Sharekhan by BNP PARIBAS

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Viewpoint

Result Update

Globus Spirits Ltd

Dispirited Q1; margin recovery to take time

Consumer goods	Sharekhan code: GLOBUSSPR	
Reco/View: Neutral ↓	CMP: **Rs. 1,014**	Upside potential: **12%** ↓

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)		✓	

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS	Positive	↔	Positive
RQ	Positive	↓	Neutral
RV	Positive	↓	Neutral

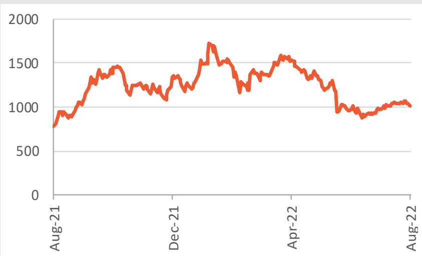
Company details

Market cap:	Rs. 2,919 cr
52-week high/low:	Rs. 1,760 / 710
NSE volume: (No of shares)	1.7 lakh
BSE code:	533104
NSE code:	GLOBUSSPR
Free float: (No of shares)	1.4 cr

Shareholding (%)

Promoters	51.0
FII	7.1
DII	1.6
Others	40.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.8	-17.0	-24.8	30.7
Relative to Sensex	-5.4	-25.8	-26.6	22.5

Sharekhan Research, Bloomberg

Summary

- Q1FY2023 performance was affected by a sharp decline in the OPM (down by 1,264 bps y-o-y and 375 bps q-o-q) affected by high inflationary pressures and a change in mix with higher contribution from the manufacturing business.
- Inflation in the raw material prices, increase in the fuel prices and a change in the mix will continue to put pressure on the margins in the near term. Company has reduced its OPM guidance to 18-20% from 24-25% earlier as inflationary pressures rise.
- GSL expects total capacity to increase from 665 KLPD currently to 944 KLPD by FY2023-end. Green field projects in Odisha and Uttar Pradesh of 200 KLPD each will increase the ethanol capacity to 41 crore litres from 18 crore in FY2021 (will increase to 28-29 crore litres by FY2023 end).
- The stock is currently trading at 15.9x/10.5x its FY2023E/FY2024E EPS. In view of near term margin headwinds, we downgrade our view on the stock to Neutral from Positive earlier with a potential upside of 12%.

Globus Spirits Limited (GSL) registered disappointing performance in Q1FY2023 with sharp decline in margins leading to 35% y-o-y decline in the PAT. Net revenues grew by 34% y-o-y to Rs. 495.4 crore with consumer business growing by 25% y-o-y led by 16% volume growth to 3.94 million cases while manufacturing business grew by 41% (backed by capacity utilisation improving to 92% on expanded capacity). Gross margins decreased by 932 bps y-o-y to 41.0% mainly on account of higher input cost and change in the mix with manufacturing business contribution increasing to 61% (having lower margins compared to consumer business). This along with higher fuel costs led to a 1,264 bps fall in OPM to 13.8% (down by 375 bps q-o-q). The OPM was impacted by the continued increase in coal prices in West Bengal up 30% q-o-q, Rice husk up 42% q-o-q, Packing material (glass bottle) up 14% q-o-q and aluminium caps up 12% q-o-q. Operating profit decreased by 30.0% y-o-y to Rs. 68.6 crore and PAT decreased by 33.0% y-o-y to Rs. 37.3 crore.

Key positives

- Consumer business sales volume grew by 16%; consistent double-digit volume growth.
- Manufacturing business' capacity utilisation on expanded improved to 92% in Q1FY2023 from 90% in Q4FY2022.
- Cash profit to EBIDTA stood at ~71%.

Key negatives

- Gross margin/OPM declined by 932/1264 bps y-o-y, impacted by an unfavourable mix and higher input costs.
- Market share in West Bengal remains low at 2%.

