Q3FY12 Result Update CMP: Rs. 121.00 February 25, 2012

Scrip ID	Industry	CMP	Recommended Action	Targets	Time Horizon
GLOSPIEQNR	Breweries & Distilleries	121.00	Add / Buy on dips to the Rs. 93.5 – 107 band	Rs. 120 & Rs. 134	1-2 quarters

In our Q2FY11 update dated November 26, 2011, (CMP Rs.100.55) we had recommended buying/adding the stock to dips of Rs. 87 for a target of Rs. 120. The stock achieved our target of Rs. 120 on February 6, 2012 and made a high of Rs.129.40 on Feb 10, 2012. It is currently trading at Rs. 121.00

GSL recently declared its Q3FY12 results and reported net sales of Rs. 152.6 cr. - up 38.0% Y-o-Y and up 15.6% Q-o-Q. The Operating Profit for the quarter was Rs. 19.7 cr in Q3FY12 vis-à-vis Rs. 19.4 cr in Q3FY11 and Rs. 17.3 cr in Q2FY12. OPM for the quarter was 12.8%, 450 bps down YoY and 10 bps down QoQ. The fall in OPM can be attributed to the 81.2% increase in "other expenses" YoY and marginal increase in raw material expense QoQ. The Net Profit for the quarter was reported at Rs. 11.7 cr vis-à-vis Rs. 11.4 cr in Q3FY11 and Rs. 9.7 cr in Q2FY12. Interest expense has risen largely due to capitalization of new capacity and an increase in working capital loans due to higher sales volumes. Increase in depreciation costs YoY is due to capitalization of new capacity since Q3FY11.

Quarterly Financials:

Particulars (Rs. Cr)	Q3FY12	Q3FY11	%YoY	Q2FY12	% QoQ	Q1FY12
Net Sales	152.6	110.6	38.0%	132.0	15.6%	114.2
Other Operating Income	0.3	1.7	-82.6%	0.6	-49.2%	1.4
Other Income	0.1	0.1	88.6%	0.2	-42.7%	0.2
Total Income	153.0	112.4	36.2%	132.8	15.2%	115.8
Operating Expense	133.4	92.9	43.5%	115.5	15.5%	96.1
Operating Profit	**19.7**	**19.4**	**1.2%**	**17.3**	**13.5%**	**19.7**
OPM (%)	12.8%	17.2%		12.9%		16.9%
Interest	1.5	0.8	84.5%	1.2	24.2%	1.1
Depreciation	3.1	1.7	80.4%	3.2	-0.3%	3.0
PBT	**15.1**	**16.9**	**-10.9%**	**13.0**	**15.8%**	**15.5**
Exceptional Items	0.0	0.0		0.0		0.0
Tax	3.3	5.5	-40.1%	3.3	0.0%	4.0
PAT	**11.7**	**11.4**	**3.3%**	**9.7**	**21.2%**	**11.6**
NPM (%)	7.7%	10.3%		7.3%		10.1%
EPS	**5.1**	**4.9**	**3.3%**	**4.2**	**21.2%**	**5.0**
P/E	**5.9**	**6.1**		**7.1**		**6.0**

(Source: HDFC Sec, Company)

Some the key highlights from the quarter:

- GSL's sales rose 38.0% YoY due to increased capacity, high ENA prices and increase in sales of Country Liquor. Increased capacities at Haryana are being operated from mid April 2011 and are contributing to an increase in volume. Increased capacity at Rajasthan finally went on stream in Q3FY12 after facing several stabilization issues.

- Operating profit margins were significantly lower YoY (450 bps) and QoQ (10 bps) largely due to higher power and fuel expenses at the Rajasthan plant due to stabilization issues and frequent boiler restarts.

- GSL continues to remain the leader in the Country Liquor (CL) segment in North India. Its IMFL sales are gradually picking up however, they are still below expectations. Country Liquor sales increased 44.4% YoY reporting volumes of 34.4 lakh cases in Q3FY12 vs 23.8 lakh cases in Q3FY11. 9MFY12 country liquor sales were 38.2% higher than that in 9MFY11. GSL launched a new brand of Country liquor "Nimboo" in Haryana, which has received phenomenal customer response pushing CL sales over 10 million for the year already. This is the first time GSL has crossed the 10 million case benchmark.

