February 6, 2016

Radico Khaitan

Performance Highlights

Quarterly Data

(₹ cr)	3QFY16	3QFY15	% yoy	2QFY16	% qoq
Revenue	401	413	(2.8)	370	8.3
EBITDA	58.5	46	27.1	50	16.6
Margin (%)	14.6	11.2	(344bp)	13.6	(103bp)
Adj. PAT	25	21	19.3	19	36.1

Source: Company, Angel Research

For 3QFY2016, Radico Khaitan (RKL) outperformed our estimates on the earnings front although the top-line came in flat yoy. On the operating front, the company reported margin expansion, primarily on account of lower raw material and selling & distribution expenses. Further, on the bottom-line front, the company reported a healthy growth due to strong operating performance and lower interest cost.

Regular & others products segment de-grew which restricted overall top-line growth but healthy volume growth in Prestige & above products segment: For the quarter, RKL's top-line grew flat yoy to ~₹401cr (our estimate was of ~ ₹432cr), mainly due to the company's shift in focus towards prestige and above products over higher volume mass market products. During the quarter, Prestige & above brands' volume grew ~10.7% yoy. Prestige and above brands' contribution to total Indian made foreign liquor (IMFL) volumes increased from 21.4% in 3QFY2015 to 24.6% in 3QFY2016. However, de-growth in Regular & others products segment which contribute more than 75% of total sales volume, restricted the overall top-line growth of the company. The company is continuously focusing on the high-margin Premium products segment to increase revenue.

PAT grew ~19% yoy: The reported net profit for the quarter grew by 19% yoy to ₹25.4cr (our estimate was of ₹23.4cr) on account of strong operating performance and lower interest cost (in FY2015 the company has repaid a significant amount of its debt; further debt reduction is also on the cards).

Outlook and valuation: RKL has not performed well in the last two years due to increasing 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 easing material costs and on expectation of better price hikes. This would result in an overall improvement in the operating margin of the company. Also, with the company having reduced significant debt from its balance sheet, it would be able to report an improvement in its profitability. We expect the company to report strong earnings CAGR of ~18% to ~₹95cr over FY2015-17E. **Hence, we recommend a Buy rating on the stock with a target price of ₹156.**

Key financials

Y/E March (₹ cr)	FY2014	FY2015	FY2016E	FY2017E
Net sales	1,452	1,488	1,517	1,635
% chg	15.4	2.5	1.9	7.8
Net profit	71	68	78	95
% chg	(7.8)	(5.1)	14.6	22.1
EBITDA margin (%)	13.3	11.4	12.7	13.4
EPS (₹)	5.4	5.1	5.8	7.1
P/E (x)	21.1	22.2	19.4	15.9
P/BV (x)	1.9	1.8	1.7	1.5
RoE (%)	9.1	8.1	8.6	9.6
RoCE (%)	9.2	7.8	8.7	9.8
EV/Sales (x)	1.6	1.5	1.5	1.3
EV/EBITDA (x)	11.8	13.2	11.5	10.0

Source: Company, Angel Research, Note: CMP as of February 5, 2016

BUY

CMP	₹113
Target Price	₹156
Investment Period	12 months

Stock Info	
Sector	Breweries & Distilleries
Market Cap (₹ cr)	1,509
Net Debt (₹ cr)	741
Beta	0.8
52 Week High / Low	131 / 78
Avg. Daily Volume	1,69,862
Face Value (₹)	2
BSE Sensex	24,617
Nifty	7,498
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	(6.4)	(14.7)	25.2
RKL	8.0	19.9	(21.6)

3-year price chart

Source: Company, Angel Research

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Exhibit 1: Quarterly performance

