HUL merger with GSK Consumer Healthcare

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Speakers:

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Operator

Good evening, ladies and gentlemen. I'm Zed, the moderator for this call. Welcome to the Hindustan Unilever Limited conference call on an update on HUL merger with GSK CH India. For the duration of the presentation, all participant lines will be in the listen-only mode. After the presentation, the question-and-answer session will be conducted for all the participants on this call. Please note that this conference is being recorded.

I now hand over the call over to Ms. Suman Hegde. Thank you and over to you, ma'am.

Suman Hegde

Thanks, Zed. And good evening everybody. On the call from the HUL end, we have Mr. Sanjiv Mehta, Chairman and Managing Director; and Srinivas Phatak, CFO, HUL. We will start the session with Sanjiv sharing his perspectives on the proposed merger, and then hand over to Srinivas to take you through the presentation.

Sanjiv, over to you.

Sanjiv Mehta

Thanks, Suman, and good evening, everyone. I'm delighted to be on the call today. Most of you, I would believe, would have read our press release by now. And we're absolutely delighted to announce that we have reached a definitive agreement to merge GSK Consumer Healthcare India with HUL, subject to, shareholders and regulatory approvals. The transaction is an all equity merger with 4.39 shares of HUL being allotted for every share in GSK CH India. And subject to, approvals, the GSK Consumer Healthcare business has been valued at INR 317 billion.

GSK CH is one of the key players in the Indian food space with iconic brands such as Horlicks and Boost, and comprises a wide portfolio, well positioned to leverage persistent national nutritional needs and increasing health awareness. The GSK CH India business has delivered a turnover of INR 42 billion in the year ended March 2018 with EBIT margins of over 20%. Pursuant to the strategic review undertaken by GSK Group, it was agreed to merge GSK CH with HUL. Horlicks with the volume share of close to 50% was introduced to India in the 1930s and has been everyday staple in several households across generations.

For us at HUL, it is a unique opportunity to acquire the number one health food drink portfolio in the largest HFD market globally. It is in line with the strategy to build a sustainable and profitable Foods & Refreshment business in India by leveraging the mega trend of health and wellness. The HFD category is over INR 7,700 crores and is poised to grow well on back of strong structural demand drivers, namely favourable demographics, rising affluence, disposable income and persistent nutritional needs. Even today, four out of 10 Indian children are undernourished, and nine out of 10 are deficient and micronutrients.

Now, we expect to grow the business in double-digits in the medium term. We understand consumers. We understand market development. And this, as you all know, has been a key strategic thrust for us in HUL. We have done this successfully through differentiated product offerings of formats across several categories, be it fabric conditioners, hair conditioners, liquid detergents, green tea, ketchup, ice creams and many more. We will increase penetration with special focus on rural markets and emerging channels and expand offerings to the fast-growing premium segments. There will also be focus on looking at future-ready formats in line with consumer trends. Our direct coverage is at 3x GSK CH and our Péclet capabilities will be a growth multiplier. On the cost side, we see significant benefits across the value chain and the transactions will be margins and EPS accretive to HUL. Our F&R business, post the proposed merger, will cross the INR 10,000 crore mark, making us one of the largest players in the country in the F&R space.

We expect the transaction to be completed by December 2019, subject to necessary regulatory approval. It's been a fabulous work done by the HUL team and the extended business partners, who have over the past many weeks put in huge amounts of effort to make this transaction a big success. In all those early mornings and late evenings, I have been absolutely certain that Boost has been the secret for their energy and, of course, complemented by generous portions of Wall's ice cream, Red Label Nature Care Tea, BRU Coffee or Knorr soups.

So, on this wonderful happening, let me now hand it over to Srinivas, who will walk you through the relevant details.

Srinivas Phatak

Thank you, Sanjiv.

I think hopefully for all of you, you would have got the strategic essence of what we are trying to do. So, I, in the course of the next few charts, will give some more details and specifics from each of these elements, and then we will take some of the questions at the end.

I will start with the Safe Harbor statements, and that's the standard way, that's for good order. And now let me move on and dwell into the paths of our business. I think it's always important to start the context of why this makes sense from an HUL perspective, and then therefore, start to look at it from an HUL point of view.

We are a power hub of a business with more than INR 35,000 crores of turnover. And couple of elements to call out here would be, for over 10 years, we have actually grown this business in a double-digit range, at 10%. This includes many categories, where the penetration has been in the high 80s and 90s, and in some of the nascent categories. This starts to show you the robustness of this engine and the powerhouse of this business. Along with this, we've also increased margins by about 530 basis points. We hope all of you track us very well and you're very clear about our footprint in terms of distribution and our brands being available in more than 8 million stores and us serving nine out of 10 households. You also understand and recognize the quality of the talent and the quality of innovation which this business has. So, I think just before dwelling into the details, it's important to call out the split of our business. As you're aware, about 47% of our business today is BPC. Now, I'm using all first half numbers just to make the point. Our Home Care is about 33%, and Foods & Refreshment is about 19%. If you look at it, in this year, we have grown our business in double-digits with healthy margins. And clearly, we are the number one BPC company, the home care company and the tea company. As Sanjiv called out, with this acquisition, which will add about INR 4,300 crores, our F&R business will now cross the INR 10,000 crores mark.

This chart gives you a flavour of our F&R business and our portfolio (using last year's data). You would see that this business has about INR 6,500 crores in revenue with good segmental margins, but the important aspect to call out is its market dominating positions, where we do well, whether it's tea where we're number one; whether it's coffee, or ice-creams, soups and ketchups. The beauty of our model is that even in Foods & Refreshments, we've continued to grow consistently, we've grown profitably, we've grown competitively. While we've had this scale from a refreshments point of view – in ice-creams and tea, foods is a space where we've not had this scale and an acquisition like this give us the scale to take it into the next level and, therefore, it falls in very well for us.

