



Radico Khaitan Ltd Premiumisation to drive growth

3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■
	+ Positive	= Neutral	- Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

ESG Disclosure Score **NEW**

ESG RISK RATING	33.41			
Updated Nov 08, 2021				
High Risk				
NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

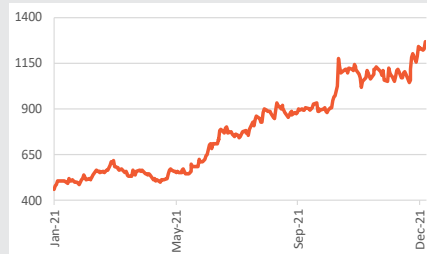
Company details

Market cap:	Rs. 16,816 cr
52-week high/low:	Rs. 1,300 / 462
NSE volume: (No of shares)	6.3 lakh
BSE code:	532497
NSE code:	RADICO
Free float: (No of shares)	8.0 cr

Shareholding (%)

Promoters	40.3
FII	20.9
DII	18.7
Others	20.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.5	29.6	65.4	161.4
Relative to Sensex	13.1	30.3	52.0	137.7

Sharekhan Research, Bloomberg

Consumer Goods

Sharekhan code: RADICO

Reco/View: Buy

↔

CMP: Rs. 1,258

Price Target: Rs. 1,475

↑

↑ Upgrade

↔ Maintain

↓ Downgrade

Summary

- We maintain our Buy recommendation on Radico Khaitan Limited (RKL) with a revised PT of Rs. 1,475. The stock is trading at 34.3x its FY2024E EPS. Strong earnings visibility and strengthening balance sheet will keep the stock under favour among investors.
- RKL's strong ability to launch new products, improving traction to premium categories, and favourable liquor policies in various states will help achieve volume CAGR of 13.5% over FY2021-FY2024 (prestige and above segment to post a 19% CAGR).
- Q3FY2022 will be another strong growth with revenue expected to grow by ~15% (led by 10% volume growth). Higher input prices will lead to a ~100 bps decline in OPM to 17% during the quarter.
- The industry is requesting the government of various states to consider price hikes to mitigate input pressure. However, in the medium term, RKL's margins are well poised to reach 19% by FY2024E.

Radico Khaitan Limited (RKL) is on consistent growth footing because of its strong ability to launch new products, improving traction to premium categories, and favourable liquor policies in various states. The company has five brands, which are selling more than 1 million cases per annum and Morpheus Premium Brandy is expected to get added to the 1 million league over the next two years. The company's recent launches such as Royal Ranthambore Heritage Collection Whiskey and Magic Moments Dazzle Vodka are gaining good traction in key markets. RKL's revenue and PAT are expected to post CAGR of 21% and 22% over FY2021-FY2024 with contribution of the premium segment going up to 35% in FY2024. The stock has delivered returns of ~40% in the past three months (since our initiation) and will continue to perform well because of its strong growth prospects.

- Premiumisation to lead to growth:** RKL's prestige and above (P&A) brands reported a CAGR of 12% over FY2015-FY2020, ahead of industry's volume growth due to strong traction to premium brands in key markets. In-line with the premiumisation strategy, the company launched new products Royal Ranthambore Heritage Collection and Magic Moment Dazzle Vodka, which are gaining strong traction in the domestic market. The brands are currently available in two states and will be launched pan India by the end of FY2023. Some of its mature brands such as Morpheus brandy (60% market share in the premium brandy segment) are likely to join millionaires club in the coming years. We expect the P&A segment's sales volume to report a 19% CAGR over FY2021-FY2024. Overall, revenue is expected to post a 21% CAGR over FY2021-FY2024.
- Q3 will be a mixed quarter:** Sustained demand from in-house consumption and improved out-of-consumption will lead to RKL's sales volume to grow by ~10% in Q3FY2022. The P&A segment's sales volume is expected to grow in high teens, while regular brand sales volume are expected to grow in single digits. We expect RKL's revenue to grow by 15% in Q3FY2022 to Rs. 785 crore. Inflation input prices will keep margin under check and, hence, OPM is expected to be lower by ~100 bps y-o-y to 17%. PAT is expected to grow in high single digit during the quarter.
- Cash flows and return profile to improve:** The company has reduced its debt by Rs. 828 crore since March 2016. Sustained improvement in cash flows will be utilised for improving growth prospects of core brands, developing new premium brands, and higher dividend payout. Raw-material pricing environment is uncertain so the company is considering backward integration. The company targets to fund any future capex through internal accruals. Return profile is expected to improve with RoE/RoCE expected to improve to 18%/23% in FY2024E from 15.1%/17.4% in FY2021.