Management Commentary

- Capacity expansion of 140 KLPD in Jharkhand is expected to be operational in Q1FY2023, 60 KLPD expansion in West Bengal & Jharkhand is expected to be operational in Q4FY2023, while expansion in Odisha and Uttar Pradesh are at initial stages of land acquisition. GSL expects total capacity to increase from 665 KLPD currently to 944 KLPD by FY2023-end. Orissa and Uttar Pradesh green field projects of 200 KLPD each will underway soon with capacity expansion to 1,344 KLPD (will increase to 41 crore litres in 3-4 years).
- To mitigate impact of the increase in raw material (broken rice) costs, GSL started procuring rice from the Food Corporation of India (FCI), which fetches an incremental ethanol realisation of ~Rs. 3 per litre (Ethanol from surplus rice vs ethanol from damaged food grain). For FY2023, 41% of raw material consumption will be done from FCI.
- Further the company has undertaken coal linkages with Coal India for supply of coal in the eastern part of India, which will lead to reduction in coal procurement cost by ~20%. Thus along with strategic cost saving initiatives (expected cost-savings of Rs. 20-30 crore p.a.) and incremental realisation (expect ENA prices to rise by 5-6% in Q2, ethanol realisation is expected to increase by December 2022 and liquor prices to increase by March,2023 under the new excise policy). This will help the OPM to improve to 18-20% by FY2024. OPM to remain low in Q2FY2023 and will improve from Q4FY2023.
- Company is focusing on strategically expanding capacities into new geographies which allows participation in consumer markets of respective states while ensuring profitability through high volumes offtake of ethanol - post the expansion (by FY25). It will have an access to 100 million cases Consumer market (combined market size of all states that GSL is present in).

Revision in estimates – We have lowered our estimates for FY2023/24 to factor in lower than earlier expected OPM, respectively due to the impact of higher fuel cost and input costs on margins. The company has reduced its OPM guidance to 18-20% from 24-25% earlier as mix of manufacturing and consumer businesses will remain at 60:40.

Our Call

View – Downgrade view to Neutral with 12% upside: In the past few quarters, performance was affected by a sharp decline in the OPM due to sharp increase in the input costs and change in the revenue mix. The management has taken key initiatives to reduce stress on margins. However, the benefits of key initiatives and expected rise in realisations would flow in from FY2024. In the near term, the performance will be subdued due to lower profitability. Thus, in the view of near-term margin headwinds, we have downgraded view on the stock to Neutral from Positive earlier with potential upside of 12%. The stock trades at 15.9x/10.5x its FY2023/24E earnings.

Key Risks

Any quick and significantly improvement in the margins will drive the strong earnings growth in the quarters ahead, which will act as a key risk to our rating on the stock.

Valuation (Consolidated) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	1,231	1,579	1,892	2,275
OPM (%)	20.7	20.8	16.3	19.5
Adjusted PAT	144	187	184	279
Adjusted EPS (Rs.)	50.0	65.0	63.9	96.8
P/E (x)	20.3	15.6	15.9	10.5
P/B (x)	4.9	3.8	3.1	2.4
EV/EBIDTA (x)	11.7	9.1	9.7	6.6
RoNW (%)	24.4	24.2	19.4	22.8
RoCE (%)	26.7	28.0	21.7	26.5

Source: Company; Sharekhan estimates

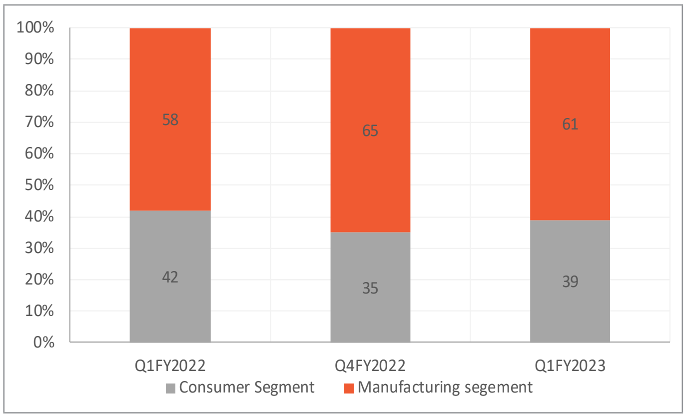
Revenue growth at 33.7% y-o-y; profitability remains impacted

Net revenues grew by 33.7% y-o-y to Rs. 495.4 crore on the back of strong 52% y-o-y growth in the bulk alcohol business, while the consumer business grew by 24.8% in Q4FY2022. Capacity utilisation in the bulk alcohol business stood at 92%. Bulk alcohol business sales volume grew by 37% y-o-y to 41.04 mn litres in Q1FY2023. Consumer business sales volume increased by 16% y-o-y to 3.94 mn cases during the quarter. High input costs and an unfavourable mix led to sharp 932 bps y-o-y decline in the gross margin to 41%. OPM declined sharply to 13.8% from 26.5% in Q1FY2022 and 17.6% in Q4FY2022 impacted by the continued increase in coal price in West Bengal (up 30% q-o-q), rice husk (up 42% q-o-q), packing material (glass bottle up 14% q-o-q) and aluminium caps (up 12% q-o-q). However, part of this was mitigated by better ENA prices (up 6% q-o-q), more FCI rice-based ethanol (6% higher realizations) and benefit from incremental sales of IMFL sales Q1FY2023 vs Q4FY2022. Operating profit decreased by 30.1% y-o-y to Rs. 68.6 crore and PAT declined by 33% y-o-y to Rs. 37.3 crore.

