

Dear Member,

We are pleased to inform you that Value Pick of Feb 2019 is released by our team on 12 May 2019. Value Pick stock of the month is Radico Khaitan Ltd (**BSE Code: 532497, NSE Code: RADICO**). Radico Khaitan has a market capital of Rs. 4609 crores and operates in liquor Industry.

1. Company Background:

Radico Khaitan is engaged in manufacturing Rectified Spirit (RS), Extra Neutral Alcohol (ENA), Country Liquor and IMFL. The company has one of the largest distilleries in India at Rampur with molasses based distilling capacity of 75 million litres per annum and grain-based distillation capacity of 27 million litres per annum.

The company also has tie-ups with 23 bottling units spread across the country in addition to its five own bottling units. In Maharashtra, Radico Khaitan has tied up with its subsidiary Radico NV (36% shareholding) for bottling operations. The company has three distilleries and one JV (Radico NV Distilleries Maharashtra – 36% stake – two distilleries) with total capacity of 157 million litres.

The company has developed its entire brand portfolio over the years. The company launched ten new brands over the past decade. Of these new brands, nine brands are in the premium category. Radico Khaitan currently has four millionaire brands in terms of number of cases sold in their portfolios which are 8PM Whisky, Contessa Rum, Old Admiral Brandy and Magic Moments Vodka.

During recent years, the company has launched premium brands like 8PM Premium Black whisky, Jaisalmer Indian Craft gin, Rampur Indian Single Malt, 1965 rum, Electra ready to drink, Pluton Bay rum and Regal Talon whisky.

Radico Khaitan is one of the oldest and largest liquor manufacturers in India, with a pan-India presence. The company has transformed itself from a bulk and country liquor manufacturer to a branded IMFL manufacturer. Favourable demographics, rising disposable incomes and changing social attitude towards alcohol consumption are the key factors driving demand for premium liquor.

2. Recent Developments:

i) Favourable Demand Outlook for Alcohol Industry in India

India's alcohol industry is the third largest in the world with a value of \$35 billion. The industry is divided into three categories: Indian Made Foreign Liquor (IMFL), beer, and homemade liquor.

Whisky dominates the IMFL category, and India has the largest whisky industry in the world. Revenue in the Alcoholic Drinks market amounted to US\$67,661 million in 2018. The market is expected to grow annually by 7.9% (CAGR 2018-2021).

The market is created by the demand and supply of products. The millennial (aged 20-39 years old) has changed the liquor industry's demand and increased it to multiple folds. Below are the points add to the market trends and development:

Change in consumer preferences to premium products: The customer has become more aware and evolved with the quality of alcohol it consumes. The drinking habits of people have changed, which is why the demands are growing. Even companies are trying their best to take advantage of the demand through their supply.

Changing the packaging of products: The alcohol industry is also doing its bit to keep the customers engaged and active by changing its packaging and adding different flavors as per customer's choice. The liquor industry has changed the packaging to recyclable and reusable products to reduce packaging prices and easy for the customers to carry.

Change perception towards consumption of alcohol: Now no celebration is complete without tossing glasses of alcohol, be it family gathering or professional parties. The perception towards the consumption of alcohol has changed and the millennial especially is too casual about the habit of consuming alcohol. As per India Whisky Market Outlook 2023 report, share of households falling into the middle-income segment (household disposable income of USD10,000+) to account for 25% of households in 2022, up from 11% in 2018.

Increasing Stress in Life: The continuous work pressure, imbalanced life has led to the stressful life of the millennial and this is taken as a reason why consumption of alcohol has increased and the demand is created in the market.

Increasing parties and the presence of Alcoholic products in them: Around 33% of the total population in India is made up of millennials (aged 20-39 years old), which will help boost liquor consumption, as drinking increasingly becomes part of social interactions.

ii) Radico Khaitan ropes in Bollywood Stars as Brand Ambassadors

Radico Khaitan announced Tiger Shroff as the brand ambassador for its iconic 8 PM Premium Black Music CDs. 8 PM Premium Black Music CDs is a brand extension of 8 PM Premium Black, India's new premium whisky. 8 PM, a flagship brand of Radico Khaitan is the world's 4th fastest growing Whisky as per The Millionaire Club 2018 global rankings.