Our Call

View – Maintain Buy with a revised PT of Rs. 1,475: The liquor industry is expected to reach close to FY2020 levels by the end of FY2022 with improvement in demand in Q2 and Q3 (especially in the premium segment). RKL will be one of the key beneficiaries of improving Indian demographics, consumer preference to premium brands, and reviving liquor policies in various states. The stock has delivered returns of ~40% in the past three months (since our initiation of the stock on October 6, 2021). The stock is trading at 43.4x/34.3x its FY2023E/FY2024E EPS. Strong earnings visibility and strengthening balance sheet will keep the stock under favour among investors. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,475.

Key Risks

Any change in liquor policies in key states/sustained increase in the excise rate on liquor would affect the sales volume and earnings growth of the company in the near to medium term.

Valuation (Consolidated)

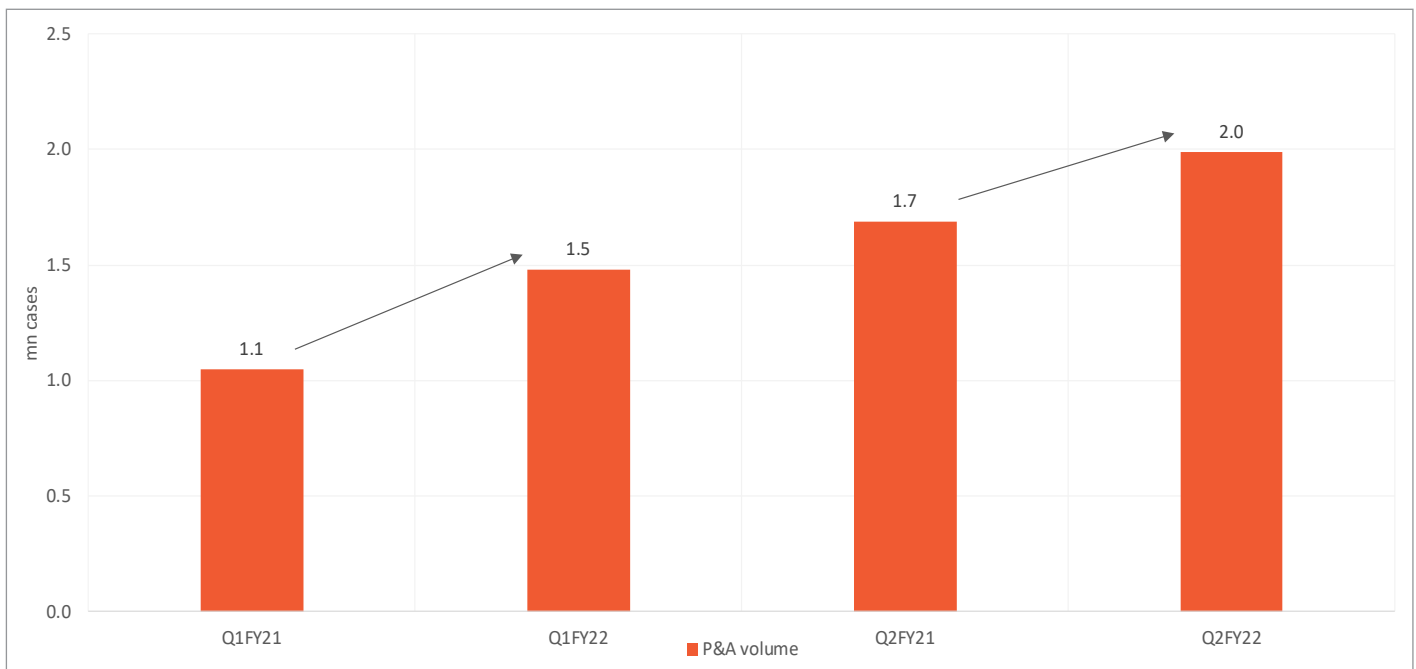
Particulars	FY21	FY22E	FY23E	FY24E
Revenue	2,418	2,878	3,343	3,870
OPM (%)	16.9	15.6	17.4	18.5
Adjusted PAT	271	286	387	489
Adjusted EPS (Rs.)	20.8	21.4	29.0	36.6
P/E (x)	60.6	58.8	43.4	34.3
P/B (x)	9.4	8.2	7.1	6.1
EV/EBIDTA (x)	41.3	37.3	28.6	23.0
RoNW (%)	15.1	14.0	16.4	17.8
RoCE (%)	17.4	17.2	20.7	23.1

