

Radico Khaitan

Performance Highlights

Quarterly Data

| (₹ cr) | 3QFY17 | 3QFY16 | % yoy | 2QFY17 | % qoq |
|------------|--------|--------|---------|--------|--------|
| Revenue | 415 | 401 | 3.6 | 447 | (7.2) |
| EBITDA | 51.4 | 58 | (12.1) | 57 | (9.5) |
| Margin (%) | 12.4 | 14.6 | (221bp) | 12.7 | (32bp) |
| Adj. PAT | 20 | 25 | (22.3) | 22 | (9.7) |

Source: Company, Angel Research

Radico Khaitan's (RKL) results for 3QFY2017 were below our estimates both on top-line as well as bottom-line fronts. The company's top-line grew by ~4% yoy to ₹415cr owing to the impact of demonetization, which led to a decline in consumer spending. Moreover, lower sales volume and subdued operating performance led to the de-growth in bottom-line by ~22% yoy to ₹20cr.

Top-line line subdued on back demonetization: Overall, the volume growth during the quarter de-grew by ~7% yoy, which resulted in the subdued top-line growth i.e. ~4% yoy to ₹415cr. This subdued volume and top-line performance was due to the demonetization led decline in consumer spending. The company has consciously shifted its focus in favor of Prestige & above products, which command better margins over higher volume mass market products. Prestige & above brands' volume grew by ~0.3% yoy, while their contribution to total IMFL volumes increased from 24.6% in 3QFY2016 to 26.5% in 3QFY2017.

Lower sales impacted the overall PAT growth yoy: On the operating front, the company's margin contracted by 221bp yoy to 12.4%, primarily due to a combination of lower sales and an increase in ENA prices. The company reported ~22% yoy fall in its net profit to ₹20cr for the quarter.

Outlook and Valuation: Going forward, we believe that the company has the potential to perform better on the bottom-line front on the back of (a) volume growth, (b) higher sales of premium products, (c) anticipation of better price hikes, and (d) gradual reduction in debt, which should lead to significant savings in interest costs. **Hence, we recommend an ACCUMULATE rating on the stock with a target price of ₹147.**

Key financials

| Y/E March (₹ cr) | FY2015 | FY2016 | FY2017E | FY2018E |
|-------------------|--------|--------|---------|---------|
| Net sales | 1,488 | 1,543 | 1,636 | 1,811 |
| % chg | 2.5 | 3.7 | 6.0 | 10.7 |
| Net profit | 68 | 77 | 86 | 108 |
| % chg | (5.1) | 13.7 | 11.5 | 25.7 |
| EBITDA margin (%) | 11.4 | 12.6 | 13.0 | 13.2 |
| EPS (₹) | 5.1 | 5.8 | 6.4 | 8.1 |
| P/E (x) | 25.2 | 22.1 | 19.9 | 15.8 |
| P/BV (x) | 2.0 | 1.9 | 1.7 | 1.6 |
| RoE (%) | 8.1 | 8.5 | 8.8 | 10.1 |
| RoCE (%) | 7.8 | 8.8 | 9.8 | 11.0 |
| EV/Sales (x) | 1.6 | 1.6 | 1.4 | 1.3 |
| EV/EBITDA (x) | 14.3 | 12.6 | 11.0 | 9.6 |

Source: Company, Angel Research; Note: CMP as of February 10, 2017

ACCUMULATE

| | |
|--------------|------|
| CMP | ₹128 |
| Target Price | ₹147 |

| | |
|-------------------|-----------|
| Investment Period | 12 months |
|-------------------|-----------|

Stock Info

| | |
|--------------------|--------------------------|
| Sector | Breweries & Distilleries |
| Market Cap (₹ cr) | 1,700 |
| Net Debt (₹ cr) | 742 |
| Beta | 0.8 |
| 52 Week High / Low | 151 / 81 |
| Avg. Daily Volume | 98,071 |
| Face Value (₹) | 2 |
| BSE Sensex | 28,334 |
| Nifty | 8,794 |
| Reuters Code | RADC.BO |
| Bloomberg Code | RDCK@IN |

