith Desai Even if I look at last year full year stated numbers it is close to 30%.

Guido De Boer So your question is what is the relation between fuel prices and distribution expense? Like I concluded in my earlier remark, one of the projects that we have implemented now is sourcing optimization where we try to source at the lowest cost possible and try to limit this concept at the factory level. So that should be having a positive impact on our sales and distribution cost and then obviously depending on what happens to the fuel price.

Ashith Desai What are out CapEx and the new breweries in the states which we did not have breweries, bring down some of these costs in future?

Guido De Boer Yes, the brewery in Mysore not so much because we already have breweries in Karnataka so in fact that will be marginal. But definitely when we start producing in Bihar that will have a lowering impact on our freight cost as well as on the import and export cost which we need to pay if you source across different states.

Ashith Desai Okay. Sir can you give some idea on how much savings or benefit you can see on this cost front in the next year or next 2 years?

Guido De Boer We do not have formal guidance on that.

Ashith Desai Okay. Sir lastly if you could give some idea on the other income which is almost 90 crores for the 9 months, how much is it from the interest payment form Balaji?

P. A. Poonacha **Rs.** 23 Cr., the remaining is linked to sale of scraps, sale of broken glass and sale of gunny bags and all those other incomes in United Breweries itself.

Guido De Boer And may be one item to explain which there is the number of provisions we took in the past years, we now fully have written it off, so the impact of that shows in our P&L at higher operating cost and exact same amount is coming as other income. So the impact of that is Rs. 22 Cr. which is a one-off effect which neutralizes on EBITDA level.

Ashith Desai And how much is from Balaji you said, from Chennai Breweries?

V. A. Poonacha 23 crores.

Ashith Desai Okay. Thanks a lot sir and all the best.

Moderator: Thank you very much. Our next question is from the line of Swati Nangalia from IDFC, please go ahead.

Nikhil Vora Just a couple of things. Till date for the first nine months we have done a volume growth of close to around 6% and overall growth of around 7%, so would it mean that the premiumisation internally whatever limited one can is that extremely limited, or that opportunity is extremely limited?

Guido De Boer Impact of this limited if we look at it on a longer basis we have always been relatively close to inflation in our price mix improvement. It depends also a little bit on quarter-by-quarter basis how your state mix moves, etc.

Nikhil Vora I did not quite get that so for 9 months we have been flattish or rather revenue growth is pretty much equivalent to our volume growth. So I did not get context sorry.

Guido De Boer So if you look at it over longer periods for multiple years then actually one of your questions is the volume numbers we mentioned are on a combined basis. So they are for UBL as well as the contract breweries as well as the companies which merged into UBL. So you can't like-for-like compared to the volumes we have shown to the UBL standalone revenue growth.

Nikhil Vora Okay. Second one for just to look at the states that we are looking at close to around 2.5 billion of CapEx for the next couple of years. Would that mean that we will not be free cash positive for the next couple of years and to take another clue from that is we have been looking at more Greenfield projects lately, so what is the option curve between acquisition and Greenfield in some of the states?

Guido De Boer We feel that with the current market position we have, with our brand portfolio, there is no real need to have an active acquisition focus. So we will build standalone breweries which meet our quality requirements and ensure they are in the right place. We are definitely on organic growth more than an acquisition one. And on free cash flow, like in earlier question we said that we are working strongly towards is bringing down working capital and enhancing margins to bring up our return on investment capital as well our cash flows.

Nikhil Vora Okay, just lastly, what is the minimum economic size that you would look at in a particular state, so while we are setting up a unit in Bihar and presuming that Bihar state has not been a high growth market till now. So what is the broad logic of setting up the capacities in states where – what is the minimum economic size for setting up capacities in certain states?

Guido De Boer Bihar has been the growth sensation of the past years I would say so it is definitely not a declining market but in this year it has been weak, but overall if you compare it over a few years horizon it is performing very strongly. If the market is very small we source the market with imports from other states or from a local contract brewery and build a brewery within the state only when the market justifies a capacity of say 0.5 million. But we build it with the opportunity to scale it up to significantly larger sizes.

Nikhil Vora That should be it. Thanks a lot for this.

Moderator: Thank you very much. Our next question is from the line of Mayur Gathani from OHM Group, please go ahead.

Mayur Gathani Hi, good evening everyone. Sir can you just let me know the gross debt figure?

P. A. Poonacha **Rs.** 813 Cr.

Mayur Gathani And all the mergers that we have to do all are complete, so we do not see any debt increasing now?

P. A. Poonacha No, we have another merger pending which would bring in debt around Rs.30 cr.

Mayur Gathani Okay. And sir elections in UP, any impact in this quarter?

P. A. Poonacha No, not significant. There is some impact but not significant.

Mayur Gathani Okay. Sir what is the market share in AP, I mean we were quite strong in Quarter 2. So do we see any….

P. A. Poonacha Closed the December quarter at around 50%.

Mayur Gathani Alright. So we can expect this to be stable now?

P. A. Poonacha Yeah, we have continuously maintained this in the last four months. I mean because from 1st September the ordering policy changed so for four months we have been able to maintain market shares hovering around that region. So we are confident that we can hold ongoing further also.

Mayur Gathani And the market share for Maharashtra would be around?

Guido De Boer 72%.

Mayur Gathani So, generally quarter 3 is a little weak quarter so I mean the market share increases and then again quarter 4 onwards, quarter 4 to quarter 1 we will have some reduction because of other players coming in and becoming more competitive.

P. A. Poonacha That used to be story in the past wherein the smaller players pumped in stocked in the summer months by huge discounts while we expect the trend to change because most of the smaller players have become financial very weak because of our patented bottle policy wherein they pay more for the bottles. Secondly, they have lost a lot of market share in the past and they have been really grappling to maintain volumes to meet their fixed cost. Going forward we expect things to change but historically what you said is right.

Mayur Gathani Okay, and how have raw material prices been sir? I mean we have seen reduction in this quarter.

P**. A. Poonacha** No, if you see raw materials as such along with inflation, inflation is around 9% so all raw materials have gone up. Our key raw material like malt has gone up 25% but we have been able to pull back on cost because 45% of our cost is on glass and we have been able to pull back on glass cost by implementing these patented bottles which have helped us achieve reduction.

Mayur Gathani Correct, but what I meant was going forward, I mean do we see reduction in raw material prices?

P. A. Poonacha Raw material prices is a function of inflation I mean you cannot expect raw material price to go against inflation, right.

Guido De Boer If you look at main raw material cost, in glass we see inflation in new bottle prices. That is given what we implemented our old bottle prices will rather go down than up. So definitely there we see an improvement. Then if you look at malt cost, are next significant cost and barley seasons will end in March it is a little bit too early to say but the signals are encouraging that we would not to see increases like we saw last year and then obviously it is oil prices and dollar which have an impact which we cannot predict.

Mayur Gathani Fair enough sir. All the very best.

Moderator Thank you very much. As there are no further questions from the participants, I would now like to hand the conference over back to Mr. Guido De Boer for closing comments.

Guido De Boer Thank you again for joining and for your good questions and hope to see you again after the Q4 quarter. Thank you very much.

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