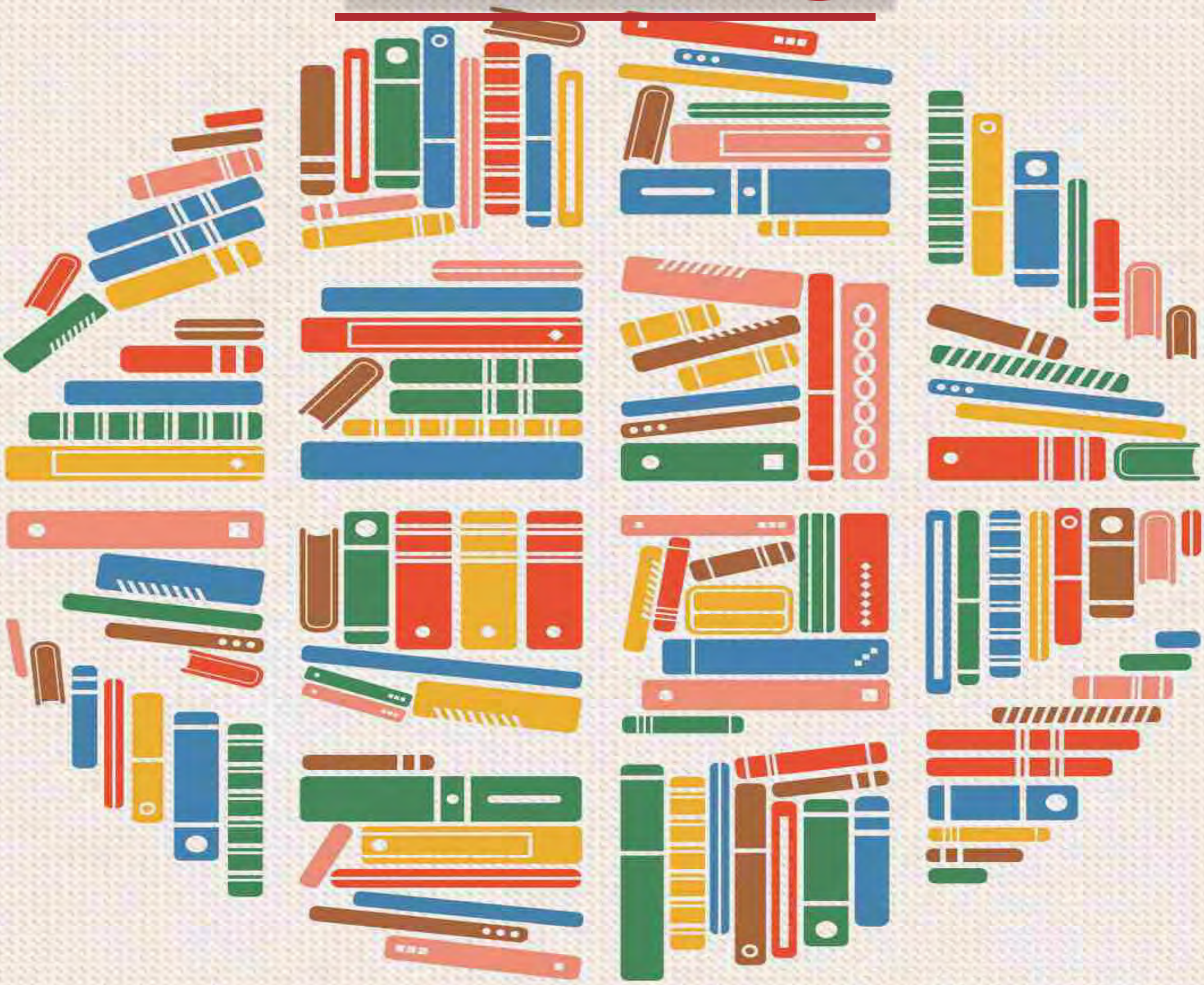
ICICI direct Research

Stock TALES



Stock Tales are concise, holistic stock reports across wider spectrum of sectors. Updates will not be periodical but based on significant events or change in price.

Radico Khaitan (RADKHA)

CMP: ₹ 330 Target: ₹ 400 (21%) Target Period: 12-14 months

BUY

September 24, 2019

Branded liquor play available at compelling valuation

Radico Khaitan (earlier Rampur Distillery Company) is among the largest manufacturers of Indian made foreign liquor (IMFL) in India. The company is also a supplier of Indian made Indian liquor (IMIL) and bulk alcohol in India. It has the distinction of being among very few domestic players that have over the years entered and generated brand equity in the prestige and above liquor segment. The company has three distilleries in Rampur (Uttar Pradesh) and two other distilleries operating in JV in Aurangabad (Maharashtra), with overall capacity of 157 million litre. Radico has progressively enhanced its return ratios (reached RoE, RoCE of 14.8%, 18.3%, respectively, in FY19) while investing into newer, existing brands, and also staying on the organic growth path. The management expects EBITDA margins to remain at 16-17% despite the hardening of input prices (ENA, packaging material) in FY20, and also expects to become debt free in two years. We expect, Radico to grow its revenues, EBITDA and PAT at 12%, 12% and 24% FY19-21 CAGR, respectively.

Continued play on premiumisation front

Radico has four millionaire brands 8PM whisky, Contessa Rum, Old Admiral brandy and Magic Moments vodka (sell more than a million cases each year). Within P&A category, semi-premium brands such as Magic Moments dominate the share in its category while the share from the super-premium brands such as Morpheus brandy continues to rise. Also, luxury brands such as Rampur single malt and Jaisalmer Gin have shown considerable growth in overseas demand, focused on US, Europe and travel retail market. Radico plans to launch two more brands in the premium space, imparting further momentum to the trend.

