



“United Breweries Limited Conference Call”

October 29, 2010



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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY11 results conference call for United Breweries hosted by IDFC Securities Limited. As a reminder for the duration of this conference call all participants' lines are 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 this conference call please signal an operator by entering '*' and then '0' on your touchstone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nikhil Vora of IDFC Securities Limited. Thank you and over to you Mr. Vora.

Nikhil Vora: Thanks a lot. Welcome you all for the Q2 FY11 conference call of United Breweries. We have with us the Management Team of UB Mr. Guido, and Mr. PA Poonacha. I hand it over to Guido to make the opening remarks and also to brief on the numbers and possibly the way forward and then we will open the way for Q&A. Over to you, Guido.

Guido De Boer Thank you, Nikhil for this introduction and thank you all for dialing in this conference call. I think it is going to be a little bit of boring story because there is good news on the growth front yet again where we had an excellent Q1 you will see on the top line state-by-state basis the growth is continuing especially states like Maharashtra, Karnataka, Andhra Pradesh and Orissa have continued their strong growth and Andhra Pradesh probably has some specific notice because in Q1 we had very easy comparable because we were not in the market last year and Q2 we did not have that advantage but what is happening now is that the benefits from this policy change are really coming through and it used to be the one of the states where we had a relatively low market share but now we have reached almost 60% in one month, so we are getting essentially strong opposition in one of the biggest peer markets in the country.

So on the volume side things very well again outgrowing the industry and then also realization you see is pretty good with net contributions per case or revenue per case is going up because of price increases we were able to achieve in the states like Kerala and in a place like Delhi and in some markets you see a little bit of stronger growth, the economy segments because their excise had been increased like for example, Maharashtra and a little bit in Karnataka but overall our revenue growth is 2/3rds volume but also 1/3rd of the price which I think is healthy.

Then moving onto the variable costs, raw materials are very well under control and still quite soft pricing for the first half year. Yet a lot of questions on what is



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happening with malt and barley cost given what is happening in Russia. Actually because we have pre stocks for most of the year the impacts on us will be very slightly in Q4.....

I think the most important profit to mention on the variable costs, actually what we are doing on our new rollout of the **patented** bottle because as you might know half of our variable costs contains of bottles from a packaging materials and the strange thing is that we, as a market leader, together with the No. 2 are the only once who injected new bottles in the market and then we have to buy back the secondhand bottles at some times quite high prices when they are in scarcity. Now we have our own proprietary bottles which cannot be used by other parties and because of that going forward in future we will have to inject less new bottles because we are not subsidizing the competition and also we expect the price of the second hand bottles to go down quite a bit.

The only proof that we have seen in some stage is very encouraging so what we are doing now this year and also next year is to accelerate the introduction of these **patented** bottles and because of that we are now injecting more new bottles that we would normally do to ensure that the pipeline is still properly in the market has sufficient bottles when big season in Q4 starts again. So our bottle costs are a bit higher than last year and that and sense will be probably a bit more to pronounced in Q3 but from Q4 onwards we really see the benefits from that driving home. So that is on variable cost.

And then on the fixed cost line I think you will see that it is quite well contained. Q2 has a bit higher ATL growth than Q1 and that is just a timing difference and the rest is more or less what is continued for growth like this.

And then the other notable thing in the results is I think the interest charge which is substantially lower than last year. And this is on the back of a very successful working capital reduction program we have initiated where we were around 67 days last year in a comparable period of working capital. We have now reduced it with almost 30% and that is really driving one lower interest charges but also freeing up of funds and a strong improvement in our cash flow generation, especially of cash conversion ratios.

All that is led to basically doubling almost for this quarter and more than a doubling for the first half year of PAT and that is obviously something we are very pleased that we managed in this first half already to make the full mettle bottle that we made



last year. So that is so much for my introduction, maybe we should move to any questions if there are.

Moderator: Thank you very much. Ladies and gentlemen we will now begin with the question and answer session. The first question is from the line of Abneesh Roy of Edelweiss. Please go ahead.