- Branded IMFL sales including sales from tie-up units rose by 9.3% to 2.1 lakh cases in Q3FY12 and rose 43.7% in 9MFY12 to 5.6 lakh cases.

- ENA prices have corrected marginally in Q4FY12 after reaching all time highs earlier due to additional demand for ethanol to blend into fuel as per regulation by the government. GSL buys ENA from outside only for tied up IMFL units in the south. For the rest it uses grains to captively produce ENA. To the extent of such buying, GSL's margins have got impacted this quarter.

- GSL could see a robust increase in volumes due to the possible downgrading of consumer preferences in tougher economic times. GSL's IMFL brands are not very expensive and people could shift to them. Moreover, several people could shift from low price IMFL to country liquor as disposable income could be crunched in such times.

- The sales from franchise bottling tie-ups are flat this year due to an increase in excise duty to the tune of "import duty" from other states by the Haryana government leading to a suspension of contract from Jagatjit Industries. Franchise bottling accounted for 17.6% of the company's sales in Q3FY12 with volumes of 2.05 lakh cases vs 2.04 lakh cases in Q3FY11 and 1.72 lakh cases in Q2FY12.

- Average tax rate for Q3FY12 was only 22.1%, which is significantly lower than the average yearly tax rate of ~35% till FY10 and ~28% in FY11 due to use of captive power produced by Globus Power (a unit of GSL), which avails 100% tax benefit for 10 years. Full year tax rate is expected to be ~28%.

- Added capacities at both plants are on stream after stabilization and both plants are running at close to full capacity in Q4FY12. Average capacity utilization for FY12 is expected to be ~70% (vs 62% in 9MFY12), which should increase to ~80-85% in FY13.

- GSL has finally got approval for Hannibal rum sales in CSDs (Canteen Stores Depot). GSL expects sales of 2 lakh cases for FY13, from this source, which could grow in subsequent years.

- Revenue from sales of spent grain, biocompost and power has increased significantly after the new capacities have gone on stream. "Other sales" now comprise ~12% of the company's revenue as compared to ~6% in the previous year.

- GSL plans to setup 65 KLPD plants for ENA at Behror (Rajasthan) and Samalkha (Haryana) in FY13 for which the company will borrow ~Rs. 10 cr. This would convert the Rectified spirit capacity of equal amount at both locations thus converting the entire facilities to ENA (vs ENA and RS currently).

Concerns:

- Government regulation is a major concern in the industry. In FY11 the Maharashtra government raised taxes on liquor sales, increasing prices significantly. While this currently has no effect on GSL's sales, the possibility of a domino effect in the other states is a concern. The increase in excise duty for franchise bottling in Haryana has had a direct negative impact on GSL as Jagatjit has suspended franchise bottling operations till the law is changed in the ensuing Budget.

- The liquor industry is very seasonal. Q3 is the best quarter while Q4 is traditionally a poor quarter due to depletion of stock due to the allocation of liquor sale licenses to retailers in the fresh fiscal year.

- "Other expenses" increased significantly in the quarter to Rs. 46.6 cr from Rs. 25.7 cr in Q3FY11, an 81.2% rise. Other expenses increased significantly in all 3 quarters due to added power and fuel costs during the stabilization period of the company's new plants. Stabilization is now complete at both the locations and these expenses could come back down in the coming quarters. "Other expenses" also increased as GSL wrote-off ~Rs. 0.5 cr worth of old inventory in Q3FY12.

- Country Liquor (CL) realization has fallen 6.7% in Q3FY12 over that in Q3FY11 because of a change in product mix / packaging mix. However, the 9MFY12 realization remains in line with that last year. GSL is seeking increase in selling price of Country liquor in Rajasthan, Delhi and Haryana and is confident of getting it effective Apr/May 2012.

- While IMFL sales are growing, they are not growing rapidly. IMFL realization fell in the quarter to Rs. 669.6/case from Rs. 1118.2/case in Q3FY12 and Rs. 804.2 in Q2FY12. This fall in realization is almost entirely attributable to a change in duty structure in new locations entered in Q2FY12 and product mix.

- GSL's capacities have risen from 288 lakh BL (bulk litres) to 700+ lakh BL from FY10 to FY12. So far the demand scenario for RS/ENA has been robust. In case there is a slowdown in offtake going forward, GSL could get hit due to higher fixed costs, which may not be fully recovered. Further the plan of GSL to get higher value add for its production by converting more of industrial alcohol into IMFL/Franchisee bottling/Country liquor has been progressing at a slow pace resulting in OPM getting hit and rerating of the stock getting postponed.