Strong free cash flow generation

Radico clocked RoE & RoCE of 14.8% & 18.3%, respectively, in FY19 (earlier 8% and 9.9% in FY16). With rising revenues and profitability and lack of any major capex in the medium term, return ratios are expected to remain healthy at 16.5% and 19.7%, respectively, in FY21. Similarly, with focus on priority states and better working capital management and lower capex, cash flows are expected to remain strong. FCF is expected to remain robust at ₹ 185 crore in FY21E (implied 4.2% yield).

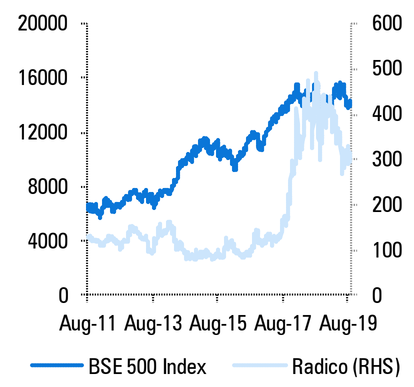
Favourable product mix to aid robust growth

A steep correction in the stock (~30%), despite superior performance parameters (with strong cash flow generation) and continued strong future prospects, makes it a preferred pick in the alcobev sector. In spite of the dominance of two global players in the 'prestige and above' segment, Radico has been able to penetrate the segment and create an own niche for itself. With a continued focus on brand development, newer premium IMFL launches and strong distribution network built over the years, we ascribe a **BUY** rating to Radico Khaitan with a target price of ₹ 400 (18x FY21E P/E).

Radico Khaitan Limited

Particulars	
Market Capitalisation (₹ cr)	4,242.4
52 Week High / Low (₹)	454/260
Promoter Holding (%)	40.4
FII Holding (%)	19.8
DII Holding (%)	6.4
Dividend Yield (%)	0.5

Price Chart



Key Highlights

- Within P&A category, semi-premium brands such as Magic Moments dominates the share while the share from super-premium brands such as Morpheus brandy continues to rise
- Radico's return ratios, RoE and RoCE are expected to remain healthy at 16.5% and 19.7% in FY21

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Key Financial Summary

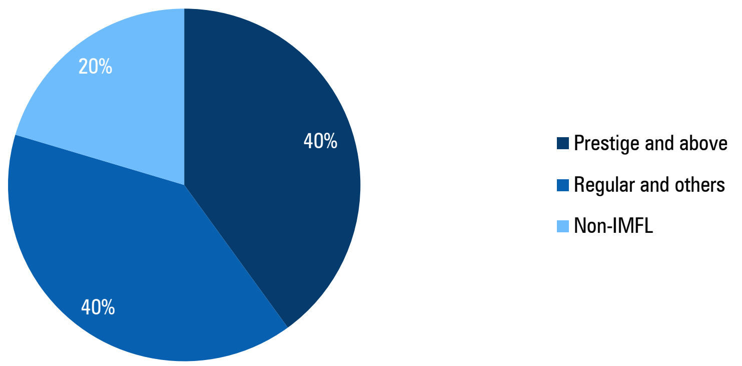
₹ crore	FY17	FY18	FY19	FY20E	FY21E	CAGR
Net Sales	1,679.9	1,822.8	2,096.9	2,348.9	2,645.9	12.3%
EBITDA	211.3	269.7	350.3	368.8	436.6	11.6%
PAT	80.2	124.0	194.1	236.8	298.4	24.0%
P/E (x)	54.9	35.5	22.7	18.6	14.8	
M.Cap/Sales (x)	2.6	2.4	2.1	1.9	1.7	
RoCE (%)	10.7	14.3	18.3	17.7	19.7	
RoE (%)	7.7	10.7	14.8	15.5	16.5	

Source: ICICI Direct Research, Company

Company Background

Radico Khaitan began its operations in 1943 and operates three own distilleries (UP based) and two in JVs (36% equity-Maharashtra based) with an overall ENA capacity of 157 bulk litre and 28 bottling units (23 owned). On the business front, IMFL revenues contributes ~80% to the topline while the rest is provided by IMIL sales, bulk ENA supply, operating as a third party bottler and sale of by-products (fertiliser, animal feed, CO2). Geographically, North, South and CSD contribute ~85% of IMFL sales.

Exhibit 1: FY19 revenue break-up



Source: Company, ICICI Direct Research

The company began its IMFL journey by launching its popular segment 8PM whisky brand in 1998. Further, it launched its first product in its semi-premium category viz. Magic Moments Vodka in 2006. Subsequently, in 2009 and 2011, it entered the premium category with the launch of Morpheus Super Premium Brandy and After Dark (premium category Whisky). The company has in-house brands in all major liquor segments: viz. Whisky (8 PM, Regal Talon, Rampur Indian Single Malt), Rum (Contessa, Pluton Bay, The Spirit of Victory), Gin (Jaisalmer Indian Craft Gin), Brandy (Morpheus, Old Admiral) and Vodka (Magic Moments).

