"Globus Spirits Limited Q1 FY-'16 Earnings Conference Call"

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MODERATOR: **MS. NANDINI AGARWAL – FOUR-S SERVICES**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Q1 FY-'16 Earnings Conference Call of Globus Spirits Limited. This call is hosted by Four-S Services. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Nandini Agarwal from Four-S Services. Thank you and over to you Ms. Agarwal.

Nandini Agarwal: Good Afternoon, Everyone and Welcome to the Q1 Financial Year '16 Earnings Conference Call of Globus Spirits Limited. We have with us today Mr. Ajay Kumar Swarup — Managing Director; Mr. Shekhar Swarup — Executive Director; Dr. Bhaskar Roy — Executive Director and CFO; and Mr. Ajay Goel — VP, Finance. We will start the conference with opening remarks from the management after which we will open the floor for questions. I will now hand over the call to Mr. Ajay Swarup. Over to you, sir.

Ajay Kumar Swarup: Good afternoon, everyone and a warm welcome to our Q1 FY-'16 Earnings Call. I will be starting the call with an overview of the business and then hand over to Dr. Roy who will brief you on the financial results. We are pleased to report strong growth in the quarter with revenue up 12% and EBITDA up 28% year-on-year. This has been driven by a robust 54% year-on-year growth in our IMIL volumes. GSL is today the largest organized player in the high growth Rs.255 billion IMIL market. From the outset, it has been our endeavor to redefine the way business is done in this bottom of the pyramid segment. "We have been a pioneer with regard to branding and introduction of high quality ENA-based products in IMIL- trends that are now driving the segment:

With the segment well set to cross 350 million cases by FY-'18 we see strong growth ahead for the company. It is already becoming visible. During the quarter we saw progress in all our markets. In Rajasthan where we are market leaders, we further consolidated our position with 42% growth in revenues. In fact during the quarter, we saw record level sales with 1.6 million cases sold. Likewise, it was a good quarter for Haryana; we posted 15% growth driven by 13% growth in volumes post a couple of difficult years.

I am also happy to report that our latest foray into Bihar has seen good traction. We started selling IMIL in Bihar in January '15 and this quarter we recorded 0.46 million cases accounting for 16% of the total 2.8 million cases sold during the quarter. We have already established exclusive marketing rights in Patna Municipality as per a 5-year tender awarded which is the biggest district in Bihar with annual sale of 2.5 million cases. With this strong traction in the Consumer business, our Bulk business revenues were lower by 34% due to higher captive consumption in IMIL. As the part of our 360 deg. model, GSL's manufacturing activities act as a base to support its Consumer business. The first priority of Bulk Alcohol produced is consumer as Consumer business delivers higher margin. Since Consumer businesses takes time to establish, manufacturing business ensures higher utilization in the transient period. During the quarter, production at our Samalkha plant was lower due to one-off plant maintenance and we expect to revert to healthy utilization levels of (+75%) in coming quarters benefiting Bulk as well as the by-products segment.

In by-products, we continue to see strong demand for the recently introduced value added by-product DDGS accompanied with higher realizations and growing customer base. The combined effect of strong growth in our higher margin consumer business, lower raw material prices and increased sales of our higher margin by-product DDGS have had a positive effect on margins. EBITDA margin was up at 10% compared with 8.8% in Q1 FY15

In conclusion, our business is at an exciting phase; the IMIL industry has been growing at a faster pace than the IMFL industry over the past few years. And Globus being an established player in this segment, hopes to reap benefits from this spend which has been established. We believe improved quality and attractive packaging coupled with rising prices in IMFL due to tax will give further strong impetus to the IMIL industry. Our ongoing expansion plans in Eastern parts are progressing well on track. These are high growth under penetrated states that will strengthen our market leadership position in the Spirits industry. The plants will have a combined capacity of 60 million liters annually taking our total capacity to 150 million liters on an annual basis, and these plants are expected to be operational during the first half of Financial Year '16-'17.

I would now like to hand over to Dr. Roy for overview of our financial performance.

Dr. Bhaskar Roy: Good Afternoon, Everybody. I will share our Financial Highlights, after which we will open the floor for Questions. In Q1 FY-'16 total operating income was Rs.1578 million, an increase of 12% year-to-year. EBITDA was Rs.158 million, an increase of 28% year-to-year and EBITDA margin was up by 10% compared with 8.8% in Q1 of FY-'15. EBITDA margins growth was driven by lower grain prices and improved productivity. Raw material cost as a percentage of sales decreased from 66.8% in Q1 of FY-'15 to 58.6% in Q1 of FY-'16. However, decrease in raw material cost was partially offset by increase in other expenses as percentage of sales from 22.3% in Q1 FY-'15 to 28.9% in Q1 of FY-'16. PAT was at Rs.35 million with margins of 2.2% versus 1.5% in Q1 of FY-'15. PAT was impacted by a higher D&A which was Rs. 86 million in Q1 of FY-'16 compared with Rs.74 million in Q1 of FY-'15.