The company launched its campaign on the lines of the brand essence i.e. smooth taste of friendship.

Similarly, for Magic Moments Vodka, marketing campaign is done with Bollywood stars Kartik Aryan and Jacqueline Fernandez. The company continues to gain market share in vodka category with Magic Moments which now accounts for 56% of the overall vodka market share and Verve accounting for 20% market share of the premium vodka category.

These marketing campaigns are being telecast across all major national and regional electronic and digital platforms.

3. Financial Performance:

Radico Khaitan standalone net profit rises 14.21% in the March 2019 quarter

Net profit of Radico Khaitan rose 14.21% to Rs 39.05 crore in the quarter ended March 2019 as against Rs 34.19 crore during the previous quarter ended March 2018. Sales rose 6.08% to Rs 509.98 crore in the quarter ended March 2019 as against Rs 480.76 crore during the previous quarter ended March 2018.

Radico Khaitan standalone net profit rises 48.81% in the Dec 2018 quarter

Net profit of Radico Khaitan rose 48.81% to Rs 52.10 crore in the quarter ended Dec 2018 as against Rs 35.01 crore during the previous quarter ended Dec 2017. Sales rose 14.59% to Rs 552.93 crore in the quarter ended Dec 2018 as against Rs 482.52 crore during the previous quarter ended Dec 2017.

For the full year, net profit rose 52.34% to Rs 188.06 crore in the year ended March 2019 as against Rs 123.45 crore during the previous year ended March 2018. Sales rose 15.04% to Rs 2096.95 crore in the year ended March 2019 as against Rs 1822.77 crore during the previous year ended March 2018.

During FY2018-19, total IMFL volumes increased by 10.8%. This volume growth was led by a strong prestige & above category volume increase of 21.3%. Volume growth was broad based across key states and key IMFL brands primarily driven by the recent price increases and favourable policy changes. A significantly improved operating environment in Uttar Pradesh continued to drive a strong volume growth and market share increase in the state. Company's recently launched brands such as 8PM Premium Black whisky and 1965 – Spirit of Victory rum also started to make meaningful contribution to the overall volumes. As per management, 8PM Premium Black has gained encouraging traction with both consumers as well as the trade channels. It is currently available in 8 key states in northern India. During FY2020, company expect to launch this brand to pan India level.

4. Investment Rationale:

i) Growing disposable incomes, increasing rural consumption, greater acceptance of social drinking and a higher proportion of the young population entering the drinking age, are all factors that make India one of top markets for global spirit companies. These demographics also support the case for the growth of aspirational brands and premium products. Consumer needs and preferences are evolving and they are now more focused on quality, convenience, value proposition and personalization to suit their styles and values. India has a young demographic profile with a median age of 28 years and around 67% of the population is within the legal drinking age. These two indicators represent significant growth opportunities for the industry.

ii) Liquor policies governing its production and sale are entirely controlled by respective State governments. With all the alcohol consuming States / Union Territories having their own regulations and entry-exit restrictions, it is very difficult for new entrants to get licenses thus providing entry barrier advantage to existing players. The States have been reasonably flexible in granting expansion of existing capacity to meet demands. This acts in favour of existing companies as new players find it difficult to start.

iii) During 2018, the liquor industry experienced a significant improvement in operating environment resulting in a robust industry performance. The Supreme Court relaxed the national highway liquor ban to take city limits out of its purview. While Kerala relaxed its prohibition to allow spirits in three and four star hotels, Bihar allowed spirit manufacturers to export products which were previously left unsold due to the ban. A number of key liquor consuming states have provided price increases thereby improving margins for the manufacturers. Furthermore, recent policy updates led to the change in route-to-market for a few states such as West Bengal moving to a government owned and controlled distribution model. The state of Uttar Pradesh recently announced a new excise policy which is aimed at transparency and improving the operating environment.

