



Q2FY14 Results Earnings Conference Call

November 13, 2013; 16 Hours IST



MAIN SPEAKERS:

MR. AJAY KUMAR SWARUP, MD

MR. SHEKHAR SWARUP, EXECUTIVE DIRECTOR

**DR. BHASKAR ROY, EXECUTIVE DIRECTOR &
CFO**



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Moderator

Ladies and gentlemen, good day and welcome to Globus Spirits' Q2 FY14 Earnings Conference Call, hosted by IDFC Securities. As a reminder for the duration of this conference, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Ms. Swati Nangalia from IDFC Securities. Thank you and over you, Swati.

Swati Nangalia

Thanks, Moshin. It's a pleasure to welcome you all to the Q2 FY14 Earnings Conference of Globus Spirits. We have with us the senior management of Globus Spirits represented by Mr. Ajay Kumar Swarup, Managing Director; Mr. Shekhar Swarup, Executive Director; and Dr. Bhaskar Roy, Executive Director & CFO. I will hand over the call to Ajay for the opening remarks and to give us an outlook on the business, post which we can move on to the Q&A. Over to you, Ajay.

Ajay Kumar Swarup

Thank you. I will start by giving an overview of the business, following which Dr. Roy, our CFO, will brief you on the financial results. We are pleased to share that we have delivered steady growth in our top-line, a testament to the strength of our unique 360 degree model straddling across all segments of the value chain in the spirit's business.

The quarter gone by was a challenging one as our key Haryana IMIL market continued its decline in volumes dragging the revenues from consumer business down. However, our manufacturing businesses, namely bulk alcohol sales and franchise bottling, buoyed by expanded capacity leading to increased production, demonstrated robust growth for yet another quarter, driving an overall positive growth in revenues.

Bulk alcohol manufacturing has been the cornerstone of this quarter's performance. We improved our grain recoveries through R&D initiatives and by operating our new capacities at higher level leading to significant increase in production. Further, given our high quality focus, exports are a large and important future market for us. There has been good traction in exports this quarter with alcohol produced by us being exported to parts of Africa and Asia, contributing significantly to bulk alcohol growth performance.

In bottling, we continue our relationships with India's top 3 IMFL brand owners. In fact, we are in the process of scaling up our bottling contract with United Spirits in Haryana and ABD in Rajasthan. This will not only boost the respective state's revenues but increase utilizations leading to better profit from this vertical.



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In our core consumer business of IMIL, we are happy to report that we have maintained our leadership in Rajasthan with a steady market share of 24% and we remain the largest private player in the state. In Haryana as well, regardless of the overall market volume declining quarter-after-quarter, we retain our second position.

Our IMFL business is now focused on three core brands and sales have been maintained above 30,000 cases this quarter as well. We did the first shipment of CSD sales of Hannibal Rum this quarter.

Another positive has been that the net realizations across all our segments have moved upwards. Currently the industry is in interesting times with consumer preferences shifting towards higher quality and premium products. In this churn, while some markets and lower end products are witnessing volume slowdown, the overall impact on the industry will be positive in terms of profitability. Globus too is aiming to participate in this shift in the IMFL business towards premium products and we have been planning future, new products in the premium segments of the business.

Our revenue mix has undergone a significant shift towards downstream manufacturing activity. Hence, there is a downward impact on margin. However, we perceive the worst to be over. In Haryana we are hopeful of scaling up our franchise bottling contracts that will drive revenues and profit from the state in second half of the year. We also expect exports and CSD sales to gain further traction. Our Rajasthan market is expected to continue its steady performance. These should tide us till we enter the next phase of growth and our Bihar project gets commissioned.

The work on the Bihar project is progressing well on schedule and we are hopeful that revenues from the project will be coming in FY16 onward. Additionally, we are procuring land in West Bengal, which will act as our second manufacturing base and provide thrust to our plans of establishing a strong hub in the fast growing eastern India market.

This quarter, in an initiative to take our corporate governance to the next level, we have appointed one of the big audit firms as our statutory auditor.

