Initiating Coverage

Globus Spirits Ltd.

October 13, 2021

RETAILRESEARCH

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Globus Spirits Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Alcobev	Rs. 1469	Buy in Rs. 1454-1482 band & add more on dips Rs. 1273-1297 band	Rs. 1619	Rs. 1761	2 quarters

HDFC Scrip Code	GLOSPIEQNR
BSE Code	533104
NSE Code	GLOBUSSPR
Bloomberg	GBSL:IN
CMP (Oct 12, 2021)	1469
Equity Capital (Rs Cr)	28.8
Face Value (Rs)	10
Equity Share O/S (Cr)	2.88
Market Cap (Rs Cr)	4231
Book Value (Rs)	203.2
Avg. 52 Wk Volumes	342524
52 Week High	1509
52 Week Low	275

Share holding Pattern % (Jun, 2021)	
Promoters	55.96
Institutions	2.41
Non Institutions	41.63
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

Fundamental Research Analyst

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Our Take:

Incorporated in 1993, over the years, Globus Spirits Ltd. (GSL) has successfully got transformed from a grain-based bulk alcohol manufacturer to a 360° alcohol beverage player. The company covers the entire value chain of alcohol manufacturing, undertaking an array of operating activities from manufacturing extra neutral alcohol (ENA) to contract bottling to marketing and selling Indian made Indian liquor (IMIL, also called as country liquor)) and Indian made foreign liquor (IMFL). GSL's vertically integrated business can be bifurcated into; manufacturing (57% of FY21 revs.) and consumer (43%). The manufacturing division (bulk alcohol) is the backbone of its 360° business model, ensuring sustained competitive advantage and, providing strong earnings and cashflows visibility. Consumer segment (IMIL and IMFL) on the other hand will be key driver of its profitability.

GSL, which is the largest and most efficient grain-based distillery in India, is one of the biggest beneficiaries of the government's Ethanol Blended Petrol (EBP) Programme. In order to achieve the government's ambitious target of 20% blending by 2025, the supply of grained-based ethanol needs to increase by 12x from current levels for which India needs to add additional ~482 Cr litres capacity of just grain-based ethanol over next 4 years. In an environment of such a massive supply-deficit, the prices of Ethanol could remain elevated to distillers' benefit. GSL is already on the path to double its existing capacity to 33 Cr Litre/p.a. by FY24E to leverage the ethanol opportunity. While currently 5 Cr litre capacity (from total 16 Cr litre currently) is fungible between ENA and Ethanol, the entire incremental capacity of ~16 Cr litre would be fully fungible, allowing GSL to opportunistically shift between ENA and Ethanol to earn better margins.

GSL, one of the largest manufacturer and marketer of country liquor, is now 'redefining' country liquor in India, by creating new category called 'premium country liquor' or medium liquor, with the launch of India's 1st ENA based country liquor brand – Nimboo. We believe medium liquor can be a game-changer going ahead. Besides, the company is also exploring opportunities for geographical expansion to achieve higher growth rate. Additionally, GSL has forayed into premium IMFL through its owned portfolio (under Unibev). Unibev is an asset-light model focusing on high margin, low volume fast growing premium segment.

While the company's manufacturing business (Ethanol/ENA) is likely to drive the growth in near term given huge tailwinds, the management's primary focus is to expand its consumer business' footprint, which we also believe is crucial for long-term success and stock re-rating beyond a point. With aggressive launch of products and widening geographical presence coupled with experienced management team, we believe GSL is well placed to ride on the rise in consumption of alcoholic beverages in India, driven by the underlying demographic advantage and the change in perception towards alcohol.

Valuation & Recommendation:

Net revenues/ EBITDA/ PAT have grown at a CAGR of 15%/40%/94% over last 5 years with EBITDA/PAT margin expanding from 9.5%/1.4% to 20.7%/11.4%. In fact the company has reported EBITDA margin expansion over past 6 consecutive quarters, with it reaching a high of 26.5% in Q1FY22. Stable working capital, lower cash outlay for tax due to availability of MAT credit and a reduction interest cost led CFO to improve to Rs 148.4 Cr in FY21 from Rs. 30.6 Cr in FY19. The company strengthened its balance sheet by reducing debt of Rs. 75 Cr despite ongoing capex. Robust cashflow generation will further aid debt reduction.

Going ahead, we expect GSL's Net Revenues/EBITDA/ PAT to witness strong CAGR growth of 21%/23%/28% over FY21-24E driven by capacity expansion in bulk alcohol and faster growth in IMIL business, led by increasing pricing gap vs. IMFL players in key states and the emergence of the 'premium country liquor' (medium liquor), which in our opinion is a game changer. Medium liquor realisations are ~50% higher than the value segment and offer strong growth and uptrading opportunities across company's key markets. While its foray in premium IMFL (highly margin accretive) through Unibev is at nascent stage, a successful ramp up here can drive the profitability.

Govt's aim of 20% blending target to 2025 has created sheer supply-deficit of Ethanol (details inside) and has led to diversion of ENA towards ethanol, creating structural support for ENA prices. While GSL may witness some moderation in margins (from 26.5% in Q1FY22), we expect the company to maintain 20%+ over near to mid-term, driven by higher realizations for bulk alcohol and benign input costs. Robust sales growth and improvement in profitability coupled with stable working capital is likely to aid higher cashflow generation in the coming years. We expect GSL to generate strong cumulative cashflows of ~Rs. 900 Cr to be utilised for its ongoing and future capex programmes and, debt reduction.

Though the stock has rallied ~4x over past 6 months, we believe there's still upside to this rally, with the caveat that the Government maintains its supportive stance on ethanol blending. **We think the base case fair value of the stock is Rs 1,619 (17x Sept'23E EPS) and the bull case fair value of is Rs 1,761 (18.5x Sept'23E E EPS). Investors can buy the in stock Rs 1,454-1,482 band (15.5x Sept'23E EPS) and add more on dips to Rs 1,273-1,297 band (13.5x Sept'23E EPS). At LTP of Rs 1,469, it quotes at 15.4x Sept'23E EPS.**

Financial Summary

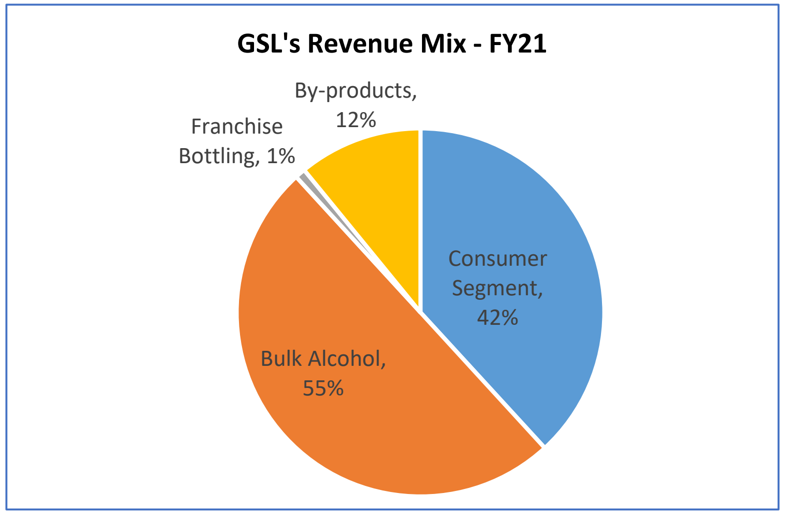
Particulars (Rs cr)	Q1FY22	Q1FY21	YoY-%	Q4FY21	QoQ-%	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	371	230	61.0	357	3.9	987	1169	1231	1486	1843	2175
EBITDA	98	39	149.7	88	11.6	88	125	255	348	420	478
APAT	56	19	197.4	51	10.0	24	50	141	203	254	295
Diluted EPS (Rs)	19.3	6.5	197.4	17.6	10.0	8.2	17.2	48.9	70.6	88.0	102.4
P/E (x)						178.3	85.4	30.1	20.8	16.7	14.4
EV/EBITDA						50.5	35.2	17.1	12.3	9.8	8.0
RoE-%						6.2	11.7	27.3	29.7	28.0	25.1

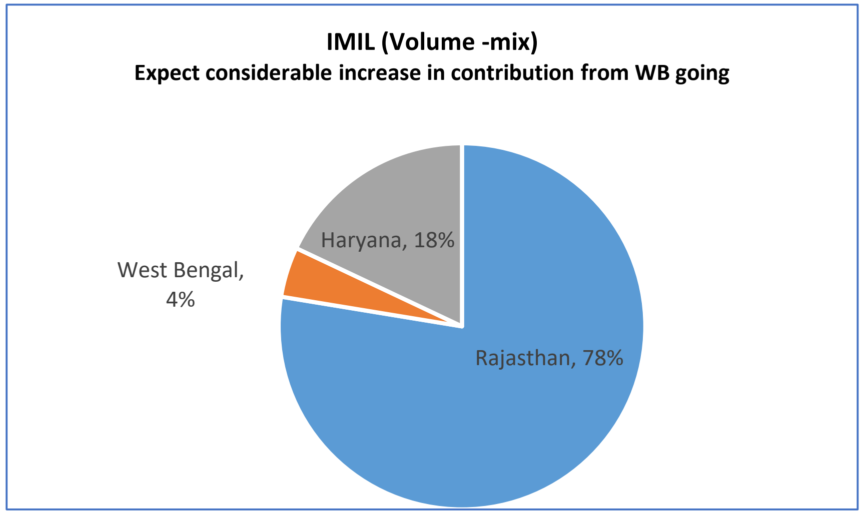
(Source: Company, HDFC sec)

