



# JOINDRE CAPITAL SERVICES LTD.

SEBI REGN NO. INH000002061 / INZ000174034

## RESEARCH REPORT

20<sup>TH</sup> Aug 2018

### RADICO KHAITAN LTD

BSE : RADICO

Sector: IMFL LIQOUR & BREWERIES

BSE: 532497

#### View - BUY

CMP : Rs. 404

Target Price: Rs 510 (In next 12 to 15 mths)

#### BUSINESS BACKGROUND

Radico Khaitan Ltd (RDCK) is the third largest volume player in IMFL segment in Indian market with annual sales of more than 20 million cases. Having entered in branded IMFL segment in late 90s, RDCK has established a wide range of products across different price levels and expanded its presence in the market.

RDCK owns six pillar brands, named 8PM, Magic Moments, Old Admiral, Morpheus, Contessa and After Dark, which have significant market presence and enjoys considerable market share in the industry. RDCK has three distilleries in Rampur, UP and holds 36% interest in a JV in Aurangabad, Maharashtra. It owns 5 bottling units and maintains 28 contract bottling units. It holds 7% market share in IMFL industry as on date

#### INVESTMENT HIGHLIGHTS

##### Strong Financial Performance for FY18 –

RCDKL reported a strong set of FY18 numbers with net sales at Rs 1882 crs as compared to a revenue of Rs 1679 crs last year, with EBIDTA placed at Rs 270 crs from Rs 211 crs last year with the PAT placed at Rs 123.50 crs from Rs 80 crs up by 54% YoY. RCDKL has declared a dividend of 50% for FY18.

For RCDKL Q1FY19 was noteworthy with Sales up by 26% at Rs 520 crs with EBIDTA up by 47% at Rs 91.20 crs with PAT at Rs 47.4 crs up by 84%. EBIDTA margins in Q1FY19 improved to 17.7% from 15.04% in Q1 last year. Volumes of the prestige & above segment (higher margin products) reported robust growth of 30% YoY to 17.1 lakh cases.

The regular & other brands volumes increased by 15% YoY. RCDKL Expects the liquor industry to grow at 9% YoY while it is targeting 15% volume growth in FY19

##### Vertical integration transformed RDCK –

RDCK is one of the oldest and largest liquor manufacturers in India, with a pan-India presence. It has transformed itself from a bulk and country liquor manufacturer to a branded IMFL manufacturer.

RDCK has created brands and now houses four major brands which sell more than a million cases per year despite advertising and sales promotion in liquor not being permissible in the county.

In addition to building up presence in the fastest growing segment of whisky, the company has also created a niche in the less competitive segment of brandy and vodka.

#### KEY DATA

FACE VALUE	Rs	2.00
DIVD YIELD %		0.24
52 WK HI/LOW		495/147
NSE CODE		RADICO
BSE CODE		RADICO
MARKET CAP	RS	5386 CRS

#### SHAREHOLDING PATTERN

PROMOTERS	-	40%
BANKS, MFs & DIs	-	5%
FIs	-	24%
PUBLIC	-	31%

#### KEY FUNDAMENTALS

YE	FY19	FY20	FY21
Rev Gr%	8	9	14
EBIDTA Gr%	17	14	14
PAT Gr%	33	30	21
EPS Gr%	33	30	21
EPS (Rs)	12.38	16.10	19.53
ROE %	13	15	16
ROCE %	13	15	17
P/E(x)		25	20



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### **RDCKLs Premiumisation strategy has been successful -**

RDCK is strategically resorting to premiumisation to drive growth and margins and is making solid progress in the premium segment. Magic Moments has become one of the leading Vodka brands worldwide with volume of 3.5m cases while Morpheus Brandy's volume has increased 55% in the last 3 years.

Favorable demographics, rising disposable incomes and changing social attitude towards alcohol consumption are the key factors driving demand for premium liquor. Until 2006, RDCK was a regular/economy segment player, participating in the sub-Rs300/unit pyramid. In 2006, it launched Magic Moments, positioned in the premium segment. This was its first attempt at moving up the value chain. EBITDA margin in premium brands is 3x the regular brands.

### **Magic Moments of RDCKL is giving competition a tough time –**

RDCK has captured 50% volume market share in the Vodka segment, from 5% in 2006. The nearest competitor is far second at 14% market share. The company has already launched an extension of Magic Moments brands with introduction of six flavors, which continue to do well.

For RDCK to accelerate its prestige segment volume growth to 9-10%, it would require other premium brands to contribute as well; Morpheus could be the next Magic Moments for RDCK.

