



## **Globus Spirits Limited**

### **Q2 and H1 FY18 Earnings Conference Call Transcript**

#### **November 17, 2017**

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**Moderator** Ladies and Gentlemen, Good Day. And Welcome to the Globus Spirits Earnings Conference Call. As a reminder, 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 the conference call, please signal an operator by pressing '\*' and then '0' on your touchtone telephone. 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, and welcome to Q2 and H1 FY18 conference call of Globus Spirits Limited. We are joined by senior members of the management team, including Mr. Shekhar Swarup – Joint Managing Director, Dr. Bhaskar Roy – Executive Director and COO, and Mr. Ajay Goel – CFO. We will commence the call with opening remarks from the management team, following which we will have an interactive question-and-answer session.

Before we begin, I would like to highlight that certain 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. Shekhar Swarup to share his initial remarks. Thank you and over to you, sir.

**Shekhar Swarup** Good morning, everyone. I trust all of you would have received and gone through the earnings presentation that was circulated earlier. Let me begin by sharing the key developments, while Dr. Bhaskar Roy will brief you on the operation performance, followed by Ajay Goel, CFO, who would take you through the financial highlights for the quarter ended September 2017.

Overall, we have seen good performance in the preceding quarter, driven by high sales from the West Bengal facility. In addition, we have seen significant improvement in IMIL in Haryana where revenues and volumes increased by 44% and 34% quarter-on-quarter respectively. We expect this momentum to continue as a result of multiple initiatives taken by the management in the past two quarters towards consolidating our distribution and brand equity. Our overall performance



during the quarter was augmented by higher contribution from the new Greenfield distillery in West Bengal, which is operating at high utilization levels.

Let me highlight that all of GSL's regular customers for ENA are buying regularly from the West Bengal distillery, which is a testament to Globus' ability to deliver technically and operationally. Overall in the company our captive consumption through franchise bottling segment continued to improve, which resulted in assured off take of bulk alcohol as well as additional contribution towards earnings.

I am glad to state that Goldee and Shahi, which are two of our key IMIL brands have received positive response from customers across all states of West Bengal, Haryana and Rajasthan. And this traction will further improve performance in the forthcoming quarters. IMIL is a key focus area for the company's growth in the few quarters and years to come. Overall, the West Bengal facility as well as the others are favorably positioned to demonstrate a strong 360° Degree Alcobev business model.

Coming to our distillery at Bihar. The High Court, by its order dated October 6th, 2017, ruled that ENA which is sold outside the state of Bihar cannot be controlled by the state of Bihar. Based on this order, we have filed for a renewal of our license with the excise commissioner and we are awaiting that renewal. We are confident, basis the stand that the legal community has taken that this facility will restart shortly.

Moving on to our IMFL venture Unibev – As highlighted on the previous call, we will be launching four brands in the state of Karnataka and Pondicherry over the next few months where we will target only high salience outlets. IMFL is an integral part of our 360° business model and the strategy is to allocate free cash flow out of Globus' IMIL and distillery operations into IMFL to generate additional returns.

Under the leadership of Mr. Vijay Rekhi, I am sure that the organization that we have created will be able to build strong brands in the premium and super premium segments.

With this, I would like to conclude by saying that we are favorably positioned to demonstrate profitable growth in the next few years as we increase our contribution from the consumer facing businesses.

Now, I request Dr. Bhaskar Roy to share the operational performance of the company.

**Bhaskar Roy**

Thank you, Mr. Shekhar Swarup. Good morning and a warm welcome to everyone. I will share the operational performance of the company during the quarter ended September 30, 2017.

As highlighted earlier, we demonstrated healthy performance during the quarter, on account of higher contribution from the new West Bengal Facility. Consumer facing IMIL business also supported the overall momentum with 15% top-line growth. During Q2 FY18, growth in manufacturing business stood at 70% while the consumer revenue grew up 15%. Contribution of consumer and manufacturing business came in at 46% and 54% respectively. Capacity utilization during the quarter is 89%. Growth in bulk alcohol revenue stood at 114% with similar growth in volumes, driven by increased sales contribution from the West Bengal facility.

Franchise IMFL volumes stood at 0.722 million cases in quarter two FY18, compared to 0.698 million cases in the corresponding quarter of last year. IMIL volumes came in at 3.33 million cases during the quarter, higher by 15% against the same period

last year, driven by volume growth of 19% in Rajasthan. Our IMIL market share in Rajasthan stood at 32% in a growing market. On the back of several initiatives undertaken by the management in the past two quarters, we were able to deliver strong growth in IMIL volumes in Haryana quarter-on-quarter. We stood at 34%, we expect this momentum to grow throughout the year.