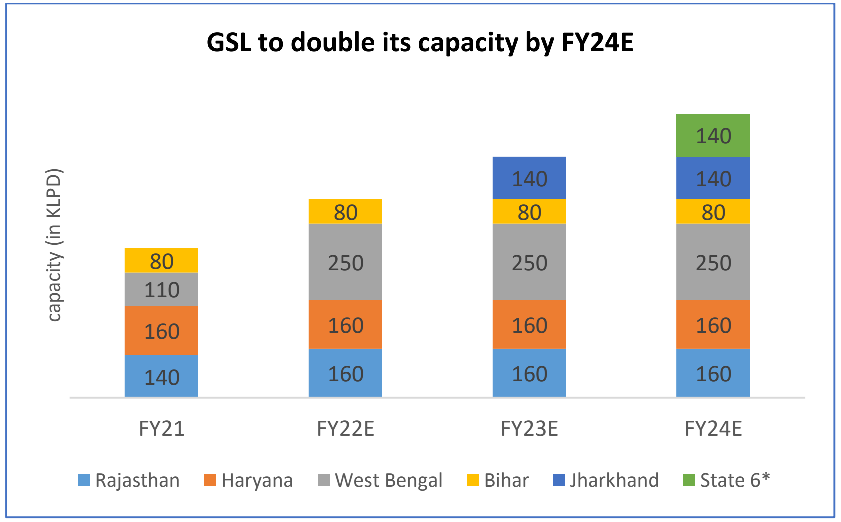
Q1FY22 Result Update

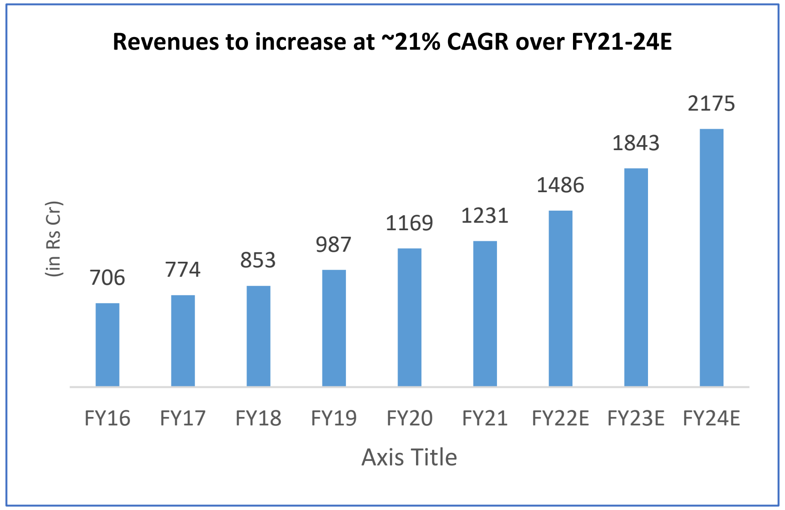
GSL, in Q1FY22, reported net revenue growth of 61% to Rs 371 Cr backed by increase in share of Rajasthan Medium Liquor (RML) in the Consumer Business segment and higher sales volume of 29.9 Mn liters in Bulk Alcohol Segment. EBITDA Margin grew for 6th consecutive quarter and stood at record high of 26.5% - up 940/183 bps YoY/QoQ in Q1FY22 on account of higher RML share in Consumer Business and better realizations. Bulk Alcohol sales volumes stood at 29.9 Mn litre in Q1FY22, up 45% YoY and 5% QoQ. Average realization for bulk alcohol came in at Rs. 51.6 per litre in Q1FY22. The share of Consumer Business grew to 42% in Q1FY22 from ~35% in Q1FY21, on the back of both volume and value growth. The Value Segment sales volumes grew by 65% YoY to 3.3 Mn cases and realisations by 16% YoY and 10% QoQ to Rs 462.5 per case in Q1FY22. Despite 2nd wave of Covid-19, the Capacity Utilization in Q1FY22 stood at 98% (vs 58% in Q1FY21 and 99% in Q4FY21). On expansion front, in West Bengal, expansion work of additional 140 KLPD is nearing completion and likely to be commissioned in Q3FY22. In Jharkhand, work has commenced on planned expansion of 140 KLPD and the project is expected to be commissioned in FY23. Additional 140 KLPD expansion is under evaluation between Bihar and another location; work expected to start later in FY22.

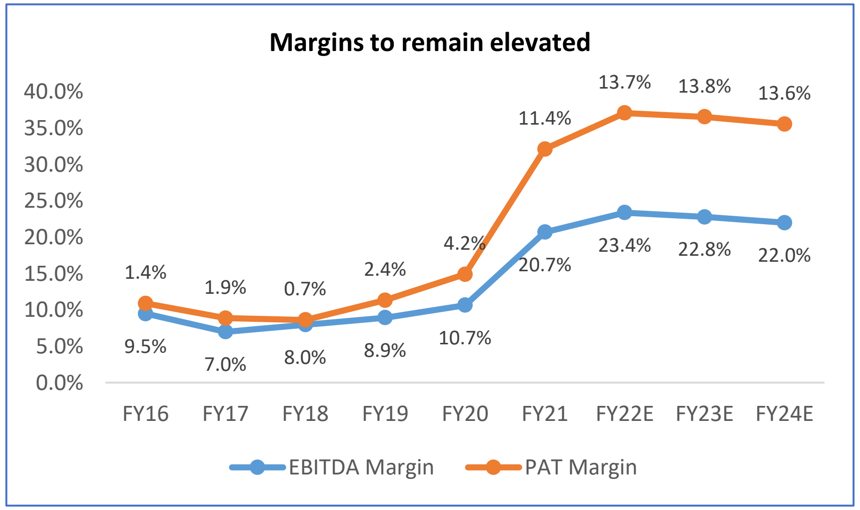
Overview of GSL

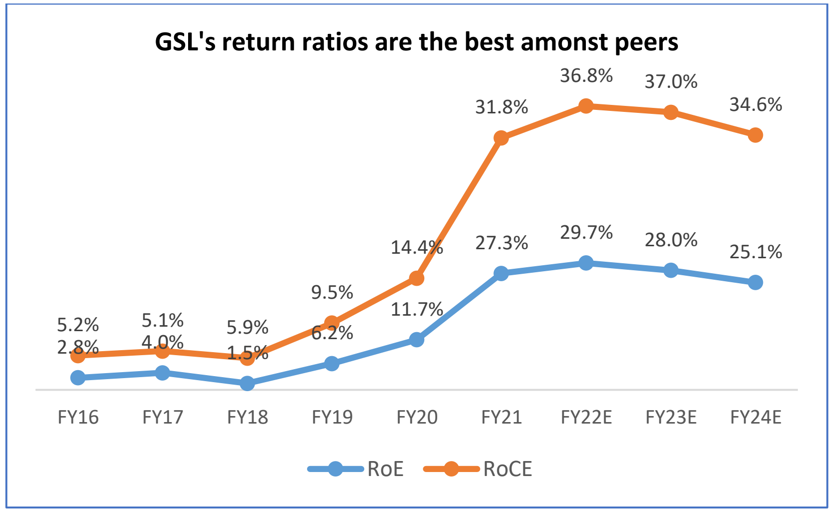












(Source: Company, HDFC sec)

Long Term Triggers

Unique 360⁰ model straddling the entire alcohol value chain

GSL has pioneered grain-based distillery operations, having set-up India's first grain-based distillery back in 1994. Historically, the Indian liquor market has been dominated by sugarcane molasses-based alcohol even as many western countries mandate to have grain-based alcohol. However, in recent times, the Indian liquor market is witnessing rapid transition from sugarcane molasses-based to grain based-alcohol.

GSL is the largest and most cost-efficient grain based distillers in India. It covers the entire value chain of alcohol manufacturing undertaking array of operating activities from manufacturing of ENA and Ethanol for bulk customers (liquor manufacturers and OMCs) to contract bottling of Indian made foreign liquor (IMFL), to marketing and selling IMIL and IMFL and, several by-products.

What do we like the most about GSL's business model?

- Being vertically integrated enables GSL to transition ENA towards captive utilisation which is key for gaining higher realisations (ENA diverted towards IMIL yields ~2.5-3X realisation) and also contributes to higher incremental margins. Also, its strategy to set-up capacities in alcohol deficit states fetches it higher realizations.

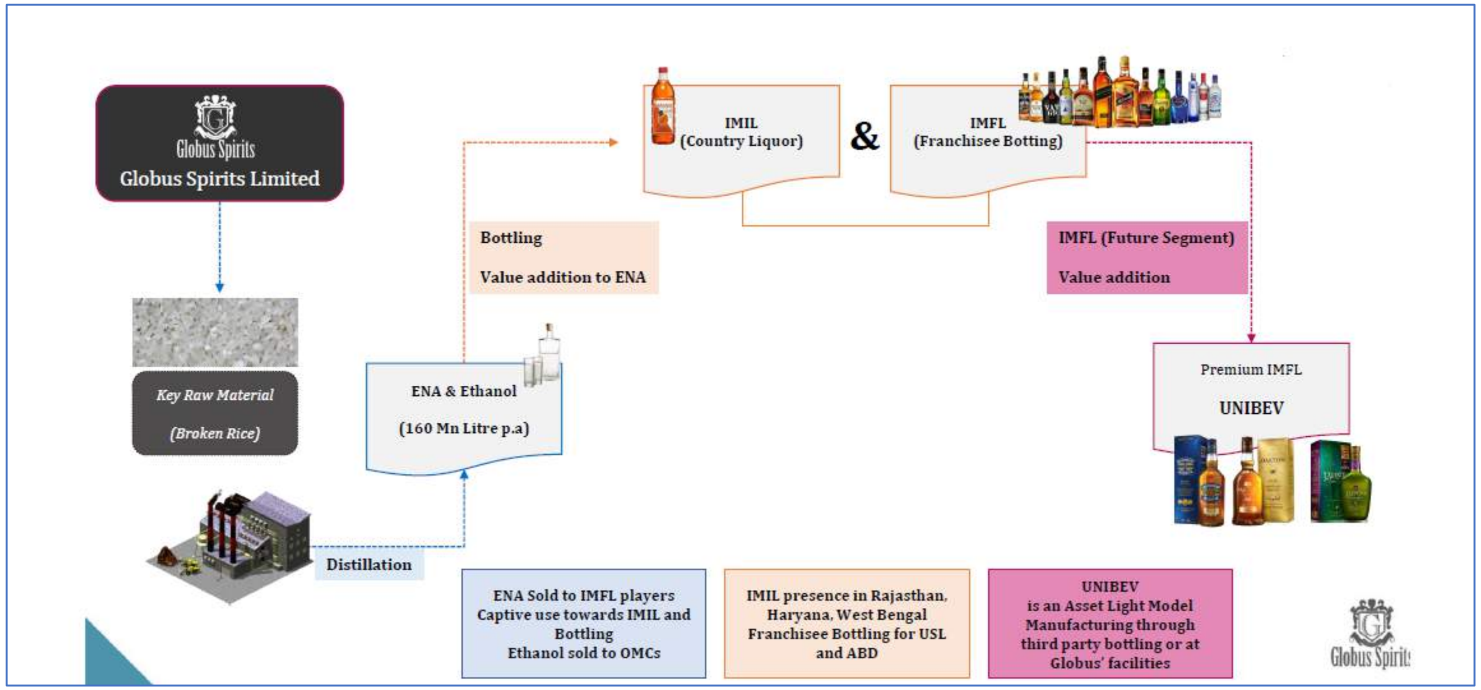
- Well placed to address the Ethanol potential in India – upcoming distilleries in Eastern Markets to support this opportunity. Additionally, incremental capacities are fully fungible between ethanol and ENA, which will allow it to opportunistically shift to make better margins

- Strong R&D focus leading to i) lowest capex/ capacity added – GSL's incremental capex at ~Rs. 80 L/ KLPD is the lowest (about 20% lower than industry average) in industry ii) Best conversion yield (grain to alcohol) – GSL has also the best conversions to alcohol with continuous focus on improving efficiencies.