Abneesh Roy: My first question is on the bottle cost which you just mentioned. I wanted to understand the process better and what kind of increase in costs will be there in Q3 and post that how much of a dip you expect in the Q4. Some color on that front.

Guido De Boer: Our bottle costs are a function of three items. The cost of new bottles which is pretty static at around Rs 8, the cost of the second hand bottles and it is the percentage of new bottle injection so normally we would inject something like 20%-22% of new bottles now because of this acceleration we are doing something like 30%. That is one thing that has impact and then the bottle cost itself and we have the industry bottles so-called **AIBA (All India Brewers Association)** bottle and their prices can be around Rs 5 per bottle now in the lower season it is maybe Rs 4.50 but in the peak season it can go up again and **patented** bottle is still to be established but it will definitely be something south of Rs 4 per bottle. So on a per case rate that would be potentially something like Rs 4-6 so that is the benefit we can realize but because we accelerate the injection in few states this increase of mix of new versus old has an impact and normally we can very well assume that in a quarter like Q1 or Q4 because that is where we make the majority of our profits but in the slower months of Q2 and Q3 it has an impact because usually historically we always have been making a net profit relatively close to zero for those two quarters so in Q3 there will be a greater impact on that but it make sense to do it now because in Q3 we need to inject the bottles into the market so that they could start coming back in the Q4.

Abneesh Roy Sir, which state are you doing this injection more?

PA Poonacha Punjab, majority in north then we have in Maharashtra also. There that problem is higher. The biggest problem of hoarding we have is in the north where the prices are really high on account of the second hand bottle suppliers getting together and hoarding bottles and releasing at very high prices. So we have identified key markets including Karnataka we have done. Whatever new bottles we are infusing new logo bottles, but we have identified that markets where in excess of what we normally would do we are pumping in more bottles so that it would pressurize the local cartons to breakdown and reduce the prices of secondhand bottles going forward. We have



also signed up with certain bottle suppliers going forward they would collect and return this logo bottle at certain fixed rates which we would negotiate this will be much lower than the average second hand bottle price.

Abneesh Roy

Sir for the new bottles how much is the raw material inflation you are facing for the key raw materials?

PA Poonacha

If you see I do not want to give you clear numbers on a per cases basis but 90% or 95% of our increase in variable cost in the second quarter this financial year vis-à-vis the second quarter of last financial year has been on account of this new bottle injection. So as such all other costs barring bottles have been flat in the second quarter of this financial year compared to the same quarter last financial year.

Abneesh Roy

That was useful, and my last question is in terms of volumes, first two quarters have been good, on a long-term basis where do you see the volume work, can it be faster than the IMFL or in terms of relative basis where do you see the volume growth.

PA Poonacha

We have been working on a business model where we are convinced that we would have a CAGR anywhere between 12%-15% over 5 years. I mean there will be brisk like in this financial year, the industry is growing at 24% and we are going a little higher than that but we do not expect this growth to be year-on-year. We would always work our business model on CAGR of five years which we expect on a very realistic terms anywhere between 12-15%.

Abneesh Roy

In volume right?

PA Poonacha

In volume, yeah

Guido De Boer:

And if you look for this year obviously Q1 was outstanding but that was because we were worn off on Andhra the year before and Karnataka had slumped because of the excise increase the previous year so we have had easy comparables which in this quarter we are not there and the growth is still pretty good. What you will expect is similar trends in Q3. In Q4 we will have a bit harder comparables because at that time last year already Karnataka started rebounding, so there the growth rates should get closer to what we expect in the long-term.

Abneesh Roy

Sir, one last question. Was there any supply issues in terms of the Commonwealth Games of the floods in some parts, where you negatively also impacted due to these results.