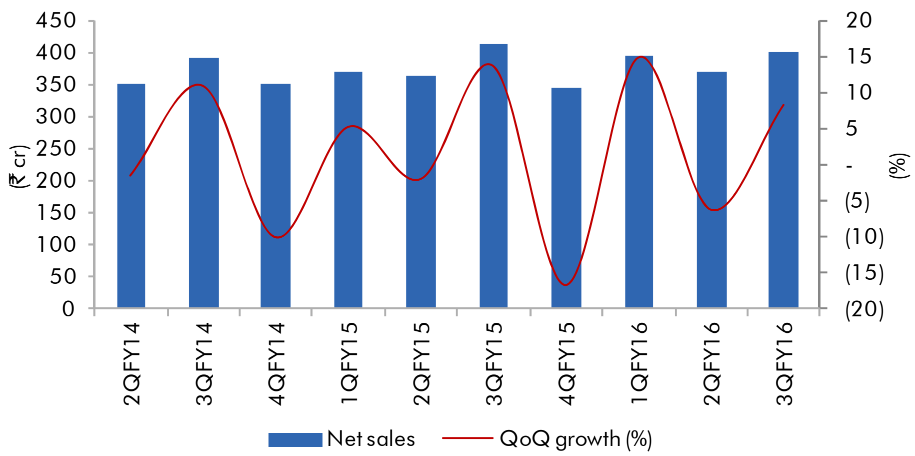
Y/E March (₹ cr)	3QFY16	3QFY15	% yoy	2QFY16	% qoq	9MFY16	9MFY15	% chg
Net Sales	**401**	**413**	*(2.8)*	**370.03**	*8.3*	**1,165**	**1,145**	*1.8*
Consumption of RM	179	221	*(19.2)*	178	*0.6*	535	562	*(4.9)*
(% of Sales)	*44.6*	*53.6*		*48.0*		*45.9*	*49.1*	
Staff Costs	29	30	*(2.3)*	29	*0.5*	85	80	*6.6*
(% of Sales)	*7.2*	*7.2*		*7.8*		*7.3*	*6.9*	
Selling & Administrative Exps.	71.4	77	*(6.9)*	64.4	*10.8*	208	217	*(3.9)*
(% of Sales)	*17.8*	*18.6*		*17.4*		*17.8*	*18.9*	
Operating Expense	63	39	*62.8*	49	*29.3*	182	149	*21.9*
(% of Sales)	*15.8*	*9.4*		*13.2*		*15.6*	*13.1*	
Total Expenditure	**342**	**367**	*(6.6)*	**320**	*7.0*	**1,010**	**1,008**	*0.2*
Operating Profit	**58**	**46**	*27.1*	**50**	*16.6*	**156**	**137**	*13.5*
OPM (%)	*14.6*	*11.2*		*13.6*		*13.4*	*12.0*	
Interest	20	23	*(14.4)*	21	*(5.3)*	62	68	*(9.6)*
Depreciation	10	9	*11.1*	10	-	30	30	*0.0*
Other Income	6.82	10.27	*(33.6)*	7.01	*(2.6)*	23	30	*(22.2)*
PBT	**36**	**24**	*46.8*	**26**	*35.0*	**87**	**69**	*26.7*
(% of Sales)	*8.9*	*5.9*		*7.1*		*7.5*	*6.0*	
Provision for Taxation	10	3	*241.7*	8	*32.3*	25	16	*55.7*
(% of PBT)	*28.8*	*12.4*		*29.4*		*28.9*	*23.6*	
Minority Interest								
Reported PAT	**25**	**21**	*19.3*	**19**	*36.1*	**62**	**53**	*17.8*
PATM	*6.3*	*5.2*		*5.0*		*5.3*	*4.6*	

Source: Company, Angel Research

Regular & other products segment's volume de-grew which restricted overall top-line growth but healthy volume growth in Prestige & above products segment

For the quarter, RKL's top-line grew flat yoy to ~₹401cr (our estimate was of ~ ₹432cr), mainly due to the company's shift in focus towards prestige and above products over higher volume mass market products. During the quarter, Prestige & above brands' volume grew ~10.7% yoy. Prestige and above brands' contribution to total Indian made foreign liquor (IMFL) volumes increased from 21.4% in 3QFY2015 to 24.6% in 3QFY2016. However, de-growth in Regular & others products segment which contribute more than 75% of total sales volume, restricted the overall top-line growth of the company. The company is continuously focusing on the high-margin Premium products segment to increase revenue.

Exhibit 2: Top-line growth trend

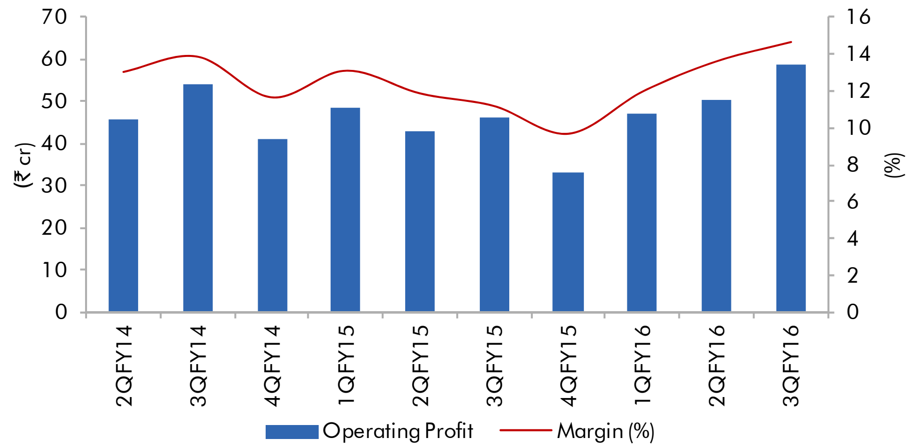


Source: Company, Angel Research

Operating margin expansion due to lower raw material and selling & distribution expenses

