SOM Distilleries & Breweries Ltd.

Earnings Conference Call Transcript

Q4 and Full Year FY2019

Management:

Mr. Deepak Arora - CEO

Mr. Nakul Sethi – Director, Finance & Strategy

Moderator: Ladies and Gentlemen, Good day and welcome to the SOM Distilleries & Breweries Q4 and Full Year FY2019 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Please note that this conference is being recorded. Joining us on this call today are Mr. Deepak Arora – CEO and Mr. Nakul Sethi – Director, Finance & Strategy.

Before we begin, I would like to mention that some of the statements made in today's call maybe forward looking in nature and may involve risks and uncertainties for a list of such considerations please refer to the earnings presentation. I would now like to hand the conference over to Mr. Deepak Arora for initial comments and then we will start with an interactive question and answer session. Over to you, sir.

Deepak Arora: Good afternoon everyone. I would like to personally welcome all of you to the SOM Distilleries & Breweries Limited Q4 and Full Year FY2019 Earnings Call. In today's call I would like to first discuss the performance highlights, industry environment and the outlook for the company going forward, then I will hand over the call to Mr. Nakul Sethi – our Director, Finance & Strategy, for the detailed discussions on the quarterly performance post which we will open up the call for an interactive Q&A.

I would like to start with the key highlights of FY2019:

During the period we generated Beer volumes of 75.9 lakhs cases which is an increase of 1.2% compared to the same period last year. Our IMFL volumes increased by 29.8% versus FY2018 to 9.7 lakh cases. Our total income for the period increased by 12.5% to Rs. 3,967 million compared to FY2019. EBITDA during the year was Rs. 528 million with the margin of 13.3%. I would like to stress here that our margins for the year were primarily impacted due to higher proportions of usage of new glass bottles as well as a hike in Barley prices of approximately 20% over last year.

In the month of March, we commenced our Orissa facility for commercial production. The consolidated financials for the year only included 10 days performance of the Orissa facility which accounted for a revenue of approximately Rs. 10 million. The initial response as we are catering through this facility have been very encouraging and good and we see that there will be a significant improvement in utilization levels of this facility in FY2020. During the year our Karnataka facility turned profitable in the second half of the fiscal year resulting in lowering of annual losses at the PAT level to Rs. 2.9 million for FY2019. The facility is already cash flow positive. We are also in the process of doubling our Beer bottling capacity at the Bhopal units and trial runs of the same are in progress and are in finality. We have deployed one of the most modern and the fastest technologies prevalent for this expansion. A total investment of Rs. 1,140 million has been incurred on this expansion. We plan to add equivalent brewing capacity in the Bhopal plant over the coming months. The investment would be done in a phase manner for the Bhopal plant for brewing through the utilization of our cash flows of the company. We expect these investments to further contribute to the company profitability in FY2020 by better catering to peak load demands during Q1.

During the year the industry faced a couple of challenges on the supply and the demand side with glass bottle being major constituents on the supply side. General elections and rise in Barley prices also impacted our performance. Management has taken a couple of strategic initiative to mitigate the risk associated with the supply chain that is shortage of glass bottles. Given the fact that we are in growth phase and will be requiring new bottles we have started importing bottles for all our facilities for the current FY. During the last quarter we also decided to start increasing our inventory of bottles to meet peak load and we believe these initiatives will help us enable to easily cater to our requirements in the near to medium term and in the current year.

Recently there has been announcement regarding the Andhra Pradesh government announcing a phased ban on liquor in the coming years. We would like to inform that SOM neither has any exposure to the market nor intends to enter this in the medium term, hence this will not have any impact on our performance and goals.

During the year despite significant capital expenditure the board of directors have recommended a dividend of Rs. 1.50 per share. We believe that sufficient investments have already been made to the company for its next phase of growth. In summary, FY2019 was a year of investment and FY2020 would be a year of consolidation and utilization and reaping benefits of these investments.

I would like to now hand over the call to Mr. Nakul Sethi who would be running the results with you all.

Nakul Sethi: Thank you so much. Good afternoon everyone and welcome to our Q4 and Full Year Earnings Call. Moving to the financial performance our consolidated total income for the year was Rs. 3,967 million representing an increase of 12.5% compared to last year. The growth was achieved despite challenges such as shortage of glass bottles, assembly elections in three of our key markets namely Madhya Pradesh, Chhattisgarh and Karnataka and general elections towards the starting of March; which again had some impact in the month of March. Our Karnataka facility commissioning was also delayed which impacted contribution from IMFL during the first half of the year.