Consumer business grew by 24.8% y-o-y aided by higher realisation and volume

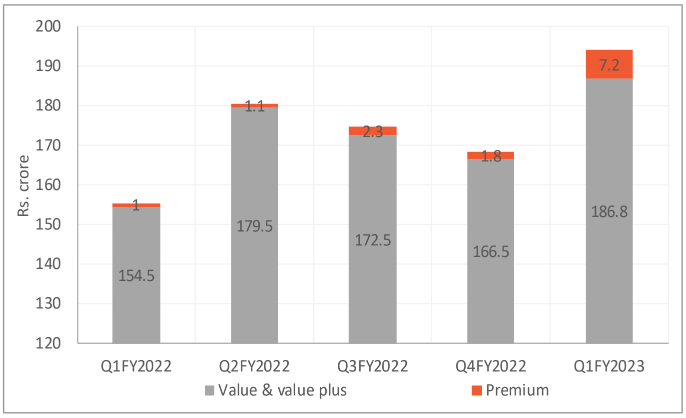
GSL's consumer business (largely IMIL sales) grew by 24.8% y-o-y to Rs. 194 crore in Q1FY2023 led by higher volume and realisation. Sales volume in Q1FY2023 came in at 3.94 Mn cases (higher by 16% y-o-y and 6% q-o-q), of which, Value segment volume stood at 2.78 Mn cases (up by 27% y-o-y and 8% q-o-q). Average Realization of Value & Value Plus segment increased by 4% y-o-y and 7% q-o-q to ~Rs. 480 per case in Q1FY2023, led by Rajasthan price hike of Rs. 39 per case for Value Plus segment liquor and Rs. 19 per case for Value segment liquor, effective 1st April 2022. GSL is strategically expanding capacities into new geographies which will allow the company to participate in the consumer market of that state while ensuring profitability through high volumes offtake of ethanol. The management has guided that post the expansion by FY25, GSL will have an addressable market of 100 mn cases per annum (combined market size of all the GSL states) for the consumer business.

Revenue mix trend



Source: Company, Sharekhan Research

Consumer business revenue trend



Source: Company, Sharekhan Research

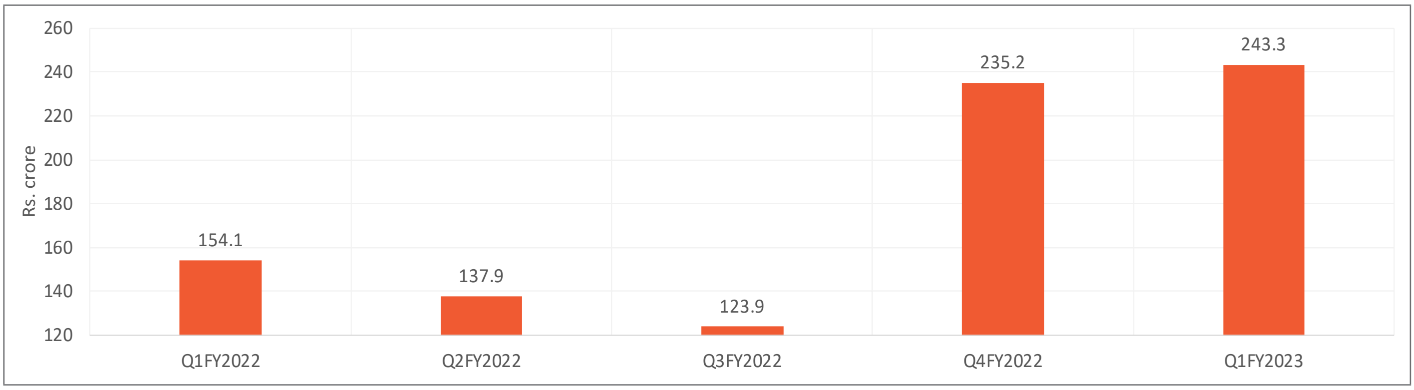
Consumer business focused on key markets