Moving to other segment – our high potential DDGS reported a growth of 9% in quarter two. The growth looks tapered in comparison to the bulk alcohol due to lower realization on account of decline in soya prices. We believe that the soya prices may continue to remain lower in FY18.

With that, I would like to call upon our CFO – Mr. Ajay Goel, to continue the discussions on the financial performance.

**Ajay Goel**

Thank you, Dr. Roy. Good morning, everyone. I will take you through the key financial highlights for the quarter ended September 30, 2017. For Q2 FY18 gross revenue stood at Rs. 3655 million, higher by 57% year-on-year basis. EBITDA came in at Rs. 204 million, higher by 70%. EBITDA margins improved by 150 basis points to 9.1%. We believe that changing product mix in terms of IMIL will drive margin improvement going forward. Profit after tax during the quarter stood at Rs. 28 million compared to Rs. 17 million in Q2 FY17, representing a growth of 52% on a year-on-year basis.

Moving to product line wise performance. In Q2 FY18 we sold 3.33 million cases of IMIL with an average net realization of Rs. 377 per case. In franchise IMFL business the aggregate volume for the quarter was 0.722 million cases. Out of this, 0.248 million cases pertain to bottling done for ABD in Rajasthan, 0.264 million cases for bottling done for sales in Haryana and the remaining 0.209 million cases for bottling done for USL in West Bengal.

Our bulk alcohol volumes stood at 14.6 million bulk liters compared to 6.8 million bulk liters in Q2 FY17. The total revenues from manufacturing stood at Rs. 1204 million in the quarter while the revenue from customer consumer stood at Rs. 1045 million. The total outstanding debt as on September 30th, 2017, stood at Rs. 227 crore.

This concludes 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. Ladies and Gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Sonali Salgaonkar from POB Caps. Please go ahead.

**Sonali Salgaonkar**

Sir, my first question is with reference with the industry, sir could you please highlight what are the industry growth rates right now, do you believe the growth rates could be in your IMFL and IMIL markets?

**Shekhar Swarup**

Sure. So, first, I would like to shed some light on the bulk alcohol market. There are largely three types of buyers for bulk alcohol, one is the liquor industry, the IMIL or IMFL players; the second is the chemical industry; and the third is the fuel companies. Whereas, each of these sets of customers purchase slightly different grade of alcohol, but the capacity is largely the same. Over the last three years we have seen that fuel companies have been increasing their requirement of alcohol at a very handsome clip, in fact, in the latest tender which as published few weeks ago by the oil marketing companies, they have doubled their requirement year-on-year from, if I remember correctly, from 150 crore liters to about 300 crore liters this year. Chemical industry is largely flat, so they are roughly at about 70 crore liters year-on-year or thereabouts. The IMIL or IMFL industry is growing at about say 8% to 10%, essentially in line with overall consumption growth in India. Coming specifically to

IMIL and IMFL, IMIL businesses in Rajasthan, Haryana as well as West Bengal have seen very good growth rates over the last, Haryana more or so in last two or three years, in Rajasthan it has been sustained for a very long period of time, similarly at West Bengal, looking at upwards of 10% growth levels year-on-year in each of these states. In fact, West Bengal has seen as high as 15% to 20% in some years. IMFL, in different segments of IMFL there are different growth rates, so the regular segment which is traditionally the economy or the regular segment which is 60% to 70% of the volume historically has been de-growing in most of the states that we operate in. There has been an exodus of consumption from this segment towards higher price points as well as lower price points, so that is one of the reasons we have seen growth in IMIL that the consumers of the regular segment are either downgrading or upgrading, essentially the value proposition at that segment is vanishing. The other segments which are semi-premium or premium, we have five or six categories within IMFL. The other more expensive segments have been growing at very handsome clip, due to, A) new consumption entering at higher price points; and B) the exodus that I spoke about from the regular segment. I hope I was able to answer your question?

**Sonali Salgaonkar** Sure, sir. Sir, my second question is with reference to West Bengal. Now, earlier this year we know that West Bengal government has decided to start the wholesale distribution for IMSL. So, could you throw some light as to how is it panning out and has it affected the sales in terms of the distribution channel in the state?