- Robust supply chain network. Dedicated mechanism to secure its agricultural raw materials at favourable prices which helps them to generate better returns.

- Alternate source of revenues through high potential by-products (like DDGS)

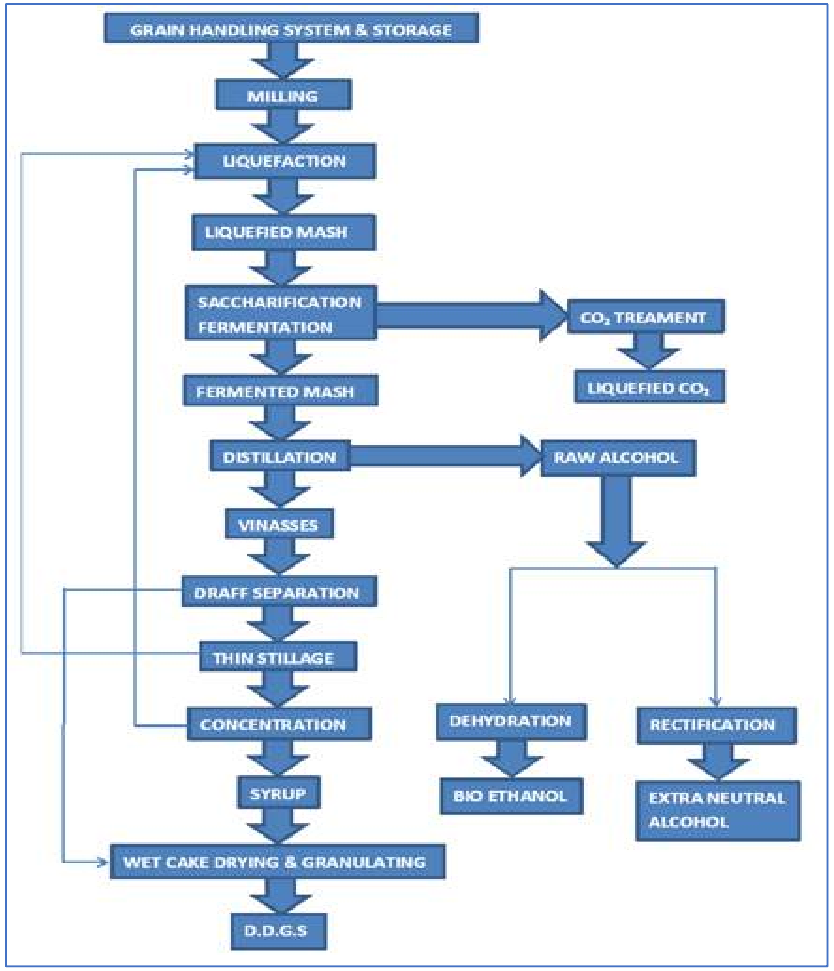
Leveraging a strong 360⁰ Business Model



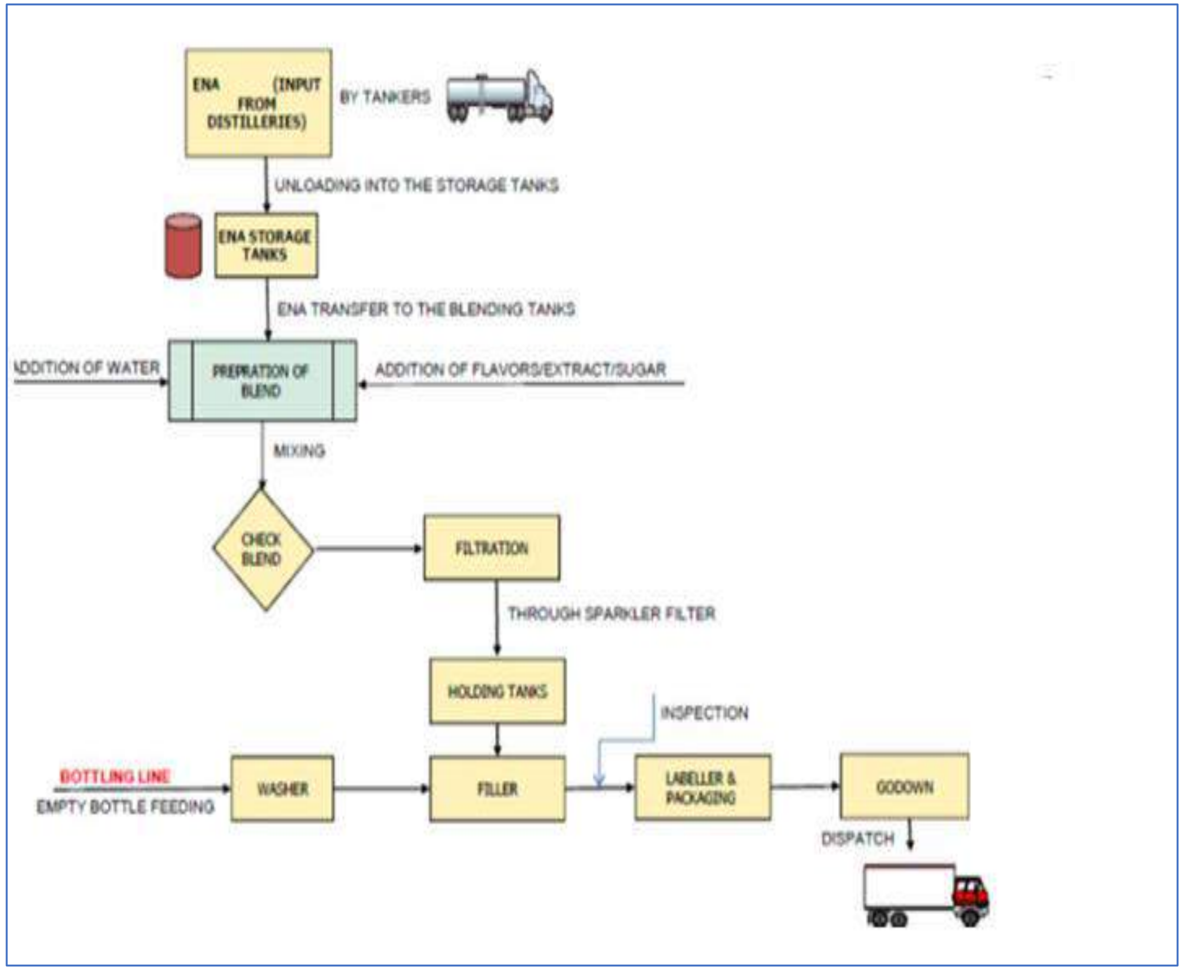
(Source: Company, HDFC sec)

Production Flow Chart

Grains to ENA/Ethanol/By-products (DDGS & CO2)



ENA to IMIL/IMFL

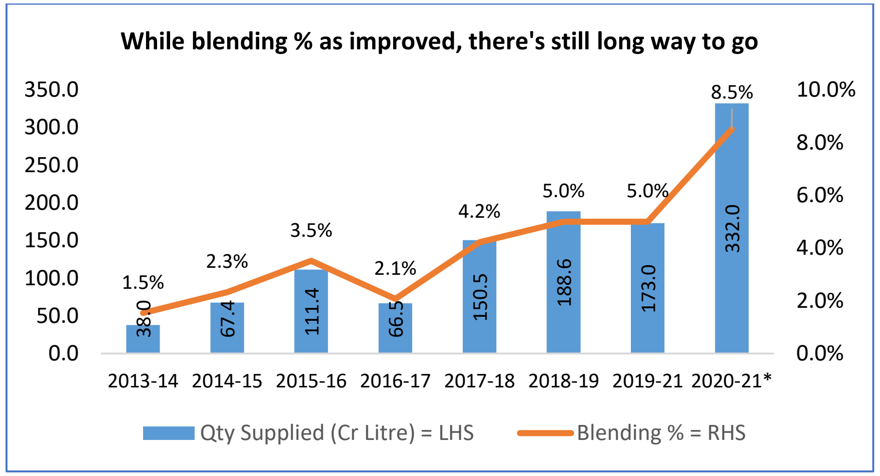


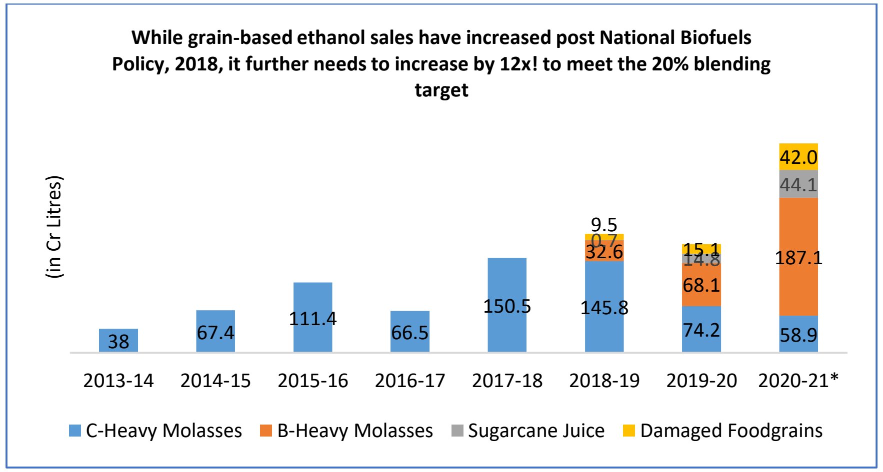
(Source: Company, HDFC sec)

<u>Govt's thrust on Ethanol, the biggest game-changer for GSL</u>

Ethanol Blended Petrol (EBP) programme was initially launched in January 2003 for blending 5% ethanol in petrol and later on increased to 10%. The programme sought to promote the use of alternative and environmental friendly fuels to reduce import dependence for energy requirements. Initially, the procurement was only from conventional C-Heavy molasses. However, due to low sugar recovery and lower distillery capacity the blending target of 10% was never achieved. The National Biofuels Policy, 2018, aimed at taking forward the indicative target of achieving 20% blending by 2030, further expanded the scope of raw material for ethanol production by allowing use of B-Heavy molasses, Sugarcane Juice, Sugar Beet and damaged foodgrains like wheat, broken rice, etc. It also marked beginning of differentiated ethanol pricing, based on raw material utilised for ethanol production. OMCs also placed a premium on grain ethanol over the traditional C-grade molasses based ethanol. The sudden increase in ethanol requirement, and consequently shift of capacities from ENA to ethanol, had a positive impact on bulk alcohol realizations which quickly moved up since December 2018, reflecting a huge supply deficit situation in the industry.