Historical Background

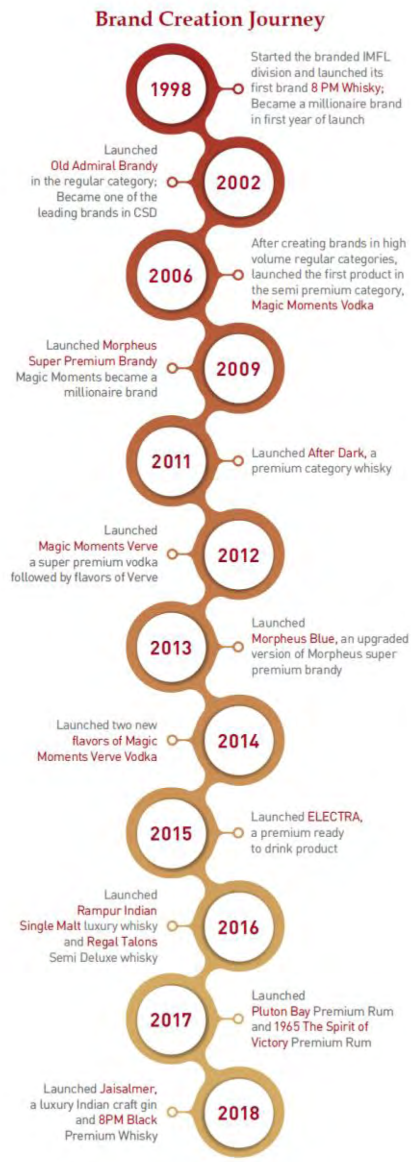
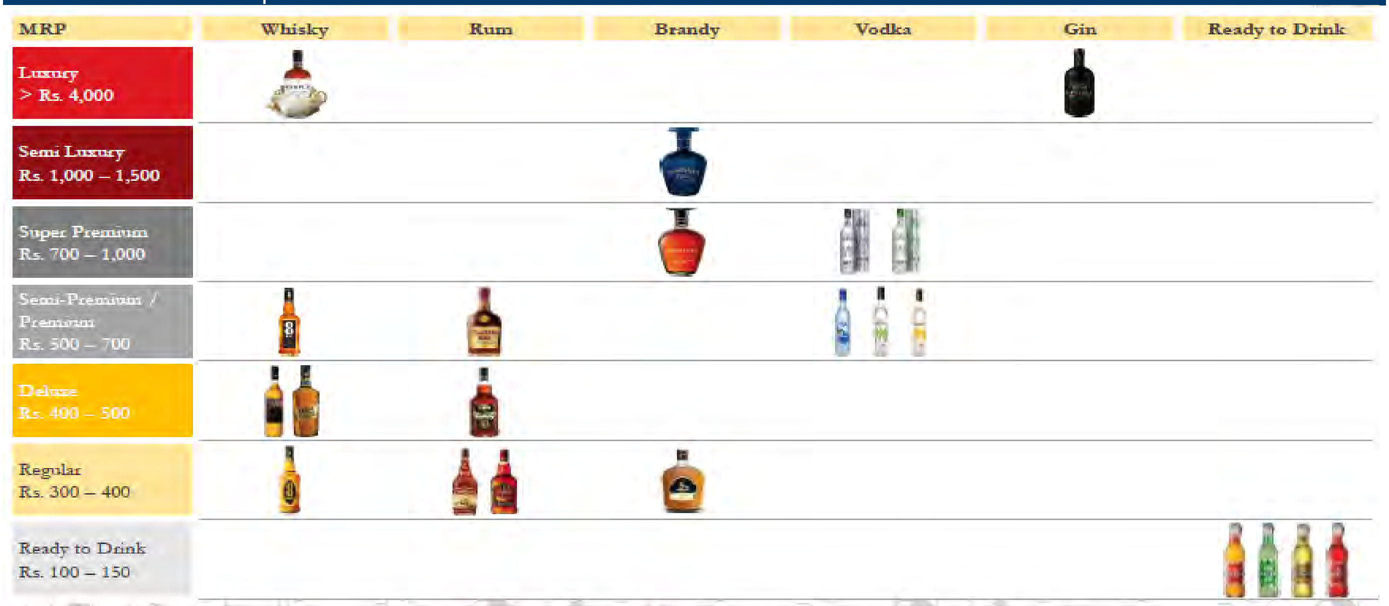


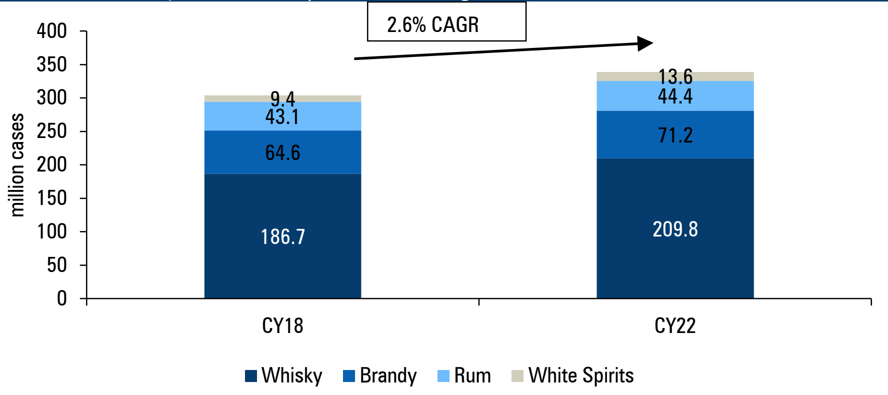
Exhibit 2: Radico IMFL portfolio



Source: Company

Industry in charts

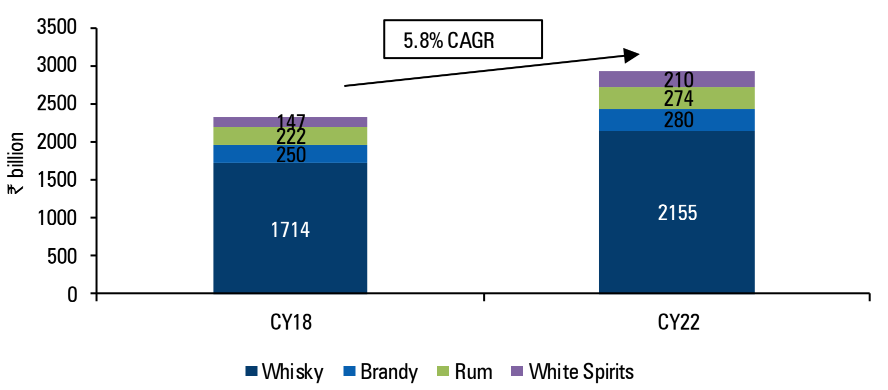
Exhibit 3: Indian spirits sales by various categories (volumes)



