



Globus Spirits Limited

Q2 & H1 FY2017 Earnings conference call Transcript 11.00am IST on November 17, 2016

Moderator: Good day, ladies and gentlemen and welcome to the Globus Spirits Limited Earnings conference call. As a reminder, all participants' 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 the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Nishid Solanki from CDR India. Thank you and over to you, sir.

Nishid Solanki: Thank you. Good morning everyone and welcome to Q2 & H1 FY2017 Earnings conference call of Globus Spirits Limited. Today we have with us senior members of the management team including Mr. Ajay Kumar Swarup – Managing Director; Mr. Shekhar Swarup – Executive Director; Dr. Bhaskar Roy – Executive Director & COO and Mr. Ajay Goyal – CFO. We will begin the call with opening remarks from the management following which we will have an interactive question-and-answer session.

Before we begin, I would like to highlight that some statements made in today's conference call may be forward-looking in nature and a disclaimer to this effect has been included in the results presentation shared with you earlier. I would now like to invite Mr. Ajay Kumar Swarup to share his initial remarks. Thank you and over to you, sir.

Ajay Kumar Swarup: Thank you. Good morning everyone. We appreciate the time you have taken to join us today for our earnings conference call. I will begin by taking you through our business model and key corporate developments, while Dr. Bhaskar Roy, COO will brief you on the operational performance followed by Mr. Ajay Goyal, CFO who will share the financial highlights.

Globus Spirits is a 360° alcobev player present across all the segments of the spirits industry including Distillery, IMIL, IMFL and Franchise Bottling. As a result, we are able to straddle opportunities across segments thereby enabling us to capture value across the alcobev chain. We are the largest grain based distillers in India with a distillery capacity of 90 million bulk liters which will be expanded to a 150 million bulk liters by Q3 FY17. Over the years, we have built state-of-the-art



manufacturing facilities that operate at better than industry parameters with higher alcohol recovery, lower energy consumption due to greater heat integration, lower water consumption due to better recycling and higher profitability due to complete conversion of raw material into value added products.

We strive to convert as much of our extra neutral alcohol into branded IMIL thereby improving our overall margins. We have strongly established the consumer business in North India and our consumer facing IMIL brands currently contributes 56% to the total revenue. The ENA produced at our captive units gives us the assurance of product quality which allows us to capture market share and grow faster than the market. Meanwhile, we continue to sell bulk alcohol in the open market and to our franchise partners with an objective of fully utilizing our capacity.

Coming to the Greenfield operations in Bihar and West Bengal, we expect to start commercial production from Q3 FY17 and anticipate the facilities to start running at optimal utilizations within six to nine months thereafter. Overall capacity at Bihar would be ~26 million BL while the capacity in West Bengal will be ~33 million BL. As highlighted in the past, alcohol ban in Bihar will have limited impact on our performance as the alcohol manufactured here will be exported to the neighboring alcohol deficit states and countries. And West Bengal continues to be an alcohol deficit state with demand surpassing overall supplies which opens huge opportunities for us to introduce and market IMIL products.

Besides, we already have a tie-up with United Spirits Limited for producing their brands and expect most of the United Spirits brand which are produced for West Bengal market to be actually produced at our facility.

To conclude, in the near term we anticipate slowdown in demand owing to the liquidity crises faced by the end consumer due to demonetization of old currency notes. However, the longer-term outlook remains buoyant and we hope to deliver strong performance in FY18 on the back of contribution from our Greenfield facilities in Bihar and West Bengal.

With that, I request Dr. Roy to share the operational performance of the company.

Bhaskar Roy:

Thank you, Mr. Swarup. Good morning everyone and welcome once again on our call. I hope you had the chance to go through our result documents which we had shared earlier. I will briefly taking through the operational performance of the company.

Our performance during the quarter stood muted primarily due to significant increase in the raw material prices combined with seasonal impact in terms of slower seasonal demand. The performance was further impacted due to plant shutdown at the Samalkha facility in Haryana. While the increase in the raw material prices was steep and unexpected I believe this is a short-term dip and the grain prices are showing signs of cooling off. In addition, we have been able to partially pass on this price impact to our clients in the bulk alcohol segment.

During the quarter under review, growth in consumer business stood at 4% year-on-year, while the manufacturing revenues declined by 5% year-on-year. Contribution of consumer and manufacturing business came in at 56% and 44% respectively. In the current year, maintenance at the Samalkha facility was scheduled in Q1 and Q3, but due to sharp increase in the prices of raw material and slower demand, we undertook the shutdown in Q2, instead of Q3 which led to



lower bulk alcohol production. As a result, the bulk alcohol production in Q3 and Q4 should be higher than anticipated. Strong off take in Franchise IMFL and DDGS segment supported volume growth of 22% and 9% respectively.