In a massive boost to ethanol producers, *the Govt. of India in June 2021 advanced the 20% Ethanol blending target to 2025 from 2030*. So far, ethanol was being primarily produced in sugar growing states given higher allotted quota to molasses-based ethanol, however, in response to massive demand for ethanol and, for welfare of farmers (as surplus foodgrains lead to lower farm income) and reduction of agricultural waste, greater emphasis has been laid on foodgrains as feedstock for Ethanol. In order to meet 20% blending target, India will require ~1,016 Cr litres of ethanol for blending in Petrol in 2025, whereas in 2020, the existing capacity of ethanol was at ~684 Cr litres. This means that significant ethanol capacity addition (~6X from current levels) will be required to meet the blending target. As per the recently published report by the Govt on 'Roadmap for Ethanol Blending in India 2020-25' (link), ~50% of ethanol requirement will be met by the sugar industry and rest from grains and other sources. Ethanol manufactured through grain-based distilleries currently amounts to only 42 Cr litres (10% of targeted capacity by FY2025-26). GSL being one of the largest grain based distilleries in the country was is in a strong position to leverage these developments.





*estimated

(Source: NITI Aayog, HDFC sec)

Demand projection for fuel ethanol

Ethanol Supply Year (ESY)	Projected Petrol Sale (Cr. Litres)	Blending (in %)	Requirement of ethanol for blending in Petrol (Cr. Litres)
2019-20	3413 (Actual)	5	173
2020-21	3908	8.5	332
2021-22	4374	10	437
2022-23	4515	12	542
2023-24	4656	15	698
2024-25	4939	20	988
2025-26	5080	20	1016

(Source: NITI Aayog, HDFC sec)

The projected requirement of ethanol for ESY 2025-26 based on petrol (gasoline) consumption is 3x the current supply (332 Cr litres in 2020-21).

The Ethanol Story: It's not all about sugar mills…

Ethanol Demand Projections

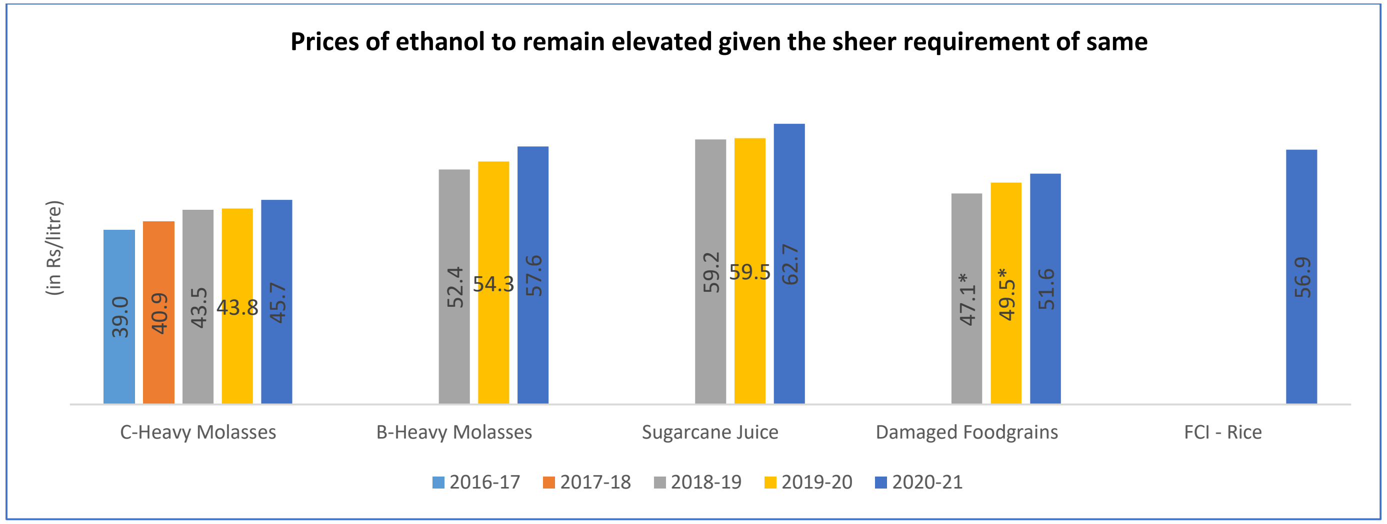
Sector-wise demand forecasts for Ethanol (in Cr Litres)										
ESY	For Blending			Blending (in %)	For other uses			Total		
	Grain	Sugar	Total		Grain	Sugar	Total	Grain	Sugar	Total
2019-20	16	157	173	5	150	100	250	166	257	423
2020-21	42	290	332	8.5	150	110	260	192	400	592
2021-22	107	330	437	10	160	110	270	267	440	707
2022-23	123	425	542	12	170	110	280	293	535	828
2023-24	208	490	698	15	180	110	290	388	600	988
2024-25	438	550	988	20	190	110	300	628	660	1288
2025-26	466	550	1016	20	200	134	334	666	684	1350

Total Capacity required by Nov 2026 to reach 20% blending target			
Ethanol Capacity (in Cr Litre)	Molasses based	Grain based	Total
Existing Ethanol/alcohol Capacity	426 (231 distilleries)	258 (113 distilleries)	684
New capacity required to be added	241	482	723
Total Capacity required	**760**	**740**	**1500**

(Source: NITI Aayog, HDFC sec)

The above 2 tables reveals that, there is massive supply-deficit for ethanol. In order *to meet the 20% blending target, India needs to increase its grain-based ethanol supply by 12x*! And *to meet this supply, India needs to add 482 Cr litres capacity* of just grain-based ethanol. Higher funding requirement and long cycle (from project approval to setup of plant) means India would continue to face paucity of ethanol for near to mid-term.

While sugar mills have enjoyed govt's favourable stance due to varied reasons, the humongous requirement of ethanol, however, can't be met through mere sugarcane given the limited supply (3 states account for ~85% production) and it being highly susceptible to the vagaries of the weather (sugarcane is very water intensive crop). Also, with ambition to double the farmers' income by addressing the issue of surplus foodgrain production, Govt, is taking varied measures (such as making available grains at subsidized costs, increasing administered prices) to promote grain-based ethanol.



*mutually decided by OMCs and distillers. From ESY2020-21, decided by govt. (Source: NITI Aayog, HDFC sec)

Historically, realizations of ethanol across feedstocks have increased at an avg. 4% p.a. and we have incorporated the same in our estimates. However, we expect the govt. to announce mid to high single-digit increase in administered price for ethanol in upcoming Ethanol Supply Year given the recent rally in crude oil price and as govt. seeks to encourage players to setup new capacities.

<u>GSL to double its capacity by FY23E to ride the ethanol wave</u>

GSL is undergoing an expansion of its grain-based distillery capacity from 490 KLPD to 930 KLPD over next two years as it braces itself to ride the ethanol wave. Its brownfield expansion in West Bengal (for 140 KLPD capacity) with estimated capex of Rs. 110 Cr is expected to commercialise in Q3FY22. The work for greenfield facility in Jharkhand (for 140 KLPD capacity) with estimated capex of ~Rs. 125 Cr has begun and facility is likely to commercialize in FY23. In addition, it is evaluating another 140 KLPD greenfield expansion in new state (~Rs. 100 Cr - 125 Cr) which is yet to be confirmed, however, the construction is expected to begin by end of current fiscal. By the time, this capex expansion wave is complete, GSL's total capacity will grow to 920 KLPD. Currently, only 1/3 out of its capacity is fungible while entire additional capacity (~450 KLPD) will be fully fungible between ENA and Ethanol allowing it to opportunistically shift to make better margins.

Ongoing and upcoming capex programmes will be funded through internal accruals on the back of strong cash generation and, as company prioritizes to reduce its debt (Net Debt/ Equity at 0.2x in FY21 vs 0.7x in FY18). For GSL, it takes around 12 months to setup a greenfield project. *GSL's capex/additional capacity addition is the lowest in industry*. For instance, its incremental capex in West Bengal is at Rs. 80L/KLPD which is ~20% lower than industry average. *<u>What facilitates this?</u>* According to our understanding, GSL procures some of its equipment domestically while importing others. It has got highly proficient in-house Technical & Engineering team responsible for installation of sourced equipment, which not only facilitates faster commercialisation of the plant but is also highly cost-effective. Besides, in our estimates, GSL has the best conversion yield (grain to alcohol) amongst distillers. These factors give GSL an unbeatable edge over its counterparts.

Capacity addition timeline of GSL

Particulars	FY21	FY22E	FY23E	FY24E	Comments
Total Capacity (in Cr Litres)	**17**	**23**	**28**	**33**	**Entire additional capacity is fully fungible between ENA & Ethanol**
- fungible capacity (can produce ethanol)	5	11	16	21	
State-wise Capacity (in KLPD)					
Rajasthan	140	160	160	160	Increased by 20KLPD in Q1FY22 through debottlenecking
Haryana	160	160	160	160	
West Bengal	110	250	250	250	Brownfield expansion of 140 KLPD to commercialize in Q3FY22
Bihar	80	80	80	80	Ethanol only given liquor ban
Jharkhand			140	140	Greenfield expansion of 140 KLPD to commercialize in FY23
Other state				140	Greenfield expansion in new deficit state, work to commence by Q4FY22
Total Capacity (in KLPD)	**490**	**650**	**790**	**930**	Capacity to double over FY21-24E

(Source: Company, HDFC sec)

Note: 100KLPD ~ 3.5 Cr litre for GSL as it operates ~350 days/yr compared to ~330 days/yr for other distilleries, facilitated by its superior technical and engineering capabilities which limit the maintenance period.

