“December Quarter 2012 Earnings Call of Hindustan Unilever”

January 22nd, 2013

SPEAKER: Management of Hindustan Unilever Limited

Moderator: A very good evening, ladies and gentlemen. I am Sourodip Sarkar, the moderator of this call. Thank you for standing by and welcome to Hindustan Unilever Limited December Quarter 2012 Earnings Call. For the duration of presentation, all the participants' lines will be in listening-only mode, and we will have a Q&A session after the presentation. I would like to now hand over the conference call to Mr. Dinesh Thapar. He is the General Manager, Investor Relations. Over to you, Mr. Thapar.

Dinesh Thapar: Thank you, Sourodip. Good evening and welcome to the December Quarter 2012 Results Conference Call of Hindustan Unilever Limited. We have this evening with us Mr. Nitin Paranjpe, CEO, and Mr. R. Sridhar, CFO, on the call from the HUL end.

As it’s customary, we will start the presentation with Sridhar sharing aspects of our performance in December quarter and then hand over to Nitin for him to share his perspective on the business performance. Before I start the presentation and hand over to Sridhar, I would like to draw your attention to the Safe Harbor Statement included in the presentation for good order’s sake. Thank you and over to you, Sridhar.

R. Sridhar: Okay. Dinesh, thank you very much and to everybody on the call, thank you for joining in and welcome to our Third Quarter Results call. As Dinesh outlined, I would like to just share with you a brief reminder of our strategy, a little bit about the operating context and then straight into the details of our performance. We can have the next chart please.

While the next chart is coming up and you are looking at the screen which has a rather attractive image of one of our most recent innovations. In fact, the product we bought to market in December quarter making an entry into the premium hair oil segment with Dove Elixir and I will talk a little bit about that as we go through the presentation. Just waiting to ensure that the technology moves this chart forward in sync with me.

Since some of you might be wondering what's happening, just the technology seems to be playing a few tricks this time around and therefore you might see a little bit of latency in the charts progressing. So you see up on the screen the Safe Harbor Statement that Dinesh drew your attention to and I request you to take note of that. Can we have the next chart please?

So in terms of the sequence of the agenda for conversation, first thing is the strategy. I just want to reinforce two points. First, our strategy remains consistent which is the compass strategic framework. You have seen that before. The other part that I would like to call out is that the goals that we are seeking to deliver also remain consistent which is to deliver growth that is consistent, competitive, profitable and responsible. We will drive our strategy and deliver these goals using the framework of the Unilever Sustainable Living Plan which in many ways is the new business model. So all of these remain the same but I think it's worth reiterating and reinforcing.

Next chart please. Coming up hopefully, we will see on the next chart is a few words to set the context in which December quarter played out for us. FMCG markets sustained levels of double digit growth during December quarter. As I pointed out in our September quarter results, the growth in discretionary category which had shown signs of slowing in September quarter, that trend, I have to say, continued and therefore when we look at the second half of calendar year 2012 and look at the growth of the discretionary categories from a market context, they are noticeably slower than the first half of the calendar 2012.

In terms of channels, Modern Trade retail growth has slowed down significantly during December quarter. Up until September quarter, we have seen a regular pace of store expansion, and in a long time this is the first quarter where next store expansion is actually negative, which means on the net basis we have had store closures in the Modern Trade retail channel.

Overall, input cost held firm in the quarter. We saw a mixed picture across commodities. As the chart says, tea prices moved up very, very significantly. Rupee was around the levels of 54 which is Rs. 3 higher than the average that we saw in December quarter 2011. Crude oil was steady during the quarter while PFAD or palm oil showed clear signs of softening. So in the aggregate, I would say input cost held firm. Similarly, in terms of comparative internship in the media space, this was sustained at high levels during the quarter. Next chart please.

Just to share with you a little bit of detail when I talk about the input cost and you can see on this chart four key elements that we have used to give you a flavor of what's been happening with the input cost. First, in the blue box, crude has remained steady in the range of 109 to 110 but if you see the green box below Rupee Dollar exchange rate while it has been steady between SQ and December quarter 2012 vis-à-vis one year ago, clearly there has been a six odd percent depreciation. Tea, as I mentioned, has shown an upward swing and you see on the chart premium North Indian tea as one reference point. The same is true for the overall North Indian tea as well while palm oil clearly shows signs of softening in the quarter. So overall, input costs held firm. Can we have the next chart please?

In this challenging environment, our December quarter results reflect consistent and broad-based growth alongside profit and margin improvement. Our Domestic Consumer Business grew by 15% during the quarter. Underlying volume growth was at 5%. Overall, our HPC & Foods and Beverages business more or less grew in the range of about the aggregate consumer growth. Rural channel growth sustained while Modern Trade retail slowed down as I mentioned earlier. Canteen stores channel which had decelerated in September quarter has recovered during December quarter.

Looking at the operating margin, we have expanded operating margin by 40 basis points. This is now the sixth consecutive quarter of operating margin expansion. Cost of goods sold was up by about 40 basis points which was driven by both currency and cost but partially offset by a strong focus on cost savings. In terms of advertising and promotion, we continued to maintain the comparativeness of our spends with an increase in our absolute spend of about 150 crores which translates to about 100 basis points of percentage of turnover. Within the A&P stepup, a significant segment of stepup was in Soaps and Detergents. Profit after tax was up about 15% while net profit after exceptional was up 16%. Can we have the next chart please?

If you look at our segmental growth, as I said earlier, you can see broad-based growth across the four segments. And as we go into the details of the categories and the segments, I will talk a little bit more in detail. In the aggregate, if you look at our growth across Soaps & Detergents, Personal Products and Beverages, these are in line with or ahead of the growth level that we delivered in the previous quarter. Packaged Foods growth is a little bit lower and I will talk about that later. Can we move to the next chart please?

Clearly, innovation is a very key driver of our growth as is market execution. During this quarter, we had several innovations, some of which are shown in this chart. We launched a colour-changing version of Lifebuoy Handwash, that helps consumer particular children to understand when the germs have been killed, how much they need to wash their hands and when the germs get killed by looking at the change in colour. As I have referred earlier, we made an entry into the premium hair oil segment with Dove Elixir which has real ingredients and deliver the benefit of overnight oiling in barely 30 minutes. In our hair portfolio, we had a new variant introduced in Sunsilk while for the first time we brought to market the cream hair styling range for men.

In our Skin Care portfolio, we launched the Vaseline germ-safe skin jelly while in our food business we have re-launched Knorr soupy noodles albeit this launch has taken place pretty much towards the end of December quarter. Shall we move to our next chart please?

I will now spend a few minutes walking you through the details of the performance of each of our key categories. Can we move to the next chart please?

And I will start with Skin Cleansing. Skin Cleansing as a category has been growing robustly for many quarters now and this quarter is no exception. We have seen broad-based growth across the portfolio and across segments. Our premium segment continues to grow well. Lux and Lifebuoy had one more quarter of solid performance. At the same time, with an eye on our future, our liquids portfolio has been extended, as I referred earlier, with the launch of Lifebuoy colour-changing handwash. So in aggregate, really a good performance in this category. Can we move to the next chart please?

Coming onto Home Care, growth clearly was led by the premium segment. In Laundry, all our formats grew in double digits. Our momentum on the premium portfolio behind Surf and Rin continued. Surf was clearly buoyed by the re-launch of Surf Excel Easy Wash while the Rin growth was led by the step up in bars. In our mass market portfolio which is Wheel, we have taken actions to accelerate growth of Wheel going forward. In our Household Care business, we continue to deliver robust growth performance led by Vim, in particular Vim growth accelerated on the back of a strong performance on the Liquids portfolio. Can we move to the next chart please?

Coming onto Skin Care, you will recall our previous reference to our observation that some of the discretionary categories we are seeing growth moderate. Skin Care, and particularly face care is one of these categories that we are seeing slowing pace of growth in the market. In this context, we have delivered double digit growth led by Pond's, Vaseline and Dove. Pond's Age Miracle continues to deliver strongly while our hand and body lotions through Vaseline and Dove performed very well.

Fair & Lovely which you know was re-launched in June quarter has retained a strong position post re-launch albeit the issue of transition from the Rs. 7 price point to the Rs. 8 price point per sachet is continuing. This is something that you will recall. We mentioned last time based on past experience. It takes a few quarters to pan out. Therefore, I'm not really surprised with the outcome in December quarter. I referred earlier the innovation in Vaseline. So that's about Skin Care. Can we move to the next chart please?

Coming onto Hair Care, this category delivered double digit growth led by premium formats. Across Sunsilk, Clinic Plus and Dove, we had a very good growth in the bottles format. We launched TRESemme towards the second part of September quarter. I'm really pleased to share that we are seeing very good positive results and good momentum behind this launch.

Again, in terms of building segments and markets for the future, hair conditioners portfolio continues to demonstrate strong growth with further acceleration in growth in this quarter. And as I called out earlier, we have made an entry into two new regimes, one being hair oil with Dove Elixir and one in the men styling range with Brylcreem during the quarter. Next chart please?

This chart really gives you a little bit detail about the portfolio of Dove Elixir which we have launched. As I said earlier, this is the precious hair oil's real ingredients, and this will really enable Dove as a brand to exploit the untouched potential of the premium market. There are three variants. It delivers the power, as I said, of overnight oiling in just 30 minutes. So that's a little bit of detail on the Dove oil launch. Can we move to the next chart please?