Shareholding Pattern (%)

| | |
|-------------------------|------|
| Promoters | 40.5 |
| MF / Banks / Indian Fls | 13.3 |
| FII / NRIs / OCBs | 21.1 |
| Indian Public / Others | 25.1 |

| Abs. (%) | 3m | 1yr | 3yr |
|----------|-----|------|--------|
| Sensex | 3.0 | 19.3 | 39.3 |
| RKL | 2.7 | 19.4 | (21.1) |

3-year price chart



Source: Company, Angel Research

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Exhibit 1: Quarterly performance

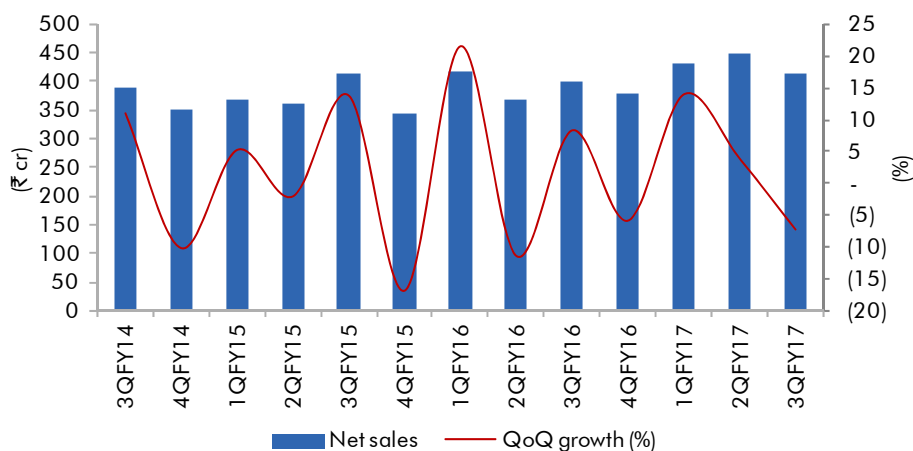
| Y/E March (₹ cr) | 3QFY17 | 3QFY16 | % yoy | 2QFY17 | % qoq | 9MFY17 | 9MFY16 | % chg |
|---|------------|------------|---------------|------------|--------------|--------------|--------------|--------------|
| Net Sales | 415 | 401 | 3.6 | 447 | (7.2) | 1,293 | 1,165 | 10.9 |
| Consumption of RM | 209 | 179 | 16.4 | 261 | (19.8) | 698 | 535 | 30.6 |
| (% of Sales) | 50.3 | 44.8 | | 58.2 | | 54.0 | 45.9 | |
| Staff Costs | 35 | 34 | 2.6 | 34 | 2.1 | 106 | 85 | 25.2 |
| (% of Sales) | 8.4 | 8.5 | | 7.6 | | 8.2 | 7.3 | |
| Selling & Administrative Exps. | 49 | 71 | (31.8) | 58 | (16.6) | 149 | 208 | (28.4) |
| (% of Sales) | 11.7 | 17.8 | | 13.0 | | 11.5 | 17.8 | |
| Operating Expense | 71 | 58 | 24.0 | 37 | 90.5 | 175 | 182 | (4.0) |
| (% of Sales) | 17.2 | 14.4 | | 8.4 | | 13.5 | 15.6 | |
| Total Expenditure | 364 | 342 | 6.2 | 390 | (6.8) | 1,128 | 1,010 | 11.7 |
| Operating Profit | 51 | 58 | (12.1) | 57 | (9.5) | 165 | 156 | 5.6 |
| OPM (%) | 12.4 | 14.6 | | 12.7 | | 12.7 | 13.4 | |
| Interest | 20 | 20 | (0.7) | 21 | (5.2) | 62 | 62 | (0.3) |
| Depreciation | 10 | 10 | 4.8 | 11 | (0.4) | 32 | 30 | 5.0 |
| Other Income | 5.96 | 6.82 | (12.6) | 4.43 | 34.6 | 14 | 23 | (39.1) |
| PBT | 27 | 36 | (23.3) | 30 | (9.1) | 86 | 87 | (2.0) |
| (% of Sales) | 6.6 | 8.9 | | 6.7 | (2.1) | 6.6 | 7.5 | |
| Provision for Taxation | 8 | 10 | (25.7) | 8 | 0.9 | 22 | 25 | (12.2) |
| (% of PBT) | 27.9 | 28.8 | | 25.1 | | 25.9 | 28.9 | |
| Other Comprehensive Inc /Exp (Net of Tax) | | | | 1 | | | | |
| Reported PAT | 20 | 25 | (22.3) | 22 | (9.7) | 63 | 62 | 2.2 |
| PATM | 4.7 | 6.3 | | 4.9 | | 4.9 | 5.3 | |