Hungry for even more…but Ethanol is not the only focus

Given the massive supply deficit for Ethanol which is unlikely to be met even after ongoing series of expansion, as discussed above, GSL's management is already considering further expansion beyond FY23, once current round of capex is over (already received in-principle approval for ~400KLPD across 3 states from DFPD – Department of Food and Public Distribution). This will likely lead to continued topline growth over medium term, while supply deficit and Govt's support programmes would cushion the bottomline. We like GSL's capital allocation strategy as it prioritizes reducing debt and funding capex only through internal accruals (despite government's interest subvention scheme for setting up distilleries), demonstrating respect for capital.

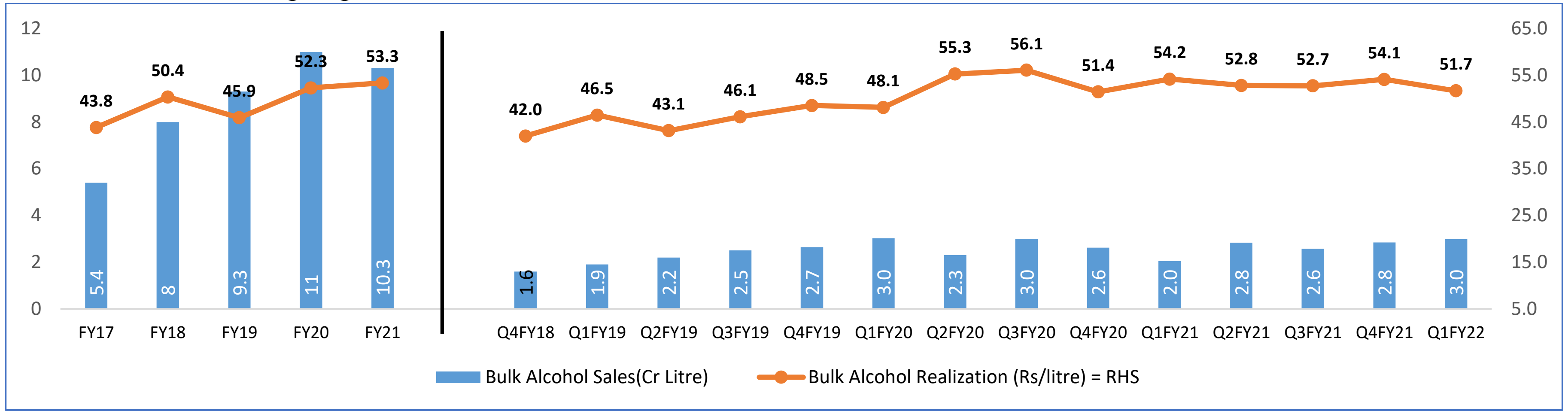
GSL's strategy to set up capacities in alcohol deficit states (states which import alcohol from others states) results in higher realisation and optimum capacity utilisation within few months from start of operation. Additionally, while Ethanol will drive the company's growth in near to medium term, its ***primary focus is to expand the footprint of its consumer business*** (margin accretive). It sets up capacity in state which offer high potential for its consumer business. For instance, in Jharkhand, it plans to launch its brands and increase the captive consumption of ENA over a period of time (ENA diverted towards IMIL yields ~2.5-3X realisation and also contributes to higher incremental margins).

With diversion of capacities to ethanol, ENA to command premium

ENA is the primary raw material for making alcoholic beverages and it is derived from different sources - sugarcane molasses and grains. While most countries globally mandate to have grain based ENA for whisky (~66% of IMFL), there are no such restrictions in India. However, companies in bid to drive premiumisation of their portfolio, have been increasingly moving towards grain-based ENA from molasses-based. For United Spirits, 70% of the ENA is grain based up from 10% in FY08 and 35% in FY13. For Radico Khaitan, ~65% is grain-based ENA while 100% of Pernord Ricard's products are grain-based. By the virtue of being first entrant and the largest grain-based distiller, *GSL is one of the largest suppliers of grain-based ENA to liquor manufacturers*, however, increasing salience of its own consumer portfolio has led to rising captive consumption which is lucrative.

With growing demand for ethanol, there have been structural changes in the spirits industry, with ENA capacity being used for ethanol. Driven by increased demand, grain-based ethanol supply has gone up as discussed above. The prices of ENA have which were ~Rs. 40/L couple of years ago have gone up sharply and this is unlikely to reverse anytime soon given huge supply deficit entailing continued higher realisations on bulk alcohol sales for GSL. Additionally, GSL's strategy to setup capacities in alcohol deficit states and with the upcoming capacities being fungible in nature allowing opportunistic shift from ethanol to ENA will further aid higher realisation.

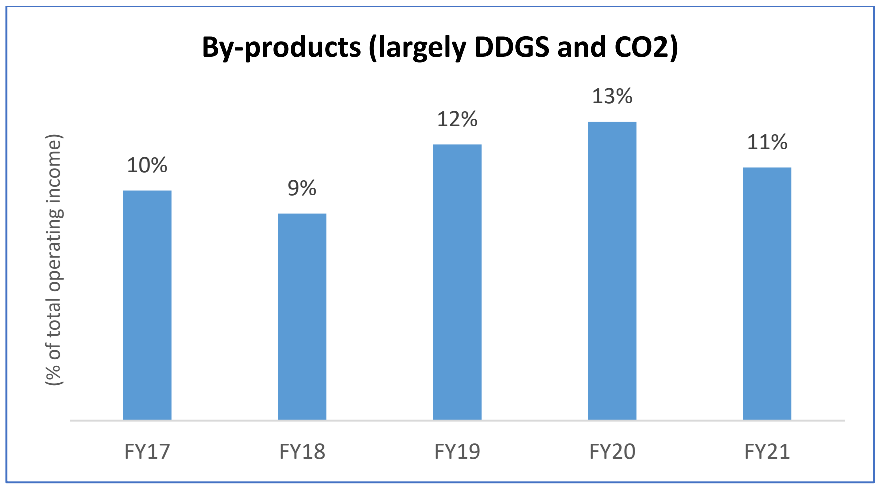
With aim of 20% blending target to 2025, the realisations on Bulk Alcohol sales will remain elevated



(Source: Company, HDFC sec)

Foray into animal feed lead to incremental revenues

Distillers Dried Grains with Solubles (DDGS), an animal feed supplement, is a major by-product from distillation process. To bring synergies with its existing business, GSL forayed into animal feed with the launch of Globus ProRice in 2015. Rice based DDGS an attractive replacement option for the conventional maize/soyabean based DDGS given higher protein content. The prices of DDGS is linked to Soya de-oiled cake prices which are currently at 5-year high and have witnessed a strong uptrend in past 2-3 quarters benefiting GSL.



(Source: Company, HDFC sec)

Renewed focus to drive the growth of consumer business

Over the years, GSL has successfully transformed from a grain-based bulk alcohol manufacturer to a 360° alcohol beverage (alcobev segment) player. Being vertically integrated offers unparalleled benefits, especially in current market scenario of sharp inflation in ENA. Transition of ENA towards captive utilisation helps in gaining higher realisation (ENA diverted towards IMIL yields ~2.5-3X realisation) and also contributes to higher incremental margin.

The consumer business revenue, comprising largely of Value segment (IMIL) and Premium Segment (IMFL), grew by ~26% YoY in FY21, on the back of higher volumes (12.2 mn cases in FY21 vs 11 mn cases in FY20) and better product mix.

On the path to become a pan-India IMIL player

GSL is one of the largest manufacturers and distributors of IMIL/country liquor with strong presence in North India. We believe, higher IMFL growth notwithstanding, country liquor is unlikely to lose significance, given the huge retail price differential between it and IMFL. Significant part of the price differential is on account of a steeper statutory levy on IMFL, which is difficult for IMFL players to narrow. Typical country liquor consumers include agri-workers in rural India, construction and industrial workers in towns/cities etc, and hence, pricing plays a crucial role.

GSL is the largest IMIL player in Rajasthan (~32% market share) and 2nd largest in Haryana (~11% market share). The company plans to further consolidate its market share in Rajasthan (aim to take upto 50%) with growing popularity of RML. Haryana, in the last few years, had been affected with rampant illicit liquor trade. However, FY21 onwards, there has been huge track-down by Govt. on illicit liquor and this should aid GSL's volume growth in the state.

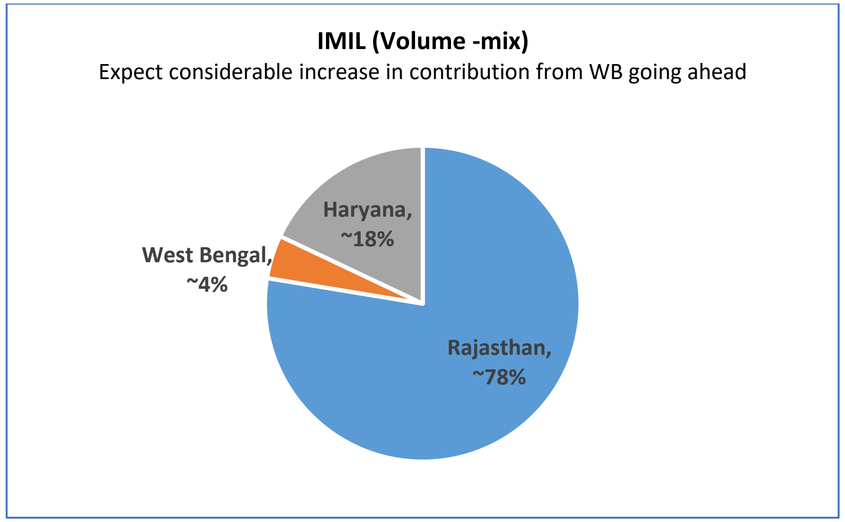
GSL entered West Bengal (2nd largest liquor market after UP) in FY19 with setting up of distillery and has garnered ~3% market share in IMIL. West Bengal being a highly fragmented market (with 25-30 bottlers) *offers a huge opportunity* to larger player like GSL for large market share gains. The company is aiming to expand geographically by entering new states (including Jharkhand with setup of distilleries) and by introducing new products. As stated by the management, a number of products are under development in each of the categories (lower/medium/premium) and are expected to be launched in the coming months.