**Shekhar Swarup** Yes, you are very right. West Bengal government has introduced the West Bengal Beverage Corporation which will act as exclusive wholesaler for all types of liquor in the state. So, they started early August I believe and in the initial few weeks there was disturbance in sales. We have seen that just before Beverage Corporation started there was lot of excess stocking done by retailers, because they were not clear of their supply position. So, therefore after the Beverage Corporation was implemented there was very few orders that came in. However, this is a blip, a very small blip which lasts may be total of eight to 12 weeks. Overall, I believe that the West Bengal Beverage Corporation will organize the trade just the way Beverage Corporation has done in other states of India.

**Sonali Salgaonkar** Okay. Sir, and my last question is with reference to GST and the impact on the input cost side. So, of course, this quarter we saw very good margin improvement in both EBITDA as well as your PAT margin. But going forward do you foresee the input cost pressures to kind of moderate the EBITDA margin level, especially in the near-term?

**Shekhar Swarup** So, I will break that into two. The reasons the margins have gone up in the last quarter has been due to the various initiatives that the company has been working on over the preceding few quarters, which includes improvement in IMIL, which includes low raw material cost and of course stabilization of West Bengal. Regarding impact of GST, I would request my colleague Ajay to answer that part of the question.

**Ajay Goel** See, in terms of GST, our larger input cost is basically the broken rice and fuel which is out of GST ambit, there is no GST per say on the two items. And there are hardly 10% to 15% of input cost which goes for manufacturing of ENA which will come under the GST regime. And the rates of GST and before GST rates more or less are the same, because earlier there was excise duty and VAT, and now it is GST. So, there is not a major impact on input cost, but yes, on the services side there is almost a 3% increase on account of GST, because largest chunk of our services are consumed. So, that way there is some impact in terms of GST.

**Sonali Salgaonkar** Sir, what about the glass cost?

**Bhaskar Roy** We have very limited procurement of glass, most of our business is PET bottles. And within glass most of our glass purchases is recycled glass where the GST is on second hand goods, which is only on the value add, so the impact is very little.

**Sonali Salgaonkar** Sure. Sir, how much proportion of ENA is from molasses and from grain?

**Bhaskar Roy** Globus Spirits only manufactures ENA from grain.

**Moderator** Thank you. We have the next question from the line of Vikram Kotak from Crest Capital. Please proceed.

**Vikram Kotak** I have two questions. One is, you talk about putting cash flow which you generate from Globus Spirits into Unibev and I have question around that. What is your current debt level we have, net debt level? What are the incremental CAPEX in Globus Spirits? And what are the CAPEX in Unibev and over the next three years where do we see our debt levels?

**Ajay Goel** See, our current debt level as I mentioned in the presentation is Rs. 227 crore and there is no incremental debt which we are planning to fund any of Globus endeavor business per se. And regarding the requirement of Unibev...

**Shekhar Swarup** So, Unibev is really a zero CAPEX business.

**Vikram Kotak** So, how much money you still need for launching brands over the next couple of years, just sort of a ball park number?

**Shekhar Swarup** So, this business is really a capital deployment kind of a business in terms of working capital. You are aware that due to the high levels of duty in each state most of those duties are funded by the bottler or the brand owner, it becomes a capital deployment play. So, rather than say that we will need x amount of money for this business, we are looking at it differently, we are saying that every year we have these kind of free cash flow and we are looking to deploy those cash flows in the most effective manner in the IMFL business in India.

**Vikram Kotak** Any plan to reduce debt over two to three years from currently Rs. 227 crore, because you are generating a good healthy cash flow now?

**Shekhar Swarup** As of now the plan, like I mentioned, free cash flow are deployed after debt, free cash flow are deployed into Unibev. So, yes, debt levels will gradually reduce.

**Vikram Kotak** Any price hike has been taken in Rajasthan in Q2?

**Shekhar Swarup** In IMIL there has been no price hike yet.

**Vikram Kotak** Any plans in the current quarter because I think you are enjoying the good markets there?

**Shekhar Swarup** Yes, we are hopeful for the same. The history on Rajasthan is that on every two to three years we get about 5% to 10% kind of price hikes. So, it is very difficult for me to tell you what time it will come, but that is what history suggests.

**Vikram Kotak** Sure. And what about Bihar operation, I know you are right now fighting with the state government, but what is the plan Because in case there is no solution, will you shift the plant to Bengal, how is it really going to work out?

**Shekhar Swarup** We have created a few scenarios internally, but suffice to say that Bihar will work out, it is a matter of time.

**Vikram Kotak** And last question, how much peak level Bihar can generate and EBITDA if it is fully operational?

**Shekhar Swarup** We are hopeful that the EBITDA margins will be at current margins. And in terms of revenue, well, it is a straight up bulk play, there will be no bottling over there. So, for a few years it will be limited to say around Rs. 40 to Rs. 50 per liter kind of ENA price.