In summation, I would like to say once again that we have a very proven unique and successful business model that has shown resilience against temporary industry headwinds and delivered positive revenue growth and profits quarter-after-quarter. We feel that from here things are only going to improve in the near term and our East India expansion will act as a catalyst for the next growth phase.



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I would now like to hand over to Dr. Roy for the overview on our financial performance. Thank you.

Dr. Bhaskar Roy

Good afternoon, everybody. I will share our financial highlights after which we will open the floor for questions. For Q2 FY14, total operating income was Rs. 1,211 million, an increase of 7.4% year-to-year. The EBITDA was Rs. 94 million and PAT was at Rs. 12 million. EBITDA margin for the quarter was 7.7%. The EBITDA was impacted due to significant change in our revenue mix as share of our lower value bulk alcohol revenues went up to 38% in the quarter as compared to only 21% in the same period last year.

This quarter our production went up 34% year-to-year as our utilizations improved significantly from 60% in Q2 FY13 to 76% in Q2 FY14. Our export revenues were Rs. 38 million compared to nil in Q2 FY13.

For half year ended September 2013, our revenues increased 5.5% year-to-year to reach Rs. 2,512 million with EBITDA at Rs. 292 million and PAT at Rs. 104 million. EBITDA margin was 11.6% and PAT margin was 4.1%. We maintain a healthy balance sheet. Our total debt has declined to Rs. 665 million and our debt equity at 0.19x times remains one of the best in the industry. Our cash position as of 30th September 2013 is Rs. 99 million.

I will now share the segment wise details. This quarter we sold 1.8 million cases of IMIL with average net realization of Rs. 289 per case, an increase of 10% year-to-year in realization. In IMFL we sold 31,000 cases with 19% year-to-year increase in average net realization. The combined net sales from these two consumer businesses was Rs. 545 million from this quarter.

The franchise business, IMFL, the aggregate volume for the quarter was 4,24,000 cases, an increase of 2% year-to-year by volumes. Our bottling fee per case was also increased 2% year-to-year. Our bulk alcohol sales increased 83% year-to-year to reach 10 million Bulk Litres (BL), with 7% year-to-year increase in realization. The total revenues from manufacturing were Rs. 666 million this quarter, an increase of 58% year-to-year. Our bulk alcohol sales compensated for a decline in consumer volumes to deliver positive top line growth. This concludes my update. 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 will now begin the question and answer session. First question is from the line of Pooja Lath from Edelweiss. Please go ahead.



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Abneesh Roy

Yeah, this is Abneesh Roy. First, thanks for the opportunity. Sir, my first question is, if you could talk about your deal with United Spirits, how things are changing post the new management has taken over?

Dr. Bhaskar Roy

Sure. United Spirits' change in management has not affected our relationship with them so far. However, we have been able to gain from a consolidation in manufacturing. As Mr. Swarup earlier said that our bottling contract with USL in Haryana has grown and we should expect 25 to 30% volume growth coming from there. Besides that there has been no change as such in the relationship.

Abneesh Roy

Sir, now if you see, we have the MNCs dominating a bulk of the market share. So how you are seeing movement in terms of pricing, in terms of systems, in terms of distribution and this will be a bit early days but your own thoughts on that?

Shekhar Swarup

Yeah, Abneesh, it's a very valid question and we have discussions about the same thing internally as well. But like you said, these are early days and it's difficult to see what change will sort of happen in the market but certainly we welcome the change that these MNCs are going to make and create more systematic way of dealing in the market. We are also expecting as others are that these companies will continue to focus on premiumization and increase average realizations for the entire industry.

Abneesh Roy

Sir, if you see currently there is a slowdown in most of segments, sentiments are down and if you see one recent study which came out points towards just 4% CAGR in terms of sales for the next few years. How you are seeing the liquor industry from a two-year, three-year timeframe in terms of volume growth and maybe even the pricing growth?

