



“United Breweries Limited Q1 FY19 Earnings  
Conference Call”

**August 13, 2018**



**MANAGEMENT:** MR. STEVEN BOSCH – CFO, UNITED BREWERIES  
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**MODERATOR:** MR. MEHUL DESAI – IDFC SECURITIES



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**Moderator:** Ladies and Gentlemen, Good Day and Welcome to the United Breweries Limited Q1 FY '19 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, please signal an operator by pressing '\*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mehul Desai from IDFC Securities. Thank you and over to you, Mr. Desai.

**Mehul Desai:** Thanks Inba. Good evening everyone. On behalf of IDFC Securities I welcome you all for Q1 FY19 Earnings Call of United Breweries Limited. From the management side we have Mr. Steven Bosch – CFO and Mr. Poonacha who heads the investor relations. We will start with an opening commentary from Steven and then we can go ahead with the Q&A. Over to you Steven.

**Steven Bosch:** Thank you Mehul and good afternoon, good morning to all. Just to kick off with a short summary for the quarter, we are pleased to report continued healthy volume growth as well as good revenue growth. UBL's primary volume grew at 12% compared to industry growth of 9% and on a secondary volume basis our market share is in line with last year's first quarter. Most of the larger markets showed good performance with Telangana, Andhra, Tamil Nadu and Uttar Pradesh all up double-digits, plus the industry benefits from relatively easy comparables given last year's highway ban.

Also, the underlying growth trend is encouraging in most markets. And if we look at UBL's performance in a number of key markets, let me highlight four states in specific:

First of all, we had a particular strong growth in Rajasthan where we are gaining share. In West Bengal the industry continued to contract due to duty related steep consumer price increases. In Karnataka we faced some challenges due to the state elections disrupting our local supply footprint which put some pressure on our share there as well and then in Uttar Pradesh you may recollect from the previous call, i.e., the policy has changed, the excise policy now in the market, has led to an increase in the number of wholesalers and because of this there was quite a strong demand growth and we faced some supply shortages to meet the demand. And our share came down as a consequence to some extent. In revenue terms we recorded a 12% net revenue growth versus the first quarter last year and we did benefit from several price increases granted to the industry including a 10-11% increase in Telangana which is of course one of our largest markets. However, the state and source mix impacted the net realization per case to some extent.

On the premium segment, premium growth continues to be in strong double digit, albeit in first quarter due to import-export restrictions not all the markets could be fully supplied. We are pleased to report that we successfully launched Amstel Strong in May and also Kingfisher Storm is maintaining its good momentum.



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From a margin point of view, our gross margin extended thanks to successful input cost management. We were also able to reduce BTL/ discounting in some markets. We managed to secure lower prices for malted barley as well as sugar, our key inputs. This was partially offset by a higher new-bottle-usage as a consequence of volume growth. EBITDA growth was strong with some 28% growth, reflecting positive operating leverage and continued cost control. We repeat our earlier volume guidance for the year as of 6-8% volume growth for the markets in medium term with UBL aiming to show growth in excess of that, confident to do a little better than the market. And our capital expenditure is in line with the earlier guidance targeting capacity expansion in several locations across the footprint.

Then finally a comment on GST – we received some questions on the advance ruling that we obtained. It was ruled that the income that we derive from our contract production units will be subject to 18% GST. However, the service charge that we pay to these contractors is exempt from GST and whilst we will appeal against that ruling we fully provided for this impact already in last year's P&L. With that I end my introduction and open to any questions you may have. Thank you.

**Moderator** Thank you very much. We have the first question from the line of Ashit Desai from Emkay Global. Please go ahead.

**Ashit Desai:** My question was on realization you had highlighted I think weak growth in Karnataka and UP but going forward do you see realization growth being ahead of volume growth?

**Steven Bosch:** Yes, as you know it is always this function of state mix so indeed as we concluded for Q1, state mix was a little bit impacted because of growth in Rajasthan, Telangana and we had this election impact in Karnataka, so it is difficult to give you certain specific guidance on state mix but those effects in UP and Karnataka clearly were a consequence of some external disruptions which may not be repeated in the coming quarters.

**Ashit Desai:** Can you quantify what was the impact on volumes in UP due to the supply constraints?

**Steven Bosch:** We do not really quantify these specific impacts, but clearly we had a tough first few weeks of the quarter due to the switch in the market. We had some initial issues to get the supply up and running.

**Ashit Desai:** Okay, these were capacity issues or distribution issues?

**Steven Bosch:** Yes, the two actually. So, on one hand it has been that we normally source UP from Rajasthan, but we could not do so due to because of the export ban. Secondly getting up to speed a large number of wholesalers that came into the business was also a challenge. Almost, I think more



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than almost 200-300 new customers came on board, so it also took some time to for them to get into the system.