Coming now to Oral Care where we have seen accelerated double digit growth during this quarter. Both our brands Close-up and Pepsodent grew double digit. Closeup gained from its re-launch in the previous quarter while in Pepsodent growth was led by the premium segment. Can we move to the next chart please?

Beverages, as I mentioned earlier, this has been a very strong quarter of growth in beverages. Tea has delivered one of its strongest quarters of growth. The growth has been broad based. We have seen a stepup in performance in 3 Roses and Red Label and Taj Mahal. And at the same time, our market development focus in building the tea bags as a segment is continuing to give us good results. At the same time, we have also seen good performance in our coffee portfolio which has maintained its double digit growth momentum. Within this, the premium offerings that we have launched over the last 12 to 18 months are continuing to do very well. Can we move to the next chart please?

Just a little bit of detail to elaborate on our tea performance. This chart gives you a flavor of the variety of interventions that we have been making to step up the growth on tea. We have strengthened our core behind 3 Roses and Red Label with the proposition of health and taste. And this has been backed by a very exciting and interactive consumer campaign that has worked well for the brand. At the same time, we are going deeper in the markets with access price point packs by also using and driving market development to upgrade consumers with offerings like tea bags and natural care tea variants. So overall, a very strong quarter on tea. Next chart please?

Coming onto packaged foods, where admittedly the growth of 8% is below our expectation. Growth in packaged food has been led Kissan and Knorr. Kissan Ketchup sustained double digit growth while Knorr Soups had a very strong performance in the quarter. As I mentioned earlier, towards the end of the quarter, we re-launched Knorr Soupy Noodles with a superior mix and really during December quarter, we took actions to manage to pipeline so that the Knorr Soupy Noodles re-launch could come in and get access by consumers quickly.

Kwality Walls which is our ice cream business registered a modest growth impacted by the challenging environment including the slowdown in discretionary categories that I talked about. As we look ahead, we are building strong summer plan so that we can accelerate the growth of this exciting business. Next chart please?

Finally coming to Pureit, I think we are quite pleased with the performance of Pureit. It continues to strengthen its leadership in an environment where consumer durables as a market segment are clearly slowing. Our portfolio is stronger with the innovations that we brought to market and we are seeing good progress on the various initiatives to drive execution and efficiency. Next chart please?

As we do always, sharing with you the reported result and comparable results to take into account the base effect of

Hindustan Unilever Limited

FMCG export that got demerged post December quarter. So as you can see, our reported growth while it is 10%, the comparable growth is 15% and therefore, as I mentioned earlier, our Domestic Consumer Business grew by 15%. Overall, at a bottom line level PAT (bei) grew by about 15% and net profit by about 16%. Next chart please?

If you look at how our operating profit translate into net profit, that being a clear contribution from the other income which is really the work that we do on treasury in managing our positive cash as well as dividend from subsidies etcetera. In terms of exceptional items in the quarter which you see in the net cost of 7 crores, it is a combination of profits from disposal of surplus properties of about 25 crores while restructuring cost of 32 crores were incurred during the quarter. Effective tax rate which is in line with what we have talked about earlier for this time is at 24 odd percent in this quarter, close to the 24.5% that we have talked about earlier. Next chart please?

So in summary, I'll characterize the December quarter results as reflecting consistent broad based growth along with margin and profit improvement. 15% growth in our Consumer Business and a 15% growth in profit after tax before exceptional items. The strategy that we've been working on is clearly out on track and delivering results. Next chart please?

I'd just like to take a moment to share with you how are performance looks over the first nine months of this financial year. Next chart please?

If you look at our nine months' performance, our Domestic Consumer Business has grown by about 16% with an underlying volume growth of 7%. Operating margins have been expanded by 100 basis points and our profit after tax before exceptional items is up 27%. Net profit is much higher benefiting from the property disposals in particular, the Gulita disposal in June quarter. Next chart please?

Finally, a few words on how we see the scenario panning out as we look ahead. I think firstly as we've been consistent for quite sometime now, the medium to long term outlook for FMCG markets remains very positive.

Given our strong portfolio brands and our superior capabilities, HUL is very well positioned to leverage these opportunities and deliver consistent performance.

In the near term we are conscious of some concerns. One is obviously the continuing volatility in global and local environments, and second is the inflationary pressures, which will put some stress on consumer wallets. In this context, I want to reconfirm that our commitment is to deliver competitive, profitable, consistent and responsible growth, which is what I talked about when we started this presentation.

So with that, let me hand over to Nitin for his perspectives on our performance. I'm sorry, with that let me just move forward before handing over to him on one other press releases that we issued during the day. Can we have the next chart please?

Now, some of you would have seen a press release that we issued along with our results press release. But what I'd like to do in a few charts is just to highlight the context and the details of the change in the royalty agreement that has been approved by the board of directors today. You will see up on this chart, a little bit of background. I'm sure many of you are familiar with it but let me nevertheless take you through it.

In the recent years, Unilever has been increasingly globalizing the resources to provide greater expertise, superior innovation and scale advantages to all Unilever operations across the world. Alongside this, there's a clear increase in the emphasis on the developing and emerging markets including markets like India. As you've seen over the last couple of years, the pace of innovation has clearly stepped up and also the scope of services that we get from Unilever has been expanded.

Now, HUL has been enjoying the benefits of this increasing stream of innovations and other services. It is also very clear to all of us that the India growth opportunity is quite large and very attractive. But at the same time, we will see increased competitive intensity in this attractive market.

In order that HUL continues to deliver superior and competitive growth and profitability in the attractive market, it is important that we continue to have access, in fact I would say greater access, to the stream of innovation and other advantages from Unilever. Unilever is committed to supporting HUL to win in the market place and thereby generate shareholder value for all shareholders. Next chart please.

Just to share with you a few examples of specific advantages and benefits to HUL from what we received from Unilever, there are three blocks that you see in this chart. The first block is an indexed representation of the innovation turnover that we've been getting and you can see over the last couple of years how this has got stepped up.

This block in the middle, it just takes a few categories to give you a sense about how they are helping us drive faster growth and at the same time be accretive to gross margins. In this you got face wash, hair conditioners, fabric conditioners, where these have grown in CAGR terms by 6X that of the HUL average with gross margins that are 1.6X that of HUL. So, we are accretive to our top line and we are accretive to our gross margin.

And a third example is the leverage that we get from our global procurement and buying capability both in terms of better rates as well as in terms of payment terms, at the same time access to the innovation that comes through from our suppliers anywhere in the world. Next chart please.

In the context of all the changes that I talked about earlier, the increased globalization etcetera, there was a request from Unilever to the HUL Board to review these arrangements. As you're no doubt aware, our current royalty agreements have an effective royalty cost of about 1.4% of turnover. Based on request of Unilever and all the other aspects of change that I referred to earlier, we did a detailed evaluation with rigorous due diligence, which was led by senior members of our team.

At the same time, we've also looked at how our rates of royalty benchmark across the peer group. Following this detailed review and the due diligence, the Board has today in its Board Meeting approved the proposal to enter into a new agreement, which will be effective from 1st of February 2013. Next chart please?

First, the summary of the new arrangements. So, as I said, the new agreement will be effective from 1st February 2013 against an existing royalty cost of about 1.4% of turnover. It will increase in a phased manner over the next four to five years, no later than financial year ending 18th March to 3.15% of turnover. So over this period, the total increase will be about 1.75% of turnover.

In the immediate period, which is 1st February 2013 to 31st March 2014, the increase in royalty cost is estimated at 0.5% of turnover. So, this is really a very quick summary of the royalty review and the change that we've detailed out in the press release, which would now be on our website. And with that, let me now hand over to Nitin. The person who's managing the chart could just move to the next chart. And Nitin, let me hand over to you to give your comments before we open it up for questions.

Nitin Paranjpe: Thank you Sridhar, and thank you to all of you who've joined this call. You just heard Sridhar talk about the performance in the quarter. Let me start by saying that in the context that we find ourselves in, I believe we've delivered a quarter of consistent broad-based performance. Domestic consumer growth is sustained and we've continued to expand margins even as we've made significant investments in this quarter. Having said that, volume growth is a little lower than what I would have liked. But we know what has led to it? It's limited to few specific reasons and actions are underway where required. I will talk about some of these a little later.

I'd like to start with some comments on the market context, which many of you have questions of. Now, despite the inflationary pressures in the economy, FMCG markets have continued to show some resilience in terms of overall growth relative to other sectors in the economy. Having said that, as indicated in our previous interactions we have seen some moderation in growth rates in some discretionary category.

This is clearly reflected in market growth rates in the second half of the year, which are slower than the first half. Notwithstanding this, we continue to believe that the growth outlook over the medium to long-term for FMCG looks positive. And we will see secular trends and premiumization of consumers wanting to uptrade and adopt niche and aspirational categories.

From a channel perspective, the positive in the quarter has been the fact the CSD channel has started of show signs of recovery. On the flipside, however, a key development is that modern trade as a channel has slowed down. In December quarter, the number of store closures has outnumbered new store openings.

