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Globus Spirits

Globus Spirits Limited's Q2 & H1 FY13 Earnings Conference Call Transcript Held on November 12, 2012 at 11:00 a.m. IST

Moderator: Ladies and gentlemen, good day and welcome to the Globus Spirits Ltd Q2 FY13 earnings conference call hosted by IDFC Securities Ltd. As a reminder for the duration of this conference all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Ms. Swati Nangalia from IDFC Securities Ltd. Thank you and over to you.

Swati Nangalia: Thanks Myron. It is a pleasure to welcome you to the Q2 FY13 earnings conference call of Globus Spirits Limited. Today, we have with us representing the management team, Mr. Ajay Swarup, Managing Director, Mr. Shekhar Swarup – Executive Director, Dr. Bhaskar Roy – CFO & Director, Finance and Mr. Manik Lal Dutta, Head - Operations. I will now hand over the call to Mr. Ajay Swarup for the opening remarks post which we can move on to the Q&A. Over to you Sir.

Ajay Swarup: A warm welcome to the Globus Spirits earnings conference call for the quarter and half year ended 30th September 2012. I will take this opportunity to share with you our perspectives on the Company`s operation following which Dr. Roy will take you through the financial highlights of the Company for Q2 & H1 FY13 results.

The focus of the Company has been on expanding its manufacturing capacities and emphasizing on value enhancement across the consumer facing portfolio. Towards that end, the Company has successfully commissioned its 35 million brown field direct wash to ENA plants at 2 of its facilities i.e. in Rajasthan and Samalkha in Haryana. With this, GSL becomes a significant player with one of the largest distillation capacities in the country at 120 million liters per annum. The expanded capacities have now stabilized and the full impact of this expansion in terms of financials will be visible from FY14 onwards. Further, the Company plans to extend its 360^0 play to the high potential and under penetrated Eastern India, by setting up green field distilleries in Jharkhand and Bihar, for which approvals have been obtained. We believe that the

Alcobev market in East India is at a nascent stage, similar to what it was in north Indian states some 7-10 years ago. We expect growth momentum in this region to be led by the transition from the unorganized to organized and from commoditized to Branded alongwith support from the Government to promote good quality safe liquor. Although, we are still in the planning stage, we expect to take firm steps towards implementation of these projects in the near future.

The Franchise IMFL business as you are aware is a proxy play on growth of branded IMFL business for us as it is a sticky business with limited investment and consistent margins. Our tie ups with leading liquor companies i.e. United Spirits, Jagatjit Industries Ltd and ABD Ltd are progressing well and we are seeing a marginal uptick in volumes given our expertise and excellent relations with them. This business not only ensures reasonably assured off take in bulk alcohol but assists in registering better margins as compared to sale of bulk spirit.

Overall, the manufacturing business enables high capacity utilization and steady growth combined with providing free cash flows for augmenting growth of branded IMFL business.

Let me now move on to the consumer portfolio. In the IMIL business, erstwhile country liquor, we continue to be one of the leading players in our regions of operation with volume of over 12 million cases per annum. The Company with the launch of Nimboo in Haryana about a year ago has pioneered branding in the IMIL market, making the category more consumer oriented. Here, I would like to mention that Nimboo today is a Rs. 350 crore brand at the retail level. We believe that the brand has immense potential and we plan to extend it to other states. We have already taken steps towards this and have recently launched Nimboo in Rajasthan. The overall performance of this business has however been subdued in the second quarter possibly reflective of the adverse impact of delayed monsoons on disposable incomes of the rural and semi urban population. Nevertheless, we believe this is not a sustainable trend and expect volumes to pick up once the disposable rural incomes start improving.

The branded IMFL business continues to be a peripheral play given its size, but remains a promising constituent of our 360^0 model and we remain committed to the development of the same with sustained brand building along with developing a strong marketing and distribution network. We are conscious that the growth in this segment has been lower than anticipated, but this is by design as we do not want to take high investment and high risk led brand building initiatives. Our focus continues to be on value enhancement and in that regard; we are currently focusing on pan India brands that offer high margins.