IMIL volumes stood flat at 2.9 million cases during the quarter due to slower seasonal demand as well as zero IMIL revenues from Bihar vis-à-vis last year. However, we registered healthy volume growth of 36% and 16% in our IMIL markets in Haryana and Rajasthan respectively. I expect this positive momentum to continue through the rest of the year. Moving to others segment, our high potential DDGS reported volume and realization growth of 9% and 19% respectively.

I would now like to handover to Mr. Ajay Goyal for update on the financial performance of Globus Spirits.

Ajay Goyal:

Thank you, Dr. Roy. Good morning to all of you. I will take you through the key financial highlights for the quarter and half-year ended September 30, 2016. For Q2 FY2017, the revenue from operations stood at Rs. 1,619 million, EBITDA came in at Rs. 113 million and profit after tax stood at Rs. 0.3 million.

As highlighted earlier, the quarterly performance was impacted due to a combination of factors including increase in raw material prices, slower seasonal demand and plant shutdown at the Samalkha facility in Haryana. For the first half of fiscal year 2017, the revenue from operations stood at Rs. 3,581 million higher by 12% year-on-year basis. EBITDA improved by 5% to Rs. 306 million translating to EBITDA margin of 8.5%. Profit after tax came in at Rs. 64 million, an increase of 34% year-on-year.

Let me now share the product line-wise performance breakup. In Q2 FY17, we sold 2.9 million cases of IMIL with an average net realization of Rs. 316 per case. IMIL volumes declined by 2% year-on-year, while IMIL revenues increased by 5%.

In Franchise IMFL business, the aggregate volumes for this quarter was 0.70 million cases. Out of this, 0.35 million cases pertains to bottling done for ABD and USL in Rajasthan and the remaining 0.3 million cases were bottling done for USL in Haryana. Our bulk alcohol volumes stood at 6.8 million bulk liters compared to 9.9 million bulk liters in Q2 FY16. The total revenues from manufacturing stood at Rs. 909 million in the quarter, while the revenue from consumer business stood at Rs. 709 million.

This conclude my remarks on the financial highlights. I would now request the moderator to open the forum for questions. Thank you.

Moderator:

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

Abneesh Roy:

My question is more on this quarter and going ahead. So in terms of demonetization, what is the impact you see in terms of demand currently and when do you see it normalizing? Any proactive steps you have taken in terms gifting and all those? Is there a big impact because of demonetization and in terms of working capital also do you see things getting stretched?



Shekhar Swarup: So on the consumption side, demonetization has not had too much of an impact right now. Yes, there has been initial few days of concern but considering the fact that IMIL is quite a low priced product and I do not think our consumers are using the old high denomination notes to pay for our products. I am not sure about the extent of impact that this will have. When it comes to working capital, again there is limited impact of this on our working capital cycle as well.

Abneesh Roy: And when do you see the demand normalizing because people are short of cash and clearly they are spending more on the necessary items. So when do you see it normalizing and last 5 to 6 days how much would be the decline?

Shekhar Swarup: This is the time of year when the consumption is picking up. So in fact, if you look at the data, there is not a decline in consumption in the last few days. I feel that the high consumption period is yet to come and we will see that towards the end of November and possibly full December and January. So, the demand is scaling up as we speak in fact.

Abneesh Roy: When you say there is no decline, all other consumption or sale it is a big decline. So you are not seeing decline in the shops or in terms of your supply to distributors there is no change. What my question is more in terms of shops, what is the data you are getting? There I clearly see decline happening in rest of the other consumption?

Shekhar Swarup: Dr Roy, are you on the line?

Bhaskar Roy: Yes, I am on the line.

Shekhar Swarup: What information to answer Abneesh's question, what information do you have from shops when it comes to consumption decline?

Bhaskar Roy: Initially, there was one or two days problem but as the information is coming the people are buying and they are continuing to buy. In the country liquor segment because people generally give Rs. 100, Rs. 50, etc., so they are continuing. I have spoken to a few dealers yesterday also, they are saying that the supply is going on and they somehow anticipate that there will not be much problem. There was initially one or two days' of difficulties.

Abneesh Roy: My last question is now GST rules are getting more clear. So what is the initial expectation, how things stand and what is your current analysis on how much can be the negative impact because of GST?

