



“United Breweries Limited’s Q3FY14 Earnings Conference Call”

February 14, 2014



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MODERATOR	MR. HARIT KAPOOR – AVP, RESEARCH, IDFC SECURITIES LIMITED



*United Breweries Limited
February 14, 2014*

Moderator

Ladies and Gentlemen, Good Day and Welcome to United Breweries Q3FY14 Earnings conference call hosted by IDFC Securities Limited. As a reminder for the duration of this conference, all participants' 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 this conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would now hand the conference over to Mr. Harit Kapoor from IDFC Securities Limited. Thank you. And over to you Harit.

Harit Kapoor

Thanks, Mohsin. On behalf of IDFC Securities, I would like to welcome you to the Q3FY14 Earnings Call of United Breweries. We have with us the senior management of United Breweries represented by Mr. Henricus P.van Zon – CFO and Mr. Poonacha – Divisional Vice President. I would like to now handover to Mr. Henricus P.van Zon to make initial remarks, post which we will open the floor for Q&A. Over to you, Henricus.

Henricus P. van Zon

Ladies and gentlemen, very much welcome to this telephone conference call regarding the Q3 Results of United Breweries Limited. As you have probably noticed in the press, very often when we have presented figures, the press is not very careful in using our name. So they use United Brewery, Kingfisher and everything of other companies not associated with United Breweries Limited. If you have seen our press release and our figures, which of course you would have, we have had a good result in the Q3. We all remember the difficulties that we were having, as highlighted and discussed during the Q2 Con call. We were confident at that point of time that the programs we had in place and with a further extra focus on costs, the Q3 would come out far better which is the case. So we are very happy to show that we have again had a good growth in our EBITDA at 11%. Also, we had a good growth in our profit before tax by 8%. Our profit after tax as you have noticed has gone down a little bit which had to do with some tax reversals that we were still able to make in the previous year. Revenue was up by 9%. We had the volume development better than what we were able to show in Q2. The industry we can say, if we look at the total industry development in the first 3 quarters of this fiscal year then we basically look at an industry which is flat. So, in that respect we are happy that our volume is slightly above zero, and we also see the effect of Tamil Nadu now basically fading out as a negative effect on our figures because they are now more than one year behind us.

That is from me as an introductory remark. I understand that we have a very huge group of participants today, we are very happy to hear so. So therefore without further ado, I would like to open the floor for questions please.

Moderator

Thank you very much sir. We will now begin the question-and-answer session. The first question is from the line of Tanmay Sharma from Edelweiss. Please go ahead.

Abneesh

This is Abneesh here. My first question is on the industry demand, we see tax rate now again being increased in Maharashtra and some of the key states. So how do you see now Tamil Nadu issue being there in the base? How you are seeing demand in the coming quarters? And, in



*United Breweries Limited
February 14, 2014*

Tamil Nadu, the other large spirit companies have done a complete change in terms of how they sell, any idea we also have on similar lines in Tamil Nadu?

Henricus P. van Zon

It is difficult for us to answer in terms of that, as you know we are not used to give any predictions, any forecast into the future also, not into the next quarter. Tamil Nadu situation has not changed at all, it has been there over the last 5 quarters, but indeed as you said it is not the basis anymore for any comparison in the future. And that is basically what we can say about it despite with the industry being flat in the first three quarters of this year. With us being slightly over zero plus still having two quarters Tamil Nadu affected our figures. We can be very happy with the way our volumes develop.

Abneesh

One follow-up question here. If I see some of the results of the spirit companies. I am not talking about the largest player, we see them still reporting relatively healthy volume growth and why is that – is beer kind of losing out because of the sharp tax increases, so consumer is kind of shifting to the higher liquor content? And second is ex-Tamil Nadu if you could share how much has been the growth in the last 3 quarters for the industry or for you?

Henricus P. van Zon

On the first matter, I think probably the beer industry develops not on exactly the same drivers as the Spirit industry would do. You do remember that we had a whole monsoon issue in the Q2, I guess that hurts us on yearly basis far more for the Beer industry than the Liquor industry, that is one of the factors then there has been a steep excise increase in Maharashtra which had a negative effect on the development of the market there. So it is difficult I think to compare the developments in the Beer industry with the ones in the Liquor industry and that is actually what I can say about it. With respect to your second question, what would be our development with excluding Tamil Nadu as a state, then our growth would be 6%.