Source: Company, Angel Research

Top-line plunges on the back demonetization

Overall, the volume growth during the quarter de-grew by ~7% yoy, which resulted in the subdued top-line growth i.e. ~4% yoy to ₹415cr. This subdued volume and top-line performance was due to the demonetization led decline in consumer spending. The company has consciously shifted its focus in favor of Prestige & above products, which command better margins over higher volume mass market products. Prestige & above brands' volume grew by ~0.3% yoy, while their contribution to total IMFL volumes increased from 24.6% in 3QFY2016 to 26.5% in 3QFY2017.

Exhibit 2: Top-line growth trend

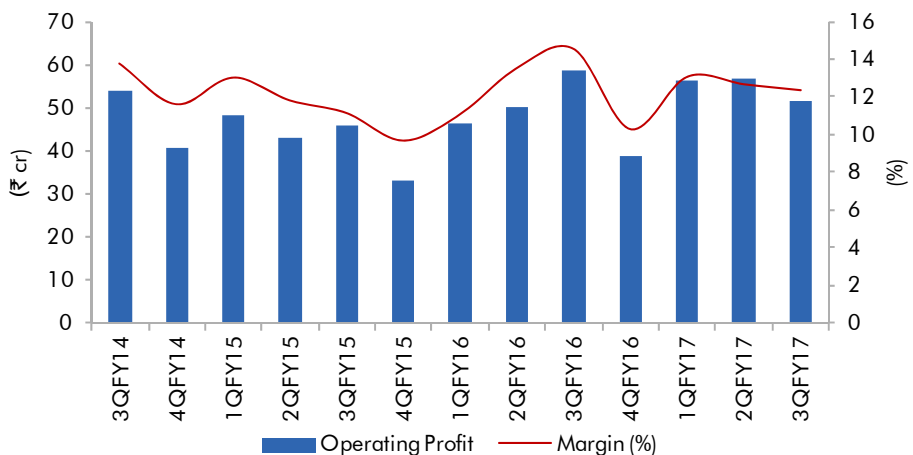


Source: Company, Angel Research

Subdued operating performance

On the operating front, the company's margin contracted by 221bp yoy to 12.4%, primarily due to a combination of lower sales and an increase in ENA prices.