To close, GSL has continuously fortified its 360^0 presence in the spirit sector right from bulk alcohol to branded IMFL, all of which are showing a promising future ahead. Our appetite for growth remains undiminished and we continue to aggressively implement various initiatives by expanding capacities and geo-graphic presence, brand launches and new product introductions, therefore, making us well poised to report sustainable growth going forward.

I would like to hand over to Dr. Roy to give you a brief overview on the financial performance.

Bhaskar Roy: Good Morning everybody. I hope you had a chance to go through our results for quarter and half year ended September 30, 2012. I will briefly take you through the financials for the quarter following which we will be happy to take any questions that you may have.

For the quarter net income was flat at Rs. 132.7 crore due to various factors which Mr. Swarup stated earlier. EBITDA on the other hand, was higher by 19% at Rs. 20.4 crore compared to Rs. 17.1 crore in Q2 FY12 and EBITDA margins improved from 12.9% in Q2 FY12 to 15.3%. The improvement in margin is largely driven by stabilization of capacities and better efficiencies across all plant locations. Last year, during this period, the new plants had not stabilized due to which the utility costs were relatively higher. This year, despite an increase in the price of our key input i.e. broken rice**,** which grew by 20-30% year to year, we have been able to improve our margins. PAT was higher by 10% at Rs. 10.7 crore compared to Rs. 9.7 crore translating into a non- annualized EPS at Rs. 4.6.

Let me now give you a segment wise break up.

During Q2 FY13, we sold 70 lakh BL of bulk alcohol translating into a revenue share year of 18.1%. In the IMIL segment, we clocked volumes of 26.4 lakh cases translating into a revenue share of 49.9%. Our branded IMFL sale stood at 1.13 lakh cases including sales from tie ups forming 3.6% of total revenue share. Franchise IMFL sales volume stood at 4.2 lakh cases contributing 18.9% to the total revenue share. The sales from other segment contributed about 15% to the total revenue share.

Overall, we believe that we are well placed to take benefits of the expanded capacities through our 360^0 presence and with the beginning of the new season. Additionally, we expect the raw material prices to taper and the pressure to ease from Q3 onwards, which would translate into sustained performance going forward.

This brings me to the end of my discussion. 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 Sir. We may now begin with the question and answer session. We have the first question from the line of Amit Dalal from Tata Investment Corporation .Please go ahead.

Amit Dalal: You have invested about Rs. 200 crore in your gross block in the last 2 years and since its distillation capacity, I believe there would not be a long gestation period. Also, in the last 2 years your sales growth has perhaps topped out in the range of Rs. 500-600 crore. So, do you see that changing drastically over the next 6 months or 1.5 years? Or this growth would come in only from March 2014.

Bhaskar Roy: Over the last 2 years, investments have been made towards increasing our capacities from 28.8 million to 120 million. So building capacities combined with increasing our bottling unit plus zero discharge, etc., takes time and requires capital. Secondly, we are trying to create value additions. So while our branded portfolio i.e. IMIL & IMFL contribute to around 48-49% to our total revenues, we are channelizing our energy to improve this contribution. So going forward, we expect the contribution from the branded portfolio to increase and the contribution from the sale of bulk sprit to go down.

Amit Dalal: What is the difference in the EBITDA margin of Bulk alcohol and IMIL?

Bhaskar Roy: In bulk alcohol, the EBITDA is around 11-12% and in branded IMIL, it is about 16%. In IMFL, the EBITDA has not picked up so far because we are still at a nascent stage and the margins would stabilize once the volume reaches certain stage.

Amit Dalal: But the branded space contributes to 50% of total revenues and has already achieved a critical size.

Bhaskar Roy: Yes. I would agree that it has achieved a critical size, but you should note that in the branded space, there are two divisions i.e. IMIL and IMFL. IMIL is a major contributor to that 50% share and gives us around 16% EBIDTA margins. In the IMFL segment, the volumes are at a nascent stage and we are still investing. Hence, it’s currently not contributing to the overall EBITDA margins.

Amit Dalal: What is the capacity utilization right now?