Again, while this is something for us to be conscious of, we have absolutely no doubt that this a transient phase and that Modern Trade is poised to become a larger contributor to our business over time. And therefore, while slower Modern Trade growth has impacted this quarter adversely, we are not losing sight from the larger opportunity that Modern Trade offers.

Competitive intensity is sustained at high levels. From a media perspective in the quarter, we have seen it hold or step up in categories such as laundry and across personal care categories like skin, hair and oral. You have heard me say before that we will not compromise on our competitiveness. And therefore, we have continued to invest behind our brands and this is reflected in our A&P numbers, which have gone up this quarter. In particular, we have stepped up our investments behind the S&D segment in the quarter well ahead of the gross margin expansion that we have seen in that segment. We remain strongly committed to ensuring that we are competitive in the market place.

Let me now move on specifically to talk about our volume growth in this quarter. Our volume growth has been lower than what we have reported over the last several quarters. The UVG in this quarter was 5% and there are fundamentally three reasons that have caused a drag this quarter. The first is the pricing transition on Fair & Lovely sachets from Rs. 7 to Rs. 8. It continues to impact our numbers in the near term. We have taken a hit on volume growth in this quarter, but the fact is that our competitive position in the category and the segment remains strong post and pre launch. And this reassures me that our consumers are with us and the launch has been well received. Having said this, I still expect that the transition will take a little longer before it stabilizes.

The second area, which has pulled along volume growth in the quarter, has been the very high-based effect of the Dove sachet. The fact is that while volume has been impacted, we have continued to grow value strongly. You will recall that in the last year we had launched and had a huge volume of Dove Re. 1 sachet given the competitive context that was prevailing then. As the year went by, we had taken up pricing of these sachets to Rs. 1.50 and as just at same level across the totality of the hair portfolio during the year.

This imbalance between volume and value, I expect to play out for a couple of quarters more. On the other hand, I am pleased that the momentum on bottoms has been sustained at high levels. And therefore, I have not doubt, I am not worried because the brand is strong, is doing well and is growing in equities.

The third area, which has been a drag on our growth this quarter is the brand Wheel. And while we continue to grow strongly in laundry, driving category upgradation, we've had a relatively soft quarter on Wheel. We have taken the corrective action. We have already seen the brand respond to these fresh inputs. Once again, I am not concerned about the health of Wheel, considering that it has been performing consistently and also considering that it has already responded to the actions that we have taken and we see the results in the market place.

In summary, as I look at the totality of our business on balance as I said, the state of the business is healthy. Action as required has been taken to ensure that we continue to make progress on strengthening our leadership positions in the market.

I now will come to the last part of what Sridhar talked about and this relates to the change in the royalty rates. You are well aware that over the last couple of years we have been receiving a range of services from Unilever, which has allowed us to increase the level of innovation, build scale, in segments of the future and benefit from a globally organized procurement organization. All of these have helped us deliver a stepup in our performance and strengthen our leadership position. You have heard Sridhar talk about the new arrangement that has been approved by the Board this morning.

I don't want to get into the details, but I only want to state that the decision was taken after a thorough due diligence to establish that the new arrangements reflect the fair payment for the benefits that HUL is receiving and will continue to receive in the future. I believe that this is right for the India business and will enable us to have access to the larger capabilities that are being built by the Unilever with a particular emphasis on D&E markets. And given the context of a huge opportunity in India as well as the increasing competitive intensity particularly from global players, Unilever is committed to ensuring that the support in terms of new products, innovation, technologies and services is commensurate at the needs of the India business and to help HUL win in the market place and generate significant value for all shareholders of this business. The message that I, therefore, leave you with is that this arrangement will be beneficial to this business.

Let me end by saying that with a 7% UVG, 16% USG and a 100 basis points improvement in EBIT margin expansion in the first nine months of this year, I believe our strategy is well on track and delivering. You have heard me articulate our strategies time and time again, and I will do so once again and reiterate that we remain focused and strongly committed to delivering growth, which is consistent, competitive, profitable and responsible. That is all I had to say. Now, I am going to hand you back to Dinesh.

Dinesh Thapar: Thanks Nitin, thanks Sridhar. With this, we'll now move on to the question and answer session. May I remind you that this call is only for institutional investors and analysts. And therefore, if anyone else from this call has a question, you might like to get in touch with us at investor relations. What I'd like to do now is to hand you over to Sourodip, who will manage the next section of questions for us. Sourodip, over to you.

Moderator: Thank you so much, sir. With this, we are going to start with the Q&A interactive session. So, I would request all the attendees and the participants, if you wish to ask any question, please press "0" and "1" on your telephone keypad and wait for your name to be announced. I request all the attendees and the participants if you wish to ask any question, please press "0" and "1" on your telephone keypad and wait for your name to be announced. And here comes the first question from Mr. Abneesh Roy from Edelweiss Capital. Mr. Roy, you can go ahead and ask your question. Your line has been unmuted.

Abneesh Roy: Sir, my first question is on the Soaps and Detergent business. We have seen gross margin expansion but the Ad spend has been ahead of that due to its EBITDA margins – the margins are contracted. Wheel has seen some issues. So, I wanted to understand this ad spend – very high ad-spend, is it because of expected growth margin expansion further? Is it because of issue in the Wheel? Is it because of the new product innovation in Lifebuoy? If you could give clarity on what really is happening in Wheel?

Nitin Paranjpe: So, I think you are absolutely right in your first observation that gross margins have expanded in the segment and A&P level have gone up even faster, the result of its segmental margins have come off. We have stated time and time again that we should resist the temptation to analyze quarterly performance in terms of how these movements are and draw conclusions beyond what are necessitated.

You would have noticed that this segment has shown strong expansion in margins over the last many quarters – over the last several quarters. In this quarter, A&P levels were stepped up based on what we found in the market place and our policy of making sure that we remain competitive in terms of our investments in the market place and some of the innovations that we have had. But primarily, the guiding factor in this quarter was to make sure that on principles and criteria, which we have in terms of share market etcetera, we've stepped up reflecting the competitive intensity, which had gone up in the segment.

Abneesh Roy: Is it that whenever we see the gross margins expand and then we see the local players come back. And Wheel also we are seeing some issues. So, on the lower end are you seeing marked increase in the lower players' competitive intensity?

Nitin Paranjpe: Firstly, I would just make a comment on Wheel, which is, I think, I do not want to overstate it. It was an issue in this quarter, but like I mentioned in my comments, it is a brand, which responds quickly. The actions have been taken and we are already beginning to see it responding to the interventions, which have been made. As a general point, what you made cannot be denied, as commodity cost soften etcetera there is a tendency for local players to start coming in. At this stage I would not want to say that we are seeing extreme pressure or excessive re-entry of local players. But, as a business, we need to be geared to address all such situations whether it is in terms of players at the top end or bottom end, organized or unorganized players.

Abneesh Roy: And sir, one follow up on that. Any colour you can give on Wheel? What exactly we've done and you said some recovery has already happened. So, is it in terms of pricing innovation, branding? Some colour on that?

Nitin Paranjpe: Relatively, a couple of interventions, we manage Wheel very carefully looking at competitiveness on a state-by-state and geography-by-geography basis because the nature of competition often varies. There were a couple of geographies where we've made product enhancements and improvements and there have been a couple of geographies, where we have ensured that market place competitiveness has stepped up and in general advertising intensity has also been increased.

So, it's been a holistic response as appropriate to the geographies like I said, a couple of geographies where we made product enhancement that was required there. A couple others where there was market place competitiveness in the form of strong trade activity and in general, a step up in advertising intensity across the board.

Abneesh Roy: Sir, my second question is on the tea business. You said this has been one of the strongest quarters. Also, what we see is that tea raw material prices are shooting through the roof and so again is it your performance? Is it again linked up because of the inflationary conditions? We see that the stronger players and the larger players gain when the inflationary condition is there. And could you give us some colour on tea bags? You spoke on that. So, what's our share in the tea bags and how do you plan to take it up further? And, some insights on where do you see tea bags as a proportion of tea business three, four years down the line?

Nitin Paranjpe: First comment is, I think our performance on tea has little to do with the inflationary effect that you talk about. Those inflationary effects are there. The impacts of those are likely to be experienced into the future. You're aware that tea has got into two seasons and we will see this effect as we move forward. So, performance in December quarter has less to do with the inflationary pressure and the impact on local players. So, that isn't the reason.

As far as tea bags are concerned, no, absolutely zero doubt in their minds that will determine how the categories will move into the future. At this moment, it is a very small and insignificant contribution to the overall business. It's growing very well. The market needs to be developed, but I wouldn't think that this will be the most material part over the next two, three years. We will keep growing it as we start future proving our business for the future.

Abneesh Roy: And sir, the one last question on modern trade.

R. Sridhar: Abneesh, sorry to interrupt. But, I think it is only fair, we come back to you later. Let's give the opportunity to others on the call and thanks for meeting. We will come back to you.

Abneesh Roy: Sure, no problem sir.

R. Sridhar: Thank you.

Moderator: Thank you Mr. Roy. The next question is from Mr. Prasad Deshmukh from DSP Merrill Lynch. Mr. Deshmukh, your line has been unmuted. You can go ahead and ask your question please.

Prasad Deshmukh: Yeah. My first question is on – How much of the revenue actually comes from brands, which are owned by Unilever? And how has this percentage actually changed over the last two or three years when the royalty was revised before this?