I will now share the Segment wise details: This quarter we sold 2.8 million cases of IMIL with average net realization of Rs.297 per case. Overall IMIL volumes witnessed a 54% year-on-year growth and realizations were approximately the same as in Q1 of FY-'15. On a pro forma basis, that is excluding Bihar as it was not operational in Q1 FY-'15 revenues increased 36% year-to-year driven by 29% increase in volumes and 5% increase in realizations. In Franchisee

IMFL, the aggregate volume of the growth was 0.79 million cases, an increase of 5% year-to-year by volumes. Out of this, 0.35 million cases pertaining to Bottling done for ABD and JIL in Rajasthan and the remaining 0.44 million cases for bottling done for USL and ABD in Haryana. Rajasthan volumes were down 27% year-to-year due to some transitory challenges faced by franchise customers in the state at the start of the financial year. With things settling out on that front, volumes are expected to be better this quarter onwards. Our Bulk Alcohol volumes decreased 29% year-to-year to reach 8.2 million BL in Q1 FY-'16. The total revenues from manufacturing were Rs.723 million in the year accounting for 46% of total revenue from operations while the Consumer business contributed the remaining 54%. This concludes my update. Thank you once again for joining us on the conference call. We will be happy to answer any questions that you may have now.

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

Abneesh: Sir, this is Abneesh here. Could you talk about the growth prospects in each of your individual state? We are having this call after a long time. So, if you could take us through what has happened in the period when there is no concall? And going ahead, in terms of regulation, are you seeing any change in any of these key states?

Shekhar Swarup: Hi, Abneesh, this is Shekhar Swarup. Good to hear from you. We over the last few quarters have been actively trying to stabilize capacity utilizations, building our IMIL portfolio as well as improving our margin profile in a very challenging atmosphere by addition of value-added by-products as well as improving recovery on our raw material. During this period, we have also been able to establish a presence in East India by way of starting IMIL in Bihar as well as having two facilities under constructions in Bihar and one in West Bengal. Clearances for these facilities are all in place, the environment clearance has been received for both facilities and like Mr. Ajay Swarup commented in his opening remarks, we should have the facilities up and running by the middle of next financial year. As far as growth prospects are concerned, essentially, we have divided our strategy into two halves — one is the mature market strategy of Haryana, Delhi and Rajasthan where we have been operating for over two decades and the other is the high growth strategy in East India. In Haryana, our business is growing at a fairly good rate of 10% to 15% year-on-year, of course this is after over a year of difficulties, but we are back to seeing some growth coming in from Haryana. Rajasthan has become a very interesting market, the industry has begun to grow well, our market share is becoming stronger and most of this is testament to the great performance of our IMIL sales and marketing departments of introducing good brands at the right time, and, of course, increasing our distribution presence. When it comes to Bengal and Bihar, of course, revenues from there is limited as of now, but in these markets the Country Liquors IMIL business is growing very well, the industry is growing very well, we have had well over 20% kind of growth rates coming in from both states at the industry level. We are also very excited about the franchise tie-ups which we already have been able to create in these two markets that is USL which has agreed to bottle with us in West Bengal and ABD in Bihar. We are hopeful of securing another one or two more exciting contracts which I will speak about as and when we have secured them. The markets for Bulk Alcohol sales there is also very interesting. Both markets are net importers of Alcohol from states like Uttar Pradesh, Punjab and even in some cases, Maharashtra. There is a clear rationale for setting up capacities there to sell Bulk Alcohol as it is import substitution. You are aware that these markets are very rich in raw material availability, these raw materials is the same that we use in North India. So we are very hopeful for high capacity utilizations as soon as we are able to commission and streamline.

Abneesh: One question was Rajasthan is a very key market for you and you have faced some dip in volumes by around 27% this quarter. We heard from one of the other players that even they faced some issue in Rajasthan. So, is it some systemic issue there, any new regulations which is impacting Rajasthan and do you expect in Q2 Rajasthan to come back to growth or will it be Q3 in terms of growth?

Ajay Goel: Abneesh, the dip in volume was in our franchise operations. In our IMIL operations the growth has been very healthy and even our other verticals of Bulk and by-products the growth has been very good. Franchise operations were affected due to a new excise policy that a new government had put in place. This was the first excise policy after the government was in place in Rajasthan and affected the entire IMFL industry. And since the franchise operations of Globus Spirits are based on demand of ABD, therefore our volumes were affected as well. This was transient and we are hopeful that it will not happen again.