Shekhar Swarup: See on our country liquor business, there would be some negative impact because our dry goods will attract GST whereas our finished product is exempt. So we will not get any set off. But on our manufacturing business, it is unclear whether ENA will be charged GST or not. Currently ENA is charged sales tax. But we should get most likely on the manufacturing part of the business to set off on inputs. Net-net Ajay I think we had done that exercise it was slightly positive for us.

Ajay Goyal: It is positive for us.

Shekhar Swarup: Assuming ENA, the GST is charged on ENA.

Abneesh Roy: Yes so, could you just explain for everyone's benefit. So suppose it is 18% you take one rate or you can take two rates. So how it is positive just take us through it?

Ajay Goyal: See there are various inputs at the moment against which we are unable to take any credit because ultimate product is tax exempt. So now, once we are importing chemicals there are double duties. They are paying the import duties and further they are paying the taxes. For all those taxes we are able to take the input credit for that in the new regime of GST.

Shekhar Swarup: All ENA assuming GST is charged on ENA.

Abneesh Roy: And if it is not charged then, what is the negative impact?

Ajay Goyal: Then we have to pass it on to the end customers.

Shekhar Swarup: Well, on ENA there will not be the worse of what we are today. Because already we are not getting set-off of import duties and other taxes on the sales tax.

Abneesh Roy: One follow up. Supposing you have to pass it on to the end consumers then what is the process and how much time it takes in any of these markets, are you able to take it on your own?

Shekhar Swarup: Let us talk about ENA and country liquor separately. ENA is a flexible price situation where we are free to control our prices. So, there it is a month-to-month rate discovery exercise that takes place. So costs can be adjusted over there. When it comes to IMIL or country liquor, there is as you are aware a price fixation that the government has. In the state of Rajasthan, historically speaking every couple of years we get a price increase which takes care of cost increases that took place in the last two years. Similarly Haryana. In the case of West Bengal, it is a free priced regime where the country liquor players can fix their own prices. We currently do not have any operations there but when we do we will be completely free to fix our own prices.

Abneesh Roy: So in Rajasthan and Haryana, you will have to wait for the Government approval, so do you expect it to take time because this is slightly extraordinary situation? Of course taxes keep rising.

Shekhar Swarup: In such situations, Government should take a favorable view of exceptional situations. Considering in Rajasthan, the Government too is a supplier of IMIL, they will be also paying GST on their packing material, they will be paying GST on extra neutral alcohol and rectified spirit as well when they procure it. So, certainly in Rajasthan we expect a favorable stand. Similarly in Haryana, the state Government rely on revenue from the IMIL business. So they should take a favorable view. Again it is very difficult for me to say how soon it will happen but we are expecting the price correction will be pretty quick.

Abneesh Roy: And till the hike does not come obviously you will have to absorb and the hike will not compensate for the prior period impact, right?

Shekhar Swarup: Yes, so Government would not give retrospective hikes yes.

Moderator: Thank you. The next question is from the line of Tushar Sarda from Athena Investment. Please go ahead.

Tushar Sarda: I wanted to know what is the increase in the raw material cost that you referred to and would this be a recurring feature every year and how does the raw material demand supply work for you?

Shekhar Swarup: So our main raw material is broken rice which we procure basically from rice mills. It is a waste produced at rice mills. Every year around Q2, the rice mills are closed because there is no crop available. So we are forced to purchase from stockists. Usually, there is a price increase, a cost increase during this period of the year, every year it happens. But the extent of increase that we saw this year was unprecedented.

Tushar Sarda: Can you quantify how much was the increase?

Shekhar Swarup: It was approximately 20% to 25%. The increase was approximately 20-25%.

Moderator: Thank you. The next question is from the line of Amit Thawani from Zenith Capital. Please go ahead.

Amit Thawani: My first question is on Bihar distillery. Can you tell us what went wrong exactly, what is the technical issue that we faced? Is it more related to bureaucracy and approvals or is it some execution issues on our part?

Shekhar Swarup: Not at all. This is not a bureaucracy related issue. We started this facility in early August and we started production as well. Subsequently, there was a planned shutdown after the start of production for a short period to set right certain things in the process. During this period, we had heavy rains and heavy floods and therefore we could not address the issue. The flooding continued for a long period of time and the work that we had to get fixed could not get fixed. And therefore, the delay. Suffice to say that Bihar facility is under commissioning. It usually takes 15 days for restart process. We are in final stages of that now. So very soon we should get some good news from there.

Amit Thawani: And can you update us on West Bengal as well?