R. Sridhar: I think, as far as this is concerned, it is pretty dynamic thing. I am not sure that, you know, we get into those specificities externally. I think, I understand the context of your question which, is in the context of the new royalty agreement and you see, that's I am assuming the context of your question as a new royalty agreement. Is that correct?

Prasad Deshmukh: Correct, correct.

R. Sridhar: I think I'll tell you the most important part is, as we've very transparently shared, A) the rational for the change, what is the benefit that HUL is getting and will continue to get? And from a royalty cost perspective, what is the change that this agreement will entail? As I mentioned earlier, 1st February 2013 to March 2014 we estimate this to be about 50 basis points of turnover.

Prasad Deshmukh: Yeah. The second question on Modern Trade. What has changed in the last one quarter? Where like – not structurally but you said Q2 modern trade was one of the key drivers and which, in a way is also important for premiumization that we keep talking about. What has change in Q3 where we are seeing slower growth there?

Nitin Paranjpe: I think we mentioned in the beginning there are certain dynamics, which are taking place in modern trade. Growth in the past has been a combination of same store growth as well as new store openings. In the quarters, prior to the current ones, which, has gone by we, have net store additions. This quarter we have seen more closure and less new stores opening as a result of which the net store additions has been negative. That has impacted the aggregate growth of the modern trade channel.

Like I again said, that I wouldn't read and think of this as a big trend. It does mean that organized players may be consolidating their business, getting their step right, but going forward there is absolutely no doubt in anyone's mind that Modern Trade will become a larger and larger contribution to the overall trade and to our business and we remain committed to it. We are in a fortunate position that we have presence and leadership positions and our presence in Modern Trade is stronger than our presence in general trade. As this trade and this channel increases, its contribution to the total market we will spend the game.

Prasad Deshmukh: Sure, sure. Thanks a lot, sir. Thanks a lot for taking my questions.

Nitin Paranjpe: Thank you.

Moderator: Thank you, Mr. Deshmukh. The next question is from Mr. Pritesh Chadda from MK Global. Mr. Hitesh, your line has been unmuted; you can go ahead and ask your question, please.

Pritesh: Yeah, hi, this is Pritesh. Just a couple of questions. One, for Mr. Nitin Paranjpe, the initial comments that you made vis-à-vis moderation of growth and the presentation talking about premiumisation at slower pace, I am just unable to resolve the math and there is a disconnect in terms of – If you check the last three, four quarters, there is a moderation on volume growth on one end, but there is an acceleration in price-led growth and we haven't seen any larger price actions in the main category. So is there anything else to read in this math?

Nitin Paranjpe: No, I think, I don't know how to make it more complicated, but, I think there are some price increases, which are not visible in the context of list price or MRP increases in the pack. So very often, actions are taken in order to manage price point LUPs or single dose items to deal with the inflationary pressures which are there.

When the price increase out there is taken not by raising the price, but by reducing the grammage or the fill level in that pack. That has an impact of indicating that the volume growth has come down and the price growth has gone up.

Now, we will talk about this, but I think, you have touched the point a very, very important aspect which needs to be looked at in conjunction to volume growth numbers that you would see because in many areas particularly price point packs and single dose usage packs that we have got, what is critical for us to judge the health of that portfolio is the number of units that we are able to sell to consumers rather than the absolute volume which may go up or down based on whether we are filling back or filling down.

And what we are pleased is that the unit growth that we have got in that part of our business is substantially higher than the conventional volume growth calculation that we would see. So you will not see it reflected in our UVG numbers, it will get captured in price growth, but in reality, it is more of measure of our ability to increase our consumer franchise which is what we are trying to judge, how many people buy our product and how often they buy it, which is reflected by the unit growth that we get in that part of the segment, in that price point for various categories. I don't know whether that helps explain what you had in mind.

Pritesh: Yeah, yeah, I think. Second, you know, is there been of lately any pricing actions in the Laundry segment, especially on the price cut side in the markets?

Nitin Paranjpe: See, nothing material in the form of price cuts that you would see in the markets, no.

Pritesh: Nothing, okay. Lastly, I just want to check, you know, you gave a comment on the Oral Care and the double digit growth, maybe if you could extend the comments towards market share?

Nitin Paranjpe: So, I think, we are pleased with the progress that we have made on Oral Care. About a few quarters ago, we had indicated that there were some things that we wish to fix. We were not participating in the premium segment, expert care segment, et cetera. We've put those into the market place and we are pleased with the progress that we are making there.

Pritesh: Okay, just one clarification I had, in the royalty payment, you know, the release it's 1.4% of turnover. I am just confirming this turnover. When you mentioned its turnover for the set of products or it is for the entire company now?

R. Sridhar: The company. So it is for the company, the total and just because the whole idea was to give a clear sense of what is the royalty cost impact that is currently there in our financial statements and in the fullness of time what that could go to. So it is on complete turnover.

Pritesh: It's as a percentage of your net sales, currently?

R. Sridhar: Correct.

Pritesh: Thank you very much, sir. Thank you, all the best to you, sir. Thank you.

Moderator: Thank you, Mr. Pritesh. The next question is from Mr. Manoj Menon from Deutsche Bank. Mr. Menon, you can go ahead and ask your question, your line has been unmuted.

Manoj Menon: Sure, thanks. Hello sir, a couple of questions. One on gross margins to start with, you know, if you look at the gross margin performance year-on-year, if you could help understand the context of, you know, some steep corrections, some of the inputs. Is it more of a timing issue or it is a function of top-down where the pricing benefit has started going away substantially. So optically, you are actually seeing a lower gross margin?

R. Sridhar: Manoj, hi, I think, you are referring to let's say the margin after cost of goods sold, right, because when we talk about gross margin, I just want to be clear, you are looking at revenue minus cost of goods sold and that proportion has gone up by 40 basis points in the quarter. Clearly there is a mix of portfolios that we have that obviously has an impact.

So as you would have seen from the segmental growth that we talked about where we had 20% growth in Soaps & Detergents and a 13% growth or so in personal products, you can well imagine that, you know, from a purely arithmetically mix perspective what happens. I think the specific thing which I want to clarify is that Soaps & Detergents, our gross margins have improved. What we have done is invested additional amounts in A&P to make sure that we remain competitive in the market place.

Manoj Menon: Okay that really clarifies. Sir, thank you. Sir, second question on, you know, the royalty. Sir, small question. When you say peer group, is it consumer companies or it would include, you know, let's say outside of consumers space in India?

R. Sridhar: As I have said, that was most for, you know, reference. We talked about Consumer Company, but that is more for reference. I think, the more important point is we have been very clear in terms of making sure that the new agreement has undergone or the new proposal which leads to the agreement has undergone proper due diligence and that it is going to be fair to HUL and to Unilever and this will then enable us to continue to deliver a strong and competitive growth alongside improving our margins and thereby we'll continue to win in the market place.

Manoj Menon: Sir, very quickly for one bullet point question on Wheel, you know. Is it the standard pack implementation of 1st November, one of the reasons to let's say to have lower volumes, you know, because today you have one kilo at 43 wherein earlier it was more like Rs. 20 and Rs. 30 sort of price points, I mean, is that an issue which is more transitory in nature?

Nitin Paranjpe: So, I think, again like the previous question, there are other nuances that you asked and I will help you understand this. I think, there was some impact of changes on account of PCRO. There were even more significant impacts on account of changes that we made in order to hold price point packs like Re. 1, Rs. 2 et cetera and address grammages and that has had a very significant impact on volumes which you would notice.

When we look at the business and we analyse that part of the business, we look at unit growth because the whole purpose is to reassure ourselves whether we are selling to more consumers and we are getting our consumers to buy us more often. All I want to say is that unit growths are growing much faster than volume growths when it comes to that area.

On Wheel and in Laundry, if you would were to start thinking of volume growth, I think, there is another aspect that you've alluded to. And I will try and see if I can help you understand this. I think on categories like Laundry, the general tendency to uptrade when people move from Wheel to Rin to Surf Excel, et cetera, is the positive signs from a business point of view; it's a positive sign from a consumer point of view in terms of the better experience that they get. However, because the moving up means more concentrated products with higher levels of active & surfactants in it the quantity which we need to use when we move from a Wheel to a Surf Excel comes down and therefore up trading of a consumer which is of the normal trend it leads to reported volume growth as we see it coming lower.

And therefore internally as we start nuancing and understanding the quality of our performance in categories like Laundry, we need to marry two things: unit price growth as well as how much active are we selling to our consumers, because that is a better reflection from the number of washing that they are likely to experience as a result of our portfolio.

So I didn't want to get into this space as I was describing our volume growth story because it introduces new dimensions and we never talk about all of these with our analysts, but clearly as we understand and study the health of our business, there are many more answers which we need to get to and not just look at a pure volume growth number which you get especially as a secular trend, we are going to see over the next many years is one of up trading and the best example I gave is one in Laundry where our consumers actually move from Wheel to Rin to Surf. The absolute amount of quantity which they will use for the same bucket wash will start coming down.

On Wheel, the nature of issues that we've had are – I've explained earlier, we have taken those corrections like I said on product quality in some areas, pricing in some other areas and a general increase in advertising across the board.

So a slightly longer answer to the questions that you asked, but I thought it might be of value for you and others to understand lot other aspects are useful to get a feel for the overall health of our business.