Our consolidated EBITDA for the year declined by 12.7% to Rs. 528 million. Our EBITDA margin declined from 17.2% in FY2018 to 13.3% in FY2019. The decline was due to combination of factors such as increased proportion of new glass bottles which were used in the year, higher employee and freight costs to target the new markets.

Interest cost for the year increased by 41.5% to Rs. 124 million this was due to the higher interest cost incurred in our Woodpecker facility. As a percentage of total income it stood at 3.1% in FY2019 compared to 2.5% in FY2018. The depreciation expense also doubled from Rs. 43 million in FY2018 to Rs. 88 million in FY2019. This was mainly due to the higher depreciation in Woodpecker. Our consolidated PAT was Rs. 197 million in FY2019 with the margin of 5%.

We have a strong balance sheet and conservative leverage profile to support future growth initiative. As of March 2019, total debt stood at Rs. 1,666 million and cash and cash equivalent of Rs. 247 million resulting in a net debt of Rs. 1, 420 million. Gross debt to equity was 0.54x and gross debt to EBITDA ratio was 3.96x.

Moving to operational performance the volume of our flagship brand Hunter recorded a growth of 7.9% compared to FY2018 to reach 32.5 lakh cases. This improvement is a testament to our capability to market it as a premium product leading to shift in consumer preferences towards this main line brand.

Black Fort Beer volume declined by 6% compared to same period last year. Our Power cool brand declined by 8.6% compared to same period last year. Our IMFL volume recorded a growth of close to 30% compared to FY2018.

We believe the cost pressures on our financials are transitionary in nature and should normalize towards the second half of the current financial year. We remain committed to continue to grow our top line and maintain the EBITDA margin in line with our historical average.

With this, we would like to now open the floor for Q&A. Thank you so much for your time and patience.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from Mr. Pritesh Chheda from Lucky Investment. Please go ahead.

Pritesh Chheda: Sir some more clarity on the EBITDA margin contraction in Quarter 4 and how will it rectify and Beer bottle reason that you highlighted what would have been the impact on account of that in the margin?

Deepak Arora: As we said this is transitory in nature. So, if we look at the financials our WIP is up which we had predicted that this would go up keeping in mind the macro condition of the bottle suppliers. There are only two bottle suppliers in the country one of them is going through a very tough financial phase which has led to this increase in cost. As a result the company has to invest a little bit more on the bottles front as of today and even start importing which is slightly higher cost, but we plan to recover this cost through our recyclable bottles concept (RGB concept) and it is more of accounting thing where we have basically taken it on our books now instead of capitalizing it.

Pritesh Chheda: Adjusting for that what would have been your EBITDA margin?

Nakul Sethi: I think we would have done about close to 15.5% to 16%.

Pritesh Chheda: Just on the full year FY19 if you could share what would be the EBITDA per case in case of Beer and in case of IMFL and what would have been your volumes at Hassan and Bhopal separately?

Nakul Sethi: We are running 3 facilities , each facility has a different ex-brewery price depending upon the excise duties in each state, but I think if you look at Beer the consolidated realization is about Rs. 427 consolidated. So, if I look as about 13.5% of that it would come about around Rs. 58 per case.

Pritesh Chheda: Would there be any erosion in profitability in your Bhopal operations for FY19?

Nakul Sethi: I mean if you look at the Quarter 4 if you dissect the numbers obviously the EBITDA margin is much lower in Quarter for standalone.

Pritesh Chheda: So, adjusting for that impact will there be any erosion in margins or EBITDA per case of Bhopal operations because that is the bulk of your cash flow?

Nakul Sethi: Yes, major portion of new bottles has been ordered out of Bhopal only because in view of the enhanced capacity. So, I mean yes, we will have an impact may be in the first two quarters while we have higher percentage of usage of new bottles.

Pritesh Chheda: And lastly I just want to check on the capacity side and all, so Bhopal with the expansion that we have is underway what will the capacity increase be and have we spent in Rs. 114 crore full CAPEX and what would be your CAPEX figure for FY20?

Nakul Sethi: I think for the CAPEX we are going to spend another Rs. 35 to Rs. 40 crore to complete the CAPEX.

Pritesh Chheda: All CAPEX this is including Bhopal, Orissa.

Nakul Sethi: So, this is only we are talking of Bhopal and we will be spent about another Rs. 15 - 16 crores for Orissa, because we are adding a new canning line in Odisha.

Pritesh Chheda: And what will be the capacity be for Bhopal and Orissa?