Shekhar Swarup: West Bengal bottling facility has started. We are bottling for United Spirits over there. Most of their brands will be bottled at our facility. We have completed the work at the distillery, we are in the commissioning process right now. There we are awaiting one final clearance from the Government which is the excise license. The excise license is on its final stage and we are hopeful of getting it very soon.

Amit Thawani: So can we expect the March quarter to have both distilleries operating at full capacities?

Shekhar Swarup: Yes, that is what our internal target is certainly.

Amit Thawani: My second question is on the GST, it just increases the incentive for people like United Spirits to manufacture inhouse, right ENA because if they manufacture in house then there is no GST because they are selling only the end product which is liquor.

Shekhar Swarup: That is a very good analysis. Either manufacture inhouse or engage with franchise players such as ourselves.

Amit Thawani: Correct. I had a meeting with a senior tax official and he was of the opinion that there will be an inhouse manufacturing tax as well like there will be some kind of a transfer pricing where they will be levy even on that. What are your thoughts on that?

Shekhar Swarup: At the moment it is all conjecture. The activity of bottling and manufacturing ENA are not two separate activities. There have been many cases that have been judged in various Courts of India which have all said that manufacturing of IMFL is one activity. And you cannot separate ENA and IMFL as two separate activities. So this has been tried in Courts before. Be that as it may, I do not know what is going to finally come out on ENA in GST it might as well happen that ENA is exempt, it might happen that ENA will not be exempt. So this is the discussion that we should have once there is clarity on whether ENA will be charged or not.

Amit Thawani: What is the latest update on raw material price as of today post the September quarter?

Shekhar Swarup: So raw material price is down. In fact, most of the increase that had happened in Q2 has already been corrected. We are hopeful for further correction as we go forward.

Amit Thawani: But this demonetization, has that impacted raw material, I understand that goods are not been able to be transported because of lack of currency and we are seeing certain holding in certain commodities?

Shekhar Swarup: See the demonetization according to me has not affected our business at all in anyway either positively or negatively. There is no problem in raw material, there has been no impact on raw material, there has been no impact on transportation of products.

Moderator: Thank you. The next question is from the line of Tushar Sarda from Athena Investments. Please go ahead.

Tushar Sarda: Sorry, I got disconnected. I was asking you about the quantification of the raw material prices?

Shekhar Swarup: So raw material price increase is to the extent of about 20% to 25%.

Tushar Sarda: So can you tell me per kg what was the cost and what is it gone to?

Shekhar Swarup: Per kg cost was around Rs. 1,600 per quintal and that went up to around about Rs. 2,000 per quintal.

Tushar Sarda: And next year, what is the outlook, this depends on what, on the normal rice or the basmati rice which broken rice you use?

Shekhar Swarup: We use whatever is rejected for food consumption. We do not use the broken rice which is used for food. We use food rejects. We buy basically through rice mills but during lean seasons when there is no crop and the rice mills are closed, we have to buy this from stockists. This last quarter, we saw a huge increase in prices been

quoted by stockists. Increases happen every year but this year the increase was unprecedented. It is difficult for me to say whether the same 20% to 25% increase will happen next year or not. That we will have to wait and see. The good news is that the levels of rice have come down to what our expectation was in Q3 already.

Tushar Sarda: So this happens every year? You stock it in summer months or you are going to have that policy?

Shekhar Swarup: Till now we have not been stocking much we believe on a quick rotation of cash and raw material and finished goods. But perhaps for next year, our policy might change I am not able to comment on that right now.

Tushar Sarda: Okay my other question is you said that Bihar distillery will be used for manufacturing goods for United Spirits for the West Bengal market, right?

Shekhar Swarup: No, that is not what we said. The Bihar distillery will be used to make ENA and then ENA will be sold in the neighboring deficit states. West Bengal distillery will be used for IMIL brands of Globus Spirits and IMFL brands of USL for sale within West Bengal.

Moderator: Thank you. The next question is from the line of Vikram Kotak from Crest Capital. Please go ahead.

Vikram Kotak: Just want to understand this IMFL marketing subsidiary – ‘Unibev’. Can you spend some time on that and what kind of investments and how it is going to operate in terms of business plans, strategy?

Shekhar Swarup: Yes sure. Vikram, that is a very interesting question and I feel that the opportunity in IMFL is something which all alcohol players in India should be looking at especially from a futuristic standpoint. As of now, our subsidiary ‘Unibev’ is on a research and development mode. Investments that have gone in to ‘Unibev’ are very small and limited. The idea is to put together a business plan along with some brands for taking to market in the future. Like I said, it is a futuristic play for Globus Spirits. Right now, our focus is to really dig in our heels and operate our new units well. Of course without taking the eye of the ball on our older units. More updates on ‘Unibev’ will come gradually as the team there is able to put together business plans.