Source: Company, ICICI Direct Research

Whisky expected to grow strongly on higher base at 3.7% CAGR

Exhibit 4: Indian spirits sales by various categories (value) – Excise inclusive



Source: Company, ICICI Direct Research

Whisky, rum, white spirits expected to clock 6%, 5.6% and 9.2% CAGR, respectively

Exhibit 5: Regulated industry with complex structure

Market Structure	Overview	Pricing Control	States
Free / Open market	A business may apply for a license for a fee defined by the state government subject to license availability	Company has reasonable independence over price increases	Arunachal, Assam, Goa, Maharashtra, Meghalaya, Tripura, Uttar Pradesh
Auction market	The license for sale of liquor is auctioned by the Government to the highest bidder on an annual basis based on an auction process	Company has to negotiate price increases with state appointed distributors	Chandigarh, Haryana, Punjab
State owned / Government corporations	The government is the wholesaler and/or distributor who purchases directly from a company. Some states also have retail shops run by the government	Strict control on pricing by the state government	Andhra Pradesh, Chhattisgarh, Delhi, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Rajasthan, Tamil Nadu, Telangana, West Bengal
Prohibition	States where sales of liquor is prohibited	Not applicable	Bihar, Gujarat

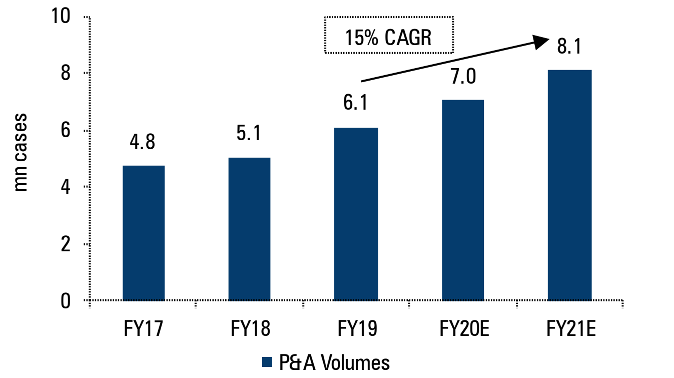
Source: Company presentation

Investment Rationale

Premiumisation continues to rule the roost

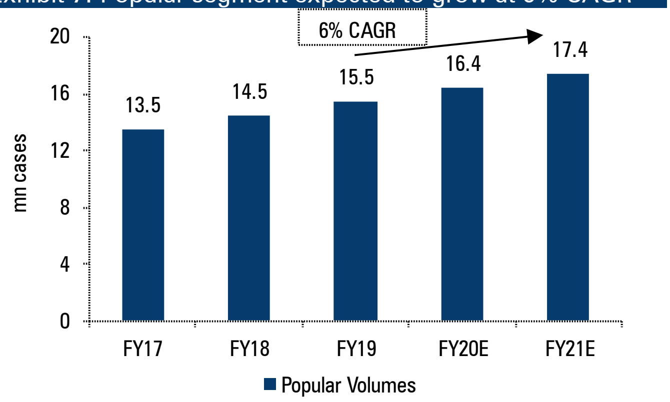
Favourable demography, rising disposable income and a greater acceptance of alcohol within the society, provides ample scope for premiumisation. With Radico's portfolio spread across the liquor spectrum, premiumisation of product portfolio is seen in its IMFL segment. IMFL volumes has remained largely flat from 19 million cases in FY13 to 21.6 million cases in FY19 (2% CAGR). However, Radico further bifurcates its IMFL division into prestige & above (P&A) and popular segment. P&A volumes have historically grown from 15-16% of the IMFL mix to 28% in FY19. Within P&A category, semi-premium brands such as Magic Moments dominate the share while the share from super-premium brands such as Morpheus brandy continues to rise. Also, luxury brands such as Rampur single malt and Jaisalmer gin have shown considerable growth in overseas demand, focused on the US, Europe, travel retail market. Radico plans to further launch two more brands in the premium space. This trend is further expected to gain momentum.

Exhibit 6: P&A volume likely to grow at 15% CAGR (FY19-21)



Source: Company, ICICI Direct Research

Exhibit 7: Popular segment expected to grow at 6% CAGR

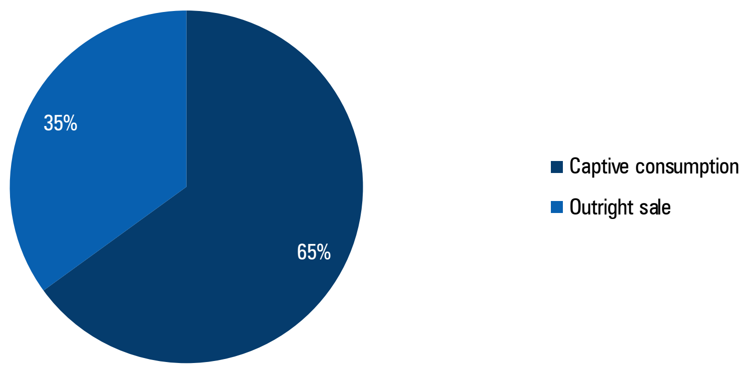


Source: Company, ICICI Direct Research

Existing capacity enough to take care of medium term demand

Radico with its five distilleries (inclusive of two JVs) boasts an ENA capacity of 157 million bulk litre, which operated at 95% capacity in FY19. The company currently employs ~65% of its capacity for its in-house usage, while the remaining part is utilised as direct sale (both bulk and third party bottling). Hence, as the share of captive usage grows, it will replace the other lower realisation businesses. Also, as volumes of the premium portfolio are increasing, the proportion of grain based ENA is expected to increase. Currently, the ENA capacity mix between molasses and grains is at 45:55. We expect the company to just incur maintenance capex in the near to medium term (₹ 60-70 crore). For the long term, we expect outsourcing to play a major role in Radico's raw material sourcing (currently 50% outsourcing), as the company would channelise its energies on building superior brands.