Bhaskar Roy: There are two types of capacities. One is RS capacity and the other is ENA capacity. If you take the direct wash to ENA capacity, then we are utilizing about 90%. On the other hand, if you take the blended capacity i.e. RS plus ENA, then we would be operating at about 60-70% because the utilization of rectified spirit is low due to subdued demand.. Just to highlight that both IMIL and IMFL are ENA based currently.

Amit Dalal: What is the upside in terms of capacity utilization going forward? How much more capacity will come into play in the next 1 year?

Bhaskar Roy: The new capacities have been added in October are now stabilizing. The full impact on capacity utilization will come only by the end of Q3 FY13. Further, once these capacities stabilize, we would move on and increase the capacities in other geographies.

Amit Dalal: What is the expected CAPEX for the full year ending March 2013? Also, what will be the total gross block?

Bhaskar Roy: Gross block will be about Rs. 370-380 crore.

Amit Dalal: So, for FY14, you may not have much growth. Would that be a fair statement to make given that you are operating at 90% utilization rate.

Bhaskar Roy: As I mentioned earlier, so far we were operating with a capacity of about 80 million liters and in Q2 the revenues came from these capacities. Now, we have increased our capacities to 120 million liters and the expanded capacities would start stabilizing by FY14.

Amit Dalal: What is the total ENA production volume sale in Q2 & H1?

Bhaskar Roy: We produced 128 lakh litres in Q2 & 270 lakh liters in H1 of FY13.

Amit Dalal: So according to you, this is what you will do for the remaining half as well.

Bhaskar Roy: It will be growing further because the new capacities have come-in in October.

Amit Dalal: Can you quantify the capacity addition in terms of percentage?

Bhaskar Roy: 12% to 15% because about 30 million liters have been added.

Amit Dalal: Do you expect a little more growth on the IML side?

Bhaskar Roy: We are trying and improving the contribution from the branded segment i.e. IMIL & IMFL. So, going forward, the contribution from branded portfolio will grow and subsequently bulk alcohol would come down.

Moderator: We have the next question from the line of Ashish from Equirus. Please go ahead.

Ashish: What is your outlook for the IMIL segment in terms of growth and margins?

Bhaskar Roy: The margins for the IMIL segment would remain stable at the moment because we expect a policy change only in March 2013. Post that, we may see some price increases which would likely lead to improvement in margins.

Ashish: Could you share your CAPEX plans for the next 2 years?

Bhaskar Roy: For the next two years, there will be no major CAPEX at our existing distilleries, apart from maintenance.

Moderator: We have the next question from the line of Avinash Wadhwa from M3 investments. Please go ahead.

Avinash Wadhwa: From an industry perspective, what are the implications if any, of a change in ownership of India`s largest sprits company and implications for GSL, if any?

Shekhar Swarup: It's a bit early for us to comment on how the industry would take shape. We believe, Diageo is not going to change a whole lot. They have had a bad experience with changing product mixes in China over the last few years. So, as of now, we don't foresee any significant changes in the industry. As far as opportunities to Globus are concerned, we have a strong existing relationship with United Sprits. We bottle their products at our Haryana facility and do not see that changing any time soon.

Avinash Wadhwa: You reported Rs. 7.76 crore as intangible assets under development in your FY12 balance sheet. In fact there is still another line item which goes as intangible knowhow and new brand development on which you extended Rs. 5.64 crore. So I am wondering what is the difference between these two heads of expenditure?

Bhaskar Roy: It's a brand expense for promoting the brands in the IMFL segment and we would write this off in the next 5 years.

Avinash Wadhwa: Why show these two items separately?

Bhaskar Roy: We have clubbed it and made the head intangible knowhow and new brand development. We have just shown one amount.

Avinash Wadhwa: Because if my understanding is correct on Page no. 31 of the annual report, you have intangible knowhow and new brand development which is Rs. 13 crore at the beginning of the year. You further added about Rs. 5 crore. Then there is another line item which is shown separately in the balance sheet which goes as intangible assets under development which appeared for the first time in FY12 for which you extended Rs. 7.76 crore.

Bhaskar Roy: It is in one head. The opening was Rs. 13.45 crore and during the year we added Rs. 5.64 crore taking it to Rs. 19.09 crore.