Nakul Sethi: 1.52 crore cases.

Pritesh Chheda: This is all combined including Karnataka?

Nakul Sethi: No, this is only Bhopal brewery.

Pritesh Chheda: And you are adding only beer capacity, right?

Nakul Sethi: Yes

Pritesh Chheda: And Orissa what will be the capacity?

Nakul Sethi: 42 lakh cases.

Pritesh Chheda: And once you do all this what will be your peak debt?

Nakul Sethi: We can add another say Rs. 50 crores as debt.

Pritesh Chheda: This is Rs. 160 crores is interest paying debt or it includes all?

Nakul Sethi: I will just give you a breakup. So, the secured borrowings are interest paying debt that is Rs. 115 crores and the Rs. 51 crores is actually loans from the associate companies so that is not interest paying.

Pritesh Chheda: So, total at the company level any case it is a Rs. 166 crores debt?

Nakul Sethi: Yes.

Moderator: Thank you. We take the next question from the line of Anil Kumar from JP Morgan. Please go ahead.

Anil Kumar: I heard you mentioned about the interest payment was high because of plant maintenance or plant commissioning in Orissa, are we expecting more debt in the coming financial year?

Nakul Sethi: I mentioned about higher interest cost due to debt in Woodpecker, but we have not taken much debt in the Orissa plant. So, I do not think that debt is going to increase that much currently.

Anil Kumar: And my next question would be on exchange filing I guess there was a confusion around filing the quarterly results or was it unintentional?

Nakul Sethi: It was a human error, we corrected it with a clarification to the exchange that the full year figures were not impacted, and this was a typo error only for the Q4 financials.

Anil Kumar: So, can you give any guidelines for the coming financial year 2020 or 2021?

Deepak Arora: So, for the coming year as I have said all our investments Anil ji have been done and this is the time to utilize our capacity and keeping in mind with a track we do not want to say some figures and under achieve this year, but looking at the trend we are looking at realizing our capacity everyone. So, personally as the company we are very bullish on the fact that this year we will see a very good utilization of our facilities, but on the guidance numbers we will come back to you after Q1

Anil Kumar: And my last question would be on export so any figures on export you would like to share with us for this quarter or for this financial year?

Deepak Arora: We would not be sharing any numbers as such, we share the consolidated numbers which we have shared already which includes exports.

Anil Kumar: I mean to say that the sales hike in terms of export can that number be shared?

Deepak Arora: Approximately 1% to 1.5% of our total sales turnover.

Moderator: We take the next question from the line of Sunil Jain from Nirmal Bang. Please go ahead.

Sunil Jain: Sir you said that the high bottle cost will continue in next two quarter, so we may continue to see lower margins in the coming period?

Deepak Arora: Sunil ji as explained by Nakul also what this means is because Q1 is the peak load season of the year and the demand outstrips the capacity every time. Therefore, all the inventory goes into the market, to build the inventory you need to use new bottles because the old bottle circulation cannot take care of the peak load. Hence the sudden cost spikes, but this should always be reviewed on a yearly basis that will give you the actual numbers on the usage, but yes you are right in the coming quarter there is a price cost hike, but which will be purely transitory in it.

Sunil Jain: Sir since this is a peak quarter Q1 is the peak quarter and there was a general election so was there an impact of general election in this quarter as well?

Deepak Arora: Since the general elections code of conduct kicked in March for MP and April in Karnataka. Therefore, we would see that there is a downfall in the consumption. However, since it is Q1 and we are better placed to deal with the situation we should see that it impacts but will not impact to the extent of last year sales.

Sunil Jain: So, last year anyhow was comparatively a lower quarter so we can see some improvement as compared to that?

Deepak Arora: As I said as a company, we are very bullish on this year utilization level. So, we will definitely see that Q1 would be a better quarter for us and as I said this is a year of realization for us in terms of capacity. So, we are sticking by that statement.

Sunil Jain: And sir this Orissa plant is from that plant where we will be supplying mainly which market?

Deepak Arora: Primarily to increase our geographical footprint across the eastern side of the country which includes markets like West Bengal, Jharkhand, Chhattisgarh, Orissa and the North East states. Since the freight component is very high which is reflected in our numbers, we have been seeding markets like West Bengal and Jharkhand from Bhopal. So, hopefully we will see some cost optimization when we start the states from Orissa. So, therefore in total we should see that as I said both realization in terms of volume as well as bottom line would be there will be addition of the Odisha.

Sunil Jain: So, this is mainly Beer plant not in IMFL?