Shekhar Swarup

Right. There are two aspects to the growth in the liquor industry. One is, of course, the organic growth in the consumption that you spoke about which has been a bit low over the last few quarters. The other aspect is the growth of alcohol going into fuel ethanol. That has been the much talked about subject over the last few months, in fact the last few years. And this year we saw for the first time significant lifting taken place by all the oil companies. The second tends to receive good response and that will of course create a fair amount of buoyancy in the alcohol industry. So these two factors will sort of balance each other going forward, and you know consumption will sort of lag behind in growth. However, the growth that's coming from fuel would certainly more than offset the shortage of growth in consumption.

Abneesh Roy

Sir, I could not get the second point. Oil companies, if you see, are now mixing more of ENA at least. That's the drive from government. So on the raw material side if you see, there is a huge pressure in the last few months because of that. So how you are

seeing that impact raw materials pricing in the second half and if you could just elaborate what you said. I couldn't get the second point.

Shekhar Swarup

Well, essentially, the oil companies require about 1.3 billion litres per year of which typically we have seen 58 to 60% supply as there is a shortage in production of alcohol in India. And in any situation when there is a shortage of commodity, it does sort of drive up the price of the commodity. So that's one effect it will have on the raw material side. However, for us it's a finished product as well. So that's what I indicated in my response.

Abneesh Roy

And sir, raw material scenario for your IMFL business and industry, is it getting even worse in second half?

Shekhar Swarup

Well, for IMFL business, the raw material, which is largely ENA is something which we have captive production of and we have assured supply of that at the best possible rates. But as far as glass costs are concerned, these have been flattish and in fact have been coming off over the last few months. I think for IMFL our cost remains steady for the next few quarters.

Abneesh Roy

Right, sir. That's all from my side. Thanks for this.

Moderator

Thank you. Participants who wish to ask a question may pressing '*' and then '1' on your touchtone phone. The next question is from the line of Varun Lohchab from CIMB. Please go ahead.

Varun Lohchab

Hi, sir, thanks for taking my question. So first question was on the consumer businesses. Now, both IMIL and IMFL have seen pretty subdued growth. So if you could talk about what are the steps being taken to address growth in both of them and specifically why IMFL has not been able to scale up over the last couple of years. So if you could just throw some light on that.

Shekhar Swarup

Sure. Within IMIL we have three markets: Rajasthan, Haryana and New Delhi. Rajasthan business of IMIL has been growing steadily. We have maintained a market share of about 24% over there, which is in line with our track record. And we are hopeful that this will grow by a few percent points in the quarters and years to come. When it comes to Haryana, the market over there has de-grown a bit. This is perhaps due to pricing of adjacent states. It is perhaps due to a slowdown in consumption, the exact reasons for that are unclear. But there has been a decrease in consumption. In addition to that, there has been an increase in competition. This year, we saw two new distilleries being set up in the state. And in order to capture market share, these distilleries did aggressive, sort of, discounting of their products and caused a bit of a problem for all of us in the market.



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At Globus Spirits, we take discounting our products very seriously, especially in the IMIL business. And in spite of not giving the levels of discounts that have been passed out in the market, we were able to maintain our number two position in the state. That is, sort of, an indication of the strength of Nimboo and other brands in the region.

Going forward in Haryana, we feel that the worst is over and the quarters to come will only see some sort of growth, exact numbers on that of course are yet to be seen. When we talk about IMFL, we have, as you have rightly pointed out, had a few quarters of de-growth in our volumes. But this has been largely due to a revamp of our product mix to focus on higher value price points. In fact, if you notice our average realisations quarter-on-quarter for the last, I think, about three or four quarters, we have been steadily increasing our average realisations, in fact in both IMIL and IMFL.

Varun Lohcab

Sir, which brand in IMFL are you betting on to get the volumes and say on a two-three-year timeframe what is the sort of volumes you could achieve in IMFL?