Manoj Menon: Sir, absolutely, thanks and that's very helpful. One absolutely, last question, you know, the Fair & Lovely transition issue, which you mentioned, I am a little unclear about it, you know, particularly for a non-price point a pack where a Re. 1 price point actually increase, you know, really the volumes for more than a quarter.

Nitin Paranjpe: Actually, you are absolutely justified in actually picking that up. Having said that, this is something that we've observed in the past ever since we moved from five-to-six, six-to-seven and now from seven-to-eight, the Fair & Lovely sachet price transition does take time. People at that end are a) when this happened they look around; they scout around to see whether is an old price stock which is available. In the early days, given how widely this brand is used, almost everyone wants to use it, the sensitivity for this price increase at that level is high and therefore this is consistent with our experiences in the past. I too would like this transition to be over quickly, but it is taking time and my feeling is it could take a month or two more.

Manoj Menon: Sir, thank you so much. I will come back in the queue.

Moderator: Thank you, Mr. Manoj. The next question is from Mr. Jamshed from Citigroup. Mr. Jamshed, your line has been unmuted; you can go ahead and ask your question, please.

Jamshed: Yes, hi, thank you for taking my question. I just wanted to touch a bit more on this Fair & Lovely aspect. Is it that you all are now, you know, sometime ago, sometime last year, there was an article which had come that, you know, regional brands, the market share had fallen dramatically over calendar year '11, early calendar year '12. Are we seeing regional brands making resurgence back into this category? Is that why the transition is also taking slightly longer than anticipated?

Nitin Paranjpe: So there is absolutely no evidence in face care that the phenomenon which you talked about is bourne out. If anything from a share point of view, Fair & Lovely within the segment is stronger today than it was before the re-launch.

Jamshed: Okay, so basically it's not like you have lost consumers, you've just stepped away for a while?

Nitin Paranjpe: I think, yeah, I think, there are some pipeline corrections, there are some consumption levels which people might be adjusting, but we haven't lost it to competitors.

Jamshed: Okay, thank you for that. On the royalty bit, could you share a bit in terms of the underlying logic behind these very precise increases, is it linked to a Unilever R&D kind of formula?

Nitin Paranjpe: When you say this precise increase, are you referring to the fact that it will likely to be 50 basis points this year? Is that what you are referring to?

Jamshed: Exactly, yes. Yeah, it seems to be a very precise roadmap to 2018. Is there some sort of deviation which could occur based on the how the mix and the volume change, is this just indicative or is this absolutely?

Nitin Paranjpe: No, I think, there is one aspect which is very precise and you must feel reassured about that aspect which is that the total increase that is likely to happen between now and no later than 2018 will have an impact on our P&L of 1.75% point. That is precise. The phasing of it and how it is managed over time is not as precise and will be managed over the next few years in line with certain guidelines and principles that we've discussed and agreed with the Board. The broad contours of which have been spelled out and will be made clear and the most important thing for you to know is that in the immediate financial year which is starting 1st February to April of 2014, the impact on our P&L will be 50 basis points. After that the absolute impact in subsequent years and the increase in the royalty will lead to a total cumulative impact of 1.75% points will be decided closer to the time based on different criteria which have been spelled out by the Board and agreed with the management.

Jamshed: Okay, thank you. I will step back in the queue.

Moderator: Thank you, Mr. Jamshed. The next question is from Mr. Manish Chand from Nomura Securities. Mr. Chand, your line has been unmuted. You can go ahead and ask your question.

Manish Chand: Thank you so much. Sir, I had this one small question on the likely tax rate in FY 14 and FY 15, if you could give just some indication of that it will be of great help.

R. Sridhar: Okay, So Manish, as far as the current financial year is concerned, you are aware that we estimate the tax rate to be about 24.5%. Yeah?

Manish Chand: Correct, yeah.

R. Sridhar: For the next financial year, we estimate that this could go up by about 200 basis points. And thereafter, to be honest, I think, we should wait and watch for, you know, what happens in the direct tax code because there is obviously that which is on the annual, which is seeking to, as per the last draft, bring the marginal tax rate to 30%. On the other hand, if nothing happens and then the direct tax code does come and the tax rates remain unchanged, then the marginal tax rate will be 33% and, you know, some of our units will still give us some tax benefits in FY 15 though it will continue at a reducing scale.

And beyond FY 14 somewhere in the range to 30 to 33 is the broad, maybe 29 to 33 is the broad estimate. We will have to wait for sometime to see, you know, what actually pans out. But FY 14 is a clearer estimate.

Manish Chand: Okay, fine. Greatly helped. Thank you so much.

Moderator: Thank you, Mr. Chand. The next question is from Percy Panthaki from IIFL. Percy, your line has been unmuted, you can go ahead and ask you question, please.

Percy Panthaki: Good evening everyone. A couple of questions from me and one more on housekeeping. First question is, I am still not very clear on why the overall gross margin is down in spite of increasing gross margin in S&D category. I understand there would be an adverse mix effect, but is it so huge to take the overall margin in negative after S&D is in positive? That is question one.

Second question is, see, not looking on a quarter-to-quarter basis as you are saying, looking more long term, if I look over the last two to three years, you have done a great work across the board. So you have substantially increased your market shares in Modern Retail, you have made your products more competitive and therefore across the board, all the very small and unorganised players have basically been more or less wiped out. And you have done a lot of innovations in new categories, et cetera. So in the last two, three years, you have done basically almost 80 or 90% of what people would think that is there on the table. So going ahead— and your 10% volume growth which has come through is basically on the basis of all these initiatives and therefore you have grown higher than market growth rate.

Now, going ahead, how difficult is for you to keep growing faster than market growth rate assuming that if you were to do so you would require again new incremental big ticket initiatives as you have done in the last two or three years? And also coupled with this, just a sub question is, any colour on this CSD impact in terms of your sales growth that has happened in this quarter? If you could just answer these two and then I will come to the housekeeping question later on.

R. Sridhar: So let me just deal, Percy, with the gross margin question and then hand over to Nitin to give you a sense although the usual caveat that we do not give an outlook will apply, but maybe try and give you a colour as to what we see as an outlook. I think, you know, I just mentioned in response to one of the previous questions, the overall COGS as the percentage of turnover which is increasing by about 40 basis points that you see as the net effect of what happened across the four segments combined because our Soaps & Detergents segment has grown by 20% and the PP segment has grown by 13%, just the mathematical weighted average would put an adverse sort of mixed pressure in terms of the margin progression, but when you look at S&D as a specific category, I just want to reconfirm that the gross margins have moved positively. However, segment margins are lower because of the increased investments we have made on A&P.

Percy Panthaki: That was my question. Does not the increase in the gross margins of S&D offset the adverse mix impact?

R. Sridhar: So if you know, maybe we can pick it up offline if you just do a simple Excel spreadsheet and, I guess, you are hampered by not knowing what are our different levels of gross margin between S&D and personal product. So that perhaps is the one, let's say, piece of important information that we do not have access to, but trust me that this can play an impact. Let me pass on to Nitin on your second question.

Nitin Paranjpe: Yeah, I think, all I would say is firstly, thank you for recognising what we've done over the last few years. All I would say is that the opportunity that the Indian market players offer into the future remains strong. I would be absolutely not in the place of thinking that over the last three years we have managed to address 80-90% of the opportunity that exists. There is much, much more opportunity that the Indian market will offer largely because there is more to gain through penetration in several categories and consumption in all categories.

We just hope that we continue doing what you described, very well for what we have done in the last three years. We would like to do that into the future because our commitment and our stated goal to find ways to deliver growth which is competitive and profitable remains and all our plans in the organisation are geared with the hope and aspiration of delivering on that.

Percy Panthaki: Nitin, just a sub question to this that in Modern Trade, apart from of course the net closure issue, do you think the fact that the market share gains within Modern Trade that you were doing a couple of years back, that opportunity has been exhausted and your market shares are more or less stable and that is one of the reasons why your gross rate is coming down?

Nitin Paranjpe: No. In fact, going forward, if we were to retain and hold our Modern Trade market shares, it will be to our advantage because our Modern Trade market shares are well ahead of our General Trade market share and as the contribution of the two changes, it will work to our benefit. So I don't think the explanation in this quarter has to do with movement in share. I also want you to realise that we are not indicating that we have declined or have not grown in Modern Trade at this moment. All we are saying is that the rate of growth in Modern Trade has been lower than in previous quarters as a result of the store closures which have taken place. Modern Trade is still growing faster than, over a period of time, what General Trade has grown.

Percy Panthaki: Right. And any CSD impact which has?

Nitin Paranjpe: I think CSD, as I mentioned in my comment, but maybe worth clarifying that there were two channel impacts in this quarter. One was a positive impact in the sense that CSD has recovered this quarter. Now, just like in Modern Trade, I would not take one quarter which has gone by and draw a conclusion out of it. I would also not take CSD and its recovery and assume that this is exactly how it will be going forward, but in this quarter we have not had either a positive impact or a negative impact on account of the channel mix between CSD and MT. One has been positive, the other has been negative. The two neutralize each other.

Percy Panthaki: Okay. And my last housekeeping question is on other income. If I look at the nine months, it has grown by about a 136%, so more than doubled over nine months. So I just wanted to understand what part of the other income is recurring, what part is one-off and therefore in FY 14 would it be prudent to actually take the de-growth over the FY 13 number?