GSL's market share in Rajasthan came in at ~33% in Q1FY2023 from ~45% in Q4FY2022. The additional whisky brand 'Globus Green' launched in March-end is gaining traction. The brand will play an anchor brand role to strengthen whisky's share in the company. Market share in Haryana came in at ~8%. The company plans to have a higher focus on Metro liquor which is expected to grow in FY2023. In West Bengal, the company's share is currently low at over ~2%. GSL launched 'County Club' in value plus segment towards April-end, which is gaining momentum. In the premium segment, of the 5 key focus markets, GSL brands have been introduced in Uttar Pradesh, West Bengal and Delhi and the company plans to launch premium brands in Haryana and Telangana in Q3FY2023. GSL's IMFL brands are now available at over 50% salience contributing outlets in the key markets of Uttar Pradesh, Delhi and West Bengal. By the end of FY23, the company expects the salience to improve to 75%. The company re-energised and expanded its portfolio in West Bengal through introduction of a larger range of products with the local manufacturing facility. The company extended Terai – India Dry Gin to Uttar Pradesh, West Bengal, Rajasthan and Mumbai and will be introduced in Haryana followed by Telangana in Q2FY2023-end.

Manufacturing business (bulk alcohol) capacity utilization at 92% in Q1

Manufacturing business registered a y-o-y growth of 40.6% y-o-y in Q1FY2023 to Rs. 302.2 crore led by enhanced capacities and improved realizations. Bulk alcohol sales volume in Q1FY2023 was reported at 40.04 million litres, higher by 37% y-o-y and 2% q-o-q on account of new capacity operational at West Bengal in Q4FY2022. The average realization grew by 11% y-o-y and 3% q-o-q to Rs. 57.1 per litre in Q1FY2023. Capacity utilisation including the expanded capacity came in at ~92% in Q1FY2023.

Manufacturing business revenue trend



Source: Company, Sharekhan Research

Capacity expansion plans on track

GSL currently has various capacity expansion projects under progress/competition. New capacity of 140 KLPD (capex of Rs. 120 crore) with bottling plants at Jharkhand is ready for production in August 2022. Post this expansion the capacity of the plant has increased to 28 crore litres per annum from 23 crore litres per annum earlier. The company has started work on enhancing the capacity by 60 KLPD each at West Bengal and Jharkhand with a total combined capital outlay of ~Rs. 80 crore. Both plants are likely to be commissioned by Q4FY2023. The additional capacities from expansion would be ~2 crore litre per annum for each facility. In Bihar, an additional capacity of 19 KLPD is being set up with a capex of 5 crore, which is expected to be operational by Q4FY2023. In Odisha, land acquisition of 25 acres has been completed for setting up a new capacity of 200 KLPD for Ethanol and ENA with bottling plants. While in UP, land acquisition is underway for setting up a new capacity of 200 KLPD for Ethanol and ENA with bottling plants. Total capacity is expected to increase from 665 KLPD currently (excluding Jharkhand commissioned in August) to 1,344 KLPD in the medium term. As per the management, all projects will be funded through internal accruals.

Key conference call highlights

- **Change in procurement strategy –** With an aim to mitigate the impact of the increase in raw material (broken rice) costs, GSL started procuring rice from the Food Corporation of India (FCI) in Q4FY2022, which fetches an incremental ethanol realisation of ~Rs. 3 per litre (Ethanol from surplus rice vs ethanol from damaged food grain), wherever applicable. The contribution of procurement from FCI currently stands at 40-45% and the company plans to maintain the mix going ahead as well. In terms of procurement of fuel, the company purchases agricultural residues (rice husk & other residues) from traders & mills. The company has recently started procuring coal from coal mines.
- **Input cost inflation to impact margins further –** The company witnessed q-o-q input cost inflation of 30% for fuel, 12% on packing material and 5% on grains. The management has guided that the margins are expected to be lower in Q2FY2023 as compared to Q1FY2023 due to higher power cost coupled with 5-7% q-o-q rise in ENA prices. The company expects ENA prices to increase in Q2FY2023, ethanol prices are expected to rise from December 2022, with the beginning of the new harvest season while prices of consumer segment are expected to be finalised by March 2023. Owing to the above increases, margins are expected to improve in FY2024, however, in the near term, continuing inflationary trend, unfavourable mix due to increasing contribution from manufacturing business and higher input cost scenario will keep a toll on margins. The management has indicated that overall EBITDA margin is sustainable at 18-20% in the medium term.