Deepak Arora: Yes, it is a Beer plant.

Sunil Jain: So, whatever we are selling from the Bhopal plant that will first get transferred to Orissa plant and thereafter how much volume we can push from Orissa means is there ready market available or we need to prepare for that and all?

Deepak Arora: I will clarify we are been seeding the Orissa market from Bhopal for more than 10 years now. So, we have a market presence in the state of Orissa while the capacity is fully designed for consumption of Orissa itself. We would be more than happy to supply to the other states as I said in the offseason months where the capacity can be further utilized. So, the unit of Orissa is primarily for the consumption to be catered in Orissa while it will also add to our synergy in terms of offseason of saving the freight cost in the offseason that is about it, but the Orissa capacity is fully inclined to serve Orissa.

Sunil Jain: See lot of capacity which has come up like Orissa and then you had expanded the capacity in Bhopal also and then earlier this Karnataka capacity. So, no doubt investment and capacity has come up, but against that since you are a consumer item you need to plan for sales, it is not like you have to give it to one customer and all, so what are all we are doing to capture the market and increase the volume?

Deepak Arora: As I said we every year take a couple of states as a seeding state. There are three things which we work on, one is the distribution, second is the trials and third is the visibility of the products. These are the three main constituents of launching a product in any state. While we work on the visibility in terms of which is limited for us as an industry, we still try to do in the first year a lot of distribution and trials at the consumer level. So, we run a lot of activity surrounding these two objectives. While in the third objectives which is the visibility once we have established our distribution that is when we start going for the visibility and that is when you start seeing us. So, in case of Karnataka if we see we do a lot of regional visibility once we finish our distribution. So, similarly for Orissa going forward this year we would see once our distribution is complete, we would be working on the visibility and the brand recall aspects. So, we have a professional setup to do that and that is why we are able to penetrate new market every year which you can see in our sales mix.

Moderator: The next question is from the line of Niraj Prakash from Nepean Capital. Please go ahead.

Niraj Prakash: I just wanted to ask you in terms of excise duty it is increased as a percentage revenue to close to 29%, so is it going to remain at that level or could we expect that to increase even more going forward?

Nakul Sethi: I think the excise duty which is deducted from the gross sales depends on the sales mix which the company plans to have. For example, if you look at Chhattisgarh that is a Duty paid market where we have to incur the duty and we get it from the government. While MP is more of only the ex-brewery price.

Niraj Prakash: Sure, but it still has an impact on the bottom line when we look at EBITDA or we look at PAT that is the cost to you it is an operational cost effectively if you look at the industry, so it is in geographies like a Karnataka might have a higher excise duty that means overall your net revenue will still be lower even though gross revenue might have grown at a good place so the net revenue is still take us hit correct?

Nakul Sethi: That is correct that is why my recommendation would be that please look at the net sales.

Niraj Prakash: Exactly that is what I am saying so the net sales have not grown as much because the excise duties have increased as a percent of revenue so in order to project the net sales for the next FY20, I am just trying to understand that will we see that percent of revenue remaining similar 29% I agree it can move around 2%, 3% bit depending on the geographies, but it is almost doubled as a percentage of revenue on FY19 is that much delta expected or will it just be 2%, 3% here and there?

Nakul Sethi: If we for example break into UP the sales are duty paid. So, obviously you will have more of the gross sales going up as a percentage of the net sales like you said about 29% or so. So, I think the key number to watch out for is the net sales.

Niraj Prakash: So, then if you can just give us is there I do not know if you have already spoken about it, is there any particular guidance that you all are providing in terms of growth rate for net sales for FY20 and also in terms of the EBITDA margin any reversions back to the sort of 14%, 15% in FY20 as utilization levels go up?

Nakul Sethi: I think as you said you missed the first part of the call, we have indicated that giving the guidance after we complete the Q1.

Niraj Prakash: Just in terms of CWIP with your balance sheet you have about Rs. 150 crores I think so is that about Rs. 100 crores in Bhopal and Rs. 50 crores of the Orissa will that be correct?

Nakul Sethi: Yes.

Niraj Prakash: And what would be the revenue potential kind of increase of the capacity increase be in Bhopal post this CAPEX?

Nakul Sethi: So, I think we talk about it after we complete Q1.

Moderator: Thank you so much. The next question is from Shakti Jain Individual Investor. Please go ahead.

Shakti Jain: I want to know there has been a rate increase in your expenditure where I can see in this Quarter 4, so what has the main cause for this?