R. Sridhar So just let me make sure, Percy, I have understood your specific question. Are you talking about other income or are you talking about other operating income?

Percy Panthaki: Other non-operating income.

R. Sridhar: Non-operating, which is financial income?

Percy Panthaki: Yes.

R. Sridhar: Yeah, so, I think, in terms of the financial income, it's something that has got two main components: one is the surplus in terms of our cash which we deployed to earn a certain level of return. And the second is obviously any income in the form of dividend that we get from subsidiaries. As far as our cash is concerned, we continue to drive a very strong working capital programme and continue to drive improvements in our working capital. A part of this therefore resulted in the payout of the special dividend. You will recall that we announced and implemented a few months ago, right?

So, I think, all I can say is that we will continue to remain focused on driving working capital and improving the working capital efficiency, but the available cash deployed certainly because of the special dividend that we paid out that will have an impact. As far as the interest rates are concerned, I think, all of us know that it's very difficult to predict what might be, what will happen in the future and therefore that we will have to take it quarter-by-quarter.

Percy Panthaki: So just to make it simple, if the 136%, out of that I were to remove capital gains from both FY 12 and FY 13, then what would the growth rate look like approximately?

R. Sridhar: Yes, can I suggest? Percy, we are beginning to spend more time to get into some more details, if you could pick it up in your subsequent interactions with Dinesh, is that alright?

Percy Panthaki: Yeah, we'll do. Thank you.

R. Sridhar: Thank you.

Moderator: Thank you, Percy. The next question is from Mr. Vivek Maheshwari from CLSA. Mr. Maheshwari, your line has been unmuted; you can go ahead and ask your question, please.

Vivek Maheshwari: Hi, my first question is on the volume growth again. While you have, you know, explained a lot about how the volume growth has panned out. But the specific thing is in terms of industry growth rate, what are you seeing? Have you lost any significant market share or the market growth rate has come down for whatever reason it could be?

Nitin Paranjpe: I think, we've mentioned right at the beginning that in the discretionary category many of them in personal products space as packaged foods, we have seen volume growth rates come down consistently between the first half and second half as we moved. And that's the comment in terms of the overall market growth rates which we talked about. And as far as the rest of the position is concerned, I think, there are about one percentage point up or down in different categories.

Vivek Maheshwari: Okay, so then essentially when your volume growth is 5%, it essentially shows how the rest of the industry would have also growth in a way. So there would be a moderation in that context.

R. Sridhar: I think, it's very important, Vivek, to bring back and understand that portfolios are very different. I know something that most if not all of you are aware, but please remember when you are comparing across companies that the diversity of portfolio and footprint of our presence across, you know, soaps, detergents, personal products, et cetera, et cetera is fairly unique and I am afraid therefore trying to draw an equivalent comparison is even conceptually not going to be possible.

Nitin Paranjpe: Having said that, I just also want to say that I myself started by saying that volume growths in this quarter were a little lower than what we would have liked and I've explained to you the two or three reasons why we feel that they are lower, the actions that we've taken and we overall believe that with these actions which I've talked about our portfolio is healthy and capable of delivering on what we are promising which is competitive and profitable growth going forward.

Vivek Maheshwari: Okay. Second, on the operating other income, in this quarter it doubled and for the last few quarters it has been growing fairly steadily. Is this entirely led by service income and therefore, you know, sustainable as we get into fiscal 14 and fiscal 15?

R. Sridhar: So let me first clarify the other operating income which includes the income from services is not the main driver of operating margin improvement. Just to clarify that while you see a significant increase in other operating income, the corresponding costs that are incurred to render those services come in different line in the P&L including employee cost line, other expenses line, et cetera. So that is not really a big driver.

For example, if the level of services that we provide and therefore what we recover goes down, you will see a reduction in other operating income lines, but you will also see the reduction in some other cost lines. What is driving really the operating margin improvement and as I've talked about in the six consecutive quarter of operating margin expansion is really what we've been talking about in terms of our strategy to deliver competitive and profitable growth, you know, whether it starts with our brands and strengthening our brands and portfolio, improving our product proposition, product quality right through to execution.

One of the things of course that we are continuously looking to do is how can we drive a better mix of our portfolio. Last but not the least is the continued focus on cost and improving our cost competitiveness, taking out waste from the system. So this is really something that we've shared with you before, nothing new and it's really not linked to the services income.

Vivek Maheshwari: But the question that I have is this doubling of operating other income is what? Is it sustainable or not as we go ahead?

R. Sridhar: No, it should not be sustainable. This is the services rendered which are based on, you know, certain global teams that operate from India. These are not something which are going to trend line that keeps going, but important to note that. Virtually, you know, this is sort of an offset to the cost line. Of course, there is a mark up in the margin to make sure we are fiscally compliant but this is not a material mover of operating margin of the business.

Vivek Maheshwari: I see. Okay. In this quarter, other expenses were up only 4%. So anything over this specifically?

R. Sridhar: I think, the question is whether there is any one off or something there? No. Two things happened. One is first of all, that we've been really driving many of our other elements of cost even harder than the prior year. One example I could talk to you about was our entire cost on the distribution space whether it's about distribution of warehousing cost or distribution freight cost as well as cost of energy and other consumption in our factories that we've been driving really hard. And we are certainly seeing benefits of that coming through. But, you know, one can get into line by line but just one to remind you that overall our goal and our objective is in the aggregate of our portfolio to deliver growth that is both competitive and profitable.

Vivek Maheshwari: Okay, okay. Sorry, one last bit on royalty again. So you mentioned about royalty increase because of the support that you are getting from parent be it in terms of new launches or in terms of a supply chain and, you know, procurement. But these things have been around. So one of your charges which you mentioned about 2008 to 2012 the kind of growth and, if I recall the number correctly, 6 X growths compared to your base business and one half time gross margins. Why is this, you know, one in terms of timing if you are doing, if Unilever was anyways supporting you from 2008, why this timing one and second is why is not on only on incremental portfolio and on everything that you are marketing today in India?

R. Sridhar: Okay, so, Vivek, I think later on when you get some time you will be able to look at a very detailed press release which absolutely addresses the question of timing that you talked about. And then let me just give you a gist in the interest of time. So what has certainly been happening is that the operating model over the recent years has changed at Unilever with Unilever increasingly globalising the resources to provide expertise, innovations, care advantage, et cetera to the operating companies around the world.

This is happening with an increased focus on D&E markets including India. Over the years, the pace of innovations and the scope of services are also expanded. The pace of innovation is what, you know, you saw in the chart and which you referred to. As we look ahead, one of the things which is very clear is that the FMCG market opportunity in India is going to be very attractive. It's a large opportunity and it will be very attractive. The fact that it's attractive means it's also going to raise the levels of competitive intensity because this attractive market will be seen by others.

In order for HUL to continue to win in this attractive market, to continue to grow competitively and profitably, it's important that we have even greater access to the resources of Unilever whether it is in terms of world-class innovations, whether it is in terms of superior practices, et cetera. It's really, really important that we continue to have access and even greater access.

So that is really the context. In terms of saying, you know, why have you shared the past information, obviously because we can't share the future information. You know, we are not in the space of giving guidance. Giving you a sense of the kind of benefits that we are getting was really to provide some, you know, slightly more level of detail as to what are these benefits rather than just talk about benefits to give you a flavour of them. As we look ahead, we will continue to get and I believe we will get at a stepped up level because that is what we will require to win in the Indian market opportunity of tomorrow. So please do go through the press release. I think, it fairly details out the specific question that you have got and of course we are quite happy to engage later on if necessary.

Vivek Maheshwari: Alright, sir. Thank you.

Moderator: Thank you, Mr. Maheshwari. The next question is from Richard from JM Financials. Richard, your line has been unmuted; you can go ahead and ask your question, please.

Richard: Hi, thanks a ton for taking my question. Sir, I have actually two questions. One relating to the quarter and the other relating to royalty, you know, I am sorry for coming back over and over again. I know a lot of people have spoken about this earlier regarding gross margin. So if I understand from you, I believe, you had a gross margin expansion and S&D. And if I would look at PP, PP you had a pretty strong EBIT margin expansion, so I would presume that for that segment itself your gross margin will not have, you know, deteriorated.

So, I mean, with these two in the context, you know, a gross margin comparison at an overall level somewhat surprised me. So this was data point number one. Data point number two is that if I were to look at the gross margin for the December quarter and the quarter prior which is actually the September quarter, I would presume that normally your mix is slightly better in December. And both these quarters we have made the same level of gross margin which is 46.9% and if at all I would think the raw material cost is slightly more benign in the December quarter than it was in the September quarter.

So, I mean, just wanted to, you know, pick your brain more on this. I know you have discussed this earlier in detail. But if you can just, you know, help me understand this seeming kind of a dilemma.

R. Sridhar: So, you know, Richard, as I mentioned in response to the question earlier, I think, the struggle perhaps or the difficulty that you are having is because you don't have, you know, clear numbers on the individual segment gross margins. And for competitive reasons we don't, you know, share that in the domain, in the public. But I am sure if you just put together an excel framework and look at what might potentially be the range of gross margins you will then be able to quickly figure out how the maths work. And as I've said trust me, the maths works that's point number one.