'Premium country liquor' is the game changer…

While IMFL is a faster growing category, there is a significant price gap between the selling price of country liquor and IMFL (~Rs. 35/180 ml vs ~Rs 120/180 ml), which management believes will be difficult to bridge, given that a significant portion of the price-differential is on account of higher statutory charges in IMFL. This gap has further widened in recent time with sharp inflation in ENA prices (most IMFL players are net buyers of ENA) and excise-duty hikes, which has also resulted in down trading. GSL has smartly bridged this gap with foray into new segment of liquor called Medium Liquor which splits IMIL and IMFL (~Rs. 70/180 ml). Surprisingly, Medium Liquor is essentially same as regular IMFL with 42.8% ABV (alcohol by Volume) yet at steep discount, offering great proposition for aspirational country liquor consumers to upgrade.

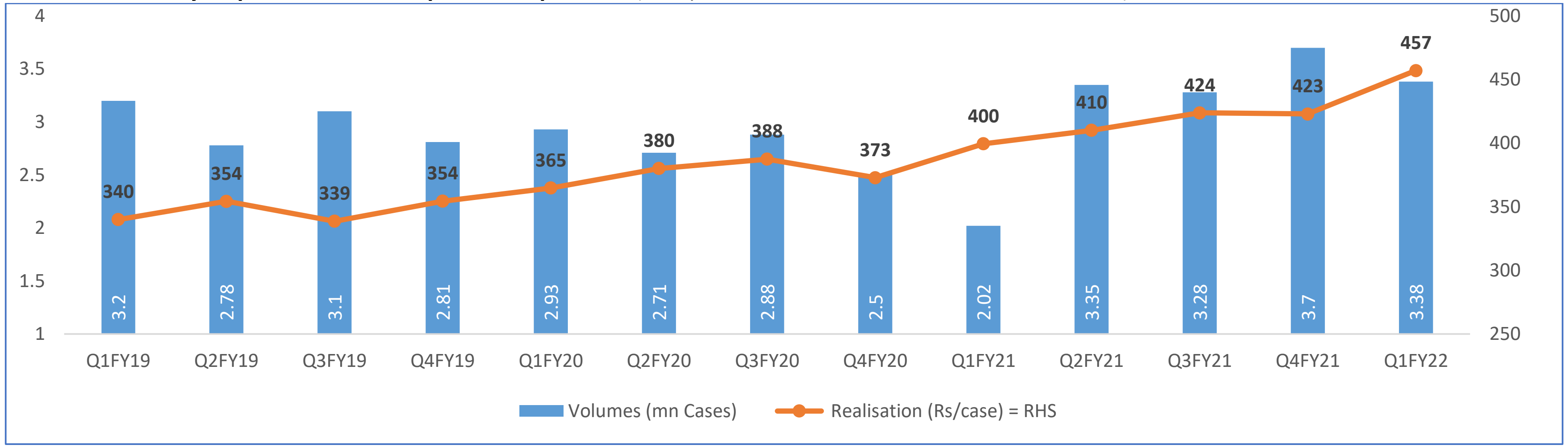
GSL introduced Medium Liquor in Rajasthan (called as Rajasthan Medium Liquor or RML) in Q4FY20 and it has been a runaway success, leading to improving realisations and greater margins. It further plans to introduce Medium Liquor in other states. Considering the massive potential this category has, we believe this to lead the topline and profitability growth.

Nimboo, Narangi, Ghoomar & Heer Ranjha are GSL's key IMIL brands in Its respective markets



(Source: Company, HDFC sec)

Rising ENA prices along with increasing contribution from medium liquor has led to sharp improvement in realisations while volumes have seen steady improvement over past few quarters (except lockdown affected in Q1FY21 & Q1FY22)



(Source: Company, HDFC sec)

<u>Premium IMFL - Building blocks for a high margin brand play through Unibev</u>

GSL has developed a unique hourglass concept, where it fancies being at either ends of an hourglass. At top of an hourglass i.e. premium/semi-premium segment there's high margin but low volumes while at bottom i.e. economy (IMIL) margins are low but volumes are higher. Resultant, GSL has forayed into premium and semi-premium liquor.

It has been working on building a strong portfolio of brands under Unibev Limited, a subsidiary company which is in the process of being merged with GSL. Unibev operates on an asset-light model with contract manufacturing arrangements. The company has identified high throughput outlets to ensure quick placement and movement of stocks. Its offerings at present include Governor's Reserve (semi-premium whisky), Oakton (premium whisky) and L'Affaire Napoleon (premium brandy). It further plans to launch Seventh Heaven (super premium whisky) in ongoing fiscal.

Higher realisation from IMFL would push the asset turnover for the company, with increased margins, thereby providing healthy contribution to return ratios. However, we expect contribution from the Unibev franchise to grow gradually.

GSL has crafted a range of premium and super-premium spirits

(Source: Company, HDFC sec)

Opportunities at extreme ends of the spirits spectrum – GSL's unique 'hourglass formula'

	IMIL/Country Liquor	IMFL – Regular	IMFL – Semi-premium Plus
Market Size	240 mn cases (Banned in South India)	270 mn cases	44 mn cases
Growth	6% estimated	Flat	~7%
Industry Contribution	Rs 1,440 Cr (Per case Rs 60, low WC)	Rs 2,970 Cr (Per case Rs 111, high WC)	Rs 3,160 Cr (Per case Rs 723, high WC)
Consumer Segment	Socio-economic (Section D), comprising ~40% of population excluding below poverty line population	Sec B, C, D, E segment	Sec A segment + Aspirational
Price (180 ml)	Rs 35	Rs 120	Rs 180++
Product	~30% (Earlier made from Rectified Spirits, now increasingly trending towards ENA) Flavored	42.8% (made from ENA) Whisky, brandy, rum vodka, gin	42.8% (made from ENA) Whisky, brandy, rum vodka, gin
USP	High volume & Low Margin		High margin & Low volume

(Source: Company, HDFC sec)

Financial Triggers

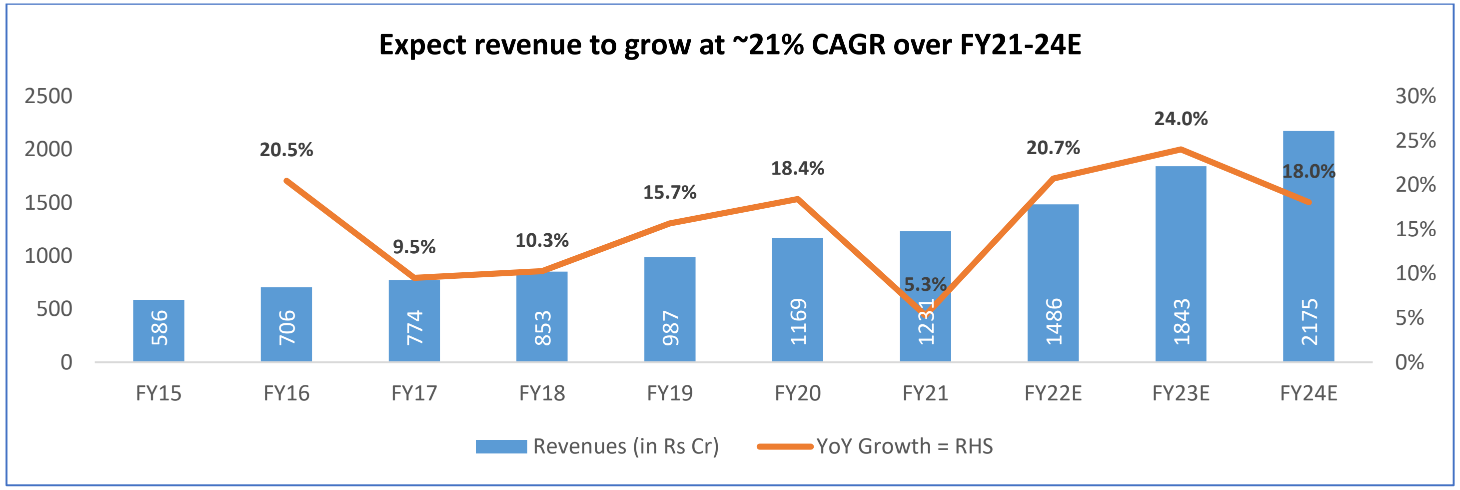
Revenues likely to grow at ~21% CAGR over FY21-24E on the back of ongoing capex programme

GSL has witnessed an impressive growth in its topline at ~16% CAGR over FY15-21, notwithstanding major hiccup in the form of liquor ban in Bihar. It has been an all-round growth, with both major segments of bulk manufacturing (including by-products) and consumer performing well. Going forward, we expect, the revenues to grow at ~21% CAGR over FY21-24E largely driven by higher ethanol sales on the back of upcoming capacities. Presuming the entire incremental capacity of 430 KLPD is used to produce ethanol, it alone would generate revenues worth ~Rs. 740 Cr at 95% utilisation levels and Rs. 100 Cr EBITDA at 13% margins (GSL generating >15% EBITDA margins on bulk alcohol sales currently). However, the company's primary focus is to grow its consumer business and transition of any incremental ENA produced towards captive utilisation would mean superior realisations (ENA diverted towards IMIL yields ~2.5-3X realisation).

While ethanol will be a major growth driver over near to medium term, we expect consumer business to be GSL's flag-bearer in long run. The consumer business' contribution has improved to 43% in FY21 from 35% in FY20. The management is working on building a roadmap for growth of consumer business over next 2-3 years, the details of which are likely to be shared in upcoming earnings concall. Renewed aggression in West Bengal (plan to double the sales volume here in next few quarters) with focus on widening its distribution and further entry into new markets (Jharkhand), along with scaling up Medium Liquor (premium country liquor) category which we believe to be a complete game changer, would drive the growth of consumer business, in our opinion.