Abneesh

One follow up, earlier you used to give volume growth across some of the key states – Maharashtra, Andhra, Bihar, Bengal, Delhi, Karnataka, etc., So the 6% volume growth are you seeing any kind of a divergence in these key states largely it is similar, say Andhra is getting impacted because of the Telangana issue, etc., some color on the state wise?

P A Poonacha

We have grown in the Northern markets; we have grown in Uttar Pradesh, we have grown in Rajasthan, and we have grown to some extent in Delhi. In the Eastern markets we have grown in West Bengal, we have grown in Odisha; however, in Bihar we have degrown. In the South, we have grown in Karnataka, we have grown in Andhra Pradesh; however, Tamil Nadu was down. In the Western markets, Maharashtra is down, Mumbai is down, Madhya Pradesh is also down, Goa there is slight growth. So this is the major markets.

Abneesh

My last question is related to the answer which you gave. Is it correct that most of the decline or slower growth in the states where obviously tax increase was much faster. So, in that context why state governments are still increasing tax? What we have seen is in cigarettes, we have seen some of the states reversed the high VAT rate, in Punjab we have seen that. So in

liquor why that understanding is not coming? And is that understanding correct that if you take a tax increase very sharp, the state government also kind of loses out because volumes takes a big knock so are you engaging with government and if you could share why in Liquor we are not seeing the same thing what we are seeing in cigarettes and at least in a few states?

P A Poonacha

While your question as to if we are engaging with the various state governments, the answer is 'yes,' we are at regular intervals meeting state governments and trying to imbibe in them that there has to be some rationale in duty increase. However, bureaucrats do not seem to understand because even if there is a sharp increase in duties, the overall duty collected, even after the volume drop, would be little higher than what was previously collected, hence they do not need to answer internally and they get away from any audit objections because that is how the various tax departments are and the revenue departments in the state are built.

Moderator

The next question is from the line of Aditi Murkute from IdenAdvisors. Please go ahead.

Aditi Murkute

Volume has been better but how much, could you quantify that figure?

P A Poonacha

You are talking about the quarter or the year-to-date?

Aditi Murkute

Year-to-date, as of quarter as well as accordingly like how it has been growing from the past?

P A Poonacha

I will give you the quarter first; it has grown from 28 million cases to 29 million cases for the quarter, for the year-to-date it has grown from 100 million cases to 101 million cases.

Aditi Murkute

Is there any consumer sentiment attached to the way that Liquor has been used or rather consumed by the consumers?

P A Poonacha

No, the very reason why beer and spirit companies have managed to get the growth we are seeing, there has been a shift in the perception of people consuming Alcohol and Beer. That is why you are seeing the growth. If it had been otherwise, you would not have seen the growth that we have been currently seeing. If you have been seeing for a period prior to a decade back, we never saw this kind of growth. Consumer sentiments are changing towards the consumption of Alcoholic Beverages and Spirits.

Aditi Murkute

Is that the Beer consumption has been reduced or it has been...?

Henricus P. van Zon

Beer consumption per capita has not reduced; it is gradually increasing.

Aditi Murkute

As an industrial outlook, has it performed a way better or ...?

P A Poonacha

Specifically if you go by state, there are certain states in which there has been strong double-digit growth, there are some states where state excise policies have gone totally wrong where the put-down price of a bottle of Beer has gone up by more than 30%, it is obvious that there



*United Breweries Limited
February 14, 2014*

will be some reduction in growth because finally Beer comes under the category of discretionary spending and with this inflationary economy the consumers purse is squeezed, and if the end consumer price of Beer goes up by 25-30% like it has in some states, there will be some effect on volumes. But that does not kill the inherit growth in Beer in the country.