- PA Poonacha** Not really, not really.
- Abneesh Roy** Okay sire, thanks a lot.
- Moderator:** Thank you Mr. Roy, Our next question is from the line of Grishma Shah of Envision Capital. Please go ahead.
- Grishma Shah:** What has been a volume growth for the first half and how was it vis-à-vis same period last year?
- PA Poonacha** Sorry I did not get the question
- Grishma Shah:** Sir, our volume growth in the first half of FY11 vis-à-vis first half FY10?
- PA Poonacha** 28% is what we have grown which is ahead of industry growth of 24%.
- Grishma Shah:** Okay and how is the entire distribution for our products been. Is it through the government corporations or is it....
- PA Poonacha** **65%** of our supplies is to government corporations. If you see majority of the business is south-centric where we have a large portion of our business which is in Maharashtra, Karnataka, Andhra Pradesh, Tamil Nadu, now barring Maharashtra all the other states I mentioned are government controlled markets wherein the primary invoicing is to government corporations. In addition to these markets that is Karnataka, Andhra Pradesh and Tamil Nadu we have markets like Kerala, markets like Orissa, Orissa is a very fast growing market, markets like Bihar also fast growing market, markets like Delhi, markets like Rajasthan all growing markets are under government corporations.
- Grishma Shah:** Okay and would you be getting your money in a period of six month cycle or how does it work?
- PA Poonacha** No, no. What happens in government corporations is the government corporations run with the working capital provided by the suppliers of beer meaning that when we invoice the government corporations they ship these various beer loads to the different depots and when these depots in turn invoice retail that is when the corporation collect their money on a weekly basis they release the money. So on a regular basis our debtors from these government corporations are equivalent to this stock in the depots of the government corporations. So this normally takes anywhere



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between 45 days to 75 days depending on the corporation and the speed at which the turnover happens.

Grishma Shah: Okay and you said Orissa and Bihar are the fastest growing market but what would be the biggest market for you, still AP?

PA Poonacha Volume wise AP is still number one and we have close competitions from Tamil Nadu, we have Maharashtra which has currently also increased in growth because of certain changes in policies there so but volume wise still Andhra is number one.

Grishma Shah: Okay and do you foresee more number of states going through this government corporation route for liquor industry as a whole?

PA Poonacha We never know what state governments have in their minds but anyway it doesn't affect our business in fact it only helps us secure our debtor, it maybe a bit of working capital situation for us wherein certain monies are stuck with the government corporations on account of us financing their depot stocks. But since you have a tax free guarantee on this so we are not a very bad situation even if other states move into corporation.

Grishma Shah: Okay, and since you are not allowed to advertise directly in most of the states how do you plan your ad expense and what are the strategies that you intend to follow and are currently following?

PA Poonacha We have always had more and more for advertising through sponsor of sports now I feel is a good forum and we have certain contracts with the tie up for example in the recent past we have tied up with the Airports Authority of India then certain new airports we have exclusivity of advertising in areas where we have served so these are things which currently UB can and have been using the past also.

Grishma Shah: Okay, fine and good luck thank you.

Moderator: Thank you Ms Shah, our next question is from the line of Abhijeet Kundu of Antique Stock Broking please go ahead?

Abhijeet Kundu: Primarily we need to understand the kind of 24% growth that the industry is seeing what we have been seeing that Karnataka which was not really contributing to the overall growth is now contributing this year how much would be Karnataka's as a component of total demand?