**Ashit Desai:** Okay and now since you are entering into a lean season would capacities be enough for you to meet the current demand or this supply issue will remain there for the rest of the year also?

**Steven Bosch:** As we speak, indeed to your point, the demand is tapering off because of seasonal factors, we should be in a better position to capture demand.

**Ashit Desai:** And secondly if you can quantify what has been the growth in premium brands for the industry and UBL? How is that growth coming up?

**Steven Bosch:** The premium beer growth is outperforming, and stronger than the overall market growth. So, it continues to be in strong double digits and we have continued to do well. So, it is both the industry and UBL growth of premium beer in double digits.

**Ashit Desai:** And what percentage of their volumes would be coming from premium brands now?

**Steven Bosch:** It is mid-single digit, it is growing but it is relatively small fraction of the total market.

**Ashit Desai:** And just to reconfirm you said compared to a high single-digit volume growth you now expect 10% growth for the year for UBL?

**Steven Bosch:** Yes, so what I have said is that the market is expected to grow some 6% to 8%. Of course, we need to keep in mind potential disruptions later in the year due to state elections as well as in the next calendar year having national elections, which might impact the market. We believe that we can do better than that 6 to 8%. So, I have confidence that we will be outperforming the market.

**Moderator:** We have the next question from the line of Chanchal Khandelwal from Birla Sun Life Mutual Fund. Please go ahead.

**Chanchal Khandelwal:** First question is where you are getting confidence of 6-8% volume growth for the industry because if I look at last 4-5 years industry has not grown to that extent. So, where are you getting confidence of this volume growth? Is it the GDP growth improvement lead to our volume growth or where is this confidence coming from?

**Steven Bosch:** We are seeing in several large markets, the growth is in double digit percentage and continuing. For instance, I will give you one example of the market of Telangana, which was last year, not yet affected by the highway ban and therefore in that market the comparables were not impacted, there we see continued growth. And in multiple other markets there was healthy consumer demand. So, the 6-8% growth that we believe for the market, is a realistic estimate.



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**Chanchal Khandelwal:** If you can also touch upon the change in distribution structure in UP, would not it be good for you for a longer term? I mean you have lost market share and it is highlighted, but would not it be good that the change in wholesale structure will help distribution reach increase and help you get more market share of a longer term?

**Steven Bosch:** Indeed, the point there is that we moved from a monopolistic distribution model where one distributor had a very high market share. That then moved into situation where we had whole range of customers so that changed the market dynamics. On top of that, as per the excise policy, the traders and the wholesalers are supposed to pay in advance for the beer when they would order. Also, there from a working capital perspective we are seeing a big improvement. So, yes, this opening up of the market is a positive for us. And we do expect in the coming quarters to see some positive momentum.

**Chanchal Khandelwal:** Lastly in terms of net realization not growing up, is it that the key states Maharashtra, Karnataka and West Bengal there were disruption and that is the reason net realization has not grown up and it has come back in the following quarter?

**Steven Bosch:** Yes, it is a mix effect. So, there are clearly states where we have a little lower realization than country average that have done well, so for instance, Rajasthan, Telangana. And some of the other markets like you highlighted where the growth was a little less this quarter. And to the earlier questions around this, I do not comment on the mix changes going forward. That is not really easy to give you an outlook on.

**Chanchal Khandelwal:** Second last question, Maharashtra after the excise increase has the volume back or it is still struggling?

**Steven Bosch:** In Maharashtra it is a little better but still you see that the market still needs to digest this spike. So, it is not yet back to where we want it to be.

**Chanchal Khandelwal:** And what is your CAPEX? You said you have a CAPEX plan, you have not highlighted the figure in terms of rupees. What is the spend we will see in the next 2-3 years?

**Steven Bosch:** In the coming 2-3 years... During our Q4, we had given you guidance in our previous call, that we will up it by 50%, that guidance I was referring to, is still intact. And of course, subject to market trends, subject to further growth, we may want to keep our CAPEX going up or going steady to ensure we have the capacity available.

**Moderator:** Our next question is from the line of Saumya Tiwari from Edelweiss. Please go ahead.

**Abnish Roy:** Sir one question was in Maharashtra now ready to drink liquor we are seeing government allow 8% kind of alcohol content. Beer could be at risk because beer ranges from 5% to 8% and in



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India if you see clearly taste and more alcohol, that could lead to a switch. What is your take on that?