Abneesh: My last question is in terms of the change in ecosystem, we had met the largest player recently, he said that all the liquor players are going in a joint form to the government and saying, how it can be a win-win situation for government in terms of taxes and for liquor players in terms of ease of operations. So, are you also seeing this, are you also part of these meetings and do you expect that this can have some positive effect or it is too difficult in terms of the entire ecosystem to expect any major change in two-year timeframe?

Shekhar Swarup: One major sort of systemic change that we have seen in the IMFL industry which is of course a part of the industry that we operate in, is that a large part of the players are now multinational companies. So this is certainly changing the way the IMFL industry operates. We have started seeing an impact of these changes in the marketplace as well; however, a wide spread impact is still some time away and we are hopeful that there will be wide spread change. On the IMIL side, which is a large part of our business, we are seeing a very sort of proactive governance coming in from the law makers in East India as well as in North India, and we are very hopeful of good growth and good profitability in IMIL in all the states that we are operating and going to be operating in.

Moderator: Thank you. The next question is from the line of Arpit Ranka from Kovil Investments. Please go ahead.

Arpit Ranka: I just have two or three questions: I will start with the Capex in Bihar, and also Rs.70-80 crores raised from Templeton in 2013-14. I just want to get an update on that – what is the total Capex there, how much you have spent?

Dr. Bhaskar Roy: Capex in Bihar and West Bengal will be around Rs.240 crores, out of which debt will be of Rs.150 crores and rest will be from the Templeton Funds and the internal accruals. We have spent already around Rs.50 crores.

Arpit Ranka: Almost in the next one year we will be spending the remaining Rs.150-200 crores?

Dr. Bhaskar Roy: Yes, we will be mostly spending the majority by December January because then the plants will be in a position to commission and trials will happen after the financial year is over.

Arpit Ranka: Another thing which I want to understand in the context of where the company was five years ago and where it is today, for example, ROC used to be about (+25%) in 2010-11 and today it is about 10%. Two key variables which have led to this is of course lower asset churn from it used to be more than 2 to today's maybe 1.2-1.3 and of course margins have also come down from (+15%) to 10%. Please correct me if I am wrong, it partly has to do with the sacrifice we have made by moving away from consumer business which used to form the bulk of our sales towards commodity which is at the form of course Bulk Spirits and Bottling. So where do you see the trend headed – do we continue to have almost 50:50 split in terms of Consumer and Manufacturing? I do not know. Today, our asset turn is about 1.3. But, what is the optimum you could see on the existing base? Of course, we will keep Bihar and West Bengal aside for a moment. And of course, margins we all know, that it is not in our control but to some extent asset turn is at least something that I would like to understand, except for the Haryana thing which happened over the last 2-years, how would you help us understand this trend which has been clearly visible over the last 4-5 years, in the context of next 2-3-years? We are not asking about next quarter or quarter after that. But how do you see this progressing?

Dr. Bhaskar Roy: I should address your concern starting with the things that first we have to attack - the EBITDA level. Our EBITDA level before 3-years, 2-years back with the highest level was around 15-16%. It came down to the level of 9% which is slowly increasing to the level of 10-11% and we are hopeful with the better performance and better cost controls and value-added products we will be reaching the position of 13-14% very soon. Then the question is coming that what is the position of asset turnover or the ROC, etc., This you have to analyze that we have had a major expansion in last 2-3-years, we had to put two additional plants in each places of adding 130 KLPD in Rajasthan and Haryana. If we had not done that time we would have been now out of the market because the whole system has changed from the basis of

Rectified Spirit base to the Extra Neutral Alcohol base, because the base spirit of country liquor now has changed from Rectified Spirit base which was 4 or 5-years ago to Extra Neutral Alcohol base which is going on now. So at that time before anticipating these things, etc., we have taken decisions and you have to take the investment in a plant happens on a block manner, we cannot do just a piecemeal manner. So we had to invest that money. And slowly as explained earlier as the consumer things will go up and the bulk things will come down, the profit levels will go up, and the EBITDA will increase, and also the percentages will also be a better position, but this ROC etc., is affecting because that level of investment previously which was low has gone higher.