Exhibit 8: ENA capacity consumption

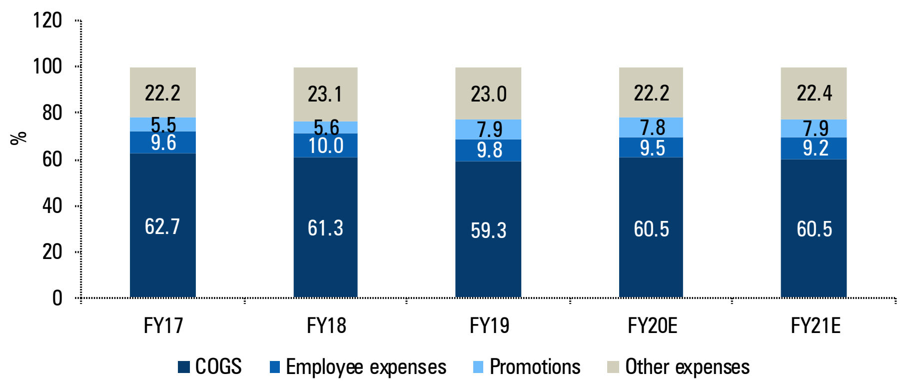


Source: Company, ICICI Direct Research

Change in product mix to keep margins elevated

The liquor industry has been experiencing higher inflation in its raw material prices since Q3FY19, after a benign H1FY19. IMFL raw material includes packaging material (~50% of raw material) and ENA (rest ~50%), prices of both of which, as per the management, have gone up 15% and 18% YoY, respectively, in the ensuing period. However, Radico has been able to maintain its gross margins at 47-50%, due to strong P&A sales (21% YoY) along with a combination of price hikes and a better state mix. Although the management expects 450 bps impact on gross margins in FY20 due to continued rise in raw material prices (10-12% expected hike in ENA, glass expected to remain flat), the management expects the gross and EBITDA margins to remain resilient in FY21 due to a combination of better product mix, price hikes in a few more states and high operating leverage.

Exhibit 9: Expense break-up (as percentage of total expense)



Source: Company, ICICI Direct Research

Continued focus on building stronger brands

Radico has achieved a rare feat of organically building multiple strong IMFL brands. It began its IMFL journey with the launch of 8PM whisky, which eventually became the eleventh largest whisky in the world by volume. Thereafter, it launched Magic Moments Vodka, which has captured 55% vodka volume share in India (also eleventh largest vodka brand in the world). A similar feat has been achieved by its brands such as Contessa rum (60% market share in super-premium category) and Old Admiral brandy. Recently, it also began premiumisation of existing brands with the launch of 8PM premium black, Magic Moments verve, etc by undertaking extensive marketing campaigns (celebrity tie-ups, premium packaging etc), which has resulted in a strong consumer response. The company has four millionaire brands in its portfolio (8PM, Contessa Rum, Old Admiral Brandy and Magic Moments Vodka).

Debt expected continue to decline in near term

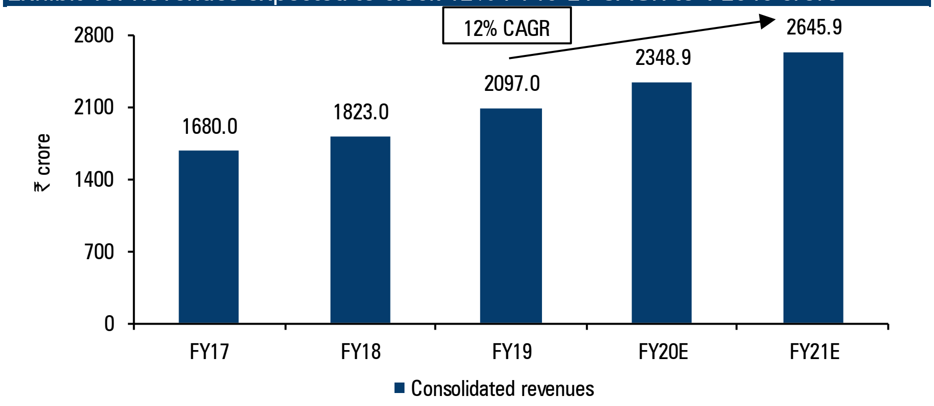
For the past couple of years, Radico has been focusing on free cash flow generation and re-payment of long term debt. Radico's current captive utilisation of ENA at 65%, eases any requirement for any brownfield/greenfield expansion for building ENA capacity in the near to medium term. On the working capital front, the company has seen its working capital days improve from 157 days to 130 days, with tailwinds from privatisation of UP distribution and retail shops from earlier Government owned network. These developments along with the strong earnings growth will enable the company to pay off its existing debt. As on FY19, the total debt was at ₹ 323 crore, a sharp contrast to ₹ 816 crore in FY16. Further, the management expects the current levels of net debt to effectively reduce to nil in about two years.

Financials

Revenues expected to grow at 12% CAGR to ₹ 2646 crore in FY19-21E

Radico's blended revenues are expected to grow in grow double digits, with IMFL segment growing the fastest at 15% FY19-21 CAGR to ₹ 2224 crore, contributing ~84% to the topline. Within IMFL, prestige & above is expected to grow 21% to ₹ 1174 crore and reach 53% of IMFL revenues, buoyed by the 15% growth in the P&A volumes, with higher growth expected in the super-premium, semi-luxury and luxury segment. On the popular segment front, growth is expected at 10% CAGR in FY19-21 to ₹ 1051 crore, as volume growth is expected to remain in single digits (6%). Within others segment, IMIL revenue growth is expected to remain stable in single digits (single digit volume growth) whereas bulk revenues are expected to decline as the company would shift the ENA towards captive consumption (increasing IMFL volume growth). Overall, others segment is expected to remain flat at ₹ 422 crore. On an overall basis, we expect blended Radico revenues to grow at 12% CAGR to ₹ 2646 crore in FY19-21E.