- Realization on exports is lower (~10% lower) than that of domestic sales. GSL exports ~2 lakh litres every month. OPM for a quarter could get impacted by the proportion of exports in total sales.

- GSL has suffered a setback in its OPM during 9MFY12 due to stabilization issues of expanded capacity at both the locations. This results in higher power and fuel costs due to frequent boiler shutdowns and restarts, low capacity utilization resulting in higher fixed costs, some quantity of lower quality production resulting in overall realizations getting impacted. While the Haryana expansion was stabilized in H1FY12, the Rajasthan expansion was stabilized only in Q3FY12. In case these issues recur, GSL could get impacted in terms of production and margins.

Conclusion:

GSL's business performance in Q3FY12 was slightly above expectations especially at the sales level. The drop in operating margin this quarter was due to a combination of reasons explained above.

Raw material prices are expected to remain steady in the foreseeable future and hence operating margins should remain firm or even grow as fuel and power expenses return to normal levels. Increased volumes post commissioning of new capacities could help push growth in top and bottom line

While volumes are growing, realization is falling largely due to a change in product mix and duty structure. The change in policy in Haryana is critical to the franchise bottling business of the company and further indication is expected in March.

GSL has good fundamentals and is a strong and sustainable player in the industry with good growth and a clean balance sheet. Positive triggers for GSL could be continued stabilization in expanded capacities, increase in realization aided by price revision in Country liquor, more value-add products, higher trajectory in IMFL sales aided by CSD registration etc

We have maintained our FY12 and FY13 estimates. At the CMP, GSL is trading at 5.7x FY12 (E) EPS of Rs. 21.1 and 4.5x FY13 (E) EPS of Rs. 26.7. However rerating of the stock could take time depending on GSL deriving higher proportion of sales from brand/value added sales.

Investors can buy/add the stock in the Rs.93.5-107 (3.5-4x FY13E EPS) band for sequential targets of Rs.120 and 134 (4.5-5x FY13E EPS) over the next 1-2 quarters.

Financials:

Annual Profit & Loss Account:

Particulars (Rs. Cr)	FY07	FY08	FY09	FY10	FY11	FY12 (E)	FY13 (E)
Net Sales	112.0	156.9	197.8	265.0	381.3	583.0	788.0
Other Income	0.5	2.8	2.7	3.3	5.9	7.0	7.0
Total Income	112.5	159.7	200.5	268.3	387.2	590.0	795.0
Operating Expense	97.0	135.2	171.8	228.3	322.1	503.8	682.8
% of sales	86.6%	86.1%	86.9%	86.1%	84.5%	86.4%	86.6%
Operating Profit	**15.5**	**24.5**	**28.6**	**40.0**	**65.2**	**86.2**	**112.2**
OPM %	13.4%	13.9%	13.1%	13.9%	15.5%	13.6%	13.4%
Interest	0.5	1.1	3.0	1.4	2.8	5.8	9.4
Depreciation	2.7	3.9	5.7	4.4	6.9	12.8	14.9
PBT	**12.3**	**19.5**	**20.0**	**34.2**	**55.4**	**67.6**	**87.9**
Exceptional Items	0.0	0.0	0.0	11.7	0.0	0.0	0.0
Net Tax	3.6	6.9	7.0	17.0	15.5	19.0	26.5
Effective Tax Rate %	29.3%	35.3%	35.1%	49.6%	27.9%	28.1%	30.1%
PAT	**8.7**	**12.6**	**12.9**	**28.9**	**39.9**	**48.6**	**61.4**
NPM %	7.7%	8.0%	6.5%	10.9%	10.5%	8.3%	7.8%
Normalized PAT	**8.7**	**12.6**	**12.9**	**17.3**	**39.9**	**48.6**	**61.4**
Normalized NPM %	7.7%	8.0%	6.5%	6.5%	10.5%	8.3%	7.8%
EPS (Normalized)	**11.3**	**10.3**	**10.6**	**8.7**	**17.4**	**21.1**	**26.7**
P/E	**10.7**	**11.6**	**11.4**	**13.7**	**6.9**	**5.7**	**4.5**

(Source: HDFC Sec, Company)

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