This is a very quick snapshot of our F&R strategy and you've seen some of this. It starts with brands for purpose, it starts with market development, but to get that scale and clear position in the market, an inorganic acquisition was clearly an imperative. And that's where, when you look at this, as Sanjiv said, this is a unique and perhaps a very, very special opportunity to acquire the number one HFD portfolio in the largest market. It's number one by sales by margin; it's a profitable business at about 20%. With Horlicks and Boost, it's got some of the most trusted brands in the consumer space and a portfolio which has brought more than 20 products in very different flavours. This is where we then start to leverage on the trend of health and wellness and when you look at it in totality, this makes a very attractive and a compelling acquisition for us. Moving on to demand drivers – it's important to contextualize it because often there are questions saying – is this the category of the future, is this the brand of the future? Hence, it's just good to take you back a bit, come to the reality and then

talk about future. If you see on the right-hand side, the category has grown in double digits for over a decade, and consistently this business has grown for many, many years. Yes, we've had a couple of years where the business was soft for many reasons including a lot of external factors. But if you see, the market is trending up and it's poised to grow well.
A lot of the work that we have done over the past few weeks and months, with the consumers, looking at the demand patterns, looking at the brand strength, many parameters continue to give us the confidence that this category is expected to grow in high-single digits to slight double digits over the next few years. The demand drivers continue to be very strong when you talk about the large young population or the rising affluence, which is an important element as some people come into the consumption market and look at the premium end of it, both then start to play. Sanjiv also mentioned, in his opening address, the persistent nutritional need in terms of the Indian children and I think that's very obvious. So, when you marry the socio-economic demographics and affluence and when you look at the category drivers, it positions us extremely well that if you manage this business with a focus on market development, you'll reap the awards.

That’s a nice segue into what I talked about in terms of market development. This is where you see the big opportunity which is about driving penetration. All India penetration today is at about 24% with rural at 14%. This is where our tried and tested model of market development comes into play – capturing the rural demand through affordable packs, making the product available and getting consumers to experience and try, really augurs well. Let’s look at the middle section (in the chart). Today we are fortunate that the business has good strong positions in the popular, premium and super-premium segments. Equally, it addresses different needs, whether it's energy and stamina or nourishment or specific health needs. So, there is a strong portfolio which is available, which helps us to manage the premiumization and meeting the different needs and tastes of the consumers. And finally, there is a pipeline of strong claims and R&D abilities and when you get through the magic and logic together will give us the opportunity to grow this category on a sustainable basis.

This is where we then said, let's do a bit of a deep dive in terms of what HUL can do with this business and to give you bit of a flavour in terms of some of the opportunities we will pick up a few of the elements for us in a bit of detail.

Penetration, we talked about, with a rural penetration of 14% and even an urban penetration of 24%, there is a sizable opportunity that you can unlock. So, the whole distribution that we can look at and affordable packs that we can look at, can continue to be a strong driver. Second is all about upgrading and premiumizing. If you look at the super premium segment of this market, it's less than 20%, but this is one of the fastest growing segments of the market – growing in high double digits. There is a good portfolio available whether it's through Horlicks Cardia or whether it's on the protein side of the equation, and that is something, that we will be able to leverage to capture the effect. The third piece is all about the HUL distribution multiplier. We have a direct reach of 3x compared to GSK CH and with the capabilities that we're putting in terms of tech and others, there's again a piece that we will unlock. The value equation that we will first want to focus is on the core, which is to get – penetration, upgrade, premiumization and the distribution multiplier. These will fire and will continue to give us a big pickup. Then we have the opportunity in terms of north and west where the preferences are a bit towards taste. We understand the consumers and I think we will be able to provide offerings, which meet that requirement. Further, there is always an opportunity with the future-ready formats which are very interesting, and some initial work has already happened. But there's a lot of healthy pipeline which is available to pick up. So, when you marry all of this, there is a very good opportunity to unlock growth.

Now, I'll come back to talk about the cost angle in a bit.

Let’s now talk about some of the examples of how HUL has been doing it. While it's just a reiteration for all of you as you track us very closely and you're fully familiar with our approach, there's no harm in elevating the positive and just bringing it to the top of your mind. Our market development model is tried, tested and it works fabulously well. You have seen an 8x increase in the way we reach consumers and the way we get them to experience our products, and that's been a big driver for us in building segments of the future. On the right-hand side of the chart, you can see some of our segments of the future, which are growing faster than HUL average, and in many cases, 2x of HUL average. There is a healthy mix of products which comes from our home care, beauty and personal care and more importantly in tea, ketchups, green tea and ice-creams. So, there is a clear model of market development which works for us across the portfolio and more importantly from an F&R point of view.

The second piece is all about premiumization which I talked to you from a growth lever perspective. We've taken an example of tea. Equally, you can see enough examples of home care. Our share in the premium is 2.5x of the market, and popular, as well, is in a very healthy space, which demonstrates the model that we continue to do far better at the premium end in terms of our share and profitability. This also starts to tell you how we've premiumized and how we have driven premiumization and you've seen enough examples in some of our other categories.

The third piece is about transformative CD capabilities. The first element is three years boost to direct coverage. Our products are available in more than 8 million outlets and as we have put tech capabilities into play, it's getting us get more stores with better and direct coverage. We're significantly increasing assortment. We've used a lot of tech in the retailer app, the consumer app – significant step changes. When you see it from a demand fulfilment point of view, significant work-enabled technology has happened to get the delivery at a faster speed and therefore, the delivery within two days of the order, Technology has also helped in unlocking the capacity at the frontend and the backend. And finally, the whole program that we're doing read in terms of Humara Shop on leveraging the point of sales data, is giving us significant tech abilities to target, to expand and also to precision marketing. So all-in-all, this whole space of technology transformation augurs very well for us in terms of taking this business forward.