On the operating front, the company's margin improved by 344bp yoy to 14.6%, primarily on account of lower raw material and selling & distribution expenses. The operating profit resultantly grew by ~27% yoy to ₹58cr. During the quarter, foreign exchange fluctuation loss was of ₹1.8cr in 3QFY2016 compared to a loss of ₹5.3cr in 3QFY2015.

Exhibit 3: Operating profit and margin trend

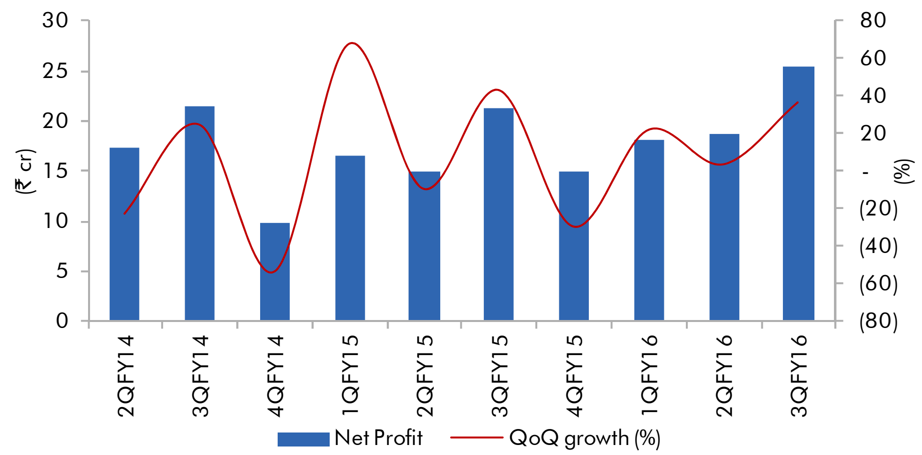


Source: Company, Angel Research

PAT grew ~19% yoy

The reported net profit grew by 19% yoy to ₹25.4cr (above our estimate of ₹23.4cr) on account of the strong operating performance and lower interest costs (in FY2015 the company repaid a significant amount of its debt; further debt reduction is also on the cards).

Exhibit 4: Net Profit and growth trend



Source: Company, Angel Research

Investment rationale

Raw material prices expected to ease

We expect the price of extra neutral alcohol (ENA), a key raw material for the company, to remain stable and potentially even decline going forward. This is because sugar production during the October 2014 to May 2015 period has risen by ~16% yoy to 27.9mn tonne, which is an 8-year high production level. As a result ENA (a by-product of sugarcane) production too would be higher this year.

Pricing environment expected to be favorable for IMFL industry

Our interaction with liquor companies suggests that the industry has now bottomed out. We expect the industry's pricing environment to likely 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 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 seven years, the company's prestige and above brands' volume has reported a CAGR of ~26% and their share in the product mix has increased from 7.9% in FY2009 to 20.7% in FY2015. We expect volume contribution of prestige and above products in the IMFL segment to increase further on back of higher ad spend. The company has roped in celebrity Hrithik Roshan as its brand ambassador. Also, RKL'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