### **RDCKL is the 4<sup>th</sup> largest player in volume terms –**

In terms of volume, RDCK is the fourth largest player in the IMFL space. Having entered the branded IMFL space in the late-90s, it has created four new millionaire brands (8PM, Magic Moments, Old Admiral and Contessa) across product segments like whisky, vodka, brandy and rum.

RDCK was earlier focused on the value for money segment, with price points of less than INR300/750ml. It has four pillar brands and a host of midsized and regional brands.

### **RDCKL looks well positioned to capitalize on rising premium IMFL Consumption –**

The Indian spirits market has slowed in recent years from double-digit growth to low single-digit volume growth. However, the slowdown has not been felt in the premium segment (made up of mostly Indian made whiskies/ Scotch/Vodka) where volumes have continued to grow in the midto- high teens. As such, the slowdown has been felt entirely in the regular segment, where profitability is significantly lower.

### **Structural Changes in the Industry Makes Indian Spirits Market More Attractive –**

#### **Entry of global majors -**

With increasing participation of global players, the industry is expected to become more efficient, operationally disciplined, and transparent and aligned to best global practices.

There is a clear shift towards creating and growing the overall market

#### **Shift from volume growth to value growth**

Corporates focusing on profitable growth as against volume growth.

Expected price increases likely to result in increase in EBITDA margins, thereby aligning margin structures of domestic players with the global counterparts.

Industry players are negotiating price hikes with state governments



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### **Increasing premiumisation– Improving product-mix –**

Several companies are increasing focus on premium products, thus driving the overall profitability.

Encouraging macro factors such as rising disposable incomes and affluence, growth in middle class households and increasing brand awareness

### **Vodka to outperform overall IMFL growth in the coming years –**

The white spirits segment - Vodka and Gin, primarily the former, holds a lot of promise in the Indian spirits industry. Rapid urbanisation, increased consumerism, and adoption of trendier lifestyles are driving vodka sales across smaller towns and cities and long considered a cosmopolitan drink in the Indian context, vodka is finding increasing acceptance among a large and growing number of youngsters and women in the Tier II cities and towns.

Sale of clear drinks has soared, triggered by the adoption of big-city trends and habits. In cities the perception that vodka has lower alcohol content compared to whisky and the colorless and odorless nature of the spirit has helped increase sales traction.

The potential of Vodka also stems from the low contribution of white spirits to the total IMFL consumption basket as compared to the global spirits consumption where white spirits segment (primarily Vodka) forms a major portion. White spirits stand at 47% of the global spirits market in volume terms while in India, they form only 3.5%.

### **Key Drivers for Growth of Liquor Consumption in India –**

#### **Income Growth**

India GDP growth of 7.6% in FY2017

Growth in per capita income to drive discretionary income growth at much higher pace than the GDP growth, boosting demand for lifestyle products including alcoholic beverages

Rural economy is likely to see a big upsurge in income levels due to various government initiatives in the mid to long term

#### **Attractive Demographics –**

Around 60% of India's population is in the age-group of 15-55

Nearly 840m people in the drinking age in CY2015. Another 65m are likely to be added by CY2020

Following these favorable demographics, demand for alcoholic beverages is set to rise

### **India is still a underpenetrated market with huge potential –**

India's per capita consumption (2.2 lpa) of alcoholic beverages is among the lowest in the world (over 7.5 lpa)

A small increase in per capita consumption to significantly alter industry growth, given the large population base



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### **Rural Consumption to Grow 3.8x and Tier 2 & Below Cities to grow 4x by 2025 –**

Cities which have a population below 1m would be the next drivers of growth, share of Tier 2 & below cities is expected to increase from 36% to 45% by 2025

These cities are expected to add 7m affluent/elite households resulting in increased demand for premium products. Growing awareness, easier access and changing lifestyles have been the key growth drivers of the consumer market. Companies will need to rethink their go-to-market, portfolio strategy and brand Communication

### **RDCKL enjoys a strong distribution footprint across India –**

RDCKL has a strong sales and distribution network with a presence in retail and off-trade outlets in the relevant segments in different parts of India

It has over 33 bottling units spanning almost the entire country, of which 5 belong to the Company and 28 are contract bottling units

Currently it sells through over 55,000 retail outlets and over 5,000 on premise outlets

Also apart from wholesalers, it has a total of around 300 employees divided into four zones, each headed by regional profit centre head, to ensure an adequate on-the-ground sales and distribution presence across the country.