So, these are three examples which you will recognize, and I was trying to marry that the whole thing with how the GSK or the Horlicks and the Boost story comes in. We talked of market development, we talked about premiumization and we talked about distribution. This is a chart which I'm sure all of you recognize. This has been an execution engine and we have generated significant fuel for growth. It's a comprehensive program. You are aware of the significant step-up that we have seen in terms of savings as a percentage or the margin expansion which the business has driven in the past five years. This continues to augur well and has served us very well when we declared our results for the first half a few weeks ago.

So, now if I marry the two, we had a discussion on growth, we started a good conversation on margins, and this is where I want to focus our attention. We will look at getting a lot of efficiencies on the cost lines across the value chain. There will be benefits which will come through as we look at the administrative and the overheads part of the organization as we merge the two companies into a single company. We will also get the synergies which will come from a common infrastructure, common IT system, common workplace and so on and so forth. If you look at it from a whole space of marketing, today we spend 7x the spends which GSK does and when you put the combined might (of both the companies), there will be an increased buying power which will give us buying savings. It also gives us ability to sharpen the way we're using data and analytics, to sharpen and get value out of our spends at GSK, and the whole program of ZBB that we have embarked on. The clear benchmark has enabled us to sharpen both media and non-media and we have taken significant value out of promotions. We understand what works in the marketplace, how is it different at a point of sales and in modern trade. This is something where we can extract value. We've talked about go-to-market, and this is where the full extended supply chain comes into play. You're all already aware that we are consolidating from 40 distribution centres to 20 centres which will get us significant benefits. We can use this full distribution strength across the country, consolidate our distribution operations, which will become a big value pickup. We have done a lot of work on the materials side of the equation. Things become extremely interesting, if you look for efficiencies in terms of packaging and other materials. There are overlaps in some of our portfolio such as sugar, SMP. There are areas, where, we believe that with the combined scale, we can unlock significant savings.

So, when you look at this in totality, there is sizable value that we can extract from supply chain, procurement, go-to-market distribution, BMI and general overheads, which then gives us the fuel to invest back into the business and to continue to drive our virtual circle of growth model.

In summary, we are confident that we have all the levers available for us to grow this business in double digit over the medium-term. We expect the full synergy benefits to add about 800 to 1,000 basis points of margin. This will come through as we, first, get the complete approvals, then, integrate the business operations, begin to drive the growth, and eventually, realize the savings. So clearly, we do see a root to these savings which will come through in a phased manner and we are confident that we will get that. Once we have stabilized the operations, there will be a focus on how much of (savings) can come in earlier into the business case, which will become significantly value accretive for all of us. So, in simple terms, this transaction will be EPS and margin accretive from an HUL point of view.

Now, I would want to spend a couple of minutes to clarify a couple of aspects of the deal. As you're all aware, GSK Consumer Healthcare company will merge into HUL, and therefore, we' will only have one legal entity going forward, which is HUL. There are a few brands which are, today, owned by the consumer company. These are Boost, Viva and Maltova. By nature of the merger, all these brands will be owned by HUL post approvals. Horlicks, as a brand today, is owned by the GSK global and group companies and not by the Consumer Healthcare company in India. Unilever has acquired the global rights to Horlicks brand for India and other territories along with 82% stake in the Bangladesh business and rights for 20 markets. So, HUL will have a full, unfettered uncluttered access to Horlicks brand, which serves us well.

The company has been valued at INR 31,700 crores. As you know, valuation involves many aspects and all those have been taken into account but use it as a reference point. We've used the 15-day VWAP as a reference point, because if we were to use the prices today, the value would be very different and hence, it is important to give you a reference point to put it into context. Post the merger, Unilever shareholding in the merged entity will come down from 67.2% to 61.9%. GSK will own about 5.7% of HUL. And you would have heard them (GSK), and seen in the press that they would look to liquidate this stake at an appropriate time to realize the cash for their needs. In a manner, this is also a reaffirmation of the confidence, which GSK has in HUL that they're very happy. You're all aware of the strategic review that talked about divesting the assets for cash, but they're very happy to invest in HUL for a period of one year during which, we will get approvals, and thereafter, they will sell at an appropriate time to realize cash, which reaffirms their confidence in this business and our ability to manage it well. We have already talked about timeliness. There is a last element around the OTC OH business. Today, GSK Consumer Health company manages the sales and distribution for many brands which are owned by the pharma entities, namely Sensodyne, Eno, Crocin, and others. HUL will continue that arrangement and will take on the selling and distribution arrangement for all these brands. This gives us a better understanding of some of the pharma and the chemist channels, which in turn, gives us a broader portfolio. It is also a significant advantage for them, given that they will leverage our distribution capabilities. So, all-in-all, this continues to be a win-win for all of us.

To summarise, this is an acquisition which is “On-strategy”. It leverages the mega trends. It gives us iconic brands, which, with HUL capacities, will unlock growth. We have talked about the share swap ratio. Clearly, this is accretive for HUL at an aggregate level and we expect to complete this transaction over a period of one year, subject to regulatory and shareholder approvals.

Now, I will hand it over to Suman and the moderator to take questions. We will take questions for about half-an-hour and hence, we will take as many questions as we can. So, I will appreciate if you can be sharp, and we will be very happy to address them through our Investor Relations team. Over to the moderator.

Q&A

Operator

Thank you very much, sir. We will now begin the question-and-answer interactive session for all the participants who are connected to the audio conference services from Chorus. To ask a question, participants may press * and 1 now. The first question is from Abneesh Roy from Edelweiss. Please go ahead.