Shekhar Swarup

So like I mentioned, we are focusing on a higher realisation and on our core brands. We are aggressively pushing our brands in North India as well as in CSD in paramilitary. Hannibal Rum started supplies to CSD in this current quarter, which is a big achievement for us. And that will continue to grow in the next few quarters. In addition to that, we have also started supplies to paramilitary, which offers better realisations for our brands. So from North as well as from CSD in paramilitary we will see a good growth in the segments. However, this does not apply to any new additions we do to this portfolio. As I have maintained in the past, we are interested in putting products in niche segments in the IMFL market, which could be along with international tie-ups or independently. We continue to work on that as well. When it comes to volumes, these markets have high contribution and low volume. And therefore, it must be viewed in that manner.

Varun Lohcab

But internally, like any number that you are targeting, say by FY15-16 in terms of IMFL volumes?

Shekhar Swarup

These numbers are very difficult to sort of accurately forecast. As another gentleman mentioned on the conference earlier, there might be certain changes taking place in the marketplace due to acquisitions and other transactions that have taken place in our industry. Therefore, it will be difficult for me to comment on volume targets.

Varun Lohcab

But can we expect, like, growth in volumes in both IMIL and IMFL going forward?



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Shekhar Swarup

Certainly. The consumer business is our core business. Our strategy of 360 degrees is focused on growth in consumer verticals and this is something that we remain actively pursuing IMFL growth and as well as in consolidating our strength in the IMIL space.

Varun Lohcab

Okay. And sir, the bottling arrangement, what is the typical tenure of that and do you have to keep renewing the contracts?

Shekhar Swarup

Well, as you are aware, in the alcohol business, brands and distilleries are on an annual, sort of, registration with the Excise Department. And bottling contracts typically tend to follow that structure. However, over the last few years, we haven't seen a situation where a bottling contract, sort of, culminates after 12 months and it is not renewed. So these are the things, which are sort of long term, but contracts of one-year, because of the way the excise departments are structured.

Varun Lohcab

Okay. And sir, second question was related to the Bihar Greenfield expansion. What is the progress out there in terms of say land acquisition, equipment ordering and all has that been already or where are we in that process?

Shekhar Swarup

Work is on. We all have made a significant headway in ordering key equipments. We hope that orders will be released as soon as the entire land parcel is with us. A large part of the land has been acquired. Few pockets are still remaining. And we continue to work on that. Like, it was said earlier, we are hopeful that business will start in FY16 for that.

Varun Lohcab

Okay. You don't see any reasons for significant delays out there?

Shekhar Swarup

No, things are on track as of now.

Varun Lohcab

Okay, perfect. That is it from my side. Thanks and all the best, sir.

Shekhar Swarup

Thank you.

Moderator

Thank you. A reminder to all the participants, you may press '*' and '1' for asking a question. The next question is from the line of Harit Kapoor from IDFC. Please go ahead.

Harit Kapoor

Yeah, hi, sir, I just had a few questions on IMFL. Just wanted to understand, is the fact that we have discontinued the cheaper brands now in the base or are we going to see continued volume decline even in the quarters to come?



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Shekhar Swarup

The cheap brands have been discontinued. There is very little business of that, which remains. And in future we should only see growth in IMFL volumes.

Harit Kapoor

Sure. With the larger spirit companies now focusing more on the premium segment, is there a case where there is a lack of focus on the lower end and mass brands, and hence, is there an opportunity there that we see or we think that just the market is moving premium and mass is not an opportunity anymore?

Shekhar Swarup

The mass market, which we often refer to as sub-premium typically constitutes of 50% to 60% of the volumes in IMFL all India and in certain states even more. By no means are these companies not focusing on the regular and the mass segments. Their strategy is clearly to increase sales from higher value product. But yes, I do believe that in the next few quarters, there will be opportunities for company such as ours, which have in-house manufacturing and therefore lower cost to be able to take advantage of some of this change in mindset and establish products of our own.

Harit Kapoor

So given this scenario, is there a pipeline that you are looking at in terms of a new branch launch across spirit or the focus over the next 12 to 18 months will only be on the three core brands?