Exhibit 3: Operating profit and margin trend

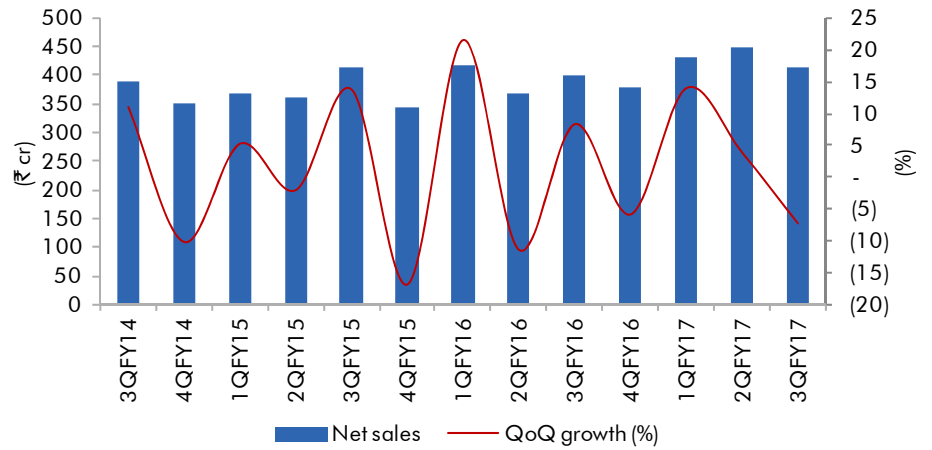


Source: Company, Angel Research

PAT de-grew by ~22% yoy

The company reported ~22% yoy fall in its net profit to ₹20cr for the quarter.

Exhibit 4: Net Profit and growth trend



Source: Company, Angel Research

Investment rationale

Pricing environment expected to be favorable for IMFL industry

Our interaction with liquor companies suggests that prices have now bottomed out. We expect the industry's pricing environment to get better going ahead, mainly because there has not been any significant price hike in products in recent times due to delay in approval by various state governments. Hence, the industry is now expecting a significant price hike in the coming financial year. Also, the industry leader United Spirits has been facing pressure at the operating level and the company has a huge debt on its balance sheet. Hence, we believe that the company's new Management would shift focus on profitability over volume growth, which in turn, would lead to an increased scope for other liquor companies to hike prices.

Higher proportion of premium products in volume mix to drive profitability

In the IMFL segment, more than 20% of the company's volumes come from prestige and above products, which is a high margin business, and the balance volumes come from regular and others brands. Since the last eight years, the company's prestige and above brands' volume has reported a CAGR of ~23% and their share in the product mix has increased from 7.9% in FY2009 to 24% in FY2016. We expect volume contribution of prestige and above products in the IMFL segment to increase further on back of higher ad spends. The company has roped in celebrity Hrithik Roshan as its brand ambassador. Also, the company's presence in the prestige Vodka segment is under penetrated, which leaves scope for growth. Thus, this would improve the overall margin for the company and result in higher profitability.

Wide distribution network with strong brands

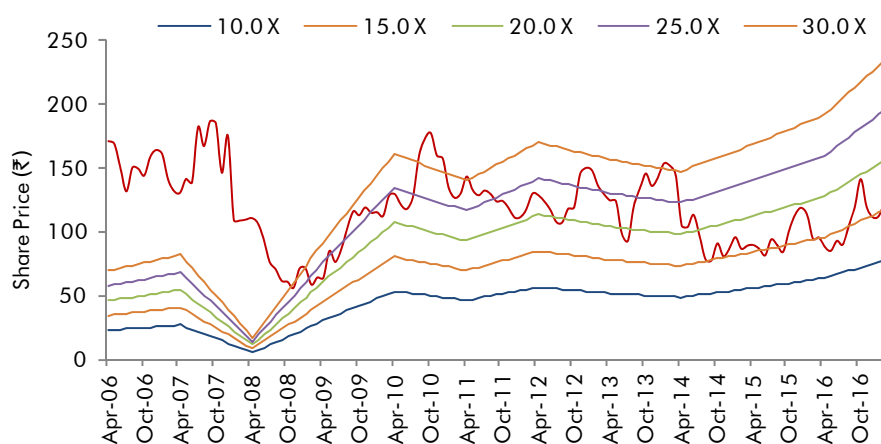
RKL has a strong sales and distribution network with a presence in retail and off-trade outlets in the relevant segments in different parts of India. Currently, the company is selling its products through over 45,000 retail outlets and over 5,000 on-premise outlets. Apart from wholesalers, a total of around 300 employees divided into four zones, each headed by regional profit centre head, ensure an adequate on-the-ground sales and distribution presence across the country.