**Moderator** Thank you. We have the next question from the line of Chinmaya Garg from Dron Capital. Please go ahead.

**Pratik G** Hi, this is Pratik Gandotra. I have one question, is there a plan first of all in Unibev, while Globus Spirits put a part of its free cash flow in Unibev, is there a plan to raise capital in Unibev itself? Because given the fact that all the IMFL companies are doing very well now and I am sure capital will be available. That is question number one.

**Shekhar Swarup** So, Unibev, whereas I said that we have to deploy free cash flow and that is really the strategy, but we are looking at Unibev as an independent entity. Whereas we are conscious that Globus' free cash flow would be limiting Unibev's growth. But as of now I do not see that to be

**Pratik G** No, I am also saying that a lot of private equity players do try and come in the initial stage itself because then it would make sense for them and they will actually back the management.

**Shekhar Swarup** So, I mean, right now whatever capital needs are there of Unibev are taken care by Globus. When we find that Globus' appetite is limiting the growth of Unibev, in that situation we would be interested in looking out for fresh capital.

**Pratik G** Okay. My second question is on the EBITDA margins, now what do you think is your sustainable level of EBITDA margins given the current concept, excluding the IMFL business? Where do you think, I mean they are at the lower end of the range, right, so where do you think they will go eventually?

**Shekhar Swarup** Good news about being at the lower end is you can also go upwards. I think the critical saying is the scale up of IMIL in West Bengal. There has been change in the routes to markets with the Beverage Corporation coming in. The other factor we have to recognize is IMIL is essentially a fixed price point business where as we are able to get price increases. More or less they set off the cost increases that take place in those few coming years. We have in the past been able to see very good levels of EBITDA margin and a lot of that has also been Q2 movement in grain prices. We are putting all these three things together, there are a number of moving parts in this equation but certainly this year's overall EBITDA margins should be greater than last year's.

**Pratik G** No, the point I was saying, okay historically what is the best kind of EBITDA margin you would have enjoyed?

**Shekhar Swarup** If my memory serves me correctly, it should have been around 12% and 13%.

**Pratik G** So, that kind of margin is possible once West Bengal starts performing at its optimal, as per what you think, right?

**Shekhar Swarup** If grain prices support.

**Pratik G** I understand, all of that has to fall in place. But that is the kind of margin possible in this business, that is why I am saying.

**Shekhar Swarup** I think it is possible to get even higher, but there are a lot of moving parts.

**Pratik G** And on top of that, once the IMFL business starts then there will obviously be a scale issue there given the fact that it is, but then it should at least start improving gross margins eventually?

**Bhaskar Roy** Yes, so just to give you an idea on that, very broadly speaking, in IMIL we enjoy Rs. 50 Rs. 70 gross margin. And in IMFL business we will not be entering any segment which is below Rs. 500 - Rs. 600 gross margin.

**Moderator** Thank you. We have the next question from the line of Dheeraj Muchhala, an individual investor. Please go ahead.

**Dheeraj Muchhala** So, one is on CAPEX, as you said I think we are not expecting any great CAPEX going forward but what kind of maintenance CAPEX should we be estimating going forward just to keep the....

**Shekhar Swarup** So, I think it is around Rs. 10 crore to Rs. 15 crore per year.

**Dheeraj Muchhala** The other thing is that in the West Bengal IMIL market could you give us some indication on how big the market is and what your market share will be like right now?

**Shekhar Swarup** Market share right now is irrelevant, we have just started in Q1. What is relevant is the first question is what is the growth levels, what is the market size and growth levels. So, the market in West Bengal is 25 lakh cases per month, which is similar levels with Rajasthan and Haryana. This has been growing at a very good rate over the last three years. The other thing is that about 25% of the market is with the only other distiller and 75% of the market is fragmented around 25 bottling plants who are all buying alcohol from either us or from other distiller or importing it from out of state.

**Dheeraj Muchhala** So, you are seeing a massive headroom in terms of how you can grow here?

**Shekhar Swarup** There is a lot of scope for expansion here. Be that as it may, we have to approach it in a cautious way, the cost of distribution in West Bengal is considerably higher than that in Haryana. So, it has to be a gradual buildup.

**Dheeraj Muchhala** And the last thing was on the West Bengal bulk alcohol margin or the bottling revenue margins, are they significantly higher than what we enjoy in Rajasthan and Haryana?