Resumption of Bihar operations was a big boost

In 2016, the company has strategically set up distillery in Bihar to ride the massive growth opportunities for liquor in the state. However, in 2017, the Bihar plant was shut down pursuant to order by the Government of Bihar to ban sale of liquor in the state. This proved to be a major damper as GSL had funded its 80 KLPD Bihar facility via debt and ban meant it losing Rs. 100 Cr + revenues. To its relief, in FY19, the Bihar high court permitted manufacturing of ENA for exports to other states, but realisations dropped. However, now, with the diversion of the capacity to ethanol and sheer demand for same has pushed even the surplus state of Bihar into deficit. A higher realisation with increased utilisation has generated better operating leverage and improved overall profitability.



(Source: Company, HDFC sec)

GSL likely to enjoy higher margins over next 3-4 years

GSL's EBITDA margins have nearly doubled from 10.7% in FY20 to 20.7% in FY21 led by dual benefit of rising realisations and benign input costs. In fact the company has reported continuous margin expansion over past 6 consecutive quarters with EBITDA margin touching as high as 26.5% in Q1FY22. *But are these margins sustainable?* While historically the company has made single-digit margins given the commoditized nature of its offerings, we feel the company is likely to hold onto its current margins (20% +) for next 3-4 years given the government's thrust on Ethanol and massive supply deficit as discussed at length in above sections. The key raw material used by the company is broken/damaged rice which essentially is the waste product of rice mills and available at very cheap rates. It can also tactically switch to other foodgrains as feedstock if they are available at favourable prices. Besides, the company has also built capabilities to procure inputs at very attractive rates. We expect continued softness in raw material price with expectation of bumper Kharif output for 2021-22 (link) further cushioning the margins.

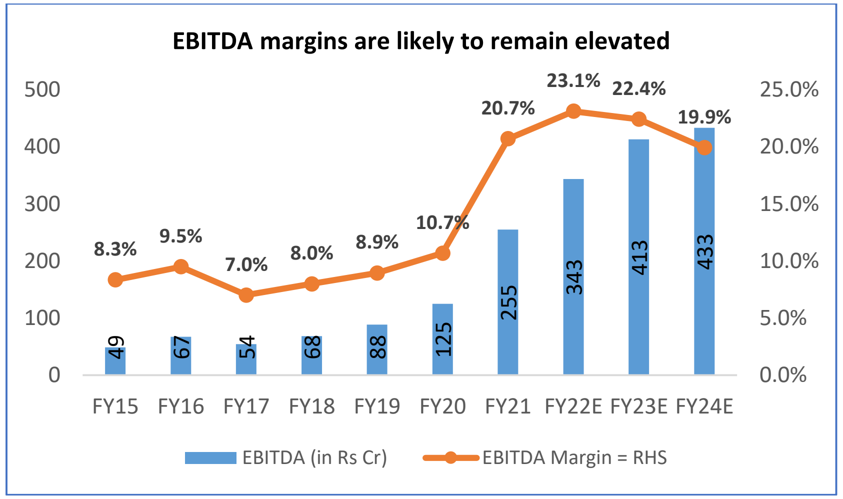
Due to Covid-19 induced lockdowns, GSL operated at 86% utilisation levels in FY21 while during Q4FY21, it operated at 99% utilisation and, despite 2nd wave of Covid-19, the capacity utilization in Q1FY22 stood at 98%. Given the deficit in the near term as liquor consumption increases on economy opening up along with ethanol demand, we expect the company to maintain 95%+ utilisation, further aiding the growth in margins.

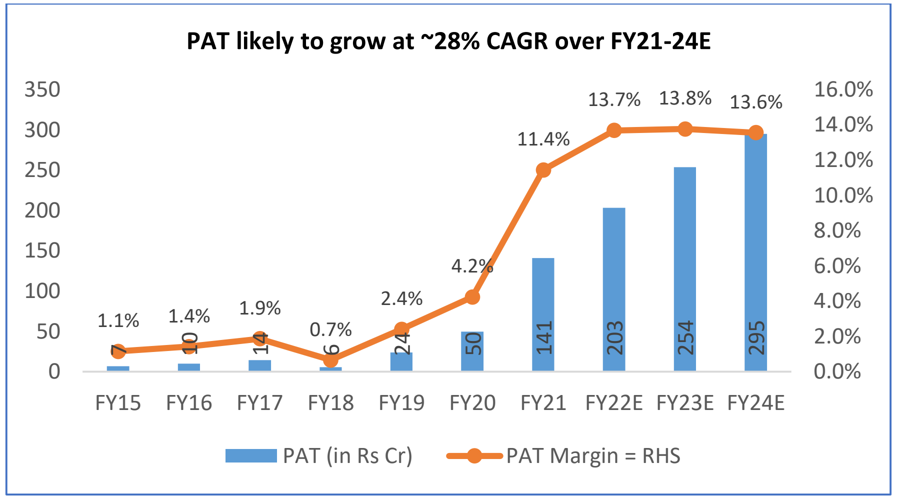
ENA realisations to remain high - With ENA shortage looming, its prices have moved up from around Rs 45/litre a year back to Rs58/litre recently due to ethanol demand displacing the ENA market, leading to deficit in ENA supply. This trend is likely to remain over next 2-3 years till additional supply comes in. High stable realisation will keep the margins high and steady.

Reaping the benefits of vertical integration – It's only in current market scenario, where a true benefit of vertical integration can be assessed. Sharp inflation in ENA prices (Key RM for Liquor) has highly affected liquor manufacturers with reduction in margins while resultant price hikes by IMFL players have further widened the gap with IMIL/country liquor adding to down trading by consumers but for GSL with its presence across value chain, margins have reached high levels. Renewed focus on consumer business (launch of new products and entry in new markets, increasing penetration of premium country liquor) including gradual ramp up of Unibev portfolio could cushion the margins going ahead.

Caution: While in near term margins may remain elevated, we expect correction in margins post 3-4 years as new capacities come up, filling the gap in the market. Margin expansion beyond that would depend on company's ability to scale up its premium liquor portfolio, which also holds the key for re-rating of stock.

PAT to grow at ~28% CAGR over FY21-24E – We expect to grow at ~28% CAGR over FY21-24E on the account of improved profitability and decline in interest cost with reduction in debt and lower cost of debt.





(Source: Company, HDFC sec)

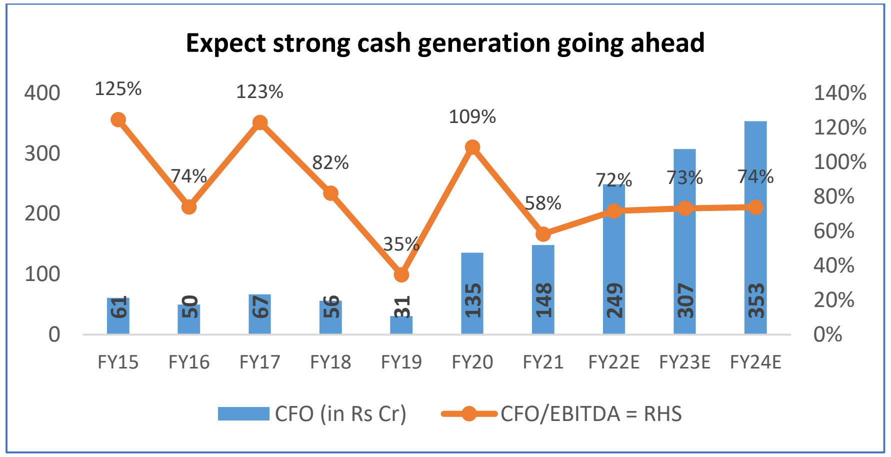
Strong cashflow generation to keep balance sheet leaner despite ongoing capex

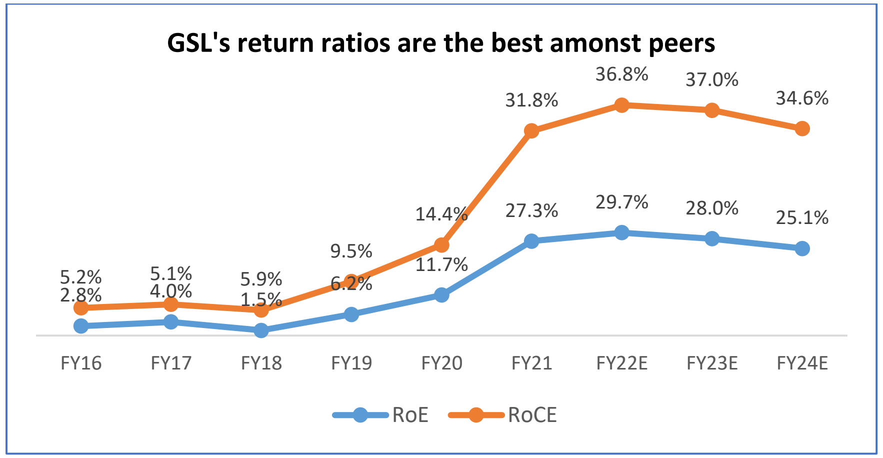
GSL's EBITDA has nearly quadrupled since FY18, while interest costs have fallen along with lower cash outlay for tax (GSL's effective tax rate is 18%) due to availability of MAT credit and 80IA deduction (on account of biomass-based power plant). All this has led to CFO improve from Rs. 55.8 Cr to Rs. 148 Cr in FY21. The company has strengthened its balance sheet by reducing debt of Rs. 73 Cr from FY18 and has further plans to bring it down aided by robust cash generation. The average cost of debt also reduced drastically to 8.8% in FY21 from 10.5% in FY18.

In terms of working capital, ENA (sales to liquor manufacturers) is a cash-based business, while ethanol (sales to OMC) has receivable days of 30-40 days. Consumer business has working capital days of 15-20 days. Overall payable days for the company stand at 45-60 days. Though contribution of the manufacturing business is expected to increase due to higher sales of ethanol, the company expects overall working capital to remain stable in the coming years. Robust sales growth and improvement in profitability coupled with stable working capital is likely to aid higher cashflow generation in the coming years. We expect GSL to generate CFO worth ~Rs. 900 Cr over next 3 years, to be utilised for its ongoing and future capex programmes and, debt reduction.

The contribution of consumer business is expected to improve (from current 43%) on account of improving demand for IMIL in key states, sustained new product additions and expansion in newer the states. This will further improve the company's profitability in the coming years.