The company has strong brands likes Magic Moments Vodka, Morpheus Brandy, Verve Vodka, Florence Brandy, After Dark Whisky, etc.

Outlook and valuation

The company has not performed well in the last two years due to increasing raw material costs (ENA is a key raw material) and with it not receiving significant price hikes from various states. We expect the company to perform well going forward in anticipation of better price hikes and healthy sales growth in premium products. This would result in an overall improvement in the operating margin of the company. We expect the company to report strong earnings CAGR of ~18% to ~₹109cr over FY2016-18E. **Hence, we recommend an ACCUMULATE rating on the stock with a target price of ₹147.**

Exhibit 5: One-year forward P/E band



Source: Company, Angel Research

Company Background

Radico Khaitan Ltd is an India-based spirits company engaged in the manufacturing of liquor. The company has three distilleries and one JV with total capacity of 150mn litres and 33 bottling units spread across the country. The company is one of the largest providers of branded IMFL to the Canteen Stores Department (CSD), which has significant entry barriers. RKL's brands include After Dark Whisky, Magic Moments Vodka, Morpheus Brandy, Contessa Rum, Old Admiral Brandy and 8 PM. Its liquor business also includes rectified spirit and country liquor. Its alcohol products include rectified spirit, silent spirit, cane juice spirit, malt spirit, grain spirit and ethanol. The company's PET division produces a range of PET bottles and jars for industries such as pharmaceutical, cosmetics, home and personal care, edible oil and confectionery.

Profit & Loss Statement

| Y/E March (₹ cr) | FY2013 | FY2014 | FY2015 | FY2016 | FY2017E | FY2018E |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Total operating income | 1,258 | 1,452 | 1,488 | 1,543 | 1,636 | 1,811 |
| % chg | 10.0 | 15.4 | 2.5 | 3.7 | 6.0 | 10.7 |
| Total Expenditure | 1,074 | 1,258 | 1,318 | 1,348 | 1,423 | 1,571 |
| Raw Material Cost | 585 | 653 | 717 | 721 | 761 | 838 |
| Personnel Expenses | 79 | 93 | 107 | 131 | 128 | 141 |
| Selling & Administrative Exp. | 235 | 286 | 284 | 273 | 286 | 317 |
| Others Expenses | 176 | 226 | 210 | 224 | 249 | 275 |
| EBITDA | 184 | 193 | 170 | 195 | 213 | 239 |
| % chg | 17.7 | 5.0 | (11.9) | 14.2 | 9.5 | 12.4 |
| (% of Net Sales) | 14.6 | 13.3 | 11.4 | 12.6 | 13.0 | 13.2 |
| Depreciation & Amortisation | 35 | 39 | 38 | 40 | 43 | 45 |
| EBIT | 149 | 155 | 132 | 154 | 170 | 195 |
| % chg | 20.4 | 3.9 | (14.6) | 16.8 | 10.4 | 14.4 |
| (% of Net Sales) | 11.8 | 10.7 | 8.9 | 10.0 | 10.4 | 10.8 |
| Interest & other Charges | 70 | 85 | 90 | 85 | 84 | 76 |
| Other Income | 30 | 36 | 45 | 38 | 40 | 40 |
| (% of PBT) | 27.8 | 34.3 | 51.6 | 35.4 | 31.7 | 25.2 |
| Share in profit of Associates | - | - | - | - | - | - |
| Recurring PBT | 109 | 106 | 87 | 108 | 126 | 158 |
| % chg | 25.7 | (2.6) | (18.1) | 23.6 | 17.1 | 25.7 |
| Prior Period & Extra. Exp./ (Inc.) | - | - | - | - | - | - |
| PBT (reported) | 109 | 106 | 87 | 108 | 126 | 158 |
| Tax | 32 | 35 | 19 | 31 | 40 | 51 |
| (% of PBT) | 29.3 | 33.0 | 22.4 | 28.6 | 32.0 | 32.0 |
| PAT (reported) | 77 | 71 | 68 | 77 | 86 | 108 |
| % chg | 21.4 | (7.8) | (5.1) | 13.7 | 11.5 | 25.7 |
| (% of Net Sales) | 6.1 | 4.9 | 4.5 | 5.0 | 5.2 | 6.0 |
| Basic EPS (₹) | 5.8 | 5.4 | 5.1 | 5.8 | 6.4 | 8.1 |
| Fully Diluted EPS (₹) | 5.8 | 5.4 | 5.1 | 5.8 | 6.4 | 8.1 |
| % chg | 21.2 | (7.9) | (5.1) | 13.7 | 11.5 | 25.7 |