Nakul Sethi: The expenditure has increased like we discussed earlier in the call because of higher raw material and packaging material cost because of usage of new bottles and barley.

Shakti Jain: And will this impact be here for this year also?

Nakul Sethi: We expect that this phenomenon will taper out as we grow and as time passes by.

Moderator: The next question is from the line of Sunil Jain from Nirmal Bang. Please go ahead.

Sunil Jain: Sir this is related to Orissa plant like how much time it will take to breakeven?

Nakul Sethi: Sunil ji let the Quarter 1 finish and then maybe we will have a discussion on.

Sunil Jain: The level of sense at which you can reach a breakeven that was like what we have seen in Woodpecker at a level of the sales which has come now you had breakeven even similar type of thing is there or is there will be different thing in that?

Deepak Arora: There are two factors which we need to consider in breakeven one is the ex-factory price which is different in Karnataka and different in Orissa. The matrix is different in terms of calculating of breakeven for different states. However, there are other factors involved in Orissa which constitute to the breakeven which will be only clear after we post Q1 results. The exact time of breakeven would be probably we will be in a more at a position to tell you after at the end of Q1.

Sunil Jain: The last question is related to the CAPEX how much CAPEX we have done in FY19 and this Orissa is not yet capitalized or will still in WIP?

Nakul Sethi: The Orissa plant sir is still not capitalized. We will capitalize it this year because still about Rs. 14 - 15 crores worth of expenditure is yet to be done there and Rs. 114 crores of CAPEX in the Brewery here at Bhopal.

Sunil Jain: That is already been done?

Nakul Sethi: Yes that has already been done.

Sunil Jain: And what was in Orissa?

Nakul Sethi: Rs. 55 we have done including the acquisition cost.

Moderator: We take the next question from Niraj Prakash from Nepean Capital. Please go ahead.

Niraj Prakash: I just wanted to follow up in terms of the debt number your debt is I think cumulatively around rs. 150 crores right now, so that should not be increasing any time way forward since CAPEX I guess will be mostly maintenance CAPEX going forward?

Nakul Sethi: We might have another Rs. 50 crores of debt in this year.

Niraj Prakash: Would that be working capital or would that be in terms of CAPEX?

Nakul Sethi: We are looking at the CAPEX completing the CAPEX at the Bhopal plant because as of now it had all been done from the Karst Peak money which we received last year, as well as the promoters' warrants which they converted into equity shares internal accruals and loans from associates. We need about Rs. 35 crores to complete the CAPEX.

Niraj Prakash: In terms of cash generation would you be able to give us how much operating cash roughly was generated this year FY19?

Nakul Sethi: I have not calculated that give me a day or two we will do that.

Moderator: The next question is from the line of Abhishek Agarwal from Jems Quest. Please go ahead.

Abhishek Agarwal: My question is what is the updates on the export to US for the year FY20 and going ahead what do you expect from that market?

Deepak Arora: Last year was our seeding for the US market where we had seeded our product in the various states of US. The response is good since there is a slight delay in their summer versus our summer. So, we expect to see some volume coming from there. The product is well accepted in the market and as we can see it is a niche product which is primarily marketed as an Indian Beer across Indian customers and Indian F&B. So, as summer goes up we will see the consumption going up and it should reflect respectively on our export volumes to US.

Abhishek Agarwal: Sir my second question would be why is the volume of Powecool and Black Fort Beer decline?

Deepak Arora: We as a company also realize that we have to sell our most premium products which is Hunter. So, the products would always be to sell more Hunter versus a Black Fort or a Powercool. So, if you see growing an ex-factory price of over Rs. 500 growing by 8% should make up for any loss in the lower category which is the Black Fort. As a company we are more focused to selling Hunter.

Moderator: Thank you. Ladies and gentlemen that seems to be the last questions for today. I would now like to hand the floor back to the management for closing comments.

Deepak Arora: We thank all the participant for participating in this Earnings Call and to conclude let me reemphasize the point that this is the year for us where we would see benefits of the investments which we have made over the previous years and we look forward to interacting with all of you in the coming quarter with hopefully at our expectation to your expectation of the company we are very confident, we are very bullish on the year ahead and look forward to interacting with you and I would like to personally thank everyone for joining this call and listening to us. Thank you.

Nakul Sethi: Thank you everyone.

Moderator: Thank you very much. Ladies and gentlemen on behalf of SOM Distilleries & Breweries Limited, we conclude today conference. Thank you for joining you may now disconnect your lines now.

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Note: This transcript has been edited to improve readability