- PA Poonacha** You were talking Karnataka as a percentage of entire country?
- Abhijeet Kundu:** Yes.
- PA Poonacha** Around between 9.5% to 10.5% I don't know the exact value, so around 10% you can take it as an average.
- Abhijeet Kundu:** Okay, has Karnataka made such a big difference in that could lead to a 24% kind of demand or are you seeing any real shift in consumption patterns also happening?
- PA Poonacha** No, there are two things one is Karnataka may not be volume wise large percentage of the industry as a whole but Karnataka is one of the most profitable markets and contributes to a large chunk of our operating profits. So growth in Karnataka gives us a huge growth in our bottom-line. That is our margins.
- Abhijeet Kundu:** Okay, right.
- PA Poonacha** Now, I cannot say that the entire 24% is account of growth in Karnataka because growth in Karnataka is below 20% not even 20% the major growth has come up in states like Bihar and Orissa and if you take as a half year vis-à-vis last financial year the first two quarters in Andhra Pradesh there is a growth because in the last year first quarter we had not supplied and as such the industry has shrunk on account of two large players not supplying in the Andhra market. So it is not an ideal comparison to say that 24% growth the industry is I mean it's not really comparable because not the first quarter the largest market was they did not supply to by two largest players.
- Guido De Boer** So maybe if you look on that on a state by state basis basically every market borrowing a few has grown in excess of 15% in this quarter. The markets that have not grown that much or in the case of Delhi even degrown a bit are on account of price increases. Because price elasticity volumes haven't grown like the rest of the markets but the growth that we see is all across the board all across India. That's not one such specific things that is it's just really an acceleration in growth.
- Abhijeet Kundu:** Okay, what could have been the growth in this quarter for Andhra Pradesh? Because I believe last year in Q1 we have the biggest two players had not really supplied to in Andhra Pradesh but second quarter the supply was there. So one is we need to know what would have been the growth in AP for the industry as a whole and secondly how...?



- PA Poonacha** The second quarter you are saying.
- Abhijeet Kundu:** Yeah second quarter
- PA Poonacha** About 30%
- Abhijeet Kundu:** About 30%. Okay, and secondly how much have you benefited from the new licensing policy because according to the new licensing policy what I understand correct me if I am wrong your India market share would now apply to your Andhra Pradesh market share?
- PA Poonacha** Yes.
- Abhijeet Kundu:** Right, so accordingly would be given to supply and that means a huge amount of volume growth for you and I believe the market share gain or the outperformance that has been seen has been as a result of this of the change in policy?
- PA Poonacha** Well you can't say that the market share gain the overall country to some extent has been on the account of Andhra but the effect of this particular change of policy only in the month of probably mid-August to end September. The ordering pattern started from say mid July. So by the time things came into place so it is have only one and a half months of this policy being in full force yes in this one and half months it has really changed the market share upside down I mean we used to be around 35% and SAB Miller used to be around 60% odd so things have reversed now with in line with the overall industry shares across the country.
- Abhijeet Kundu:** Right, okay sir, thanks.
- Moderator:** Thank you Mr. Kundu before we get the next question. Our next question is a follow up from the line of Abneesh Roy of Edelweiss please go ahead
- Abneesh Roy:** Sir two follow up questions one was you mentioned Karnataka is your most profitable market?
- PA Poonacha** Yeah.
- Abneesh Roy:** Wanted to understand the reason why Karnataka is different and is it sustainable going to be most profitable?



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PA Poonacha

No, Karnataka as long as the industry has been there as is the most profitable market for any beer manufacturer because that's how the excise policies are in Karnataka. Now the other profitable states are in Maharashtra. We have profitable states also in Orissa there it's a government corporation again but in the case of Orissa the government needs to give their annual price increases but in the case of Karnataka the manufacturers of beer are free to take price increases as and when they want. So it is different each corporation acts differently but Karnataka has by and large over the last one and half decades been the most profitable beer market for all manufacturers of beer.

Abneesh Roy:

In Karnataka normally we take one annual price hike or based on raw material we take numerous hikes also?

PA Poonacha

No, we cannot they say you cannot kill the golden goose right, so we are very careful that we take price increases in Karnataka in fact we took price increases more than a couple of years back because the last year the government changed the excise policy in Karnataka wherein instead of duties being charged on a literage basis that is on volume basis they started, they changed it to ad valorem basis that is as a percentage of your basic price so it increased the put on price on every bottle it was rupees ten and it really affected the market in the last financial year that is the financial 09-'10 was really hit by de-growth in the Karnataka market.

Abneesh Roy:

Sir you just mentioned that in Maharashtra your growth rate has increased due to some policy changes can you elaborate on that?