Exhibit 10: Revenues expected to clock 12% FY19-21 CAGR to ₹ 2646 crore

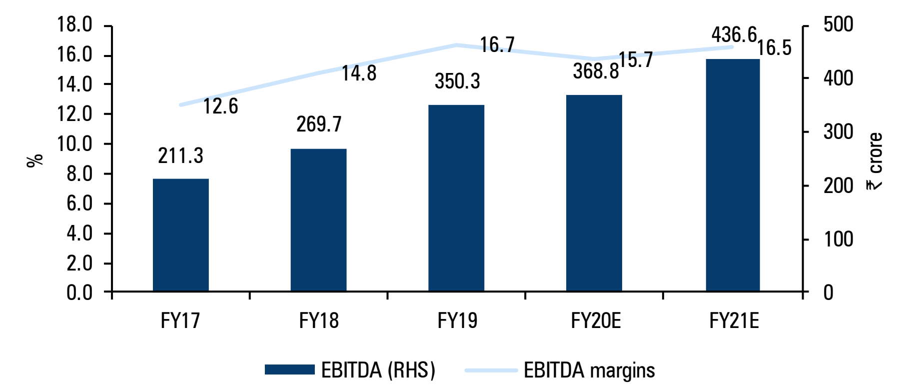


Source: Company, ICICI Direct Research

EBITDA margins expected to remain largely flat due to COGS inflation

Liquor companies have been experiencing a rise in raw material inflation (i.e. ENA and glass) since H2FY19. The management expects glass prices to remain benign for the rest of FY20 while expecting 10-12% inflation in ENA prices. Advertisement expenses are expected to stay at ~7% due to continued investments in the P&A portfolio. Also, other expenses are expected to stay low due to strong operating leverage and absence of any major capex in the near term. Overall, we expect EBITDA margins to contract 60-70 bps in FY20, mainly led by the contraction in gross margins and in spite of the strong operating leverage. However, we expect EBITDA margins to rebound with similar impact in FY21. Hence, EBITDA margins are expected to remain flat at 16.5% in FY21E with absolute EBITDA growing 12% to ₹ 437 crore.

Exhibit 11: EBITDA expected to grow 12% to ₹ 437 crore

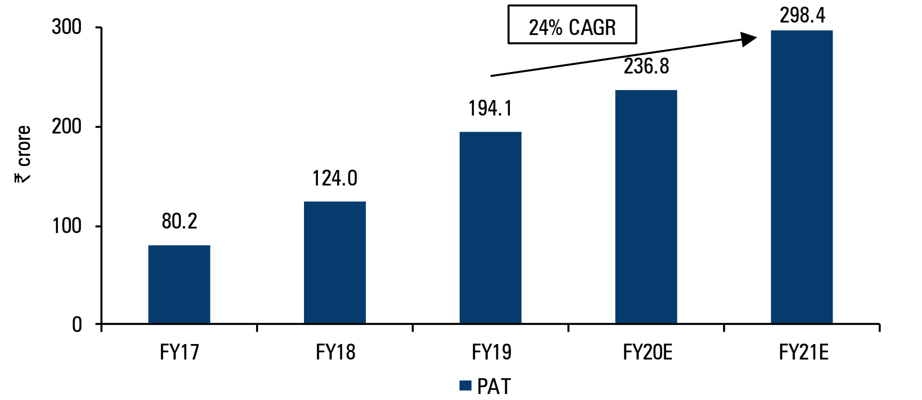


Source: Company, ICICI Direct Research

PAT expected to grow at 24% CAGR to ₹ 298 crore in FY19-21E

Radico has been continuously deleveraging its balance sheet. In FY16-19, the debt has reduced from ₹ 816 crore to ₹ 323 crore in FY19. This has led interest expenses to decline from ₹ 85 crore to ₹ 36 crore in FY19. The management has further guided for nil debt over next two years, which is expected to ramp up the profitability of the company. We expect the capex to remain range bound at ₹ 70-80 crore in the medium term. Thus, PAT is expected to grow at 24% FY19-21 CAGR to ₹ 298 crore, higher than the expected growth on the EBITDA front.

Exhibit 12: PAT expected to grow 24% to ₹ 298 crore

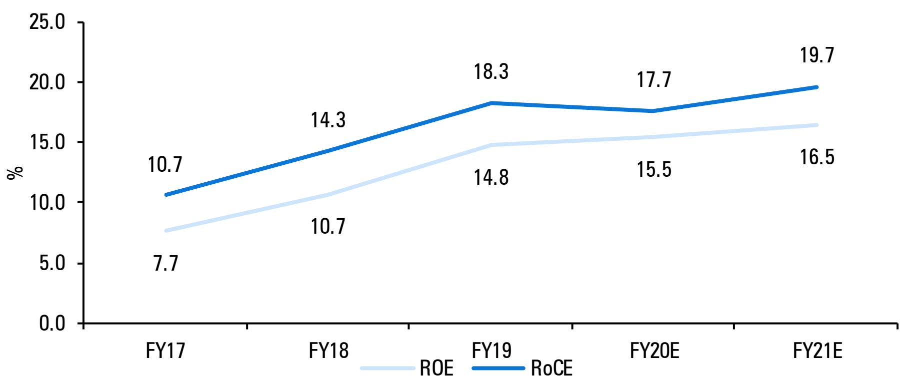


Source: Company, ICICI Direct Research

Return ratios, free cash flows to remain strong, going ahead

Radico clocked RoE & RoCE of 14.8% & 18.3%, respectively, in FY19. With rising revenues and profitability and lack of any major capex in the medium term, return ratios, RoE and RoCE are expected to remain healthy at 16.5% and 19.7%, respectively, in FY21.