- Aditi Murkute** So the major part of it was hit because of the excise duties which have been increased?
- P A Poonacha** Yes.
- Aditi Murkute** What is the current market share?
- P A Poonacha** We are at 51% year-to-date, and if we take just the month of December it is far higher.
- Moderator** The next question is from the line of Ashit Desai from B&K Securities. Please go ahead.
- Ashit Desai** I have a couple of questions. Firstly, if you could just give some color on the product mix for geographical mix improvement in terms of what is the contribution from Kingfisher versus last year, and contribution from your Premium brands – ULTRA, Heineken versus last year?
- P A Poonacha** I cannot give you specific numbers; however, if you can see the increase in the revenue line vis-à-vis literally flat volume growth, it is very clear that our Premium products are doing well, and in addition to our Premium products doing well, states where the per case revenue is high, for example, one of those is Karnataka, there has been good volume growth, thereby as a mix you would see that revenue is fairly high in comparison to a flat volume growth.
- Ashit Desai** It was like 40% market share out of the 51% that was accounted by Kingfisher earlier. Has that changed materially which is benefitting the gross margin?
- P A Poonacha** We would not want to give out information on that, but the Kingfisher and its other products like Kingfisher Umbrella are doing well, thereby having this high revenue growth. You can say Economy brands are not growing as fast as Kingfisher and Kingfisher Umbrella brands.
- Ashit Desai** Any colour on the growth rates between lower end Kingfisher and the premium end, which is growing faster if you can say, if not the numbers?
- P A Poonacha** I have given you the answer saying that the revenue line has gone up, because the Kingfisher and Kingfisher Umbrella brands are growing faster than the Economy brands.
- Henricus P. van Zon** I think that it is important to say that we have no lower end Kingfisher brands.
- Ashit Desai** You used to mention the usage of second hand bottles earlier, if you can give that for this quarter?



United Breweries Limited
February 14, 2014

- P A Poonacha** The consumption of used bottles in this quarter has been almost half what would have been normally budgeted. Reason being in the first two quarters of this financial year, due to an excise notification by the State Government of Maharashtra, we were compelled to use new bottles in all our three units in the state of Maharashtra which meant huge infusion of new bottles. Now, with this notification being withdrawn effective the 1st week of October 2013, the quarter-ended December has seen lower consumption of new bottles, which means higher consumption of old bottles or returnable bottles thereby a cost advantage in the particular quarter.
- Ashit Desai** Sequentially, how would the ratio would have changed?
- P A Poonacha** No, that we donot want to share, but you can see the financials and if you see the cost line you can see a huge gain that we have made on account of this.
- Ashit Desai** These gains can be sustained or you see them to be a one-off because your first two quarters were affected by the policy?
- P A Poonacha** You will see same for this quarter that is for the March quarter after which it goes, means the first six months higher consumption of new bottles would have resulted in a higher cost in the first two quarters; however, it will lead to a lower cost in the next two quarters. One quarter is already done; we are sitting in the next quarter, so by March the positive effect would be over.
- Henricus P. van Zon** I think what you correctly said is, if we will be at the end of the calendar year, the level of usage will be sustainable on the year basis, not on the quarter basis.
- Ashit Desai** So year-on-year if I compare FY15 to '14, your usage of second hand bottles will be more or less similar?
- Henricus P. van Zon** Yes.
- Ashit Desai** Why I am asking this because your December quarter margins, this is a low volume quarter, and these are your highest ever margins for a December quarter?
- Henricus P. van Zon** Yes, you are right.
- Ashit Desai** You see there are some one-offs in this quarter or this can be continued based on the cost curtail?
- P A Poonacha** You cannot call this one-off, like you had one-off of downside in the last quarter, we have a one-off upside in this quarter on cost.
- Ashit Desai** Yes, so 9-month would be more comparable?