Return Ratios to remain strong - GSL has tremendously improved its ROE & RoCE from mere 6.2% & 9.5% in FY19 to 27.3% & 31.8% respectively, which is higher than most Indian companies. With rising revenues and profitability, we expect stability in GSL's return ratios.





Key Risks

Constantly changing regulatory environment: The liquor industry is exposed to multiple regulatory risks emanating from state taxes, adverse ruling from courts and changes in regulations with respect to pricing, licensing, working of operating facilities, manufacturing processes, marketing, advertising and distribution.

Volatility in RM prices: GSL produces bulk alcohol primarily from the broken rice (>95% of RM requirement). Broken rice/ damaged grains are waste product of rice mills, thus, the price is not entirely correlated with rice price. Any sharp increase in RM price can potentially affect margin, however, ENA is a sellers' market while procurement prices for Ethanol are decided in October by the govt. (December-November is an ethanol supply year) after accounting for the crop output, thus margins are expected to remain stable in near term.

Change in government's Ethanol Policy: Given the steep target of 20% ethanol blending by 2025 and resultant massive deficit in ethanol production, we expect GSL to continue enjoying high operating margins over next 3-4 years. Over the longer term as the new capacities come in, the margins in bulk alcohol business may drop sharply due to its commoditized nature.

Diminishing spread between petrol and ethanol: At present, excise duty on landed cost of petrol at oil depots is higher than GST on the landed cost of ethanol and the benefit is being passed on to the retail consumers. However, in the future, should the price of ethanol increase beyond that of petrol, OMCs may feel discouraged to blend.

Company Background

Globus Spirits Limited (GSL) is one of the leading grain based distillery companies in India. Over the years, the company has transformed its business from a bulk alcohol manufacture to a 360° alcohol beverage player. GSL has diversified its operations into the entire value chain of liquor from the sale of Extra Neutral Alcohol (ENA) to marketing and selling of Indian Made Indian Liquor (IMIL) and contract bottling for leading IMFL (Indian Made Foreign Liquor) players. Also, under 'Unibev', GSL has launched three IMFL liquor brands in Prestige & above category in a few states and is gradually ramping up its presence in more states. The company has a total manufacturing capacity of 490 KLPD of bulk alcohol and a bottling capacity of ~ 18 million cases p.a., spread over five integrated manufacturing facilities in Behror (Rajasthan), Samalkha & Hisar (Haryana), Burdwan (West Bengal) and Hajipur (Bihar). However, in order to capitalize on government's Ethanol Blending Programme, additional capacity of 140 KLPD West Bengal, apart from greenfield setup of 140 KLDP in Jharkhand and new deficit state (yet to be announced) is expected to be commissioned by FY23. Post the capacity enhancement, the total manufacturing capacity would be scaled to ~940 KLPD.

Financials

Income Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Net Revenues	**987**	**1169**	**1231**	**1486**	**1843**	**2175**
Growth (%)	15.7%	18.4%	5.3%	20.7%	24.0%	18.0%
Operating Expenses	899	1044	976	1138	1422	1696
EBITDA	**88**	**125**	**255**	**348**	**420**	**478**
Growth (%)	29.5%	41.4%	104.2%	36.5%	20.8%	13.9%
EBITDA Margin (%)	***8.9%***	***10.7%***	***20.7%***	***23.4%***	***22.8%***	***22.0%***
Depreciation	36	38	41	49	56	61
Other Income	7	4	7	7	9	11
EBIT	59	90	221	306	373	429
Interest expenses	26	24	19	16	10	7
PBT	33	67	202	291	363	422
Tax	9	17	61	88	109	127
APAT	**24**	**50**	**141**	**203**	**254**	**295**
Growth (%)	2.4%	4.2%	11.4%	13.7%	13.8%	13.6%
EPS	**8.2**	**17.2**	**48.9**	**70.6**	**88.0**	**102.4**

Balance Sheet

As at March	FY19	FY20	FY21	FY22E	FY23E	FY24E
SOURCE OF FUNDS						
Share Capital	29	29	29	29	29	29
Reserves	369	419	557	754	1000	1287
Shareholders' Funds	**398**	**447**	**585**	**783**	**1029**	**1315**
Borrowings	230	178	179	119	84	54
Net Deferred Taxes	24	28	52	87	129	175
Other Non-Current Liabilities	7	12	12	17	21	24
Total Source of Funds	**659**	**665**	**828**	**1005**	**1262**	**1568**
APPLICATION OF FUNDS						
Net Block	574	569	579	699	784	804
CWIP	12	29	48	24	12	6
Other Non-Current Assets	32	25	61	71	88	104
Total Non-Current Assets	**617**	**623**	**688**	**794**	**884**	**915**
Inventories	78	106	102	126	151	179
Trade Receivables	49	34	88	122	167	209
Cash & Equivalents	2	20	58	81	207	439
Other Current Assets	23	16	56	69	86	101
Total Current Assets	**152**	**176**	**304**	**398**	**610**	**928**
Trade Payables	95	108	119	138	177	209
Other Current Liab & Provisions	17	26	45	49	56	66
Total Current Liabilities	**111**	**134**	**163**	**187**	**232**	**274**
Net Current Assets	40	42	140	211	378	654
Total Application of Funds	**659**	**665**	**828**	**1005**	**1262**	**1568**

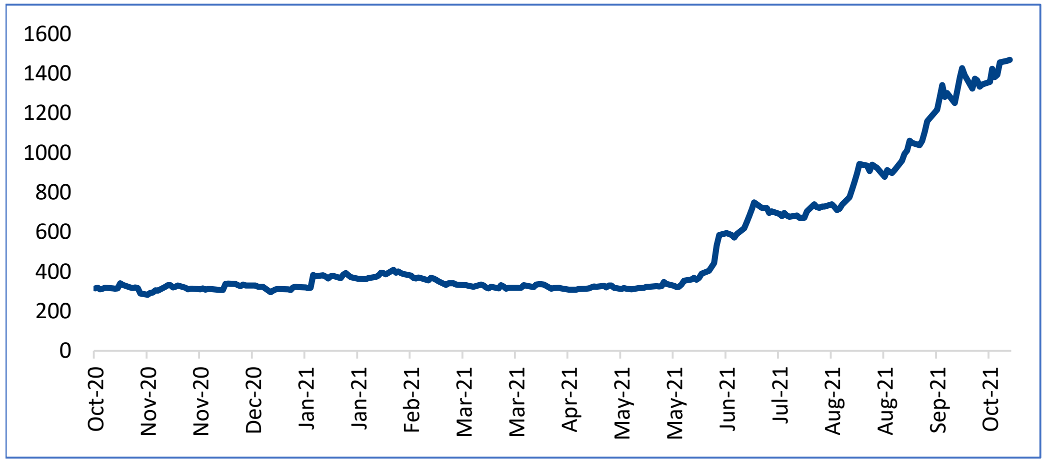
(Source: Company, HDFC sec)

Globus Spirits Ltd.

Cash Flow Statement

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Reported PBT	23.7	49.7	140.8	290.8	362.8	421.7
Interest Expenses	36.1	38.0	40.7	48.7	56.2	60.5
Depreciation	72.3	78.5	118.5	56.7	50.5	52.7
Working Capital Change	-56.8	19.0	-76.6	-45.6	-38.4	-40.1
Tax Paid	-8.7	-11.7	-34.3	-52.9	-67.5	-81.0
OPERATING CASH FLOW (a)	**30.6**	**135.4**	**148.4**	**248.9**	**307.4**	**353.3**
Capex	-30.0	-39.0	-89.2	-145.0	-129.0	-75.0
Free Cash Flow	0.6	96.4	59.2	103.9	178.4	278.3
Investments and Others	0.3	0.1	-1.1	0.0	0.0	0.0
INVESTING CASH FLOW (b)	**-14.0**	**-36.7**	**-87.0**	**-145.0**	**-129.0**	**-75.0**
Debt Issuance / (Repaid)	9.9	-53.4	-20.9	-60.0	-35.0	-30.0
Interest Expenses	0.0	0.0	0.0	0.0	0.0	0.0
Share Capital Issuance	0.0	0.0	0.0	0.0	0.0	0.0
Dividend	0.0	0.0	-2.9	-5.8	-7.2	-8.6
Others	0.0	-1.4	20.0	0.0	0.0	0.0
FINANCING CASH FLOW (c)	**-16.7**	**-80.4**	**-23.3**	**-81.4**	**-52.5**	**-45.7**
NET CASH FLOW (a+b+c)	**-0.1**	**18.4**	**38.1**	**22.6**	**125.8**	**232.6**

One Year Price Chart



Key Ratios

(Rs Cr)	FY19	FY20	FY21	FY22E	FY23E	FY24E
Profitability Ratios (%)						
EBITDA Margin	8.9	10.7	20.7	23.4	22.8	22.0
EBIT Margin	6.0	7.7	17.9	20.6	20.2	19.7
APAT Margin	2.4	4.2	11.4	13.7	13.8	13.6
RoE	6.2	11.7	27.3	29.7	28.0	25.1
RoCE	9.5	14.4	31.8	36.8	37.0	34.6
Solvency Ratio (x)						
Net Debt/EBITDA	2.6	1.3	0.5	0.1	(0.3)	(0.8)
Net D/E	0.6	0.4	0.2	0.0	(0.1)	(0.3)
Per Share Data (in Rs)						
EPS	8.2	17.2	48.9	70.6	88.0	102.4
CEPS	20.8	30.4	63.0	87.5	107.6	123.4
BV	138.2	155.3	203.2	271.8	357.4	456.7
Dividend	-	1.0	2.0	2.0	2.5	3.0
Turnover Ratios (in days)						
Debtor days	18.2	10.6	26.1	30.0	33.0	35.0
Inventory days	31.6	37.2	38.2	40.5	38.9	38.5
Creditors days	38.4	37.9	44.4	44.4	45.3	44.9
VALUATION						
P/E	178.3	85.4	30.1	20.8	16.7	14.4
P/BV	10.6	9.5	7.2	5.4	4.1	3.2
EV/EBITDA	50.5	35.2	17.1	12.3	9.8	8.0
EV / Revenues	4.5	3.8	3.5	2.9	2.2	1.8
Dividend Yield (%)	0.0%	0.1%	0.1%	0.1%	0.2%	0.2%

(Source: Company, HDFC sec)

HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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