<Q - Abneesh Roy>:
Sir, congrats on the acquisition. My first question is post Indulekha acquisition, there was a sharp scale-up. Now, in this acquisition, there is a 3x distribution which you bring to the table, but how much of that is relevant to Horlicks given the price point and given the north and west issue? And second is in terms of chemist, how much benefit does HUL get because GST has been very strong? So, if you could address how much does the HUL benefit from the chemist.

<A - Sanjiv Mehta>:

Okay. When Srinivas talked about the distribution, he just gave a reference point to the distribution. Of course, Horlicks will be deployed only in the relevant channels and stores, Abneesh. But we were just making a point that our distribution machinery is very strong, and we'll be able to leverage. The other big thing, as you guys are aware, is that we play the complete price benefit pyramid whether you look at hair care, whether you look at laundry, whether you look at skin cleansing. So, we are able to grow our penetration using the low unit price packs strategically, and at the same time, we are able to premiumize the portfolio. Now, this is a game which we are very adept at and we remain very confident that we will be able to do that in the case of Horlicks and Boost as well. Now, when we look at from a perspective of how we grow and strengthen our brand, the two critical parameters are driving penetration and increasing distribution. The national penetration of this category is still about 25% and the rural penetration is just about 14%. So, there is a big runway for us to increase our penetration. The other critical aspect, Abneesh, you would be aware of, is our focus on market development. We have been 20% of our portfolio, where we have been growing at 2x to 3x the rate of HUL's rest of the portfolio and that is something, which, again, we have huge competency in. So, this is what gives us the confidence of bringing in synergies as far as the growth is concerned.

<Q - Abneesh Roy>:
And sir, on the chemist what will be the benefit which HUL gets?

<A - Sanjiv Mehta>:
Yes. Now chemist, Abneesh, for BPC, is increasingly becoming a very important channel, and this is a channel where we are under-indexed. We will be able to leverage and also strengthen our position in BPC in the chemist channel.

<Q - Abneesh Roy>:
And sir, one follow-up here was Sensodyne sells strongly in chemist and there is a conflict of interest, right? You have Closeup and Pepsodent.

<A - Sanjiv Mehta>:
No. You have to understand, Abneesh, that we deal with multiple brands and categories. The positioning of Sensodyne is very different to Closeup and to Pepsodent. They're very distinct positioning. So, just like in hair, skin cleansing, laundry where we have distinct positioning, similarly, this would be distinct positioning and I don't see a conflict of interest. I, in fact, see using each other, to build on the total category footprint.

<Q - Abneesh Roy>:
And one last one, north and west has been historically a big issue for Horlicks. You mentioned in the opening remarks on the taste aspect. Now, if you see middle class India, especially in north and west, is going towards many other product segments like Hershey's Syrup and all that, so could you go to address taste through a completely different product also? Would you be open on that?

<A - Sanjiv Mehta>:
Of course, we will look at all possible opportunities. You look at it as an issue. I look at it as an opportunity.

<Q - Abneesh Roy>:
Okay. Okay, sir. That's all from my side. Thank you.

Operator

Thank you. Next question is from the line of Arnab Mitra from Credit Suisse. Please go ahead.

<Q - Arnab Mitra>:
Yeah. Hi, everyone, and congratulations on the acquisition. On the cost synergies, just a couple of clarifications. This 800 to 1,000-basis point, would you see this as a gross saving which you would partially reinvest or this is what you believe can be the net uplift in the margins in GSK? And I understand you can't give an exact timeline, but approximate time range would help on what timeframe do you think this can be realized in.

<A - Srinivas Phatak>:

So, we would want to see this on a net basis. Obviously, then there are various things we will play. They could be a bit more higher in terms of growth and you could invest that. But the range that we're talking is about 800 to 1,000 basis points which will be the net increase we will see. Important to clarify, you will not see all of this only in that particular segment. For example, in a typical area like media, when you get the scale and a differentiated model, you'll see that money. Similarly, when we look at some of the supply chain efficiencies and when we start to consolidate all of this from a distribution standpoint, we will get lots of benefits in terms of how I plan, distribute and load. Therefore, the benefits will come through. So, I just want to make that distinction between the size of the price and the range of what we will go after, but where will it land is a slightly different space. On the timing and how it's going to land, I'll have to give you a directional space, because the first and important step for us is to integrate this. This is a large business in one sense, at INR 4,500 crores. Therefore, our first focus will be to integrate the business post getting the approvals. And thereafter, we will start to see a pace scale up. So, over the next few years, we will find and realize this benefit. I'm not going to give you a marker in terms of how each of the years will play out. Suffice to say that we will try and see how much of this can come through in the earlier stages of life rather than later. But over the medium term, this is clearly the markers that we are going after. At this stage, I think that's the best way to look at it, but we have clear line of sight in terms of how we can realize these savings.

<Q - Arnab Mitra>:
Sure. Thanks. And a couple of accounting questions, so what would be the royalty rate that HUL will be paying for Horlicks and Boost? And is there any intangible assets being created which will be amortized or not amortized based on how it's classified?

<A - Srinivas Phatak>:
Okay. So, a couple of things, Boost is a brand which is owned by the GSK Consumer Healthcare India company. So, to that extent, there is no royalty on Boost. On Horlicks, today, depending on the variant, there are range of rates which are in place, ranging from 1.8%, going up to 4.5%. We will have to work that through. Unilever will own the brand and we will have to pay a royalty and we will. Having said that, we also need to work out the SEBI guideline and their implications which will come through from 1st of April. So, there are a few moving pieces which need to be worked through. Yes, but for Horlicks, there will be a royalty pay out. The second part of your question was on...