Results (Consolidated) Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Gross sales	**683.0**	**550.6**	**24.0**	**654.2**	**4.4**
Excise duty	187.5	180.1	4.1	174.9	7.3
Net sales	**495.4**	**370.5**	**33.7**	**479.4**	**3.3**
Material cost	292.1	183.9	58.8	277.4	5.3
Employee cost	14.2	14.5	-2.3	14.4	-1.4
Other expenses	120.6	74.0	63.0	103.2	16.8
Total operating expenses	426.8	272.4	56.7	395.0	8.1
Operating profit	**68.6**	**98.1**	**-30.1**	**84.4**	**-18.7**
Other income	1.7	1.1	57.7	1.8	-5.4
Interest expense	2.2	3.9	-43.9	2.8	-20.1
Depreciation	12.5	10.3	20.9	11.3	10.6
Profit before tax	**55.6**	**84.9**	**-34.5**	**72.1**	**-22.9**
Tax	18.3	29.3	-37.3	23.5	-22.1
Adjusted PAT (before MI)	37.3	55.7	-33.0	48.6	-23.3
Minority interest (MI)	0.0	0.0	-	-0.1	-
Reported PAT	**37.3**	**55.7**	**-33.0**	**48.5**	**-23.1**
EPS (Rs.)	12.9	19.3	-33.1	16.9	-23.3
			bps		**bps**
GPM (%)	41.0	50.4	-932	42.1	-108
OPM (%)	13.8	26.5	-	17.6	-375
NPM (%)	7.5	15.0	-751	10.1	-261
Tax rate (%)	33.0	34.4	-147	32.6	35

Source: Company; Sharekhan Research

Segmental performance Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Value Segment (Consumer business)	186.8	154.5	20.9	166.5	12.2
Premium Segment (Consumer business)	7.2	1.0	620.0	1.8	300.0
Bulk Alcohol Segment (Manufacturing business)	234.3	154.1	52.0	221.5	5.8
Others (including bottling & by-products)	67.9	61.0	11.4	86.0	-21.0
Net revenue from operations	**495.4**	**370.5**	**33.7**	**479.4**	**3.3**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Structural change in the alcohol industry

Indian Made Indian Liquor (IMIL) is evolving from a restricted quota-based, commoditised market to a consumer-driven brand-based industry. The main attractiveness of this market lies in its sizeable base, comprising SEC-D below which could translate into ~40% of the total population (excluding the Below Poverty Line). Growth in this segment is expected to be driven by a growing consumer base, rising rural incomes, and consumption, conversion from illicit/toddy to IMIL with increasing awareness about health and quality, conducive regulatory policies, and growth in population. In the short run, the IMIL industry could benefit from lower discretionary incomes, which would push up demand for lower-priced liquor. The government is targeting to achieve a 20% blending of ethanol by 2025, which would result in higher demand for grain-based molasses in the coming years.

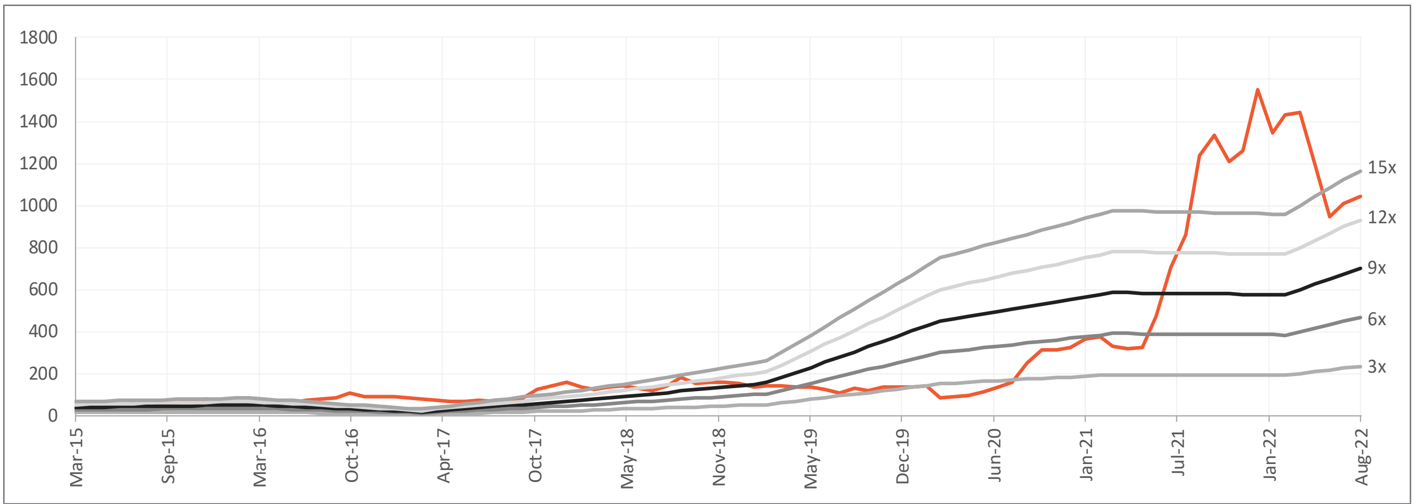
■ Company Outlook – Margins to remain under pressure in the near term