Balance Sheet

| Y/E March (₹ cr) | FY2013 | FY2014 | FY2015 | FY2016 | FY2017E | FY2018E |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| SOURCES OF FUNDS | | | | | | |
| Equity Share Capital | 27 | 27 | 27 | 27 | 27 | 27 |
| Reserves & Surplus | 702 | 754 | 812 | 877 | 950 | 1,042 |
| Shareholders Funds | 728 | 781 | 839 | 904 | 977 | 1,068 |
| Total Loans | 768 | 904 | 849 | 851 | 755 | 700 |
| Deferred Tax Liability | 70 | 85 | 85 | 85 | 85 | 85 |
| Total Liabilities | 1,566 | 1,770 | 1,773 | 1,840 | 1,816 | 1,853 |
| APPLICATION OF FUNDS | | | | | | |
| Gross Block | 744 | 821 | 831 | 851 | 871 | 891 |
| Less: Acc. Depreciation | 214 | 250 | 288 | 329 | 371 | 416 |
| Net Block | 529 | 571 | 542 | 522 | 499 | 475 |
| Capital Work-in-Progress | 5 | 8 | 8 | 8 | 8 | 8 |
| Investments | 109 | 108 | 98 | 98 | 98 | 98 |
| Current Assets | 1,161 | 1,330 | 1,379 | 1,471 | 1,500 | 1,646 |
| Inventories | 186 | 211 | 212 | 220 | 233 | 258 |
| Sundry Debtors | 435 | 523 | 538 | 562 | 596 | 660 |
| Cash | 16 | 15 | 10 | 11 | 16 | 18 |
| Loans & Advances | 314 | 441 | 470 | 492 | 524 | 565 |
| Other Assets | 209 | 139 | 149 | 185 | 131 | 145 |
| Current liabilities | 249 | 262 | 270 | 274 | 304 | 389 |
| Net Current Assets | 912 | 1,067 | 1,109 | 1,197 | 1,195 | 1,257 |
| Deferred Tax Asset | 11 | 15 | 15 | 15 | 15 | 15 |
| Mis. Exp. not written off | - | - | - | - | - | - |
| Total Assets | 1,566 | 1,770 | 1,773 | 1,840 | 1,816 | 1,853 |

Cashflow Statement

| Y/E March (₹ cr) | FY2013 | FY2014 | FY2015 | FY2016 | FY2017E | FY2018E |
|----------------------------------|-------------|--------------|--------------|-------------|--------------|--------------|
| Profit before tax | 109 | 106 | 87 | 108 | 126 | 158 |
| Depreciation | 35 | 39 | 38 | 40 | 43 | 45 |
| Change in Working Capital | (242) | (53) | (47) | (87) | 6 | (59) |
| Interest / Dividend (Net) | 42 | 50 | 90 | 85 | 84 | 76 |
| Direct taxes paid | (23) | (26) | (19) | (31) | (40) | (51) |
| Others | 13 | 22 | - | - | - | - |
| Cash Flow from Operations | (66) | 137 | 149 | 115 | 219 | 169 |
| (Inc.)/ Dec. in Fixed Assets | 48 | (141) | 11 | (20) | (20) | (20) |
| (Inc.)/ Dec. in Investments | (3) | (0) | (10) | - | - | - |
| Cash Flow from Investing | 46 | (141) | 0.2 | (20) | (20) | (20) |
| Issue of Equity | 1 | 1 | - | - | - | - |
| Inc./(Dec.) in loans | 97 | 99 | (55) | 2 | (97) | (55) |
| Dividend Paid (Incl. Tax) | (12) | (12) | (10) | (12) | (13) | (16) |
| Interest / Dividend (Net) | (71) | (84) | (90) | (85) | (84) | (76) |
| Cash Flow from Financing | 15 | 3 | (154) | (94) | (194) | (147) |
| Inc./(Dec.) in Cash | (5) | (1) | (5) | 1 | 5 | 2 |
| Opening Cash balances | 21 | 16 | 15 | 10 | 11 | 16 |
| Closing Cash balances | 16 | 15 | 10 | 11 | 16 | 18 |