RDCKLs strategic bottling units are spread across the country. This is to avoid the high taxes levied on inter-state movement of finished and in-process liquor

It also has tie up with Ernest & Julio Gallo of California (one of the largest wineries in the world) for distribution of their wines

### **Uttar Pradesh market boost for RDCKL –**

Uttar Pradesh is an important market for RDCK where the new government introduced 'go-to-market' distribution model from Apr'18. This is positive for strong brands including RDCK's 8PM Whisky and Magic Moment Vodka. This policy has been very positive for RDCKL as UP contributes 20% to RDCK's overall volumes.

### **RDCKL enjoys a strong balance sheet with huge scalability potential going ahead –**

RDCKL runs a strong business model covering multiple product segments across multi locations with a efficient working capital management while it continues to invest on a sustained basis largely from its internal accruals.

RDCKL has reduced its debt on the balance sheet in Q1 FY19 by Rs 140 crs and plans to repay debt fully by FY21 and deleverage its balancesheet further.

We expect that going ahead overall bottomline growth in the next 3 years starting FY18 onwards should easily increase at a CAGR of 25-27% and with capex funded largely from internal cash flows. Hence going ahead we expect both the ROCE and ROE to improve to 17% and 16% by FY20 from 12% and 11% in FY18.



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### **Business Outlook & Stock Valuation –**

On a rough cut basis, in FY19, Topline will see a steady rise wherein Topline is expected to touch Rs 1975 crs in FY19E.

On the bottomline level we expect the company to record a PAT of Rs 165 crs in FY19E. Thus on a conservative basis, RDCKL should record a EPS of Rs 12.38 for FY19E. For FY20E and FY21E our expectation is that earnings traction for RDCKL would continue to be strong wherein we expect a EPS of Rs 16 and Rs 20 respectively.

RDCK launched premium variant of 8PM whisky – 8PM Premium Black and a superior variant of Morpheus brandy – Morpheus Blue during Q1FY19

New launches led the volume growth. The regular & other brands volumes increased by 15% YoY. Management expects the liquor industry to grow at 9% YoY while it targets 15% volume growth for FY19E

RDCK repaid debt of Rs 140.2 cr during Q1FY19. The outstanding debt stands at Rs 430 cr as on 30<sup>th</sup> June 2018. These steps are in line with the RDCK's existing policy to become a debt-free company by FY21.

RDCK benefitted from lower raw material costs during the Q1FY19. The management has guided soft raw material prices to continue throughout FY19E. Premiumization and debt reduction strategies are panning out as per guidance. Looking at RDCKL's steady financial track record, strong product domain and dominant market share and strong promoters we expect the stock to get re rated in future.

With margin drivers remaining intact, improvement in operating cash flows is likely to continue which coupled with better working capital management and lower capex requirements will continue to drive debt and interest cost reduction over FY18-21E

We believe that with strong brands and a good distribution network, RDCK is poised for an upward rerating in its valuations multiple.

The RDCK management's strategy on premiumization and deleveraging is reaping benefits now. The product mix is constantly improving which is resulting in margin improvement. The RDCKL stock is down 18% from its recent peak levels due to the midcap sell-off but looking at the strong EPS growth expected over FY18-FT21 we think this is a good buying opportunity given it's a strong consumer franchise with high entry barriers.

Hence we believe that the RDCK stock should be purchased at the current price for a price target of around Rs 510 over the next 15 months.



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## FINANCIALS

For the Year Ended March RsCr	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	1679.90	1822.80	1975.20	2150.20	2450.50
EBIDTA	211.30	269.80	315.10	360.20	410.10
EBIDTA %	12.58	14.80	15.95	16.75	16.74
Interest	80.40	68.20	46.00	25.00	12.00
Depreciation	41.70	40.90	43.00	46.00	49.00
Non Operational Other Income	19.60	26.70	26.10	26.00	25.00
Profit Before Tax	108.90	187.30	252.20	315.20	374.10
Profit After Tax	80.10	123.50	165.30	215.00	260.70
Diluted EPS (Rs)	6.00	9.25	12.38	16.10	19.53
Equity Capital	26.70	26.70	26.70	26.70	26.70
Reserves	1017.50	1115.50	1280.80	1495.80	1756.50
Borrowings	802.70	590.00	350.00	150.00	105.00
Net Block	703.80	685.50	675.00	650.00	635.00
Investments	219.60	205.40	205.40	205.40	205.40

Source Company our Estimates

## KEY CONCERNS

### Regulatory Environment

Liquor is largely a state subject in India, as a result most states have their own policy regarding licensee, taxes etc. This has led to high level of taxes and increase in price point for consumers

### Fluctuations in raw material prices

As major raw material is derived from sugarcane or other grains, the prices are affected by production of particular crops and government's procurement prices.

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