Source: Company; Sharekhan estimates

Premiumisation strategy playing out well

RKL's P&A brands posted a CAGR of 12% over FY2015-FY2020, ahead of the industry's volume growth due to strong traction to premium brands in key markets. In-line with the premiumisation strategy, the company recently launched new products – Royal Ranthambore Heritage Collection and Magic Moment Dazzle Vodka, which are gaining strong traction in the domestic market. The brands are currently available in two states and will be available in seven states by the end of the current fiscal. Both the brands will be launched pan India by FY2023. Rampur Indian Single Malt Whisky has been launched in Delhi and Uttar Pradesh and is on the canteen stores department (CSD) channel. Jaisalmer Gin is currently available in 10 states and CSD channel. Management is expecting to launch it in other states in FY2023. Some of its mature brands such as Morpheus Brandy (60% market share in the premium brandy segment) are likely to join the millionaire's club in the coming years. We expect the P&A segment's sales volume to post a 19% CAGR over FY2021-FY2024. With increased contribution of P&A brands to overall sales volume, blended realisation is expected to go up in the coming years.

Increase in sales volume of P&A brands



Source: Sharekhan Research

Q3 will be a mixed quarter – Revenue to grow in double digits; Margins to decline

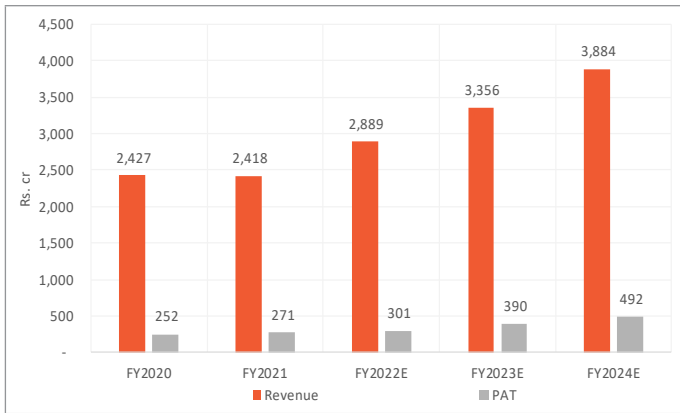
Sustained demand from in-house consumption and improved out-of-consumption will lead to RKL's sales volume to grow by ~10% in Q3FY2022. The P&A segment's sales volume is expected to grow in high teens, while regular brand sales volume is expected to grow in single digits. We expect RKL's revenue to grow by 15% in Q3FY2022 to Rs. 785 crore. Inflation input prices will keep margins under check. Hence, OPM is expected to be lower by ~100 bps y-o-y to 17%. PAT is expected to grow in high single digits during the quarter.

Margins to remain under pressure in the near term; Targets to expand them in the medium term

RKL's OPM is expected to decrease by 130 bps y-o-y to 17.6% in Q3FY2022 due to 306 bps decline in gross margin due to inflated raw-material cost (including ENA and packing materials). Raw-material inflation continued in Q3 and it will have an impact on Q3 profitability. The liquor industry has lobbied for price hikes in key states. The state of Karnataka is likely to increase the price hike next year followed by other states. In the medium term, the company is targeting OPM to improve substantially with increased contribution from premium categories. We expect RKL's OPM to stand close to 19% in FY2024 from 17% in FY2021.