*United Breweries Limited
February 14, 2014*

- P A Poonacha** This is what I have just said that your calendar numbers are comparable.
- Ashit Desai** Any color on the savings and selling expenses that you have seen in the quarter? As a percentage it is more or less similar, but a freight cost or trade expense that you have seen lower because you have commented on a peak competitive activity.
- P A Poonacha** We have to continue with our brand building that was not changed. As a percentage your sales expense will be no different, because we are in a competitive market, we have to ensure that our brands are vibrant. So you will not see much of a change there.
- Harit Kapoor** Just wanted to understand how is the roll out in terms of Heineken proceeded, where we are in terms of state or city wise count and any color you could give on that?
- Henricus P. van Zon** The roll out is proceeding which means that we are on a regular basis at new markets for Heineken and also we did in the previous 9 months we will keep on doing so, which means that not only because of that but also in the markets where we are present from the beginning, we see a good growth, we start of course from a very low level but the brand is developing well.
- Harit Kapoor** Any key markets that you would have added may be in the first two or three quarters as compared to last year is something more specific if you could share on this?
- Henricus P. van Zon** We are by now in all the main urban areas in India.
- Harit Kapoor** Just wanted to know Karnataka is probably the most profitable market for us, how do we see the change in excise structure in today's state budget affecting us or what is the kind of likely thought process that we would have on that front?
- P A Poonacha** That will affect but then what the effect is we can probably comment only after we go through the budget in full and calculate what the effect would be.
- Henricus P. van Zon** We have only got a couple snapshots, we have not seen the whole thing yet. Let us indeed first look at.
- Harit Kapoor** Because interest costs have come off and they continue to moderate, if you just help me what the current gross debt levels would be for us?
- P A Poonacha** About Rs.870 crores the gross debt;the gross debt is down in comparison to the last financial year because we have decent profitability in this financial year. Growth levels are not that high, thereby the CAPEX expansions are not as fast as they would have been, thereby outflows are much lower than what they should have been. To add to that we do not have very many repayments in this financial year, thereby we have had good internal cash flows or cash



retention out of the profits, which has been placed in our working capital limits and thereby lower borrowing levels, lower interest levels.

Harit Kapoor

What would be the average cost of debt now for us?

P A Poonacha

We would not want to share that, it is very competitive.

Harit Kapoor

I just wanted to understand what are our CAPEX for this year in terms of how much will we end at and if we have some idea on next year? Why I am asking this is also because to understand whether internal accruals would suffice or would we need to increase this gross debt number further in order to fund capacities where there is working capital.

P A Poonacha

The last two years – that is Financial Year '12-13 and the current year, the volume growth has not been as high as we would have probably expected, thereby CAPEX growth would not be in the same region as you have seen in the past, and we really would not want to make commitments on this because if I say something now, it can go horribly wrong, it will basically be the way the volume pans out in the first quarter of the next financial year.

Harit Kapoor

Would you have the number for FY14 at least?

Henricus P. van Zon

As Mr. Poonacha said, we will follow of course the development of the market and we will invest as much as we need to invest in order to be able to supply. We will try in order to pre-invest or to invest for ideal capacity. So that is very clear. The intention of your question that what you mentioned, "Will we be able to finance this out of accruals internally?" The answer is 'Yes.'

Harit Kapoor

I just wanted to understand... just a hypothetical, in an environment where taxation is not punitive or regulatory issues do not impact us state wise as much as they have in this year, how do you think the industry can grow in terms of volume, what could be a sustainable number like maybe even a 5-year framework or a 3-year framework, given that taxation levels remain more or less modest, just to understand what is your thought process is on that at least for the industry not for others?

Henricus P. van Zon

For us it is very clear that we will do everything we need to do to keep our market positioned that we have currently at least. What the market will do is very difficult to say. We want to kind of abstain from making any comments from that. If you look in the past this year we have no growth in the market to previous years, it was small single digit and then before that we had 2 years with an enormous growth. So Indian market will grow into the future that is I think certain. The question is in what kind of pattern it would grow is very difficult to predict.



United Breweries Limited
February 14, 2014

- Harit Kapoor** One last one, the market share growth has been very good, any pockets of competitive intensity, may be which have risen over the last 6 months or 9 months, if we want to highlight any region in specific, or any certain competitor or just a general comment?
- P A Poonacha** All international brands have been launched in India are being very competitive and there is competition in most markets in the country. There is no specific place where they are behaving differently. So we have to handle competition and we are doing it to the best we can, and all we can say is that as we speak we have been successful.
- Moderator** Thank you. The next question is from the line Ashit Desai from B&K Securities. Please go ahead.
- Ashit Desai** If not numbers, if you could give some trend as per how your margins in Tamil Nadu or profitability in Tamil Nadu is?
- P A Poonacha** Margins are better off than where it was prior to this ordering pattern has changed. Per case margins are better but what the problem there is volume.
- Moderator** As there are no further questions I hand the floor back to Mr. Harit Kapoor. Over to you.
- Harit Kapoor** Thanks, Mohsin. On behalf of IDFC I would like to thank all participants as well as management of United Breweries for taking time out for this call. Hans, would you have some last words?
- Henricus P. van Zon** Just to thank you all for your interest in our company and your interesting questions and we look forward to the next conference.
- Moderator** Thank you. Ladies and gentlemen, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.