**Shekhar Swarup** Yes, so the cost card of that looks something like this, so the grain in West Bengal is substantially cheaper than that in Rajasthan or Haryana. A lot of the grain that comes into Rajasthan or Haryana comes in from east UP or from Bihar, in fact even from West Bengal. And here we are sitting in that sort of rice bowl in West Bengal. The other factor is that West Bengal is a alcohol deficit state and in order to complete its alcohol requirements they need to import alcohol from states like Punjab and Haryana. Therefore, we enjoy not only much higher prices on ENA, and we maintain import price parity. We also enjoy lower prices on the raw material.

**Dheeraj Muchhala** Okay. But could you give some indicative number in terms of how much higher the margins are compared to others?

**Shekhar Swarup** I would say about 15% higher than our average, 15% to 20% higher than our average.

**Moderator** Thank you. We have the next question from the line of Mohan Swami from Crest Capital. Please go ahead.

**Mohan Swami** My question is more on the industry front, the politics which is governing the alcohol industry right now. We have concentrated market position in few states, now how do we manage any risk, I mean there is election coming, Karnataka now and it seems the government there is studying the Bihar model. So, there are immediate gains from acting against the industry in the polls. So, how do you view this situation and how do we protect ourselves?

**Shekhar Swarup** So, there is nothing new in the year 2017. These risks have been there since independence for every state. In fact, the company itself has seen two or three years of prohibition in Haryana, which was unsuccessful. Similarly, other states over the last 70 years of independence have tried this several times, there are few states that are trying it now. These are, I presume, inherent risks in our industry in India and protecting them is something which is difficult. Be that as it may, Globus's business model is hedged to the extent that we can continue to run our capacities, even though there is prohibition, as has been said by the High Court in Bihar recently. But honestly, we should understand the extent of that risk, we believe that there has been talk and there is talk pretty much every year. In reality, prohibition is unsuccessful in most states.

**Mohan Swami** And do the courts differentiate between manufacturing and kind of selling, because if a state like the Bihar situation, do you think they will rule rationally and allow you to manufacture there even though selling is prohibited?

**Shekhar Swarup** By the way, we have been permitted to manufacture there, it is not if any more. There are two different things, one is the manufacturer of liquor and the other is manufacturer of extra neutral alcohol. Manufacture of extra neutral alcohol cannot be governed by the state, manufacture of liquor can be.

**Moderator** Thank you. We have the next question from the line of Abhishek Panecha from Vibrant Securities. Please go ahead.

**Abhishek Panecha** Sir, I have two questions, one is regarding the Bihar unit. What sort of operational cost are we incurring right now?

**Shekhar Swarup** It is around about Rs. 10 lakhs a month.

**Abhishek Panecha** What sort of water requirements are there, how much water do we require to produce the alcohol?

**Shekhar Swarup** That is a very technical question, I can tell you that IMIL has roughly 30% alcohol strength, so the rest is all water.

**Abhishek Panecha** Actually, regarding Rajasthan, Rajasthan has a history of droughts, so how does the water requirement affect, if there is a drought then we have seen that in Maharashtra distilleries have been closed because of the water requirement. So, has there been any history in Rajasthan of that sort?

**Bhaskar Roy** Not as of now, we have never felt any problem.

**Moderator** Thank you. We have the next question from the line of SB Bhaiya, individual investor. Please go ahead.



**SB Bhaiya** My question is, what sort of growth you are contemplating in the second half of this year, first half is very good, it is about 57%. So, what sort of planning you are doing for the second half, sir?

**Shekhar Swarup** The growth that has happened in the first half is coming on the back of consumer business as well as new factory. And both these are growths that will sustain for the next part of the year.

**SB Bhaiya** So, almost similar sort of growth should be there for second half as well?

**Shekhar Swarup** That is what it looks like so far.

**SB Bhaiya** And second thing, there is more than proportionate increase in the share of your other expenses, I think it is more due to West Bengal facility or something else?

**Ajay Goel** Yes, basically other expenses increased primarily on account of West Bengal facility, there were many costs which have gone up and classified under other expenses like franchisee cost plus the fuel cost, which are classified under other expenses.

**Moderator** Thank you. That was the last question. I now hand the conference over to the management for their closing comments.

**Nishid Solanki** Thank you, everyone, for your time and being with us on the call. If you have any further questions please do write or contact us directly, or you may also get in touch with our IR agency, CDR. Thank you so much.

**Moderator** Thank you. Ladies and gentlemen, on behalf of Globus Spirits, that concludes this conference call for today. Thank you for joining us. And you may now disconnect your lines.