Shekhar Swarup

I don't believe that new brand launches are necessary. We have realigned our portfolio to be positioned for such opportunities. Like I said, the value add is going to be in geographies where we have captive manufacturing. In states where we don't have captive manufacturing and some of these other companies, in those states our cost cards would look fairly similar. And therefore, in our states where we have manufacturing facilities, we are poised extremely well to take advantage of potential upsides due to change in market structure.

Harit Kapoor

Okay. In the IMIL space, is there a case of the market structurally de-growing or do you see potential in IMILs for the next two, three years in terms of volume growth?

Shekhar Swarup

Actually, whatever, the de-growth will typically happen in the state of Haryana. And it is changing now. Hopefully, things will improve from here because it is already on the bottom thing. But if you see the other states, there is no de-growth. It is increasing slightly from the previous figures.

Harit Kapoor

I understand because even Rajasthan the volume growth is minimal. And that is the state where we have about 60% of our IMIL business. So I am just trying to understand, you know, your growth from the markets that you are present in, do you think that if not a de-growth there is a case for a much lower quantum of volume growth in IMIL over the next two or three years or probably over the long term as people actually structurally move up, are you seeing that happening now?

Shekhar Swarup

Right. In IMIL, we typically classify the geographies into two segments. One is what we consider mature markets and the other is what we consider, sort of, nascent markets. India has, you know, the states of Punjab, Rajasthan, Haryana, UP, Maharashtra, to name a few, are some of the mature markets in the IMIL segment. Here, the growth is typically in line with the consumption patterns of the state. What has happened over the last few quarters in Haryana is a sort of a decline in volumes which is attributed to consumption as well as to certain extraneous factors of, for example, cross-border trading of alcohol which has come off.

If we look at the second type of market which is the nascent IMIL market, here there is a significant growth in IMIL. In fact, in Bihar we are looking at approximately 25% growth year-on-year over the last few years in IMIL. We also believe that this growth is being stunted due to a lack of supply of IMIL into the market. Similar numbers are coming out of West Bengal and Jharkhand. It is very crucial for our organisation in our plants to establish a presence in those states, as there is significant opportunity to make EBITDA in the IMIL segment in the country.

The IMIL segment of the country is approximately 260 million cases that is growing at 6% to 8% per annum. And like I mentioned, some states of that are growing at 20 plus percent and the others are growing at 3% to 5% levels.

Harit Kapoor

Right, fair enough. The next question, I just wanted to understand what are the margins in the bulk Spirits space because a large reason for the fact that your EBITDA margins have come off is a high proportion of bulk Spirits. So typically, in this segment what are the kind of operating margins that we are at?

Shekhar Swarup

Right, the margins – I would like, Dr. Roy, speak a little bit more about the margins, but I would just like to say something before that. The margins in this are governed by the price of rice in the state as well as the price of ENA in the state. And sometimes, we have seen that these do not move in line especially because of the current supply position in Haryana. But Dr. Roy, what are the operating margins that we operate?

Dr. Bhaskar Roy

Actually, in the bulk segment there are two key things as was mentioned. One is the cost of the raw materials and, second is the the selling price. But the selling price also varies based on the market in which you propose to sell, domestic/ international. Since we have large capacities and we would like to operate these at high utilization levels, we are operating in both markets. Realisations within the state, i.e., in our domestic markets, are higher. But when we are exporting outside India, we have to compete at the international levels. There we have to match prices with the international markets and standards. So, here the realisations are not in line with

domestic realisations. While the overall margin in the states we operate, say, is around 10-11%, this falls to around 6-8% if you are export out of the state to other states or international markets.

Harit Kapoor

Okay. Got it. Have you seen impact on profitability for the other segments also because I would understand that IMIL and IMFL because of realisations would have had better margins, right?

Dr. Bhaskar Roy

The question is that the volume also has fallen down. Now, IMIL volume in Haryana has fallen down. And overall, volume if you see has fallen down. Our EBITDA's main portion is coming from IMIL. Hence, overall EBITDA margin has come down.

