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Globus Spirits Limited's
Q3 & 9M FY13 Earnings Conference Call Transcript
Held on February 13, 2013 at 11:00 a.m. IST

Moderator: Ladies and gentleman good day and welcome to the conference call of Globus Spirits Limited hosted by IDFC Securities Limited. As a reminder for the duration of the conference call, all participant lines are in the listen only mode and there would be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touch tone phone. Please note that this conference is being recorded. At this time I would now like to hand the conference over to Mr. Nikhil Vora from IDFC Securities. Thank you and over to you sir.

Nikhil Vora: Thanks. I welcome you all to the Q3 & 9M FY13 earnings conference call of Globus Spirits Limited. We have with us the senior management team of Globus Spirits represented by Mr. Ajay Swarup – Managing Director, Mr. Shekhar Swarup – Executive Director and Dr. Bhaskar Roy – CFO & Director, Finance. I will now hand over the line to Mr. Ajay Swarup to make his opening remarks and then we will have the floor open for Question and Answers. Over to you Mr. Swarup

Ajay Swarup: Good Morning everybody and I welcome you all to the Q3 & 9M FY13 earnings conference call of Globus Spirits Limited. As you are all aware, GSL is the only spirits Company in India having a 360° presence across all the segments; right from manufacturing to marketing and sale of branded products. This enables us to straddle opportunities across the sector and balance our operations in variable market scenario.

The performance during the quarter is the reflection of our strong integrated and unique 360° business model. Testimony to this is the performance of our manufacturing business which is partly moderated by the impact of lower earnings from our consumer facing portfolio. The manufacturing business has not only enabled high capacity utilization and steady growth but is also providing free cash flows for augmenting growth of the branded business.

Let me now take you through businesswise performance

The manufacturing business which includes Industrial Alcohol and Franchisee IMFL continue to report robust performance. This is on the back of expanded capacity from 84.4 million BL last year to over 120 million BL in the current year. Given the weak demand for rectified spirits, we are currently operating only direct wash to ENA plants at Behror and Samalkha. The blended utilization for 120 million BL for the nine months period stood at 58%. However, excluding the rectified spirit capacities at our two units, we have achieved a capacity utilization of over 85%.

The uptake in volumes in the Industrial Alcohol business is already visible in the nine months results where we have recorded strong volume growth and we expect this growth to continue with improving utilization rates. Besides, as you would be aware we are in advanced stage of extending the 360° play to the high potential and underpenetrated Eastern India by setting up green field distilleries in the region for which licenses have been obtained. Given the confidence in the business and its outlook, the promoters would infuse up to Rs. 20 crore by way of warrants issued. Besides, we are in advanced stage of discussion with an investor to raise Rs.70 crore through issue of Cumulative Compulsorily Convertible Preference Shares. We shall keep you updated on the progress of this transaction.

The Franchise IMFL business continues to register healthy performance. Our tie-ups with leading liquor Companies' i.e. United Spirits, Jagatjit Industries and ABD Limited are progressing well and we are seeing a marginal up-tick in volumes given our expertise and excellent terms with them. To re-iterate, this business not only ensures reasonably assured off-take of bulk alcohol, but also assists in registering better margins as compared to sale of bulk spirit.

Let me now move on to our consumer facing portfolio. While the performance of our branded IMFL is subdued; it is in line with our overall strategy on value enhancement. During the quarter, the Company has undertaken steps to rationalize the branded IMFL portfolio to restrict operations to profitable brands only. We remain committed to development of this business as it forms a promising constituent of the 360° business model. Towards that end, we are channelizing our efforts towards volume growth of our existing brands, market expansion and brand launches which we believe will enable us to deliver improved performance in the long term.