<Q - Arnab Mitra>:
Intangible assets or goodwill.

<A - Srinivas Phatak>:
Intangible assets. Over the course of the next few years, there is more work which will happen in this space. Yes, there will be intangible assets, but we'll have to work this through in terms of how much will be amortizable and how much will not. We will work that through and, therefore, where we want to queue all of you, is to think on an underlying basis what does this mean in the initial few years. What does it mean on a net reported basis, is something we will work through. But, I see more value, on a relative sense, on what will be intangible and will not be amortized, but there are some of the elements that we need to work through over the course of the next few weeks before we start to do our filings with the various authorities.

<Q - Arnab Mitra>:
Sure. Thanks. That's it from my side.

<A - Srinivas Phatak>:
Thank you.

Operator
Thank you very much. Next question is from the line of Amit Sachdeva from HSBC. Please go ahead.

<Q - Amit Sachdeva>:
Hi. Good evening and thank you for taking my question. Sir, very quickly, I heard GSK comment on the television that they are paying £570 million to Unilever. Is that the number correct and is this a fair understanding of the number, if you can just confirm that?

<A - Srinivas Phatak>:
You can see it in the Unilever press release, which is out there in the public domain. The whole deal, from what I read, is €4.6 billion. I'm happy to answer from an HUL point of view, but I can only refer you to that. The deal, what I see on the website, is for €4.6 billion. HUL bid using this value a littler under €4 billion, so approximately €600 million would be for the Bangladesh business, and the brand ownership and rights for 20 markets.

<Q - Amit Sachdeva>:
Okay. Okay. Sure. So, about £600 million. Okay. Okay, perfect. And secondly...

<A - Srinivas Phatak>:
No, no, not pounds, euros, I'm counting everything in euros.

<Q - Amit Sachdeva>:
Euros, okay, okay, okay, got it.

<A - Srinivas Phatak>:
So, I would request you to take a look at the press release, which Unilever has put out and it's got I think detailed write up in terms of specifics that you're looking for.

<Q - Amit Sachdeva>:
Perfect. And second, Srinivas, very quickly, just very basic fact checking is that, when you make this acquisition of GSK Consumer Healthcare, can you give us that what would be the exact amount of cash you will have right to, at the time of acquisition or now, based on what the estimate is? And then, second, what sort of properties and all those things that come with it, which are actually going to be redundant?

<A - Srinivas Phatak>:
Interesting question, but I would say, if you want to look up the cash, you can see it in their books as it exists today. So, I think that's the easiest one. It is somewhere in the range of INR 3,500 crores to INR 4,000 crore – that's the number, which you can look at. But there are other elements, Amit, which I want to split up. My first focus is on looking at integrating the operations, getting the growth, getting the operational levers and drivers. So, the whole joy will come in the double-digit top line growth, and that margin realization of 800 to 1,000 basis points.

<Q - Amit Sachdeva>:
Okay.

<A - Srinivas Phatak>:
The rest of these elements will be cash flows at a particular point in time, and we'll take it in its due course.

<Q - Amit Sachdeva>:
Sure. But there are obviously elements which are part of that sort of deal?

<A - Srinivas Phatak>:
There will always be. If you're going to take a large company, there will be many aspects to it. So, equally, at some stage, if I'm going to harmonize the distribution network, the warehouses, the godowns, I'll also have restructuring costs. So, there is also a plus, there is also a minus. But of course, there will be (other elements). When you buy a business of this magnitude, there will be.

<Q - Amit Sachdeva>:
Sure. Last, very quickly again, as a process question, as we go next day from tomorrow till the time this completes, what sort of post-merger management would be on in terms of integration? Or would it be just an announcement? How will this work from tomorrow?

<A – Srinivas Phatak>:
So, look, obviously, we'll have to first do some of the important regulatory filings, including CCI. Once we get at that and till such time, there are two independent businesses completely run separately. Once we get those

approvals, it will give us window to then start to talk to each other in a coordinated manner. Clearly, there will be an integration team which has been put together or being pulled together from a HUL point of view. We will now start to look at various facets of how we can manage, being very cognizant of what is that we can do today, prior to approvals, versus what is that we can start to do post approvals. But at least then, it starts to give us time and energy to put a comprehensive and a robust plan for driving the performance when the approvals come through.

<Q - Amit Sachdeva>:
Sure. So, it hits the ground running as the time happens fairly. And is there any call option or some sort of lines as Unilever to buyback that 5-odd-percent stake which GSK would have or it has to open market? What would happen to that stake? Have you managed that part of the deal?

<A - Srinivas Phatak>:
Yeah, there are no call options, et cetera. GSK has an equity in HUL, which they are in a full liberty to either hold on to or sell it later or on day one. They may sell it whenever they wish. And our stock is liquid enough, it can take it. GSK may also decide to sit for some more time and then decide on it. So, even if you hear their press release and their briefing, their intention is to liquidate that and realize cash, timing of which, they will decide – Unilever doesn't have options on this.

<Q - Amit Sachdeva>:
Okay. Perfect. That's very, very helpful, Srinivas, and all the best and thank you so much.

<A - Srinivas Phatak>:
Thank you.

Operator

Thank you very much. Next question is from the line of Sanjay Manyal from ICICI Securities. Please go ahead.

<Q - Sanjay Manyal>:
Hello, sir. Congratulations for acquiring two brilliant brands. Just one question, sir – one important question is why Unilever will have the brands or brand ownership when majority of the cost has been borne by HUL?