Vikram Kotak: And what kind of money you are going to spend in the next two years or three years on this business?

Shekhar Swarup: Like I said Vikram, it is as of now I do not have any forecast. Suffice to say there is not in the current financial year there is not much more investment that is expected in Unibev. Towards the end of this year or may be some time next year, we will have some business plans to share.

Moderator: Thank you. The next question is from the line of Rangan Venky from Brilliant Securities. Please go ahead.

Rangan Venky: I can see that your cost of raw material pegged to 60%. You have put the consolidated balance sheet for the half year and quarter, correct?

Shekhar Swarup: I am sorry your question was not clear, could you please repeat your question?



Rangan Venky: You have put the results for the consolidated unaudited results for the quarter and six months ended, correct?

Shekhar Swarup: Yes correct.

Rangan Venky: The question is that there is an increase from Rs. 449 crore to Rs. 516 crore on a half year basis, so there is a marginal increase in the profit before operation and other finance income. So we are in a risky phase or something like that, I would like to know that? Then what about the expansion, anything there currently? Now, as I can see the other expenses in the power and fuel constitute more than Rs. 55 crore. Now, we are in an expansion mode or we are trying to reduce? One way the company can reduce the expenses or one way do not bother about the expenses which keeps on increasing the topline? Now it should be done simultaneously, that way it is always better.

Now what is the DDGS which is a very futuristic product, what is that and how is that going? The other thing about United Spirits, you are doing bottling for them, but there are so many companies I find they are doing business for the other companies like CRAMS or something like that, they will end up in loss because they have some many terms and conditions after the contract.

Shekhar Swarup: Thank you for your questions. I will attempt to answer all of them. The performance in Q2 has been affected due to a sharp increase in raw material prices. This raw material price increase happens every year in this period. However, in this year it was very high increase which was not expected. This is a temporary phenomena and already in Q3 we have seen an improvement and in fact grain rates are as per our targets in Q3. The company is in expansion mode, the company's business is based on setting up distilleries manufacturing ENAs, converting ENAs to as much as we can to IMIL and then the balance that is available, we convert it into IMFL for other brands such as USL and other players or sell it in bulk.

Our business with USL is in the states of Rajasthan, Haryana and now in West Bengal. Our terms with them are set every year, are set in the beginning of the year and they are favorable to the company. Our main business to them remain supply of extra neutral alcohol which is manufactured by us. The bottling piece is a value added service we perform to get visibility on ENA off take for the year. There are no such hidden costs or pressures that USL or other companies put on us. DDGS is a by-product of Globus Spirits. The waste product after manufacturing alcohol has high protein ingredient, also has high water. We are able to with our processes remove the water in an energy efficient way and concentrate the proteins. These proteins are used for animal feed and compete with soya de oiled cake in the market.

Rangan Venky: What will be the topline for the next three years. I asked about the power and fuel because company should also concentrate on the expenses and the raw material expenses like the power and fuel cost. Now there also you can make some capital addition like backward integration to keep on reducing the cost and until you have to work out that and it will be better?

Shekhar Swarup: So if you permit I think I will be very happy to explain to you our numbers and our plans. But I think it will take some time. If you permit, I will request our IR team to get in touch with you and schedule a meeting.

Rangan Venky: Yes sir, I will mail them.



Moderator: Thank you. The next question is a follow up from the line of Rangan Venky from Brilliant Securities. Please go ahead.

Rangan Venky: Any other further capital investment will be there?

Shekhar Swarup: Our new units in East India are not yet capitalized. When they are fully operational, then they will be capitalized, so there will be an increase at that stage.

Rangan Venky: How much will be there over the next one or two years, and what is the paid-up capital whether there will be any increase?

Shekhar Swarup: No, there will be no further increase that is planned after the projects are fully capitalized.

Rangan Venky: The paid-up capital, there will not be any increase from now onwards?

Shekhar Swarup: There is no plan for that as of now.

Moderator Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for closing comments.

Shekhar Swarup: Thank you all for taking time out to attend our call. I hope all the questions have been answered. In case you have any further questions, please do reach out to our Investor Relations team. Their contacts are available in the invite that we sent and also on our website. Thank you again and have a good day.

Moderator: Thank you. On behalf of Globus Spirits Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.

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