In the IMIL space, we continue to be undisputed leader in North India with strong marketing and distribution network and volume of over 12 million cases per year. Moderation in performance in the quarter gone by is reflective of the challenges faced by the rural population in terms of declining disposable income due to the deficit monsoon which has had adverse impact on the off-take of our IMIL products in general. We believe that this trend is transient and we expect volumes will pick up once the disposable rural income starts improving. We are also taking steps to strengthen the marketing and distribution network and leverage our strong positioning through introduction of new flavors and products in the IIML category. Further, we are exploring opportunities in to new states either directly or through franchising our strong brands like Nimboo to garner market share from companies who continue to relay on the commoditized approach. Towards this end, we have launched IMIL in the Maharashtra market in the month of January 2013. Maharashtra is again is one of the largest IMIL markets and we hope to gradually become a player to reckon with in that market as well.

As we move into the last quarter of this financial year, the outlook for all our businesses remains buoyant and we will continue to chase growth while maintaining a healthy balance sheet. With various initiatives being undertaken combined with turn around and sentiment relating to the overall macroeconomic picture, we are confident that we will continue to drive the growth path based on a strong India centric consumption model.

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

Dr. Bhaskar Roy: Good Morning everybody. I hope you had a chance to go through our results for Q3 & 9M FY13. I will briefly share the highlights of our financial performance following which we would be open to any questions that you may have.

For the quarter, net income stood at Rs.157.1 crore, EBITDA was marginally higher at Rs. 20.2 crore, PAT stood at Rs. 10.7 crore translating into a non-annualized EPS of Rs. 4.65.

For the nine months period, net income was higher by 8% at Rs. 433.7 crore, EBITDA stood at Rs. 59.4 crore up by 6% and PAT stood at Rs. 31 crore translating into a non-annualized EPS of Rs. 13.44.

Let me know give you a segment wise break up.

During Q3 FY13, we sold 101.74 lakh BL of Bulk Alcohol translating into a revenue share of 24%. In the IIML segment, we clocked volumes of 26.3 Lakh cases translating into revenue share of 41%. Our branded IMFL sales stood at 0.73 lakh cases including sales from tie-ups forming 4% of the total revenue share. Franchisee IMFL sales volume stood at 5.4 lakh cases contributing 14% of the total revenue share. The sales from other segments contributed 16% to the total revenue share.

During nine months ended, we sold 274 lakh BL Bulk Alcohol translating into a revenue share of 21%. In the IMIL segment, we clocked volumes of 78.95 lakh cases translating into a revenue share of 44%. Our branded IMFL sales stood at 2.63 lakh cases including sales from tie-ups forming 4% of the total revenue share.

Franchisee IMFL sales volume stood at 13.63 lakh cases contributing 17% to the total revenue share. The sales from other segment contributed 15% to the total revenue share.

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 question that you may have now.

Moderator: Thank you very much sir. We will now begin the question and answer session. We are going to take the first question from the line of Sonali Salgonkar from Crisil Research. Please go ahead.

Sonali Salgonkar: On an industry basis, what has been the consumption in terms of volumes for the IMFL and country liquor segment in 9M FY13?

Ajay Swarup: The industry figures normally come in the following financial year. Also, you need to keep in mind that the liquor business is not so well reported in terms of national and state-wise consumption because there is no central body which actually produces this. So we are unable yet to give you numbers.

Sonali Salgonkar: Any approximate growth number in both these segments?

Ajay Swarup: I believe the growth in both these segments have been quite flat as compared to last year. This is the general report we get from across the country.

Sonali Salgonkar: Is hike in duties across most of the key liquor consuming states the key reason for a flattish kind of growth?

Ajay Swarup: Hike in duties may not be the only consideration. I think overall depressed disposable income in the hands of consumer has been the main driving force for this flat growth.

Sonali Salgonkar: What have been the prices of ENA in Q3 FY13?

Dr. Bhaskar Roy: The average for Q3 FY13 was Rs. 44 per litre.

Sonali Salgonkar: What trend do you expect in the ENA prices over the next one or two years?

Ajay Swarup: Largely it is going to be driven by the ethanol policy which has recently come into force. With this, we expect huge quantities of alcohol to get diverted into mixing with petrol. Also, we expect free pricing to come in unlike earlier where there was an administered price at which OMC's were buying from the sugar companies. So this move is likely to result in Ethanol prices moving from level of Rs. 27 to Rs. 35-36. This will form the basis for ENA pricing as well. Hence, we believe that over the next years we are going to see a significant hike in ENA prices because of the increased prices and demand of Ethanol.