Point number two, you know, when you talk about sequential margins et cetera, et cetera you are right that yes the proportion of personal product sales in the quarter is certainly higher. But equally, you know, when you look at the cost environment and you know what is benign, you have to take into account the sort of holding level that we entered this quarter with and what we exited the quarter with.

So the purchase cost in the quarter was on the aggregate, I would say, balanced. You had a benign trend in palm oil. You had a sharp increase in tea and you had crude more or less staying at the same level as it was in the previous quarter.

So in summary, it's really about trying to understand, you know, what would be the procurement prices perhaps and what would be the consuming and the sort of a pricing which are based on the inventory. And the maths of it ultimately works out to the final margin in the P&L. But, I think, the more important question is to step back and say, you know, how is the health of the business or what is the health of our business in our Soaps & Detergents portfolio? What's the health of our business in our Personal Products portfolio? And how is that evolving and that's what Nitin, you know, spent a little bit of time going through in fair detail during his opening remarks.

Richard: Sure. I mean, if I can just ask, you see, I'd presume that, you know, since you had a lot of a Dove sachet rupee one volume last year, I mean, you said that the gross margin in the Soaps & Detergents has actually expanded y-on-y. Can I ask you if, you know, the PP gross margin has expanded our contracted by itself in just that segment?

R. Sridhar: No, in other segment also it should have improved.

Richard: Sorry?

R. Sridhar: It would have improved as a segment.

Richard: Yeah, exactly. So both your major segments have seen gross margin expansion. The overall, okay, anyway I think I will take with Dinesh offline, I mean—

R. Sridhar: I can only assure you Richard that while it does seem to be a contradiction, you know, when we get a few moments together without quoting real numbers but we can just put an excel sheet together and trust me that the dilemma would become at least credible when you can look at some scenarios.

Richard: Sure, no problem. And second is with respect to this, you know, royalty going up over a period in time and I get it that you have done with due diligence and therefore arrived at, you know, some bit of a framework to take it up with

3.15% by FY 18. I mean, you know, if you look at the level of service that Unilever is actually rendering to you right now, I mean, why would you actually phase out this royalty payment then, I mean, what's the logic of, you know, increasing it by 50 bips every year. And I mean, is it contagion on some kind of a conditions being made or anything like that. You don't have to specify the details to me, but I just wanted to understand why this phasing of, you know, of the percentages, that is number one.

Number two, if you can help me understand what is the gross rate? So this 1.4 and 3.15 is actually of the net turnover, but in terms of the, you know, the gross rate on whatever is the proportion of the product on which it is charged, I mean, how is that going to move over a period of time?

R. Sridhar: Well, to be honest, you know, the broad proposal which the Board has approved is what really we've shared. Clearly there is work to be done to make sure that the details of the agreement are pulled together and find out what the Board has approved is this proposal. Firstly, to your question about, you know, why is this phase, et cetera, are there any guidelines? So I can say to you that, yes, there are some guidelines which the board has given us. And it is the context of those guidelines that we have made it transparent what is the potential scale of the increase in the royalty cost in the subsequent years, you will see in the press release beyond the first year there is a range that we have specified 30 basis points to 70 basis points, yeah. So that's really the range, which will be based on the guidelines.

As far as what will happen in terms of the components of the agreement, so we are going to enter into a new agreement. And at this point of time I would say, you know, what is really important is to understand what's likely to be the impact on the P&L. Details of the new agreement et cetera are still being worked through.

Richard: Okay. And sorry I didn't get it, but what's the logic of, you know, of phasing this increase over a period in time?

R. Sridhar: I think it's just a simple phasing. Phasing is making it clear what will be the increase that will get into effect as we start now. And the balance now is really to see how you phase it across the years and the specific increase will be based on certain guidelines, so it's just a simple phasing as, I think, I will just say, you know, a normal business thing to do.

Richard: Okay, I mean, you know, if I can be a little, I mean, for one of a better word, you know, if you think that the service is worth X, you know, why not charge X right from day one, I mean, why to say that, I mean, one and half percent now, two and half percent later and three percent in another later point in time. I mean, is there some kind of target that you think, you know, should be met before the royalty, you know, is worth 3% of turnover.

Nitin Paranjpe: No, I think, Sridhar has explained that we had discussions with the Board. There are some guidelines, which are there, and beyond that I don't think it will be appropriate for us to share anything beyond that. Suffice to say that there is absolute clarity in terms of what the upper band is. There is absolute clarity that it won't happen beyond 2018 and there is a range which has been specified in terms of what will happen within a year. I think beyond this the specific to what the guidelines are I don't think it is relevant or appropriate for us to share.

Richard: Okay, alright, done. Thanks and wish you all the best.

Moderator: Thank you, Richard. The next question is from Mr. Arnab Mitra from Credit Swiss. Mr. Mitra your line has been unmuted; you can go ahead and ask your question, please.

Arnab Mitra: Yeah, thanks for taking my question. Just two short questions. Firstly on royalty again, just wanted to know I understand the phasing till FY18 beyond that does this 3.15% hold for a period of time or theoretically can it again be re-negotiated or a new contract be entered, you know, as you go ahead after the FY 18 gets over.

R. Sridhar: So, Arnav, you know, the discussions that we have had and the proposals that Board have approved is as specific as what we have put out. So, as of now, I think, for the want of any other information you should assume that this is the rate of royalty that will continue.

Arnab Mitra: But there is no clear definite time period, say, for a 10-year period where, you know, this kind of 3.15 is the maximum limit, I just wanted to understand that whether there is any such time limit?

R. Sridhar: As of now, I would say we have not had any specific discussion. As of now I will say that this is what will continue. Now, five years, 10 years, 15 years later depending on what changes in the business model, what changes in terms of the resources that we meet et cetera, et cetera. But that is, you know, a very, very long-term thing. So for the foreseeable future, this is what we should work with.

Arnab Mitra: Okay, thanks. And the second question is just on the tax rate. As you said, you will be going close to marginal in fiscal year 15. That's typically that happens when you know a lot of your plans and exit a 10-year period. So would you also see excise duty rates actually going up in fiscal 15 as that 10-year period of exemption ends?

R. Sridhar: To be honest, excise duty rates, you know, they have already started going up. So to that extent that's been sort of more and more phased out, already thus far. Yeah, conceptually you are right that when we talk about fiscal benefits, units coming out of the fiscal incentive that has both an excise leg and income tax leg. But I think a large part of excise leg is more or less behind us.

Arnab Mitra: So, you would not expect a very sharp like in taxation there is a sharp jump, it will not be as sharp in the excise rate?

R. Sridhar: See, frankly, the way we look at, you know, all the elements of cost and this is something I was alluding to earlier in a different conversation when somebody was talking about royalty. Our responsibility as management is to manage, you know, all drivers to make sure we get the right outcome. Excise is a cost which we have seen. For example, increase in exercise duty that took place in the budget of 2012, right. So all of these line items will keep moving in different directions. As a management team, we have to make sure that we manage all of this in a manner that allows us to deliver the outcomes that we would like deliver.

Nitin Paranjpe: I also want to just make one more comment about tax rate et cetera. Yes, they are going up, but that's the general trend that you will see for everyone because give a break of a year or two in terms of phasing as to how, at what stage different companies ask, the direction of movement for everyone is going to be to move towards the marginal rate of tax, unless something happens with DTC and some new tax levels that have been established.

So the simplistic assumption that tax rate means a certain direct impact might be exactly that, a little simplistic because across the industry most companies would start experiencing a higher degree of taxation than they were experiencing earlier and will find ways to manage this as people move forward.

Arnab Mitra: Right. Thanks so much.

Moderator: Thank you, Mr. Mitra. The next question is from Mr. Ravi from Union KBC Mutual Fund. Mr. Ravi, you can go ahead and ask your question, your line is been unmuted.

Ravi: Good evening, everyone. Sir, could you tell us for each of our categories as a percentage of sales, what percentage would come from premium products and how is this number evolved over a period of time?

R. Sridhar: So, Ravi, firstly, now, I don't think we will be comfortable to share the composition of our category turnover across the segments, your premium, mass et cetera. That's something we would not want to do but, however, we can say that the secular trend of – if you take a reasonably long timeframe, then certainly there is a secular trend of premiumisation and as we look forward again our perspective is that India will see a secular trend of premiumisation.

Ravi: Okay, sure. Thank you.

Moderator: Thank you, Mr. Ravi. The next question is from Mr. Puneet Jain from Goldman Sachs. Mr. Jain, you can go ahead and ask your question, please.

Puneet Jain: Hi, good evening and thanks for taking my question. My question is with respect to royalty. Do you think that there will be changes with respect to various segments, with respect to royalty, as you move forward?

R. Sridhar: Sorry, can you repeat the question, Puneet?

Puneet Jain: Do think that royalty increases will be different for different segments like Soaps & Detergents, Personal Products, Beverages et cetera as you move forward given the fact that more launches may happen in Personal Products and given you have more support in personal products than other categories?

R. Sridhar: I think, you know, what we have discussed and what the Board has approved is, you know, at an overall basis, we don't expect this be anything really materially different category by category. The reality is all the categories are important for us. We are going to grow all of these categories. We will continue to source technology, innovations, capabilities which span not just the sales-related aspect, but also in terms of some of the functions, for example, like procurement or buying or for example in other service, other areas or functions, so it will be more or less similar across categories.