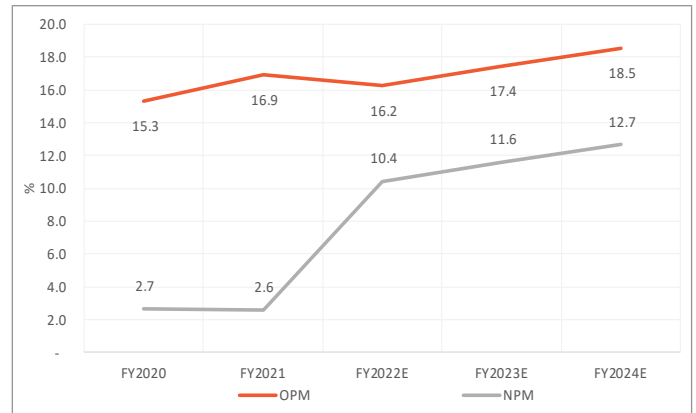
Financials in charts

Consistent growth in revenue and PAT



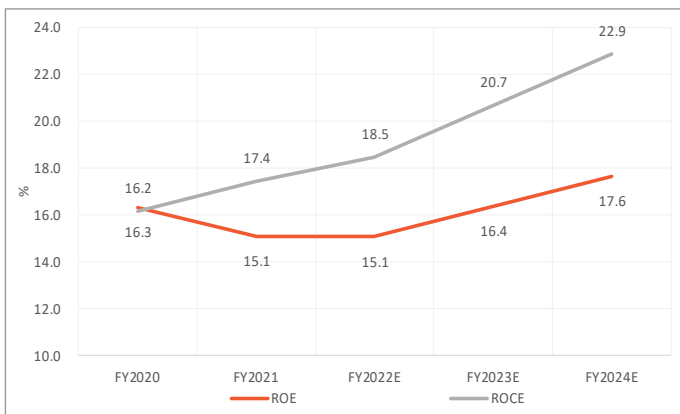
Source: Company, Sharekhan Research

Margins to expand from current level



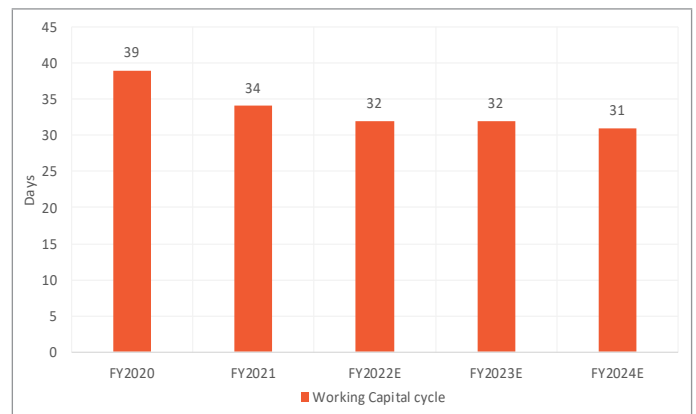
Source: Company, Sharekhan Research

Return ratios to improve



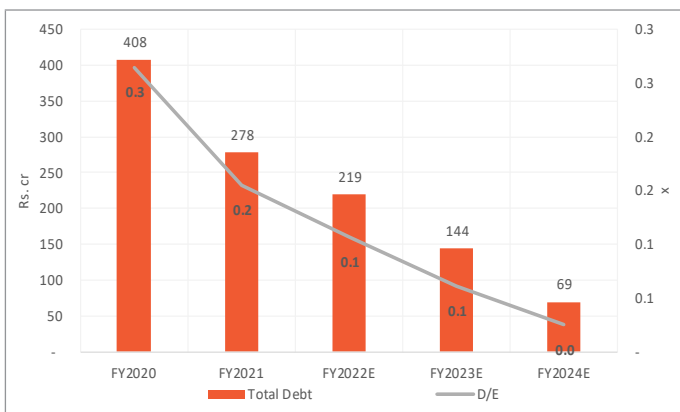
Source: Company, Sharekhan Research

Consistent working capital cycle



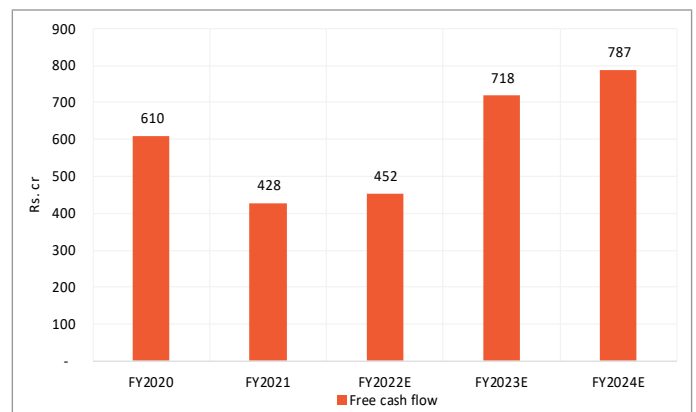
Source: Company, Sharekhan Research

Debt position to improve



Source: Company, Sharekhan Research

Significant free cash flow generation



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector outlook – Liberal state policies and changing consumer preference to drive growth

Indian-made foreign liquor (IMFL) sales volumes in India witnessed a significant dip of 18% to 274 million cases due to COVID-19 induced lockdowns during the early part of the year. By Q4FY2021, eight out of 11 