<A - Srinivas Phatak>:
So, a couple of elements here. As I said, this is a merger between HUL and the GSK Consumer Healthcare Company. Let's start with what is the nature of deal that we are doing – that's the first and the foremost step. So today, Boost was owned by the company, and hence, it has come to us. Horlicks is a brand which was not owned by this company, and that's why it becomes the matter of a separate deal. Now, the question for us is that, Unilever has interest in this asset not only in an Indian market but also in international markets, and it has got further interest to take it beyond. When we look at it from a HUL point of view and an economic rationale point of view, the value which I can access from a brand and get unfitted rights at a variable level, which is royalty-linked performance versus putting this investment in buying the brand, even from an economics logic point of view, we did not find a compelling reason for HUL to bid for this brand separately. Unilever was very happy to do so. We are getting the economic benefits of it. And therefore we believe it is a win-win for all parties concerned.

<Q - Sanjay Manyal>:
Okay. So, can we assume that, in future, royalty payment will not be there or it means HUL may not be paying royalty to HUL because again...

<A – Srinivas Phatak>:
No. So, look, there is an existing royalty which GSK CH pays to its parent (company). If HUL is going to access this brand, we will pay a royalty. Let's be clear – these are arm's length transactions. Unilever has bought a brand by investing sizable money, so, there will be a royalty. The rate of the royalty is something, we will have to work through, depending on the arrangements in place today, so on and so forth. We also need to consider potential changes, which could come into regulation. Some of it, we are all aware is coming from 1st of

April. We need to work it through. So, the answer is there will be royalty. The rate will be worked out in due course, taking into account various factors and subject to, approvals from the board of Hindustan Unilever Limited.

<Q - Sanjay Manyal>:
Okay. So, why I'm asking this is because it sounds a bit negative from a minority shareholder point of view that...

<A – Srinivas Phatak>:
I would urge you to just pause the question there. If you've not understood, let me repeat that. The merger is between HUL and GSK Consumer – absolutely value-adding merger. What you're asking me is that why did HUL not go and bid for – so what should we bid? Because GSK was willing to sell the whole global rights, so should HUL have gone and bid for all the global rights of Horlicks brand in 20 markets and international operations? No. GSK wasn't, why would we? Because as HUL, our interest is only in the domestic market, so just get that aspect very clear. The second aspect to be clear is that Unilever has bought the brand and it wants to take it larger and this makes sense. As far as the Indian operations are concerned, we're getting an access to the brand on an economically viable and sensible model, which works for us and which is value accretive for us. And this has been as explained and cleared with the board, and we're comfortable with it. So before we start to worry about things which do not exist, it is the right and value adding thing from a minority point of view. I want to make this explicit and absolutely clear, lest there be some misunderstanding on this.

<Q - Sanjay Manyal>:
Okay. So, just one more question on probably brand extension possibilities. How would you be looking to sort of extend this Horlicks brand or Boost brand to the other categories? If you can elaborate a bit on which all category could come through brand extension?

<A - Sanjiv Mehta>:
First is, we don't discuss innovations ahead of time. And also right now, it is too premature for us to talk about brand extensions. Like Srinivas said, our first focus would be on getting approval and our second focus would be on integration – our intent is absolute seamless integration. And then, of course, at the same time, we will look at the pipeline of innovation and see how we can boost the core and how we can get into new segments.

<Q - Sanjay Manyal>:
Okay. Thank you very much. All the best.

<A - Sanjiv Mehta>:
Thank you.

Operator

Thank you very much. Next question is from the line of Amnish Aggarwal from Prabhudas Lilladher. Please go ahead.

<Q - Amnish Aggarwal>:
Yeah. Hi, sir. Congrats on the...

Operator
Sorry to interrupt, Mr. Agarwal, but may we please request you to speak a bit loud as your voice is not audible?

<Q - Amnish Aggarwal>:
Yeah. Is this just fine now?

Operator
Yes, much better. Please proceed.

<Q - Amnish Aggarwal>:

Congrats sir on this acquisition. I have a couple of questions. One being, when we are talking about the synergy gains of say 800 basis points to 1,000 basis points, can you please elaborate that how much will come from which areas of synergy?
<A - Srinivas Phatak>:
So, I gave you the clear markers of all the areas. See, I'm not splitting that today to see what comes from where. Clearly, general overheads and infrastructure will be a big area. Media and non-media interestingly, which many of you don't think as an area of opportunity, is actually very interesting and a sizeable area of opportunity. You would have seen that as we went through the whole ZBB program – we unlocked significant savings at our end. With that learning and experience and now which adds another 20% extra budget on top if I were to call it, it opens ups many more areas. Moreover, there is a whole selling system, infrastructure and supply chain. In totality, there is a lot that we can do. We will have a look at the growth leverage as we run this business, so there are multiple levers at play. But I think today, given the context of the deal size, it's important to give you all clear markers of what that opportunity is, perhaps, today is not the day to start saying what is year three or which bucket gives how much – that is something, which will come through in due course. We are a little away in time, before we get the approvals, to start integration and extract value.

<Q - Amnish Aggarwal>:
Okay. So, my next question is on the innovations in pipeline, because in your remarks you said that there's an impressive pipeline of products and innovations. So, are these innovations already done by Glaxo Consumer India or are they from Unilever's table or are your own innovations? So, can you throw some more light on this?

<A - Srinivas Phatak>:
Okay. As Sanjiv said, we're not getting into specifics, but there is a rich pipeline, which is available with the company. They've got fabulous R&D capabilities, a very good understanding of the science in this category and there is a very strong funnel available. Equally, there is an interesting portfolio of claims, which they have, which are at various levels of evaluation and establishment. Therefore, that becomes important. So, the message we want to cue is that when you take those capabilities and the marketing capabilities of HUL and when you have the whole strategy coming into picture, there is a potential pipeline of growth, which will come through. Today, I think it's important to just explain the sense of where we will go.