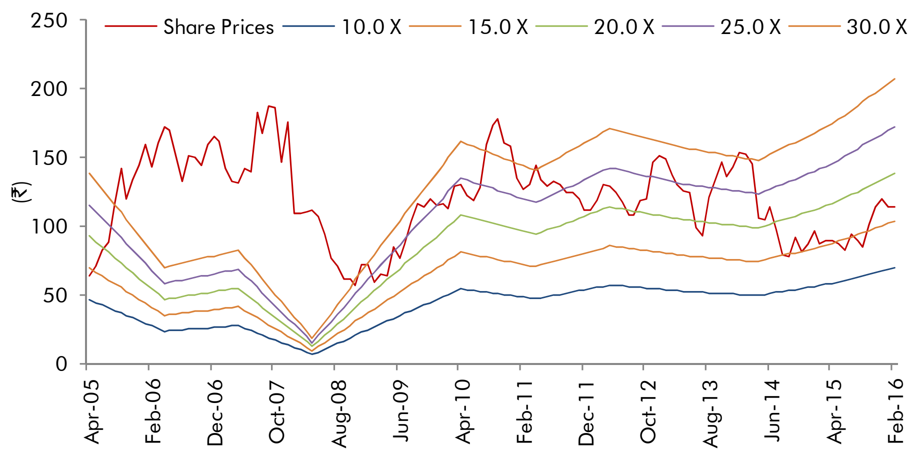
RKL has a strong sales and distribution network with a presence in retail and off-trade outlets in the relevant segments in different parts of India. Currently, the company is selling its products through over 45,000 retail outlets and over 5,000 on-premise outlets. Apart from wholesalers, a total of 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.

Apart from this, the company has strong brands likes Magic Moments Vodka, Morpheus Brandy, Verve Vodka, Florence Brandy, After Dark Whisky etc.

Outlook and valuation

RKL has not performed well in the last two years due to increasing 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 easing material costs and on expectation of better price hikes. This would result in an overall improvement in the operating margin of the company. Also, with the company having reduced significant debt from its balance sheet, it would be able to report an improvement in its profitability. We expect the company to report strong earnings CAGR of ~18% to ~₹95cr over FY2015-17E. **Hence, we recommend a Buy rating on the stock with a target price of ₹156.**

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 manufacture 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, country liquor and IMFL. 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)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Total operating income	**1,144**	**1,258**	**1,452**	**1,488**	**1,517**	**1,635**
% chg	*20.9*	*10.0*	*15.4*	*2.5*	*1.9*	*7.8*
Total Expenditure	**987**	**1,074**	**1,258**	**1,318**	**1,324**	**1,416**
Raw Material Cost	546	585	653	717	699	744
Personnel Expenses	71	79	93	107	114	128
Selling & Administrative Exp.	205	235	286	284	276	286
Others Expenses	166	176	226	210	235	258
EBITDA	**157**	**184**	**193**	**170**	**193**	**219**
% chg	*3.9*	*17.7*	*5.0*	*(11.9)*	*13.1*	*13.9*
(% of Net Sales)	*13.7*	*14.6*	*13.3*	*11.4*	*12.7*	*13.4*
Depreciation& Amortisation	33	35	39	38	41	42
EBIT	**124**	**149**	**155**	**132**	**152**	**178**
% chg	*0.1*	*20.4*	*3.9*	*(14.6)*	*14.9*	*17.0*
(% of Net Sales)	*10.8*	*11.8*	*10.7*	*8.9*	*10.0*	*10.9*
Interest & other Charges	58	70	85	90	84	84
Other Income	21	30	36	45	45	45
(% of PBT)	*24.6*	*27.8*	*34.3*	*51.6*	*40.0*	*32.3*
Share in profit of Associates	-	-	-	-	-	-
Recurring PBT	**87**	**109**	**106**	**87**	**112**	**139**
% chg	*(12.6)*	*25.7*	*(2.6)*	*(18.1)*	*28.9*	*23.9*
Prior Period & Extra. Exp./(Inc.)	-	-	-	-	-	-
PBT (reported)	**87**	**109**	**106**	**87**	**112**	**139**
Tax	23	32	35	19	35	45
(% of PBT)	*26.8*	*29.3*	*33.0*	*22.4*	*31.0*	*32.0*
PAT (reported)	**64**	**77**	**71**	**68**	**78**	**95**
% chg	*(12.6)*	*21.4*	*(7.8)*	*(5.1)*	*14.6*	*22.1*
(% of Net Sales)	*5.6*	*6.1*	*4.9*	*4.5*	*5.1*	*5.8*
Basic EPS (₹)	**4.8**	**5.8**	**5.4**	**5.1**	**5.8**	**7.1**
Fully Diluted EPS (₹)	**4.8**	**5.8**	**5.4**	**5.1**	**5.8**	**7.1**
% chg	*(12.7)*	*21.2*	*(7.9)*	*(5.1)*	*14.6*	*22.1*