**Steven Bosch:** We clearly play in the category of either below 5%, the mild beer and between 5-8% the strong beer category. We believe that, that is where the growth is and that is where the opportunity is there for us. Also look at the premium segment growth that is largely in the mild space as well. So, this is where we want to focus and anything beyond 8% is more for other players to look into, including the spirit players.

**Abnish Roy:** So, this one says up till 8%, so this will definitely compete with strong beer. So, you do not expect any meaningful impact?

**Steven Bosch:** I think there has been one press release or let us say some press coverage by I think one of the local Mumbai newspapers, if you are referring to this, but we are seeing that the excise for RTDs has actually gone up. So, this notification that was referred to in the news incorrectly stated that, “also for beer the excise would come down”. But that is not confirmed. So, in the end, relatively speaking RTD excise is making beer more affordable, relatively speaking.

**Abnish Roy:** My second question is on the eCommerce. If you see for FMCG Steeple’s company it is 1.5-2% already volumes from eCommerce. In Bangalore I understand there are a few players which are already offering, and we have seen United Spirits pick up a stake in one of those. So, my questions are two – do you also intend to pick up a stake in any? Second is do you see this going into more cities? And in Bangalore already are you getting reasonable numbers from these eCommerce companies?

**Steven Bosch:** On your first question, I do not comment on what our potential acquisition strategy could be. But it is fair to say that it is really-really early stage. This business of eCommerce, it is also in many markets, not allowed. The excise rules do not allow for delivery on eCommerce services for alcohol. So, whilst we do look at it, we will monitor the market, but it is still very-very small and often not permissible.

**Abnish Roy:** Yes, but in Bangalore any significant update?

**P. A. Poonacha:** Actually, the excise rules do not allow sale of beer and spirits through eCommerce.

**Abnish Roy:** No but Bangalore it is allowed, right, already companies are doing it?

**P. A. Poonacha:** Yes, but they just take the order, but the final billing has to be done of the retail shelf.

**Abnish Roy:** Yes, so essentially, they tie up with the retail store and customer does not have time etc. so the same convenience of eCommerce is basically being done by a tie up with a physical store, but consumer is getting it at his home delivered.



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- P. A. Poonacha:** Basically, suppose you want your stock, you basically opt and hire somebody to go, make the billing and then deliver to your house. It is no different from asking your driver to get it for you.
- Abnish Roy:** No sir, this is through an app and this is completely different.
- P. A. Poonacha:** Yes, instead of physically telling the driver, through an app you tell somebody else to get it for you.
- Abnish Roy:** But if you do not have a driver also you can get here. That is the main thing that it is happening through eCommerce.
- P. A. Poonacha:** The excise rules are very clear that it has to be a retail transaction. You can read excise of Karnataka, very clear.
- Moderator:** The next question is a follow up from the line of Ashit Desai from Emkay Global. Please go ahead.
- Ashit Desai:** My question is on margin, I mean despite flat realization your gross point is 166. What is driving that what more debug you have for market expansion going forward?
- Steven Bosch:** Yes, there are two points I would like to highlight. So, one is the input cost of barley, which of course is one of the key inputs. And the price of input materials, has been a bit more favorable than last year i.e. the malted barley, including the conversion cost and any rates and taxes on that transaction. And secondly, due to supply constraints that we had in some markets we were able to reduce discounting to a certain extent. So, in a couple of markets we had less competitive pressure to incentivize the trade. These are the two key ones that are worthwhile to mention.
- Ashit Desai:** And going forward what more levers can we expect in terms of margin expansion?
- Steven Bosch:** We are working on critically reviewing and critically assessing all our input materials. Of course, in many instances we are also subject to macro drivers like crude prices going up, also affects the total costs, or the foreign exchange rates or the global barley price levels, so, we are taking steps and monitoring and we try to be as efficient as possible, but I will not give a particular outlook on how we see the trends going forward.
- Ashit Desai:** And lastly, due to the change in tax structure in Uttar Pradesh, is there any change in accounting and any impact on that on the P&L?
- P. A. Poonacha:** No, accounting remains similar to what was there in the last financial year.
- Moderator:** We will take the next question from the line of Mehul Desai from IDFC Securities. Please go ahead.



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**Mehul Desai:** Just two questions from my side. One is on the higher other income for this quarter. Is there any one-off for that and second is what is your outlook on the debt part given that we have seen a substantial reduction in debt and also you have stated that there are lot of working capital improvement that you are seeing?

**P. A. Poonacha:** I will take the first question. The increase in other income is on account of reversal of provisions that we have made for collectibles which were above six months as of 31<sup>st</sup> March 2018. So, subsequent collections have meant that we had to reverse these provisions. So, a large majority of – I mean in fact of the Rs. 15 crores about Rs. 11.5-12 crores is on account of this reversal. And the debt, if things are in line with the current situation till the end of the year we should be almost debt free.