Moderator: Thank you. We are going to take our next question from the line of Pankaj Shah who is an individual investor. Please go ahead.

Pankaj Shah: Could you throw some color on your IMFL strategy?

Shekhar Swarup: The reason for decline in IMFL volumes has been largely due to realigning our brand portfolio towards the profitable brands. Over the last year, due to increase in various costs, the cheaper brands have become unprofitable and hence we decided to do away with those for the time being. As far as value enhancement, we are focusing on certain SKU's and brands which are yielding better margins along with focusing on states which allow us better margin such as Rajasthan and Haryana and some other North Indian states. Going forward we do see the need for launching higher value added brands such as French Castle brandy that was launched in South India in the current financial year. Certainly a more premium brand launch is needed for the North Indian market as well.

Pankaj Shah: Is there a target in terms of volumes that we are looking at over the next 2-3 years in this segment?

Shekhar Swarup: Yes, we did have a target which was formed inclusive of the lower end brands. However, as I mentioned, we have stopped supplies of lower end brands in some markets. Those targets are currently under revision and hopefully by the next concall we should be in a position to announce them.

Pankaj Shah: On your expansion plan of IMIL into the state of Maharashtra; could you give us a sense of how big that state is for IMIL as a segment and what is the growth pattern?

Ruchika Bansal: The Maharashtra IIML market is estimated to be about 35 to 37 million cases per annum.

Pankaj Shah: How are we going to enter this market? Are we setting up a distillery here or how does that work?

Shekhar Swarup: We have tied up with the bottling plants for manufacturing our IMIL on a franchised basis.

Pankaj Shah: From when do we start?

Shekhar Swarup: We have already started in January 2013.

Pankaj Shah: Have you seen price increases in key IMIL states so far?

Shekhar Swarup: IMIL prices are revised on a financial year basis. So those are under consideration currently and announcements should happen in the next month to be effective from 1st April. In the last financial year, there were certain price increases in the IMIL states that we operate.

Moderator: We are going to take our next question from the line of Amit Sharma from Wallfort Financial. Please go ahead.

Amit Sharma: Just wanted to understand our strategy going forward, from being an IMIL Company we have started shifting into IMFL segments. So how is the consumer shift happening and do we see that shift resulting into our strategy?

Shekhar Swarup: Our strategy is always been to be a 360° player in the alcohol industry of India which means that we make use of opportunities in the bulk or commodity segments in the Franchisee bottling segment and in the consumer facing segment. We see that India will remain a country where there is a low income population consuming IMIL as well as high income population consuming various types of products in the IMFL. So Globus Spirits hopes to remain a 360° player and make use of opportunities across the entire value segment.

Amit Sharma: With the rising disposable income, the shift is happening from non-branded to branded IMIL and then from IMIL to may be IMFL, but what about our own brands? Do we have any millionaire brands or do we strategize to create any millionaire brands?

Shekhar Swarup: For IMIL, we have total sales of about 12 million cases per year and our largest selling brand Nimboo is about 4 million cases within that. This brand has been launched in new markets like Maharashtra. In addition to that, Rajasthan is a market that we have been thinking. As far as disposable income goes, there are people who have seen an increase in disposable income and therefore shift to other product categories. However, if you look at the math, the consumption in either IMFL or IMIL, I think they are very sustainable industry segments, which continue to grow at a certain rate. In some years, in some markets the rate may be slightly flat, in other years it might be better. For example, Haryana over the last 5 years saw growth rate ranging from 5% all the way to 25% in a certain year. So, these are very sustainable industry segments.

Amit Sharma: I understand this from an industry perspective or from the product perspective. But from the Company's perspective, you said we have a brand which is Nimboo in IMIL, which is one of the largest brands. However, what is your strategy in creating a millionaire brand in IMFL.

Shekhar Swarup: We currently do not have a millionaire brand in the IMFL segment. We started IMFL segment a few years ago by focusing on creating distribution using cheap and regular price points in certain parts of the country. However, over the last 12-18 months there have been significant cost increases which have made those product segments unprofitable and unviable and therefore we had to rethink our entire strategy. Fortunately, over the last few years, we did launch some higher value added products and those are the ones that we are focusing on today.