Shekhar Swarup

However, the margins have remained pretty steady in IMFL and IMIL segments. In IMFL, we have seen an increase in profitability.

Harit Kapoor

Got it. And lastly, if you could just explain the 6-crore depreciation charge, you said there is some shift?

Dr. Bhaskar Roy

Actually, we were charging depreciation on a shift basis and on straight line method, wherein the rate was 4.75%. But it has now been pointed out that we should charge on a continuous basis plan, as some portion of the distillery is being operated on a continuous basis. This rate is 5.28%. That is why for the current year, there is an increase in depreciation rate. And for the earlier years also, we have provided at the new rate.

Harit Kapoor

So this is, okay, with retrospective effect?

Dr. Bhaskar Roy

Retrospective effect, that is right.

Harit Kapoor

Yeah, got it. Okay, that is from me, sir. Thanks and all the best.

Moderator

Thank you. Participants who wish to ask a question may press '*' and '1' on their touchtone phone. The next question is from the line of Amit Dholakia from Value Invest. Please, go ahead.

Amit Dholakia

Thank you, sir. Sir, my question is regarding Maharashtra. You recently entered into Maharashtra. So just wanted to check what our IMIL sales were in Maharashtra in Q2 and H1?

Shekhar Swarup

We have not entered Maharashtra yet. We have not started operation. We were planning to start this year, but it was delayed and we are in the process of approvals,



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et cetera. So nothing is in the top line or the bottom line, nothing is included. Maharashtra sale is not included.

Amit Dholakia

So when are we planning to start our operation in Maharashtra?

Shekhar Swarup

We are examining a start-up in the next financial year.

Amit Dholakia

Okay. Can you please throw some light on the Maharashtra market? Realization will be better or lesser than the current margin?

Shekhar Swarup

Maharashtra market opportunity is a unique opportunity for us. By and large in India only the distillers in a state supply country liquor in that state. We have been able to create a mechanism in Maharashtra whereby we do not need to set up a distillery. And similar to how the IMFL players sub-contract their manufacturing, we will enter into similar structure and market our brands there. When it comes to the profitability of the sale, it would be lower than what we have in our states. But the entry cost is limited. It is a very good way for us to explore a new territory before making large investments in the state. That is what the purpose of the Maharashtra entry was. The impact on profitability and the impact on top line will be limited as it is a contracted operation to begin with.

Amit Dholakia

Okay, great. And sir, if we are looking to our H1 numbers, the growth has come mainly along with the bulk we have seen the export growth. So can you throw some idea on the exports and which countries we are exporting and what are the margins we are having in the export market?

Shekhar Swarup

The margins in exports are, sort of, linked a little bit to the rupee value as well as to, of course, the cost of ENA in the country. The margins in exports are possibly little less than what the margins are in bulk in India. We have been supplying ENA to various parts of Africa as well as to Asia. And we are hopeful that this business will continue into the next few quarters.

Amit Dholakia

Okay. So any further growth expected in the next quarter?

Shekhar Swarup

We are hopeful that the performance of the last quarter will continue for the other quarters of this year.

Amit Dholakia

Okay. And just a last question, sir. Regarding your bulk business, I just want to check the reason behind the improved margin from bulk business?

Shekhar Swarup

The improvement in bulk margins has been largely due to an increase in efficiency at our plants. We have seen an increase in raw material cost and a proportionate



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increase in realisations. So therefore, the increase in profitability has been due to improvement of efficiencies.

Amit Dholakia

Okay. Thanks and that's it from my side.

Moderator

Thank you. As there are no further questions, I would now hand the floor back to Swati Nangali. Over to you.

Swati Nangalia

Thanks, Moshin. I would like to thank the management of Globus Spirits for removing time for this call. Also, thanks to all the participants for joining in today. Shekhar, would you like to make any closing comments?

Shekhar Swarup

Thank you everybody for joining our Q2FY14 Earnings Conference Call. I look forward to speaking to you again soon.

Moderator

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