PA Poonacha

What has happened in Maharashtra was the especially in Mumbai hope for many years there are a very few outlets that has the number of license issued were capped for over two decades. Now what the government has done is the government has relaxed the policy to some extent wherein you have certain licenses issued at very nominal cost for serving beer alone so this has helped the growth in Mumbai and in and around Mumbai which we track separately though it is part of Maharashtra because it is a large base and this was remaining quite confident though the rest of Maharashtra, growing very fast rate in the last years Mumbai and its surrounding areas was stagnant in growth. Now with this change there has been growth in Mumbai also which has increased the Maharashtra overall growth rates.

Abneesh Roy:

Sir, how much distribution you would have added in Mumbai?



- PA Poonacha** Really I would not have off hand but then it would be fairly large because it has really impacted our volume growth rates.
- Guido De Boer:** Yeah and I think that's one piecing in the sector but if you look at rest of Maharashtra where we have really done strategically is in the launch of LP Strong in the economy segment, we did not have a strong offering, and since the launch earlier this year that has delivered excellent growth across the board. So its exposable income that it is basically strong in Maharashtra its outlet has increased the availability but the public offering that is driving this.
- Abneesh Roy:** And, in Delhi we are seeing a decline in volumes so how much was the price increase and is this a temporarily decline in volumes that you are seeing?
- Guido De Boer::** The consumer price increase for two reasons one, earlier in the year we took a price increase and we can do that because the minimum pricing rules because Delhi says that you need to have the lowest price all across the country and because we have raised prices in other markets we could also raise this and we introduced some variants. On top of that for the commonwealth games Delhi excise has added another surcharge on taxation and so the bulk of them added together substantially increased the consumer and price and that affected volumes.
- Abneesh Roy:** What is the percentage increase in price, the two combine's ones?
- PA Poonacha** Yeah the per bottle price went up by it was Rs. 10.
- Abneesh Roy:** Okay and you think this will get reversed volume decline?
- PA Poonacha** No state government would go forward in reverse such things when revenues are already there.
- Abneesh Roy:** Okay, okay sir thanks a lot all the best.
- Moderator:** Thank you Mr. Roy our next question is from the line of Mahesh Nandurkar of CLSA please go ahead
- Mahesh Nandurkar:** My question pertains to the launch of Heineken in India can you give us some more details on where we are on that and whether manufacturing has been done, etc.?
- Guido De Boer:** Yeah, absolutely we are preparing Mumbai Brewery now to start brewing Heineken within the next month or so the first trial runs of Heineken brew and apart from that



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we are well on schedule with our marketing plan. The big thing is that we are still waiting on some of the equipment from Germany. So that is still a bit of un-certainty but we are planning for end of this financial year to start the Heineken brew.

Mahesh Nandurkar: Okay, and will you manufacture Heineken only in Bombay Breweries and will supply to the rest of the country?

Guido De Boer: Yes, we only brew it in Bombay and then supply it to the rest of the country.

Mahesh Nandurkar: Okay, and is there any such similar plan on the other side of the table as in a Kingfisher being sold elsewhere as a part of Heineken network is that being planned?

Guido De Boer: It is being planned. We have we are having detailed discussions on that currently and as soon as that specific agreements, we will obviously announce that.

Mahesh Nandurkar: Okay, so do you expect that Kingfisher will start getting manufactured somewhere outside of India and pulled in the local market say in the next financial year?

Guido De Boer: Sorry can you repeat that?

Mahesh Nandurkar: As per your plans would you expect Kingfisher to start getting manufactured outside of India and then getting sold in that specific local market sometime in the next financial year?

Guido De Boer: Potentially in any case I expect next year that other markets will be Heineken or its partners will sell on our behalf. How this is produced that on a case by case that we need to look it whether we have it produced abroad or whether it makes more sense for us to export it that is just how the economics workout at that time.

Mahesh Nandurkar: Sure and traditionally you have seen over the last few years strong beers actually outgrowing the mild beers how has been the trend in the current financial year so far?

Guido De Boer: It is actually very helpful because the past few years we did not only see strong growth in strong beer but actually decline in mild and that's a trend that has been arrested since Q1 and the mild segment is showing healthy growth again.