Balance Sheet

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
SOURCES OF FUNDS						
Equity Share Capital	27	27	27	27	27	27
Reserves& Surplus	642	702	754	812	878	958
Shareholders Funds	**668**	**728**	**781**	**839**	**904**	**985**
Total Loans	650	768	904	849	840	830
Deferred Tax Liability	65	70	85	85	85	85
Total Liabilities	**1,384**	**1,566**	**1,770**	**1,773**	**1,829**	**1,900**
APPLICATION OF FUNDS						
Gross Block	687	744	821	831	851	871
Less: Acc. Depreciation	185	214	250	288	329	371
Net Block	**502**	**529**	**571**	**542**	**521**	**500**
Capital Work-in-Progress	5	5	8	8	8	8
Investments	**111**	**109**	**108**	**98**	**98**	**98**
Current Assets	1,016	1,161	1,330	1,379	1,458	1,570
Inventories	179	186	211	212	216	228
Sundry Debtors	348	435	523	538	553	596
Cash	21	16	15	10	25	35
Loans & Advances	382	314	441	470	482	515
Other Assets	86	209	139	149	182	196
Current liabilities	259	249	262	270	272	292
Net Current Assets	**757**	**912**	**1,067**	**1,109**	**1,186**	**1,279**
Deferred Tax Asset	**9**	**11**	**15**	**15**	**15**	**15**
Mis. Exp. not written off	-	-	-	-	-	-
Total Assets	**1,384**	**1,566**	**1,770**	**1,773**	**1,829**	**1,900**

Cashflow Statement

Y/E March (₹ cr)	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Profit before tax	87	109	106	87	112	139
Depreciation	33	35	39	38	41	42
Change in Working Capital	(15)	(242)	(53)	(47)	(63)	(83)
Interest / Dividend (Net)	37	42	50	90	84	84
Direct taxes paid	(18)	(23)	(26)	(19)	(35)	(45)
Others	18	13	22	-	-	-
Cash Flow from Operations	**142**	**(66)**	**137**	**149**	**140**	**137**
(Inc.)/ Dec. in Fixed Assets	(118)	48	(141)	11	(20)	(20)
(Inc.)/ Dec. in Investments	(9)	(3)	(0)	(10)	-	-
Cash Flow from Investing	**(128)**	**46**	**(141)**	**0.2**	**(20)**	**(20)**
Issue of Equity	1	1	1	-	-	-
Inc./(Dec.) in loans	109	97	99	(55)	(9)	(10)
Dividend Paid (Incl. Tax)	(11)	(12)	(12)	(10)	(12)	(14)
Interest / Dividend (Net)	(101)	(71)	(84)	(90)	(84)	(84)
Cash Flow from Financing	**(2)**	**15**	**3**	**(154)**	**(105)**	**(108)**
Inc./(Dec.) in Cash	12	(5)	(1)	(5)	15	10
Opening Cash balances	**9**	**21**	**16**	**15**	**10**	**25**
Closing Cash balances	**21**	**16**	**15**	**10**	**25**	**35**

Key Ratios

Y/E March	FY2012	FY2013	FY2014	FY2015	FY2016E	FY2017E
Valuation Ratio (x)						
P/E (on FDEPS)	23.6	19.4	21.1	22.2	19.4	15.9
P/CEPS	15.5	13.3	13.7	14.2	12.7	11.0
P/BV	2.2	2.1	1.9	1.8	1.7	1.5
Dividend yield (%)	0.7	0.7	0.7	0.7	0.8	0.9
EV/Sales	1.8	1.7	1.6	1.5	1.4	1.3
EV/EBITDA	12.9	11.6	11.8	13.2	11.3	9.8
EV / Total Assets	1.2	1.2	1.1	1.1	1.0	1.0
Per Share Data (₹)						
EPS (Basic)	4.8	5.8	5.4	5.1	5.8	7.1
EPS (fully diluted)	4.8	5.8	5.4	5.1	5.8	7.1
Cash EPS	7.3	8.5	8.3	8.0	8.9	10.3
DPS	0.8	0.8	0.8	0.8	0.9	1.1
Book Value	50.4	54.8	58.7	63.0	68.0	74.0
Returns (%)						
ROCE	9.4	10.0	9.2	7.8	8.7	9.8
Angel ROIC (Pre-tax)	10.4	10.9	9.9	8.4	9.6	10.9
ROE	9.5	10.6	9.1	8.1	8.6	9.6
Turnover ratios (x)						
Asset Turnover (Gross Block)	2.3	2.4	2.5	2.7	2.9	3.3
Inventory / Sales (days)	57	54	53	52	52	51
Receivables (days)	111	126	132	132	133	133
Payables (days)	38	36	33	33	32	31
WC cycle (ex-cash) (days)	130	144	152	151	153	153

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DISCLAIMER

Disclosure of Interest Statement	**Radico Khaitan**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

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%)*