iv) Radico Khaitan is promoted and managed by Khaitan family. Radico Khaitan has been in the business of liquor manufacturing since 1943 (by the name of Rampur Distillery). In 1998, the company entered the branded liquor segment with launch of 8PM Whisky. Radico Khaitan has launched various successful brands and currently the company is one of the leading players in the Indian liquor industry. Radico Khaitan has a distribution agreement with Suntory (Japan) and E.&J.Gallo Winery (USA) for marketing its premium brands in Indian Market.

v) With favourable demand outlook for premium products, the company focus is on building brands and driving a profitable growth. The company is expected to generate strong cash flows with higher profitability from prestige and above category brands like that of past. The company is reducing its debt and target to have no borrowings by FY2021.

vi) The company recent new launches are well accepted in market. As per management, 8PM Premium Black whisky has performed extremely well in the first year of its launch with distribution only in select states in northern India,. During FY2020, it will be launched across other key states which will drive volumes of this product further. Driven by focused marketing investments, Magic Moments vodka continued its leadership position with market share gains and achieved volumes of over 4 million cases. The repackaged premium variant of Magic Moments vodka, Verve has delivered faster than industry growth. The company also launched a semi-luxury variant of Morpheus brandy which provided a fillip to the growth of this brand. The company's investment in creating malt capacities for Rampur Single Malt will start to bear fruits in the future given the strong demand for its single malt whisky.

vii) The management has maintained guidance of 8-9% growth in overall volume in FY20E with prestige & above category expected to grow at a faster pace of 13-15%, while regular category is expected to grow at lower single digit on YoY basis. The company's footprint is primarily in the low margin regular category; whereas bulk of the profit resides in prestige and above category.

viii) As on Dec 2018, promoter's shareholding in the company is at 40.35% out of which 4.55% shares are pledged. Institution shareholding in the company is at 29.92%. The company has a history of paying uninterrupted dividend and declared dividend of Rs. 1.20 per share for FY18-19 (increase of 20% compared to dividend of Rs. 1 per share paid for FY17-18), dividend yield at current price is at 0.35%. During last 3 years, the company has registered sales and profit CAGR of 8.7% and 18.3% respectively with ROE of 9.4%. With company's plan to use free cash flows to reduce debt and become debt free by end of FY21, ROE is expected to improve significantly over next 2 years.

ix) As per our estimates, Radico Khaitan can deliver PAT of 248 crores for FY 2020-21 with estimated EPS of Rs. 18.59. At current price of Rs. 345.50, stock is available at price to earnings multiple of 18.6x based on estimated earnings which makes it attractively valued at current levels. Assigning fair P/E ratio of 28 on estimated EPS for FY20-21 considering significant discount in valuation compared to market leader, company's healthy balance sheet, and better realisation with ongoing premiumisation of its product portfolio, we arrive at price target of Rs. 520.

5. Key Concerns & Risks:

i) Alcoholic beverages is a heavily regulated industry in India. Excise and other taxes from the IMFL industry hold great importance for state governments; any abnormal increase in taxation on liquor constitutes a downside risk.

ii) ENA (Extra Neutral Alcohol) forms a major component of the raw materials required for the Company's product portfolio and hence commodity price volatility remains one of the key considerations. ENA is produced from the by-product molasses in the sugar

manufacturing process or from grains. Lower than anticipated sugarcane production or any sharp rise in prices of molasses or ENA will have an impact on the company's profitability.

iii) Central Pollution Control Board, New Delhi has recently made certain observations on zero liquid discharge system of one of the plant of the company to improve the environmental conditions and pending fulfilment of additional requirements has directed closure of manufacturing operations at Radico Khaitan's plant at Rampur. The company has submitted all required details to the authority and is awaiting further response from them. The management is positive on resolution of the issue in near future.