Mahesh Nandurkar: Okay. Sir so that can potentially have a positive impact on the margins of the company if that trend was to sort of accelerate going forward?



- Guido De Boer:** It is still the strong segment that's growing faster so in terms of mix actually its strong is still on the rise.
- PA Poonacha** To that extent we have insulated the margins that we make on mild are as good as the margins we make on strong.
- Mahesh Nandurkar:** Okay, what the update on the acquisition of brewing unit from Balaji where are we on that and what sort of further outgo do you expect on that front?
- Guido De Boer:** We are awaiting news from that from both Balaji and USL and so it's a I think we should look at I think USL since taken from yesterday on the status and the way I understand its now for hearing at the AIFR and once there is clarity there then the post this could go relatively quickly but we are still looking at both Balaji and USL for that and then once that becomes clear then we will also indicate the specific of the transaction at that time.
- Mahesh Nandurkar:** And how about the consideration for the same will it be in cash or sort of more outgo would be there or will that be like an amalgamation where you offer share swap or something?
- Guido De Boer:** Just as soon as the board has considered how to do that then we will announce that.
- Mahesh Nandurkar:** Okay, thank you very much.
- Moderator:** Thank you. Our next question is from the line of Puneet Sarogi of Arisaig Partners please go ahead.
- Puneet Sarogi:** My question was essentially on the working capital we have seen some great improvement, can you give us the reason why that has happened and what sort of steps are you taking?
- Guido De Boer:** Yeah, we identified that this was an area where there was potential benefits to be made and especially given the high growth that we have it makes much more sense to be efficient as much as possible with working capital so around six months ago we started these initiatives and then basically all across the boards big focus has been on tightening the credit terms we give to our customers for example in markets where there is relatively long credit where we ourselves pay the excise portion upfront which helps us significantly. We have been more stringent in paying our suppliers. We have optimized our payment systems on when do we remit excise duties and



pooling debts fortnightly payments. Basically, every pick in the book on working capital optimization we explored and that has now already within half a year led to decrease from around 70 days down to 45.

Puneet Sarogi: What sort of improvement can you achieve there from current level say from 45?

Guido De Boer: I think we are now looking to first is stabilize it at this levels and growing it in the company and from now on it will be a continuous focus on looking for opportunities to reduce it. So I don't think you should expect step changes again. From now onwards it will be a gradual process to bring it down to more optimal levels.

Puneet Sarogi: Okay, my next question was on AP essentially with the change in the policy with the growth that you have seen, is AP now making money for United Breweries the market?

PA Poonacha AP was positive always after the last price increase but then the markets are not big but it's the large volume growth that we have enjoyed on account of this change in the policy in the last few months its only going to positively affect us going forward

Puneet Sarogi: Okay and my last question is on MABL can you share some numbers there?

PA Poonacha Generic, you can speak about it but then nothing specific no.

Puneet Sarogi: Generally on the operating level as we have seen the business make some losses last year so what are the expectations this year and?

PA Poonacha I really cannot comment on the entire MAPL Group of Company because one of them is a listed company, and let's wait for a few more days once their results are out then we can speak.

Puneet Sarogi: Okay, thanks.

Moderator: Thank you Mr. Sarogi. Ladies and gentleman that was the last question. I now hand the conference over to Mr. Nikhil Vora to add further comments

Nikhil Vora: thanks to all the participants and specially Guido and Poonacha for sparing the time while you are abroad right now and just hope that the volume growth story continues in this company. you want to make any closing remarks Guido.



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Guido De Boer: No, no I would just like to thank you Nikhil for excellent organizing of this call. So I really appreciate that and also the participants for all their excellent questions. Thank you very much. If there is anything gives us ring. Thanks a lot.

Moderator Thank you members of the management team and Mr. Vora. Ladies and gentlemen on behalf of IDFC Securities Limited that concludes this conference call. Thank you for joining us on the Chorus Call Conferencing Service you may now disconnect your lines.