Exhibit 13: Return ratios to remain stable



Source: Company, ICICI Direct Research

Similarly, with focus on priority states and better working capital management and lower capex, cash flows are expected to remain strong. FCF is expected to remain strong at ₹ 185 crore in FY21E (implied 4.3% yield).

Valuations

While the liquor industry has continued to report subdued growth (~360 million cases in FY19), premiumisation within the sector (i.e. shift of volumes from cheap and regular segment towards prestige, semi-premium and above segment) has led to higher growth (6-11% CAGR) in the prestige and above segment. Radico began its journey with its entry into the regular segment (8 PM whisky) and progressively creating successful brands in prestige and above segment (Magic Moments, Jaisalmer craft gin, etc), while leveraging its strong distribution network. With a strong topline growth (12% CAGR in FY19-21) and resilient EBITDA margins (16-17% range), robust balance sheet (management expects it to achieve zero debt in two years), strong return ratios (RoCE ~20%) and FCF generation (~4% yield in FY21E), we ascribe a **BUY** rating to Radico Khaitan with a target price of ₹ 400 (18x FY21E P/E).

Exhibit 14: Radico valuation

Year	Sales (₹ cr)	Sales Gr. (%)	EPS (₹)	EPS Gr. (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	1679.9	1.7	6.0	16.3	54.9	23.3	7.7	10.7
FY18	1822.8	8.5	9.3	55.0	35.5	17.9	10.7	14.3
FY19	2096.9	15.0	14.6	56.6	22.7	13.4	14.8	18.3
FY20E	2348.9	12.0	17.7	22.0	18.6	12.5	15.5	17.7
FY21E	2645.9	12.6	22.4	26.0	14.8	10.2	16.5	19.7

Source: Company, ICICI Direct Research

Radico trades at ~63% discount to USL despite continued improvement in its fundamentals

Exhibit 15: USL valuation

	Sales (₹ cr)	Sales Growth (%)	EPS (₹)	EPS Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY17	8817.5	0.0	1.4	-86.0	471.8	46.3	8.2	16.3
FY18	8590.6	-2.6	8.7	533.2	74.5	37.2	26.2	22.4
FY19	9340.8	8.7	9.5	9.0	68.4	32.1	22.7	21.0
FY20E	10443.9	11.8	12.6	33.1	51.4	29.0	22.9	22.2
FY21E	11815.0	13.1	16.4	30.0	39.5	23.4	23.0	24.6

Source: Company, ICICI Direct Research

Risks and concerns

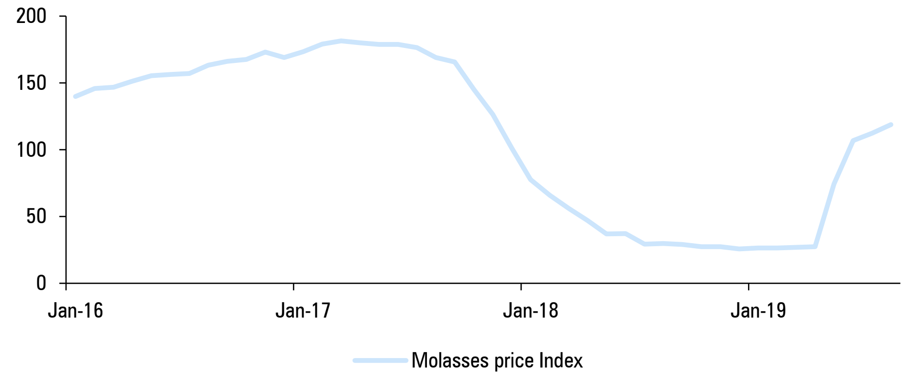
Highly regulated sector

Liquor distribution business in India is subject to strict regulations. The rules and regulation vary in different states. Any change in policies by the respective state governments with regard to production, distribution or marketing of IMFL can impact the operational performance of the company. Also, changes in taxes and other levies by the state government can impact the financial performance of the company.

Increase in raw material costs

The prices of molasses and grains (which is one of the primary raw materials for manufacture of IMFL) and packaging material have been hardening since H2FY19, which has impacted the margins of liquor companies. Any further significant and sustained increase in their prices can impact the profitability of the company.

Exhibit 16: Molasses price Index



Source: ICICI Direct Research

Slowdown in volume growth

Any significant slowdown in volume growth could impact the operation and financial performance of the company in a negative manner.

Inability to take price hikes

In majority of the states, price hikes are decided by the government. If the company is not granted price hikes or the price hike is insufficient to cover for increased input cost, it can impact the margins of the company.

Financial Summary

Exhibit 17: Profit & loss statement (₹ crore)

(Year-end March)/ (₹ crore)	FY18	FY19	FY20E	FY21E
Total Operating Income	1,822.8	2,096.9	2,348.9	2,645.9
Growth (%)	8.5	15.0	12.0	12.6
COGS	952.2	1,035.4	1,197.9	1,336.2
Gross Profit	870.5	1,061.6	1,151.0	1,309.7
Gross Profit Margins (%)	47.8	50.6	49.0	49.5
Employee Expenses	155.0	171.4	187.9	203.7
SG&A	87.3	138.5	155.0	174.6
Other Expenditure	358.5	401.4	439.2	494.8
Total Operating Expenditure	1,553.0	1,746.6	1,980.1	2,209.3
EBITDA	269.7	350.3	368.8	436.6
Growth (%)	27.7	29.9	5.3	18.4
Interest	68.2	35.5	26.2	10.3
Depreciation	40.9	42.4	48.8	52.4
Other Income	26.7	13.3	14.1	15.9
PBT before Exceptional Items	187.3	285.7	307.9	389.8
Less: Exceptional Items	0.0	0.0	0.0	0.0
PBT after Exceptional Items	187.3	285.7	307.9	389.8
Total Tax	63.8	97.6	77.5	98.1
PAT	123.4	188.1	230.4	291.7
Profit from Associates	0.5	6.1	6.4	6.7
Adjusted PAT	124.0	194.1	236.8	298.4
EPS Growth (%)	55.0	56.6	22.0	26.0
EPS (Adjusted)	9.3	14.6	17.7	22.4