Key Ratios

| Y/E March | FY2013 | FY2014 | FY2015 | FY2016 | FY2017E | FY2018E |
|------------------------------|--------|--------|--------|--------|---------|---------|
| Valuation Ratio (x) | | | | | | |
| P/E (on FDEPS) | 22.0 | 23.9 | 25.2 | 22.1 | 19.9 | 15.8 |
| P/CEPS | 15.1 | 15.5 | 16.1 | 14.5 | 13.3 | 11.2 |
| P/BV | 2.3 | 2.2 | 2.0 | 1.9 | 1.7 | 1.6 |
| Dividend yield (%) | 0.6 | 0.6 | 0.6 | 0.7 | 0.8 | 0.9 |
| EV/Sales | 1.9 | 1.7 | 1.6 | 1.6 | 1.4 | 1.3 |
| EV/EBITDA | 12.7 | 12.8 | 14.3 | 12.6 | 11.0 | 9.6 |
| EV / Total Assets | 1.3 | 1.2 | 1.2 | 1.2 | 1.1 | 1.0 |
| Per Share Data (₹) | | | | | | |
| EPS (Basic) | 5.8 | 5.4 | 5.1 | 5.8 | 6.4 | 8.1 |
| EPS (fully diluted) | 5.8 | 5.4 | 5.1 | 5.8 | 6.4 | 8.1 |
| Cash EPS | 8.5 | 8.3 | 8.0 | 8.8 | 9.7 | 11.4 |
| DPS | 0.8 | 0.8 | 0.8 | 0.9 | 1.0 | 1.2 |
| Book Value | 54.8 | 58.7 | 63.0 | 67.9 | 73.4 | 80.3 |
| Returns (%) | | | | | | |
| ROCE | 10.0 | 9.2 | 7.8 | 8.8 | 9.8 | 11.0 |
| Angel ROIC (Pre-tax) | 10.9 | 9.9 | 8.4 | 9.4 | 10.5 | 11.8 |
| ROE | 10.6 | 9.1 | 8.1 | 8.5 | 8.8 | 10.1 |
| Turnover ratios (x) | | | | | | |
| Asset Turnover (Gross Block) | 2.4 | 2.5 | 2.7 | 3.0 | 3.3 | 3.8 |
| Inventory / Sales (days) | 54 | 53 | 52 | 52 | 52 | 52 |
| Receivables (days) | 126 | 132 | 132 | 133 | 133 | 133 |
| Payables (days) | 36 | 33 | 33 | 32 | 31 | 31 |
| WC cycle (ex-cash) (days) | 144 | 152 | 151 | 153 | 154 | 154 |

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Radico Khaitan

| | |
|---|----|
| 1. Financial interest of research analyst or Angel or his Associate or his relative | No |
| 2. Ownership of 1% or more of the stock by research analyst or Angel or associates or relatives | No |
| 3. Served as an officer, director or employee of the company covered under Research | No |
| 4. Broking relationship with company covered under Research | No |

Ratings (Based on expected returns over 12 months investment period):

Buy (> 15%)

Accumulate (5% to 15%)
Reduce (-5% to -15%)

Neutral (-5 to 5%)
Sell (< -15)