Puneet Jain: Okay. And you've mentioned that the royalty will increase by 50 basis points of FY 14. So will it be similar for FY 15 as well?

R. Sridhar: For FY 15 and beyond, the Board has approved that it will happen in range of 0.3 to 0.7%. There are some guidelines on the basis of which this will happen and therefore at this point of time that's really the range.

Puneet Jain: And on a broader basis, do you think that you will be able to pass it on the customers and protect your margins? Or what is your thought process behind that?

R. Sridhar: So I just want to remind you of our goal which I started off in the beginning of the presentation which is to say our goal remains unchanged. We used to deliver competitive and profitable growth along with being consistent and responsible. So there is no change in that.

Puneet Jain: Okay. Just another question, do you think that there is some slowdown in Modern Trade could be because of inventory destocking apart from some store closings? Could there have been some inventory destocking?

R. Sridhar: I think at this point time we don't have any specific information that suggests that there has been any significant destocking. Having said that, as Nitin said, this is one quarter, and you know, this is a lot of information to set the context of quarter. I don't think we should draw any medium-term conclusion either way from this.

Puneet Jain: Okay.

R. Sridhar: Thank you very much.

Puneet Jain: Thanks a lot.

Moderator: Thank you, Mr. Jain. And the last question is from Mr. Ankit Babu from Subhkam. Mr. Ankit, you can go ahead and ask your question, please.

Ankit Babu: Yes. Good evening, sir. I have two questions. One is that, since last few quarters you have been mentioning that there has been some slowdown in the discretionary expenditure and at the same time you are continuously launching new products into the premium segment which is again dependent on the discretionary expenditures. And your growth is also coming from the premium segment products. So I just wanted to understand the disconnect like, if there is a slowdown, then how come the premium products are doing well and why are we focusing on that segment?

Nitin Paranjpe: So I think we have always mentioned that our strategy is to ensure that we straddle the pyramid which means to have offerings at the top, the middle and the bottom. Our focus in the recent year in terms of the premium segment was to ensure that our portfolio which was more complete to address the new emerging requirements of a much larger set of people who are expecting these sort of offerings in new segments and therefore as we started looking at our business and asked ourselves the question as to what is the portfolio we are likely to require to win in the India of tomorrow, with the consumers of tomorrow, in the segments of tomorrow, the clear answer to all of that was that we will need to augment our portfolio at the top end and drive uptrading and premiumization.

We are also absolutely convinced that irrespective of what happens for a few quarters because of slowdown, because of inflationary pressure, because the economy is going through all of these, despite all of that the medium-term trend will be one towards uptrading and premiumization. And therefore from a strategic perspective we will introduce offerings which help complete our portfolio and help us win into future.

Now just because we are doing that does not mean that we don't compete at the lower end. We have a portfolio which is complete. We do participate in all categories at the bottom end of the market and we spend sometime talking about Wheel, for example, a short while ago in terms of actions which we are taking. So the eye is not out of the ball when it comes to other segments, but for the future premium portfolio and premium segments will remain important and that's why we have been driving our presence out there.

Ankit Babu: So, sir, which segment, you know, enables you to understand and there has been a slowdown in discretionary expenditure? How you come to know, means, which segment tells you that there has been a slowdown?

Nitin Paranjpe: Yeah, I think when we talk of segments and categories, there are reports which come, we track several reports, we track what Nielsen says, we track what the household panel talks about, we see our own growth rate, we talk to organised retailers and figure out from them what is happening. We also see feedback from other categories, just beyond what we are talking about and on the basis all of that, there is evidence to show that some of the categories which will become large, which are relatively discretionary at this stage are showing a slowing growth trend over what they had earlier. This doesn't mean that they are not growing. The rate of growth has been slower than what it used to be.

Ankit Babu: I agree that you know there are some third-party reports which mention that but looking at your performance it doesn't seem like you are feeling a pinch of a slowdown in discretionary because your premium segment is growing on. So just wanted understand, is it impacting you as a company or not?

R. Sridhar: I think, you know, if you look at one of the segments of growth, when you look at Personal Products, right, if you recall, our Personal Products growth was, you know, generally used to be about 15% closer to 16 odd percent. If you have seen the last couple of quarters, we are seeing the growth that's close to 12-13%. So that's very, very clearly – You know, one example, I can quote an example from ice cream et cetra but just to give you one example.

Ankit Babu: Okay. Sir, second question is on your royalty. Now definitely you have mentioned that, you know, though there has been an increase in royalty, but it will bring some added advantage from parent company which can help you to improve your efficiency. Now, my worry is that will your margins be impacted or higher royalty payment would be offset by some added advantage which we get from the parent company and hence enabling you to maintain your margins?

R. Sridhar: I think, this might be fourth or fifth time I am making this statement, so apology if it sounds repetitive. I just want to, you know, remind people and reinforce that our goal to deliver competitive…

Ankit Babu: Yes sir, I agree, I understand, but you know. It is profitable I agree but can it be more profitable? That's what I need to understand.

R. Sridhar: So when we say profitable growth, we mean that our operative margins should be in line with or ahead of the previous trend.

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Nitin Paranjpe: Look, on profitability, our plan we have always said we want to grow ahead of the market and continue to demonstrate modest improvement in the operating margins consistently. That's what we want to do and that's what we will work towards doing in the future.

Ankit Babu: Okay. Considering the impact of the royalty, there is further room for margin improvement in coming quarters on account of yourself, you know, cost structure and all those rationalising all those things?

Nitin Paranjpe: I have articulated our position and you can be sure that as a business, every one of us is committed to working towards that goal.

Ankit Babu: Okay. Yeah, that's very helpful, sir. Thank you and all the best.

Moderator: Thank you, Mr. Babu. With this, I would like to hand over the conference to Mr. Thapar for the questions on the chat. Over to you Mr. Thapar.

Dinesh Thapar: Alright. Thanks Sourodip for moderating that session. Before we bring this session to a close, there are a couple of questions that have come to us on the web. I would like take a couple of them. So there is one from Nikhil Bora, which is to Nitin. He says, “Hi Nitin, are you puzzled with the lack of a stimulant in FAL as a brand and as a category, and this at the time when competitive elements have been relatively sedate?” And second question was, “Most importantly, almost all of Unilever’s USD one million brands are now in India. So where is the future of new product developments in HUL?”

Nitin Paranjpe: More than saying surprise, in many ways before seeing your question I had commented about FAL. It has taken time, not different from what's happened in the previous occasion when we have raised prices. I too would like this to be over. I suspect it would take a month or two more. I don't think it is a competitive issue like you said. It is not a competitive issue and you think you picked that up correctly. We have seen a general slowdown, but the strength of FAL and its market share within the segment is better today than earlier. It is a combination of slowdown in market rate and pipeline corrections which happened to be significant when it comes to the sachet. So that's really what I would say when it comes to Fair & Lovely.

As far as the large brands are concerned, brand like TRESemme etcetera have just come in. We see significant opportunities going forward. I know that you are passionate about foods and the opportunity that it has. It has not been a part of the business which has been growing at the rate we would like, but I do believe that going forward it will start contributing to larger and larger part of our business as we move forward. So I remain optimistic about our ability to continue growing this business and delivering competitive growth into the future as the Indian market expands rapidly.

Dinesh Thapar: We have another question from Sagarika Mukherjee, who asked that how is the beverages segment margin expanded by 200 basis points when tea prices have shot up significantly?

R. Sridhar: I think, you know, we have addressed it earlier. So the tea cost increase in the quarter is obviously something which will play out in the future. Tea is procured in seasons. It is not something that is procured 365 days of the year. So the margin expansion of the quarter is not directly co-related with what we have seen play out in terms of the procurement prices in the market.

Dinesh Thapar: And Sagarika's next question is where exactly is the slowdown in Skin Care? Which price segment is getting hit exactly? Age miracle is premium, then where is the slowdown exactly happening?

R. Sridhar: I think, I briefly mentioned earlier that if you look at Skin Care, we see the slower rate of growth across both Face Care and Hand and Body. So it is not specifically isolated to a single price point.

Dinesh Thapar: And our last question is form Shirish Pardeshi who asked, "Can you please give us some understanding on volume growth by channel, traditional trade, grocery, chemist, wholesale and market, and how is your CSD business performing?

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R. Sridhar: So Shirish, our CSD business has recovered. You will recall in September quarter, we had pointed out that was a drag. I am pleased to say that we have recovered. It is different matter that the recovery has been offset by the slow pace in Modern Trade retail. As far as growth by channel across various channels, Shirish, you will appreciate this is not something that, you know, we have shared. Of course, we track this very, very regularly within the business but it's not something that we would like to be sharing given its competitive implications. But thanks anyway, Shirish, for your questions.

Dinesh Thapar: Thank you. I think with that, we would like to bring the call to a close. Just before that, you know, audio-visual replay of this event will be available on the investor relations website and you can always go back to refer to it. With that, I would like to bring the call to a close. Thank you everyone for your participation and have a great evening. Bye.

Moderator: Thank you so much all the panellists. With this, we conclude the conference for today. Wish you all a great evening ahead. You all can disconnect your line. Thank you so much.