Amit Sharma: One of the biggest markets in India is the South Indian market as far as IMFL is concerned, but in recent past we have seen an unfavorable government policy which has turned into quota system putting break on the extent of growth that a Company can make?

Shekhar Swarup: That is in the case of Tamil Nadu. We do not have supply in the state of Tamil Nadu. However, i agree that the Tamil Nadu policies are a major question mark for the entire industry and for all the stake holders of the industry.

Amit Sharma: So is there a likelihood of this percolating to other states as well?

Shekhar Swarup: I find it very unlikely that this system would move into other states. Tamil Nadu has a history of policies being framed to favour certain groups of people and in fact that is the reason that majority of the brands sold in Tamil Nadu are brands owned by people from the region. So, I sincerely doubt that these kind of practices would percolate into the other states of South India.

Amit Sharma: Where are we present currently and do we plan to have a larger presence?

Shekhar Swarup: Our main presence today is in the North Indian market where we have IMIL, IMFL as well as bulk manufacturing capacities. In addition to that, we have presence in South India, in Kerala and in Andhra Pradesh and we have recently launched our IMIL in Maharashtra which is a very small part of our presence today.

Amit Sharma: Which brands of IMFL do we sell in Kerala and in A.P.?

Shekhar Swarup: In South India, the market is only IMFL and we have our IMFL products present there. We have our Rum called GR8 Times, we have a brandy called Le Mans Brandy, and we have French Castle Brandy which was recently launched in a premium segment. These are some of the brands in South India.

Moderator: We are going to take our next question from the line Sachit Keda from Smart Equity. Please go ahead.

Sachit Keda: Is the addition in gross block of Rs. 60 crore for capacity expansion?

Dr. Bhaskar Roy: Yes. We have added 65 KLPD plants in both Samalkha and Behror which were capitalized in October.

Sachit Keda: There is about Rs. 70 crore lying in capital work-in-progress. So can you throw some light on that?

Dr. Bhaskar Roy: We have put certain evaporators in the old plant in Hisar and Samalkha. In addition, there are roads, constructions and utilities under construction which hopefully will be over in the current quarter and majority of it will be capitalized.

Sachit Keda: Are these towards expansion to 120 million BL?

Dr. Bhaskar Roy: Yes. Out of the 120 million BL, we are not operating the RS capacities, but we want to operate the RS capacity at Samalkha and we would start doing so by this quarter.

Sachit Keda: Higher capacities you mean over and above the 84 million BL?

Dr. Bhaskar Roy: Yes.

Sachit Keda: Also, over the last nine months the revenue mix has shifted towards Bulk Alcohol and Franchisee IMIL?

Dr. Bhaskar Roy: If the capacity increases, the quantity of Bulk Alcohol also increases which is reflective in the percentage rise.

Sachit Keda: Historically, these have been the low margin business?

Dr. Bhaskar Roy: Yes. However, it is still giving us substantial margins.

Sachit Keda: Can you share the margins that you make across businesses?

Dr. Bhaskar Roy: Bulk alcohol margins are at 12-13%, while IMIL gives us about 16%.

Sachit Keda: Do you expect 12-13% margins to sustain in the bulk alcohol segment?

Dr. Bhaskar Roy: Yes.

Sachit Keda: There has been a significant capacity addition as compared to the capex?

Dr. Bhaskar Roy: Yes.

Sachit Keda: By when do you expect to achieve optimum utilization rates from the enhanced capacities?

Dr. Bhaskar Roy: By Q4 FY13 or maximum by Q1 FY14. We have already started operating the ENA plants which are operating at 80-85% utilization levels. The old plants of RS are under synchronization. In Rajasthan, we will not be able to operate the old RS plant, but we will operate it in Samalkha definitely by this quarter end.

Sachit Keda: What are your expectations for blended utilization rates by end of the current financial year or by Q1 of the next financial year?