Source: Company, ICICI Direct Research

Exhibit 18: Cash flow statement (₹ crore)

(Year-end March) (₹ crore)	FY18	FY19	FY20E	FY21E
Profit/(Loss) after taxation	124.0	194.1	236.8	298.4
Add: Depreciation & Amortization	40.9	42.4	48.8	52.4
Add: Interest Paid	68.2	35.5	26.2	10.3
Net Increase in Current Assets	-66.8	-41.1	-125.9	-145.8
Net Increase in Current Liabilities	5.8	13.9	36.5	39.7
Others	143.6	63.9	0.0	0.0
CF from Operating activities	315.8	308.7	222.4	255.0
(Purchase)/Sale of Fixed Assets	-22.8	-71.7	-70.0	-70.0
Long term Loans & Advances	0.0	0.0	0.0	0.0
Investments	-18.0	54.2	-3.1	-3.2
Others	6.3	-135.2	-66.8	-66.6
CF from Investing activities	-11.7	-81.0	-69.9	-69.8
(inc)/Dec in Loan	-132.0	-199.0	-85.0	-145.0
Dividend & Dividend tax	-16.1	-19.3	-19.3	-19.3
Less: Interest Paid	-68.2	-35.5	-26.2	-10.3
Other	-79.5	21.4	0.0	0.0
CF from Financing activities	-295.8	-232.4	-130.5	-174.6
Net Cash Flow	8.3	-4.7	22.0	10.6
Cash and Cash Equivalent at the	14.1	22.4	17.7	39.6
Cash	22.4	17.7	39.6	50.3

Source: Company, ICICI Direct Research

Exhibit 19: Balance Sheet (₹ crore)

(Year-end March)	FY18	FY19	FY20E	FY21E
Equity Capital	26.7	26.7	26.7	26.7
Reserve and Surplus	1,130.2	1,288.3	1,505.7	1,784.8
Total Shareholders funds	1,156.9	1,314.9	1,532.4	1,811.4
Minority Interest	0.0	0.0	0.0	0.0
Total Debt	522.2	323.3	238.3	93.3
Deferred Tax Liability	92.5	104.1	109.3	114.7
Long-Term Provisions	9.8	10.4	10.6	10.8
Other Non Current Liabilities	1.0	0.7	0.7	0.7
Source of Funds	1,782.4	1,753.3	1,891.1	2,030.9
Gross Block - Fixed Assets	803.5	868.0	938.0	1,008.0
Accumulated Depreciation	118.0	154.1	202.8	255.2
Net Block	685.5	713.9	735.2	752.7
Capital WIP	20.2	16.0	16.0	16.0
Fixed Assets	705.7	729.9	751.2	768.7
Investments	251.3	163.4	166.5	169.7
Goodwill on Consolidation	0.0	0.0	0.0	0.0
Deferred Tax Assets	0.0	0.0	0.0	0.0
Other non-Current Assets	100.0	111.9	114.1	116.4
Inventory	310.9	359.7	402.9	453.9
Debtors	630.0	641.8	720.8	811.9
Loans and Advances	54.5	46.7	47.2	47.6
Other Current Assets	171.2	159.6	162.8	166.0
Cash	22.4	17.7	39.6	50.3
Total Current Assets	1,188.9	1,225.4	1,373.2	1,529.7
Creditors	214.1	244.8	276.7	311.7
Provisions	81.6	68.4	69.7	71.1
Other Current Liabilities	167.8	164.1	167.4	170.8
Total Current Liabilities	463.5	477.3	513.9	553.6
Net Current Assets	725.5	748.1	859.4	976.1
Application of Funds	1,782.4	1,753.3	1,891.2	2,030.9

Source: Company, ICICI Direct Research

Exhibit 20: Key ratios

(Year-end March)	FY18	FY19	FY20E	FY21E
Per share data (₹)				
Reported EPS	9.3	14.6	17.7	22.4
BV per share	86.7	98.6	114.9	135.8
Cash per Share	1.7	1.3	3.0	3.8
Dividend per share	1.2	1.4	1.4	1.4
Operating Ratios (%)				
Gross Profit Margins	47.8	50.6	49.0	49.5
EBITDA margins	14.8	16.7	15.7	16.5
PAT Margins	6.8	9.3	10.1	11.3
Inventory days	62.2	62.6	62.6	62.6
Debtor days	126.2	111.7	112.0	112.0
Creditor days	42.9	42.6	43.0	43.0
Asset Turnover	2.3	2.4	2.5	2.6
Return Ratios (%)				
RoE	10.7	14.8	15.5	16.5
RoCE	14.3	18.3	17.7	19.7
RoIC	13.8	18.0	17.5	19.6
Valuation Ratios (x)				
P/E	35.5	22.7	18.6	14.8
EV / EBITDA	17.9	13.4	12.5	10.2
EV / Net Sales	2.6	2.2	2.0	1.7
Market Cap / Sales	2.4	2.1	1.9	1.7
Price to Book Value	3.8	3.3	2.9	2.4
Solvency Ratios				
Debt / EBITDA	1.9	0.9	0.6	0.2
Debt / Equity	0.5	0.2	0.2	0.1
Current Ratio	2.5	2.5	2.6	2.7
Quick Ratio	1.8	1.8	1.8	1.9

Source: Company, ICICI Direct Research

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