Shekhar Swarup: Our strategy is to be a 360 degree player, which means we will continue to straddle all verticals of the alcohol industry. We believe that having multiple business verticals gives us the best utilization of our assets and gives us a hedged play in the marketplace. As you are aware, the Country Liquor business even the IMFL business, our pricing is not in our control, it is controlled by the government; however, in the case of Bulk Alcohol and the commodity business, pricing is very much in our control. We have month-on-month contracts with all our customers. So therefore it gives us a very good hedge in the market. The consumer space gives us value add as well as growth. The bulk and manufacturing play gives us a certain amount of stability. The other thing that I would like to mention here is that over the last 2-years, the company has done a lot of technological innovations and been able to produce Alcohol at the lowest cost of raw material as well as the lowest cost of fuel. This has been made possible in spite of environment where raw material and fuel prices have been going up for us as well as for the entire industry. A lot of this is possible due to by-product sales, DDGS which is a high-protein product, which is consumed by the animal feed industry, this has added a lot of value to our profit & loss account as well. So whereas our strategy remains to increase and consolidate our IMIL and IMFL business, by no means is the Bulk business a mistake, it is a vertical which is here to stay, it is a business which is a strategic business for the company.

Arpit Ranka: I do tend to agree that lends resilience to our business to an extent. It is just that from our strategy perspective, just wanted to get a glimpse into how the management is thinking about return ratio if at all? So, is it fair to say that with higher utilization and maybe if the operating margins go back to 13-14%, you would inch above 15%, would that be a fair assessment on the existing capacity keeping Bihar aside which will have its own trajectory in terms of putting it to work but on the existing 90 million liters, what would be ideal return number to keep in mind? Of course, it is a very hazy way putting it, but it just helps us understand the quality of the business that you are looking at and potential in terms of growth and operating leverage in terms of margin expansion?

Dr. Bhaskar Roy: So if you have seen that there is a growth from the quarter even in Q1 of FY-'15 or Q4, etc., we are trying to improve within higher capacity utilization, we are trying for higher margins also, but we cannot say exactly that what will be coming out, we are hopeful that the things will be better in the coming times to come.

Arpit Ranka: Another question, it maybe a little naïve, but reading some press releases announcement something sugar company, there was a reference to one company getting into producing ENA. Is that possible that with the glut in the sugar industry, going ahead, sugar companies can actually start producing ENA and thereby impacting the realizations on that part of the business or it does not work like that?

Shekhar Swarup: Most sugar mills already produce alcohol and in fact better utilization for their raw material which is molasses is to supply to the fuel ethanol market. Even today majority of the sugar mills that have a distillation capacity are supplying alcohol to the fuel companies and even if they do not have distillation capacities the molasses that is used, a lot of it does eventually end up going into fuel ethanol, therefore sort of creating a space for the grain-based alcohol manufacturers. In fact this brings me to a point which I hinted about earlier as the IMFL market continues to get more sort of invested by international companies there will be a gradual shift away from molasses-based Extra Neutral Alcohol towards grain based Extra Neutral Alcohol. As you are aware, whiskies, vodkas or all products which are meant to be sort of manufactured from grain-based alcohol rather than molasses. We already know that Pernod does not buy any molasses alcohol for their manufacturing and we can already see trends in the market of other players shifting towards or rather preferring grain alcohol over molasses.

Arpit Ranka: You make a very valid point and that did go into assessing the value of the assets that you have put up. But just to get a sense, how the competition is playing this out because the trend is visible, right from RS-based ENA to grain-based ENA with MNCs coming in with higher price IMFL. For example, if a competitor around, he is also ready to be able to produce grain-based or it works out of geography, technology and all of these play a part?

Shekhar Swarup: Firstly, it is a raw material play. Distilleries that are in UP will continue to manufacture molasses-based ethanol and supply to fuel companies, there is sufficient raw material available, and there is a good amount of demand available as well. Similarly, in Maharashtra, majority of the alcohol production will remain molasses-based, but there are other states where there is a lot of grain that is available and in those states already we have a much more grain-based alcohol being produced than molasses-based alcohol, for example, Punjab, Haryana are fine examples of my case. Also to set up a new distillery one does require licenses which are issued by state governments, increasingly, the Ministry of Environment is laying down very stringent laws for environment management which Globus Spirits and the technology we have, the processes we adopt, we are able to comply with those, these compliances require a fair amount of investment which according to us gives us pay back only when a company straddles all verticals of the alcohol industry. So there is a challenge in setting up a new investment in the Alcohol business and largely it is because of the kind of Capex that is needed and to get returns on the Capex, the kind of spread of business that is needed, besides of course the regulatory hurdles of getting clearances for this business.

Arpit Ranka: Just one quick question on the value-added DDGS. What was the contribution from that segment in this quarter sales, if you could just give us the numbers?

Dr Bhaskar Roy: Rs.13.5 crores was the sales amount out of the net sales of Rs.113 crores.