Raw material price inflation, increase in fuel prices and change in the mix will continue to put pressure on the margins in the near term. We expect OPM to reduce to 16-17% in FY2023 and will improved to 20% by FY2024 (lower than earlier expectation of 23-24%). Earnings growth will remain flat in FY2023 due to lower margins, while grow in strong double digits due to improvement in the margins. Around 40% of the expanded capacity (of 1,090 KLPD) will be utilised for manufacturing ethanol. Thus, we expect GSL's bulk alcohol sales volumes and revenues to report a CAGR of 21% and 26%, respectively, over FY2022-FY2024. The company plans to double its capacity over the next 3-4 years from 665 KLPD currently to 1,344 KLPD. The contribution of the consumer business is expected to stand at 40% in the near term.

■ Valuation – Downgrade view to Neutral; expect an upside of 12%

In the past few quarters, performance was affected by a sharp decline in the OPM due to sharp increase in the input costs and change in the revenue mix. The management has taken key initiatives to reduce stress on margins. However, the benefits of key initiatives and expected rise in realisations would flow in from FY2024. In the near term, the performance will be subdued due to lower profitability. Thus, in the view of near-term margin headwinds, we have downgraded view on the stock to Neutral from Positive earlier with potential upside of 12%. The stock trades at 15.9x/10.5x its FY2023/24E earnings.

One-year forward P/E (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
United Spirits	61.0	56.6	47.9	37.4	37.6	30.9	22.1	22.2	24.6
Radico Khaitan	46.5	37.7	28.8	30.3	24.9	18.8	15.1	15.8	19.4
Globus Spirits	15.6	15.9	10.5	9.1	9.7	6.6	28.0	21.7	26.5

Source: Company, Sharekhan estimates

About company

Established in 1992, GSL is one of the leading players in the Indian alcoholic beverages industry. The company manufactures, markets, and sells Indian Made Indian Liquor (IMIL), Indian Made Foreign Liquor (IMFL), bulk alcohol, and contract bottling for established IMFL brands. GSL's manufacturing business segment contributes ~59% to revenue and comprises bulk spirits, franchisee bottling, and by-products, whereas the consumer business segment contributes ~41% to revenue and comprises the value segment and premium segment. GSL is one of the largest and most efficient grain-based distilleries in India with a capacity of 195 million litres.

Investment theme

GSL will be one of the key beneficiaries of the change in the government's ethanol policy with 50% of ethanol blending expected to happen through grain based. Around 75% of expanded capacity (of 420 KLPD) will be utilised for manufacturing ethanol. Consumer business's (IMIL) contribution has increased to 41% versus 35% in recent years, which has 2x higher margins than the bulk alcohol business. With increased sustainable demand for ethanol and scale-up in the consumer business, GSL's earnings are expected to grow in strong double digit in FY2024. However, in the near term, the margins will remain under pressure due to higher input prices and fuel & power cost.

Key Risks

- Changes in regulation/policy by state or central government on alcohol distribution/selling policy would act as a key risk to GSL's consumer business.
- Any delay in the operation of new capacities would act as a key risk to GSL's earnings in the near term.

Additional Data

Key management personnel

Vivek Gupta	Chairman
Ajay Kumar Swarup	Managing Director
Bhaskar Roy	COO
Nilanjan Sarkar	CFO
Santosh Kumar Pattanayak	Company Secretary

Source: Company Website

Top 8 shareholders

Sr. No.	Holder Name	Holding (%)
1	Massachusetts Institute of Technology	3.90
2	Old Bridge Capital Mgmt Pvt Ltd	2.41
3	INTL Asset Recons	1.87
4	Samar Voyager LLP	1.80
5	Motilal Oswal AMC	0.35
6	Chadha Sunil	0.05
7	American Century Cos Inc	0.03
8	State Street Corp	0.03

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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