Avinash Wadhwa: Ok. We will take this off line. So you are saying that this expenditure will be written-off over a period of 5 years right?

Bhaskar Roy: Yes

Avinash Wadhwa: Are these expenditures tax deductible expenditures.

Bhaskar Roy: Yes. They are tax deductible expenditure.

Avinash Wadhwa: And these expenditures are made only for your branded IMFL or it is for IMIL as well?

Bhaskar Roy: Yes. A substantial portion is for our own branded IMFL and for IMIL, it is marginal.

Avinash Wadhwa: Your power and fuel expenditure has increased from Rs. 34.71 crore to Rs. 100.66 crore from FY11 to FY12. Is there any element of a non-recurring nature in that head of expenditure?

Bhaskar Roy: No.

Avinash Wadhwa: Normally companies provide what is called as a Form A with the director's report. Have you prepared a Form A, and if yes would it be possible for you to email it to me?

Bhaskar Roy: I will definitely check whether it is a Form A or Form B and send it across to you.

Avinash Wadhwa: In your opening remarks, you said that you wish to have distillation capacity in the state of Bihar and Jharkhand. In the annual report, there is an advance paid for the Punjab and Jharkhand licenses.

Bhaskar Roy: We have obtained a license in Punjab also, but we are not pursuing Punjab. Seeing the opportunity in the eastern side, we are pursuing only the eastern side as you cannot establish all over at a time. So, seeing our resources, we have decided to go to the eastern side first.

Avinash Wadhwa: You have in your investor update mentioned Net capital work in progress as on 30th September to Rs. 90.4 crore. So what exactly is this capital work in progress for?

Bhaskar Roy: That's for the expansion which we have done. Rs. 60 crore was the capital work in progress last year which has increased to Rs. 90 crore due to the new plants being put up. It would be capitalized going forward as the added capacities stabilize.

Avinash Wadhwa: So is the entire expenditure of Rs. 90.4 crore for the expansion of your capacity from 84.4 bulk liters to 120 million bulk liters?

Bhaskar Roy: Yes. We have also increased some bottling capacities and a part of this is towards maintenance CAPEX.

Avinash Wadhwa: What is the quantum of maintenance CAPEX that you would provide on the existing plants?

Bhaskar Roy: The usual would be about Rs. 20 crore looking at our current capacities.

Avinash Wadhwa: Could you just provide me your production figures in bulk liters for the first half of 2013?

Bhaskar Roy: For H1 FY13, we produced 270 lakh bulk liters.

Moderator: We have the next question from the line of Rohan. Please go ahead.

Rohan: What is the outlook for the franchise IMFL business? Are we likely to report any increase in volumes from USL? Further, what is the net retention per case for Globus right now?

Bhaskar Roy: The Franchise IMFL is operated from two distilleries. In Rajasthan, we do bottling for ABD and in Haryana; we do the bottling for ABD, USL and Jagatjit. Now, for ABD in Rajasthan, the volumes are steady at 70,000-75,000 cases per month. It's likely to go up to 85,000-90,000 cases. In Haryana, we are seeing a marginal uptick in volumes from USL. They started with 15,000-20,000 cases and now we are clocking volumes of 50,000 cases and we believe that it can reach about 65,000-70,000 cases per month. In case of Jagatjit also, it was a slow start of 15,000- 20,000 cases but, now they have increased their brand portfolio. They have Aristocrat as a premium whiskey also which they have started bottling here. Hence, it has increased to 45,000 – 50,000 cases and we expect it to scale up to 70,000 cases per month by the end of the year.

Moderator: As there are no further questions, I would now like to hand the floor over to Ms. Swati Nangalia for closing comments.

Swati Nangalia: Thanks Myron. I would like to thank the management team of Globus Sprits for removing time for this call. Also thanks to all the participants for joining us today. I would now request the management team to make some closing comments.

Bhaskar Roy: Thank you all for joining us on this call. Should you have any other queries, do feel free to contact us or our investor relations team and we will be happy to answer them.

Swati Nangalia: Thank you Sir and Wish you a Very Happy Diwali.

Moderator: On behalf of IDFC Securities Ltd., that concludes this conference. Thank you for joining us and you may now disconnect your lines.