6. Saral Gyan Recommendation:

Liquor industry offers attractive investment opportunity considering India has a large young population and alcoholic beverage segment remains an underpenetrated market in the country with lowest per capita consumption compared to western countries. Radico Khaitan volume share in the IMFL segment is around 6 percent. Magic Moments vodka brand of the company is highly popular and commands a market share of more than 55 percent in the mid-market segment. The company has increased its advertising spends to enhance brand visibility and is also expanding its distribution channel to gain volumes across regions.

Currently, Radico Khaitan is trading at trailing PE multiple of 24.50 whereas market leader United Spirits is trading at PE multiple of 52.40. We expect the company to narrow down its PE gap with United Spirits in coming years. Considering consistent improvement in earnings growth and better performance of the company compared to other players in the Industry, new launches in prestige and above category to drive future growth in premium segment, higher spending in brand building and promotion activities with two mega TVC (television commercials) and ongoing debt reduction plan with target to become debt free by end of FY2021, Saral Gyan team recommends "Buy" on Radico Khaitan Ltd at current market price of Rs. 345.50 for target of 520 over a period of 12 to 24 months.

Buying Strategy:

- 70% at current market price of 345.50
- 30% at price range of 300 - 320 (in case of correction in stock price in near term)

Portfolio Allocation: 3% of your equity portfolio.

LEGAL DISCLAIMER: Saral Gyan Capital Services (hereinafter referred as 'Saral Gyan') is an independent equity research Company. Use of the information herein is at one's own risk. This is not an offer to sell or solicitation to buy any securities and Saral Gyan will not be liable for any losses incurred or investment(s) made or decisions taken/or not taken based on the information provided herein. Information contained herein does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors. Before acting on any recommendation, investors should consider whether it is suitable for their particular circumstances and, if necessary, seek an independent professional advice. All content and information is provided on an 'As Is' basis by Saral Gyan. Information herein is believed to be reliable but Saral Gyan does not warrant its completeness or accuracy and expressly disclaims all warranties and conditions of any kind, whether express or implied. As a condition to accessing Saral Gyan content and website, you agree to our Terms and Conditions of Use. The performance data quoted represents past performance and does not guarantee future results.

DISCLOSURE WITH REGARDS TO OWNERSHIP AND MATERIAL CONFLICTS OF INTEREST:

- a. 'subject company' is a company on which a buy/sell/hold view or target price is given/changed in this Research Report
- b. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any financial interest in the subject company.
- c. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have actual/beneficial ownership of one percent or more securities of the subject company
- d. Neither Saral Gyan, it's Associates, Research Analyst or his/her relative have any other material conflict of interest at the time of publication of the research report.

DISCLOSURE WITH REGARDS TO RECEIPT OF COMPENSATION:

- a. Neither Saral Gyan nor it's Associates have received any compensation from the subject company in the past twelve months.
- b. Neither Saral Gyan nor it's Associates have managed or co-managed public offering of securities for the subject company in the past twelve months.
- c. Neither Saral Gyan nor it's Associates have received any compensation for investment banking or merchant banking or brokerage services from the subject company in the past twelve months.
- d. Neither Saral Gyan nor it's Associates have received any compensation for products or services from the subject company.
- e. Neither Saral Gyan nor it's Associates have received any compensation or other benefits from the subject company or third party in connection with the research report.

GENERAL DISCLOSURES:

- a. The Research Analyst has not served as an officer, director or employee of the subject company.
- b. Saral Gyan or the Research Analyst has not been engaged in market making activity for the subject company.

Definitions of Terms Used:

- a. Buy recommendation: This means that the investor could consider buying the concerned stock at current market price keeping in mind the tenure and objective of the recommendation service.
- b. Hold recommendation: This means that the investor could consider holding on to the shares of the company until further update and not buy more of the stock at current market price.
- c. Buy at lower price: This means that the investor should wait