**Mehul Desai:** And finally, one question on the distribution channel, I mean the highway ban had substantially reduced the outlets and then the state started recognizing as state highways and we saw some of the outlets come back. In this one year have you seen, I mean what is the distribution outlet market and have you seen incremental increase in the number of outlets coming up? If you could give some sense on that part?

**Steven Bosch:** Indeed, so we have monitored the trend after the highway ban, it is not yet back upto originally where it was. Before the highway ban, the number of outlets, points of sale across India totaled from 82,000-83,000 outlets. After a dip that number is slowly up. To your point, that clarification was made that some outlets could reopen. So, we are round about, sort of, 74,000-75,000, is the estimate, or latest count. So, we are not yet back to that level that we were at last year. But the consumer demand has basically been refunneled or replaced into these remaining outlets. That shock effect should now be largely over.

**Moderator:** Our next question is from the line of Tushar Sarda from Athena Investment. Please go ahead.

**Tushar Sarda:** I wanted to understand about this wage in urban city especially your craft beer. There are many outlets which have open which served customized kind of beer or craft beer with various flavors. So, how do you compete with them and what would be there in terms of the overall price of the beer market?

**Steven Bosch:** We distinguish between two types of segments, where one is the Brew pub space and the other is the craft beer where you see craft beer in a packaged form. So, on the first one, the Brew pub space you see in big metros Bangalore, Pune, Mumbai you see a lot of new places coming up over the last 18 to 24 months and it has grown. Those largely cater to the local audience, local consumers. They do not package, they do not have a license to package their beer. So, therefore it is also, in volume terms, still relatively small. Then you have the craft beer space where you see brand names coming up. Also, were they command a very high mind share or people talk about those brands because it is new, but in volume terms it is still relatively modest.



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Nevertheless, as we have announced earlier that we also want to play a role in that space and come up with our own craft & variety offering, which we will announce when we are ready to do so. Yes, it is an exciting trend as more and more players are coming up. But overall in India the volume share of that segment is still very small.

**Tushar Sarda:** Just a follow-up on that, globally what would be the size of this specialized beer as percentage of the total market?

**Steven Bosch:** Globally I would say it is single digit percentage. Only the 2-3 markets where this really has picked up is of course in the US and in Western Europe you see this. Clearly across the world you see demand for this type of product, but still it is not yet a very high percentage share. It is single digit market share percentage.

**Moderator:** We will take our next question from the line of Rajasa K from Franklin Templeton. Please go ahead.

**Rajasa K:** My question is on your other expenses. This quarter we have seen pretty mild increase in your other expenses on an absolute basis. Is that something that we can extrapolate for the full year? Is there some sort of cost saving program that you have instituted that will ensure that the inflation and overhead is going to be minimal for the rest of the year as well?

**P. A. Poonacha:** It is the same percentage of revenue you can extrapolate the balance of the year.

**Moderator:** The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

**Pritesh Chheda:** Sir I missed your comment on why you think that the volume growth for the year will be less than what you recorded in the first quarter, in any case for the past so many years the volume growth has been fairly soft, so actually I was not able to understand your comment on that.

**Steven Bosch:** Two points on that, then to reiterate. One, as the volume Q1 is on the basis of relatively easy comparables. That is what you see in Q1 last year for industry, was affected by the highway ban. That needs to be kept in mind when we look at the industry volume and the growth of that volume. Secondly it is fair to say that we have a number of state elections coming up and also national elections next year which may form a challenge or could lead to disruptions in the route to market in Q3 and Q4 in particular. So, whilst we have seen good growth, we retain or maintain earlier guidance of 6-8% market growth.

**Pritesh Chheda:** What would be your slightly medium to longer term volume prognosis for this industry?

**Steven Bosch:** It is unchanged. It is still in its mid to high single digit range is where we are able to see it.



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**Moderator:** As there are no further questions from the participants I would now like to hand the floor back to Mr. Mehul Desai for closing comments. Over to you sir.

**Mehul Desai:** On behalf of IDFC Securities, I thank Steven and Poonacha for coming on the call as well as answering all the queries. Steven I will hand over to you if you want to give any kind of closing comments for the call.

**Steven Bosch:** Thank you Mehul. Thank you everyone for the time and look forward to our next call. And in the meantime, any questions please feel free to raise them. Thank you.

**Moderator:** Ladies and gentlemen, on behalf of IDFC Securities that concludes this conference. Thank you for joining us and you may now disconnect your lines.