<Q - Amnish Aggarwal>:
Okay, sir. Thanks a lot.

Operator

Thank you. Next question is from the line of Rohit Chordia from Kotak Securities. Please go ahead.

<Q - Rohit Chordia>:
Hi. Good evening, all. A quick two or three questions. One, I'm just extending the question asked by Amit on cash. So, Srinivas, GSK is sitting on around INR 3,800 crores of cash. Are they free to distribute it over the next one year? Is there a closing condition on cash?

<A - Srinivas Phatak>:
We are all entitled to do what we want to do in the normal course of the business. There are no restrictions. Anything which is beyond the normal course of business, there's obviously going to be a discussion on both sides and we will handle it from there.

<Q - Rohit Chordia>:
So, if they deviate significantly from their normal pay-out ratios, then...

<A - Srinivas Phatak>:
Either them or us. It's both ways.

<Q - Rohit Chordia>:
Fair enough. Sounds good. Second question, is there any breakup fee here? Are you disclosing that?

<A - Srinivas Phatak>:

So, there will be some components to it, which we're not talking about it at this stage. But, to be honest, we're very comfortable with what some of those elements include, the quantum and the conditions. However, at this stage, we're not talking about all of this.

<A - Sanjiv Mehta>:
Our focus is on consummating the deal.

<Q - Rohit Chordia>:
Of course, Sanjiv, of course. In the contingency, you never know.

<A - Sanjiv Mehta>:
Okay.

<Q - Rohit Chordia>:
Last question is on this distribution business where the press release suggests this is a five-year agreement.

<A - Srinivas Phatak>:
Yes.

<Q - Rohit Chordia>:
Now, how should we look at this in perpetuity in the sense, would this be up for discussion after five years? Would GSK Pharma arms be taking over this distribution after five years? Is there any understanding on that side?

<A - Srinivas Phatak>:
It is a five-year agreement because both sides believe there is a value adding proposition, which I explained to you. They will get a significant step-up not only to direct distribution, but also to the full access of our ecosystem, the way we plan, the way we run the analytics and the way we distribute. In turn, we get access to stores, chemists channel and all of that. The best way for us to look at it is as a value adding arrangement and we're working together for five years, and it's open for both of us to then see how do we want to take it forward. We think it's going to be value adding proposition and we can make it work, but then look as that's something which will play out. Unfortunately, I know you'll have to make an assumption from your model point of view, to which all I can say is that we are interested to make it work and it will be win-win for both of us. Does that help from your model? I'll leave it to your judgment.

<Q - Rohit Chordia>:
Sure. A quick related question is, the terms of this agreement will be the same as GSK consumer business India has with GSK Pharma arms today?

<A - Srinivas Phatak>:
Broadly same, but there will be a bit of a rejig in the contract, because, one – it is important to understand that it is one GSK arm versus another GSK arm and the transaction is at an arm's length, but it's completely within the GSK Group. Tomorrow, it's a transaction between GSK and HUL, which are two different legal entities. So, there will be a bit of a change in terms of some of the roles and responsibilities, we have redone that. But as a principle, the net margins will still be in the same ballpark, though some of the percentages and costs will change. However, the net margins will be in the similar ballpark.

<Q - Rohit Chordia>:
So, the net spread that is being made, again, from a modelling standpoint, we should not expect...

<A - Srinivas Phatak>:
Similar ballpark is the best way. There will always be some variations, but nothing material; similar ballpark is a good way of going about.

<Q - Rohit Chordia>:
Yeah, 30, 50 basis points here or there is okay, nothing beyond that, right?

<A - Srinivas Phatak>:
I'm not commenting on that, but I've given you answer. I think it's similar ballpark, and you can run with it.

<Q - Rohit Chordia>:
All right. Thank you so much. Good luck. Thanks for that.

<A - Srinivas Phatak>:
Thanks.

Operator

Thank you very much. The next question is from the line of Harit Kapoor from IDFC. Please go ahead.

<Q - Harit Kapoor>:
Yeah. Hi. Good evening. Just one question. Over the last two to three years, this company has seen a slower rate of growth versus its historical average. Now, you did mention in the beginning of the release that most of the factors you believe are more macro-led, but just wanted to get your prognosis on why you felt that – or why the growth was low, was it something within the entity, was it outside, is it a category issue, I mean, if you could just give a sense of what your prognosis was when you've done this transaction?

<A - Srinivas Phatak>:
I think let me put into perspective. Yes, we wanted to understand some of the issues of the performance, but it's more important to understand that are they structural issues from a brand point of view, consumer point of view and benefit point of view, when you look into the future. Honestly, if you ask us, there were a few factors. And I'm sure if you read through some of the performance commentaries from the management, I think they've been very clear and explicit of what have been the performance drivers over a period of time. Clearly, there were also some externalities. But I would rather talk about from a future point of view. The brand health is in very strong space, the drivers are very good, the portfolio looks exciting, and the market development opportunity is huge. So, when I marry the context of it, I think we have enough to be excited about future, and very little to be worried about what happened during the short period time.

<Q - Harit Kapoor>:
Understood. Just one more question. When you say this 800 to 1,000 basis points of synergy, the reference point in terms of year you take is FY 2018, right?

<A - Srinivas Phatak>:
Yeah. So, the starting point of where we are worked it through is right, obviously.

<Q - Harit Kapoor>:
So, FY 2018 is where you are taking it from?

<A - Srinivas Phatak>:
FY 2018, give or take some of the assumptions, when you look through deals and transaction of this there's never going to be “a” certain data point, but FY 2018 is a clear starting data point.

<Q - Harit Kapoor>:
Got it. Got it. That's it for me. Thanks and all the best.

<A - Srinivas Phatak>:
Thank you.