Dr. Bhaskar Roy: On an overall basis, capacity utilization would be around 60-65%. However, if you deduct the RS capacities, than we are doing around 85-90%.

Sachit Keda: You expect even higher capacities to come in by this year end?

Dr. Bhaskar Roy: Overall, we expect at least 75% utilization rates on a blended basis and for about 90% utilization for only our ENA plants.

Sachit Keda: So we can expect significant tractions during FY14?

Shekhar Swarup: Correct.

Moderator: Thank you**.** We are going to take a follow up question from the line of Pankaj Shah from individual investor. Please go ahead.

Pankaj Shah: Just wanted to know whether the margin profile in Maharashtra is similar in terms of price realizations, etc. Also, is there a volume target that we are looking at or is it too early to say?

Shekhar Swarup: As far as the realization structure goes, there is a slight difference in Maharashtra because we do not have our own production facilities and therefore we have to give Rs. 30 as a charge to bottler there. To start with, it will have less EBITDA as compared to the markets where we have our own facilities. But it is seen as low hanging fruit in terms of the entry as downsides are very little of entering in this fashion**.** To start with, we have targets of about 25,000 to 35,000 cases a month but that is over a few quarters. I think for January, we closed at about 7,000 cases. It is too early to say what our annual targets will be, because as you are aware this is our first launch in Western India and we are still trying to understand the nuances of marketing our product.

Pankaj Shah: Could you share the CAPEX figures for this year and the next year?

Dr. Bhaskar Roy: CAPEX under the capital work-in-progress will be capitalized for this year. For FY14, a lot would depend on starting of the Greenfield project. If we start the Greenfield project, then there will be separate CAPEX, but not in the existing locality.

Moderator: We are going to take the next follow up question from the line of Sachit Keda from Smart Equity. Please go ahead.

Sachit Keda: Out of the total debt of about Rs. 125 crore, a large portion is towards working capital and very little is towards the term loans. I just wanted to know, if the next Greenfield operation were to be materialized, then what would be the change in the debt-equity profile because I think about Rs. 90 crore is being infused by the strategic investor and the promoters just in the form of warrants. So I just wanted to know a little bit along that line?

Dr. Bhaskar Roy: In the case of warrant, we have to put in 25% of the money. Whether, you convert it to the share capital or not it is actually the part of the net worth. So, by the conversion time of 18 months, our project would also start.

Sachit Keda: So free cash flows would be sufficient?

Dr. Bhaskar Roy: Yes, at this moment we will not increase the debt. We will start the projects operations from the money which we will raise. We may raise the debt level only after completing one or two projects.

Moderator: We are going to take the next question from the line of Nikhil Vora from IDFC Securities. Please go ahead.

Nikhil Vora: With this changeover in the industry where Diageo is coming on play and Pernod starting to contract facilities with another player, do we see a role for ourselves in a materially large way than where we are today?

Shekhar Swarup: We believe that due to change in the industry, there will be opportunities for players like Globus Spirits to encash on, especially when it comes to the lower value segments of IMFL industry. However, it's still too early to say what those specific opportunities might be. But yes FY14 seems to be a very promising year for this industry.

Nikhil Vora: Could you just share some light on what sort of opportunities one might be able to look at, is it more on contract bottling? Is it more on bottom-end brands that we can look out for?

Shekhar Swarup: There could be opportunities on marketing low price products which certain players may not want to continue, it might be to take on Franchising of some brands which certain players may not want to continue. It might be to increase contract manufacturing relationships by taking on more products. It really depends on how these players create their strategy for the next few years which, we believe, internally is being created as we speak.

Nikhil Vora: Would you think that there could be options to buy out some of the key brands of the lead players?

Shekhar Swarup: Perhaps.

Nikhil Vora: Thank you. As we have no further questions I would like to close the call and thank all participants and the management team for being there.

Dr. Bhaskar Roy: Thank you everybody for participating and thank you IDFC for hosting it. If you have any queries, please feel free to contact us or our investor relations teams. Thank you once again.

Moderator: Thank you. On behalf of IDFC Securities Limited, that concludes this conference call. Thank you for joining us and you may now disconnect the line.

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