Arpit Ranka: Margins if you could disclose?

Dr Bhaskar Roy: It is a byproduct, etc., so very difficult to disclose it, because it adds to the Industrial Alcohol.

Arpit Ranka: One final observation from the perspective of an investor which I wanted to bring upon for your consideration. There is a qualification which our auditor has been making every quarter and even in the annual report pertaining to classifying money spent on brand promotion and advertising as intangible asset which is not in compliance with accounting standards. That reflects fairly aggressive way of approaching this. I do not know how to put it in perspective. It just makes us a little uncomfortable as to how specifically given the fact that we set aside Rs.30 crores out of our IPO also towards brand promotion for the IMFL. And if you look at the performance there, I am not too sure if it is being that successful, which is okay, you cannot always get what you want, but purely from the perspective of being little conservative, do you not think that it makes a lot of sense to expend them even at the cost of having a lower EPS because as investors I can tell you that we look through it, we would rather be more comfortable with the conservative management and accounting leading to a lower EPS rather than aggressive way of handling that and landing with higher EPS, somehow mix is very uncomfortable and I can tell you that quite a few of people who would not invest just because of this one qualification. I am talking about long-term investors, I am not talking about the people who get in for a quarter or two quarters because we typically come from a background, we look at something for 3+ years and that really-really makes me uncomfortable. I just want to get your perspective. One quarter you see a massive write-off because of adjustment of Rs.10, 20 crores and people will look through it, it was official, what you are doing, it is not easy correcting yourself in this manner but as an investor, we would completely love that because for a company I find that in the Spirits space, we are almost transparent ones and you have been a little ahead of the curve if I read through. I went through possibly a lot - IPO and all the annual reports. So, we do like the way you have been running the business and we do appreciate all the bandwidth the effort that has gone into creating something like this. Except for this assessment of how to deal with, especially something is not in compliance to accounting standards, then why do we do it? That is the question and also I would love to hear your views on that.

Shekhar Swarup: Thank you very much for your feedback and this is the kind of feedback that we would really like to hear it, it helps us become a better organization. We are working towards strong corporate governance and you yourself have said that our efforts have been visible, we must thank you for that feedback as well. In the past, we had received certain advice on the treatment of certain expenses and once we had a change in auditor, the new auditor of course had their own views on that. And that is why this change took place. But you have made a very valuable point about taking the hit and sort of biting the bullet if I may use that, we will certainly take that into consideration.

Arpit Ranka: Absolutely, because every passing quarter it will become difficult, the number will keep getting higher and higher and higher. That is the sense I get and I should be vocal because that is what I think

Shekhar Swarup: Thank you for the suggestion and feedback.

Moderator: Thank you. The next question is from the line of Apurva Shah from Dimensional Securities. Please go ahead.

Apurva Shah: Sir, my only question is on other expenses, like since last four quarters, we have seen higher expenses.. I do not know if I am missing something. Can you let me know the reason for the same?

Dr. Bhaskar Roy: The other expenditure if you see in FY15 totally it was 29% and this Q1 is 28.9%, almost at the same level.

Apurva Shah: So, if I look at quarterly numbers, it was earlier Rs.30-35 crores till Q1FY15

Dr. Bhaskar Roy: If you see the percentages, in that other expenditure, one element is there in the selling and distribution expenses. We give a payout, i.e., franchise fees means profit the brand owner has o take. We keep this as a payout in the franchisee expenses and selling and distribution expenses. So, as the franchisee volume goes up, that expenses also goes up.

Apurva Shah: So that is for Rajasthan …?

Ajay Goel: Rajasthan franchise business.

Dr. Bhaskar Roy: Another point was that, I am telling you where the difference was there, even Rajasthan in IMIL, means there was an increase in the Bottling fees; the Bottling fees part is increased practically by Rs.15 etc., but it is a change in the government policy. So that has also increased the other expenditure, as it is booked in thishead. IMIL volumes have also grown up. That is the reason also.

Apurva Shah: And sir, going forward, what will be the major lever for margin improvements?

Dr. Bhaskar Roy: Major lever for the margin improvement is the DDGS stability which is the value added product which we have got, higher production and increase in the efficiencies which we are working it.

Moderator: Thank you. As there are no further questions, I would now like to hand the floor over to Mr. Shekhar Swarup for closing comments.

Shekhar Swarup: Thank you, everyone for taking time out to join us for our earnings call today. If you have any further questions, please do feel free to reach out to us directly or through our IR agency. We would be very happy to entertain any questions. Thank you, again and wish you all the best.

Moderator: Thank you. On behalf of Four-S Services, that concludes this conference. Thank you for joining us and you may now disconnect your lines.