Operator

Thank you very much. Next question is from the line of Manoj Menon from ICICI Securities. Please go ahead.

<Q - Manoj Menon>:
Hi, team. Congratulations on the deal. I've just only one question here...

<A – Srinivas Phatak>:
Manoj, congratulations on your new role. Please continue.

<Q - Manoj Menon>:
Yeah. Thank you.

<A – Srinivas Phatak>:
Yeah. Go ahead, Manoj.

Operator
I'm sorry to interrupt, Mr. Menon, but we're not able to hear you.

<A – Srinivas Phatak>:
Manoj, we couldn't catch the question. Could you repeat that, please?

<A - Srinivas Phatak>:
Hi, Manoj.

Operator
Mr. Menon, are you there? It seems that we have lost the line from the connection for Mr. Menon.

<A - Srinivas Phatak>:
So, conscious of time, we'll move on, and then we will come back.

Operator
The next question comes from the line of Kunal Vora from BNP Paribas. Please go ahead.

<Q - Kunal D. Vora>:
Yeah, sir. Just one question. Can you talk about the tax implication for Lever and HUL from this transaction? Will there be any tax benefits in terms of goodwill write-off which you kind of realize? You did mention a bit about amortization, but still if you can talk about any tax benefits specifically?

<A - Srinivas Phatak>: In a total tax neutral merger, depending on which side you're looking from, there is an angle from the shareholders' point of view. In a tax neutral merger like this, there will be goodwill and there are certain aspects in terms of its tax deductibility. There are views which say that we will get tax deductibility, there are some views which say that we may not. But to be honest, I'm more excited about some of the operational benefits and how the synergies will come through. Tax deductibility on a goodwill will help, but the bigger diver and kicker for us is the operational synergies and what we can do.

<Q - Kunal D. Vora>:
Sure, but considering the book value of GSK...

<A - Srinivas Phatak>:
You are right. And I'm saying that there will be goodwill, but we'll go from there. So, at this stage, I'm not giving...

<Q - Kunal D. Vora>:
So, that could also be sizable number, if I'm not mistaken. So, have you considered any benefit in terms of tax?

<A - Srinivas Phatak>:
We have looked at many aspects and many sensitivities. It’s very easy to talk about one side of the equation and all positives. We have looked at positives and the downsides, and the equation adds up in its totality

<Q - Kunal D. Vora>:
Okay. Thank you. That's it.

<A - Srinivas Phatak>:
So, conscious of time, we will take a quick look at some of the questions on the web. We'll see, if there's something which we need to answer. You should continue to reach out to IR, and Suman. Any questions, Suman, that we need to pick up from the list?

<A - Suman Hegde>:
So, I think the first question from Manish has been answered – all three elements of it. Manish, I think you have got the responses from the earlier questions that Srinivas and Sanjiv have already taken. There's a question from Mania Mishra from RCI Partners on what will be the post-merger management or organization structure that you are looking at?

<A - Srinivas Phatak>:
There are three phases to this – securing approvals, during the course of which, we will pull together an integration team, which will start to think about how do we want to take this business forward. I think that's going to be the important piece. This will be a larger and expanded role, when we get the approvals and do the transition. Once the merger happens, all the employees of GSK Consumer become employees of HUL. We have not worked out the destination, organization structure and so and so on so forth. Today, he bigger piece of joy is to look at integration and try to get a full plan, so that we hit the ball running. And in due course, we will formulate and finalize what these things would be. We would then share, as relevant, in an appropriate stage.

<A - Suman Hegde>:
Thanks, Srinivas The next one is from Sagarika Mukherjee from Elara Capital. What will be the distribution margin that HUL will be getting for distributing Glaxo's OTC products.

<A - Srinivas Phatak>:
We already addressed this. There is a current agreement and I said that we should look at the net margin on a ballpark basis or something which we assume to continue. Yes, it will not be the same because we're going to change some responsibilities and the cost depending on the nature of the transaction.

<A - Suman Hegde>:
I think we've Manoj back on the line. Zed, you want to put Manoj back on call.

Operator
Sure. The next question is from Manoj Menon from ICICI Securities. Please go ahead, sir

<Q - Manoj Menon>:
Hi, team. Only one question. Given that the Unilever's global portfolio is predominantly refreshments, are you looking at the malted food drink products, which you're acquiring, both from a refreshments and nutrition or independently? Just some perspectives on this would be helpful.

<A - Sanjiv Mehta>:
It is too early to look at how we'll extend our presence in HFD and the adjacent categories. We'll also have to take a very close look at the pipeline of innovations that they have and then we'll take up view on that. I think it's bit early for us to comment on that.

<Q - Manoj Menon>:
Okay, okay. Understood, understood. Thank you.

<A - Suman Hegde>:
And the last question on the web call is from Tejas Shah from Spark Capital. R&D capabilities are core to MFD capabilities. GSK in its earlier avatar had support of parents for the same. How do you see the same capability revolving in the future?

<A – Sanjiv Mehta>:
See, if you look at it, the bulk of the business was in India. And the R&D capabilities, a large extent, rest in India. We will supplement it with the massive foods and refreshment R&D capabilities that Unilever possess.

Suman Hegde

So, thank you. And I think that's all we have on the web queue. We've come to the end of the Q&A session. You will find the transcript of this on the Investor Relations website in a short while. You can refer to it. A copy of the presentation is also loaded on the website. With that, we draw to a close. Thank you, everyone, and have a good evening.

Operator

Thank you very much members of the management.

Sanjiv Mehta

Thank you, everyone.

Operator

Ladies and gentlemen, this concludes the update call for Hindustan Unilever Limited. You may now disconnect your lines. Thank you for connecting to audio conference service from Chorus. Thank you.