top liquor consuming states had returned to above pre-COVID levels. Demand for premium brands is relatively less impacted by the industry's slowdown due to COVID-19. Consumers are having more disposable incomes, which they can use to have quality experience at home. Therefore, premium brands are likely to show much more resilience and grow in the near future. India has an incredibly large young demography, which presents many opportunities to firms in the industry. As the youth approach the legal drinking age and become more affluent, they are likely to drive much of the expected and projected future demand. Further, some of the key states are coming out with more liberal policies to drive its respective excise revenue, which will help brand players to scale up its revenue in those states.

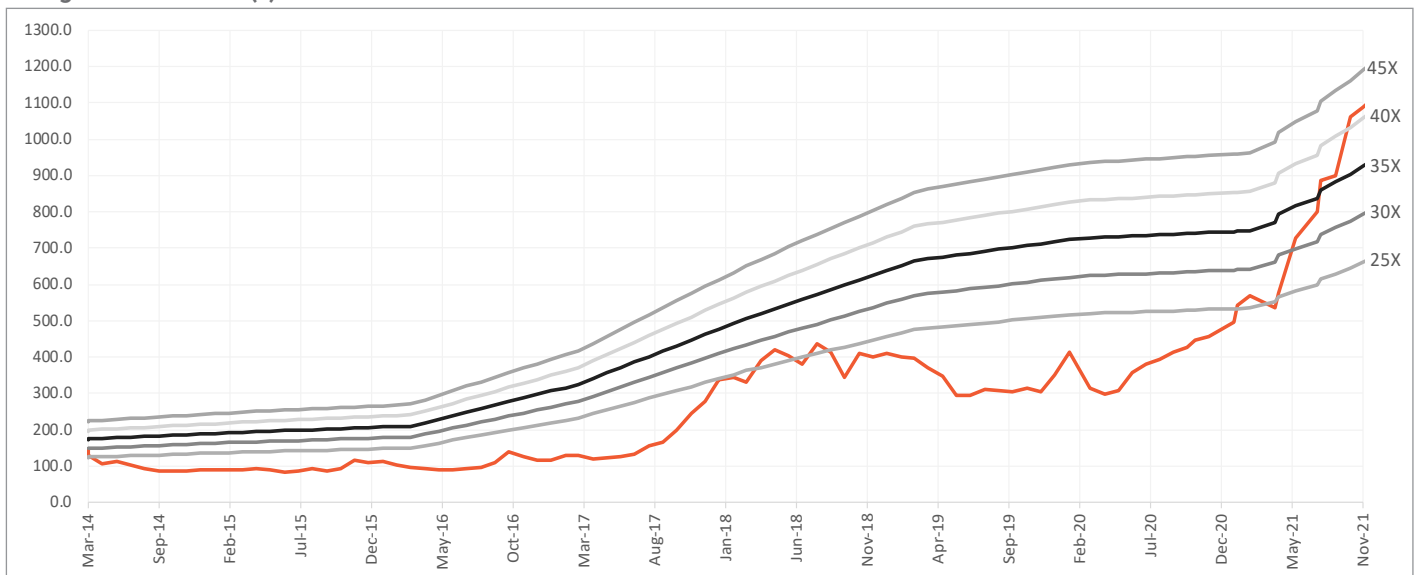
■ Company outlook – Premiumisation would lead to strong earnings growth

With consumers shifting to premium IMFL brands, RKL's focus on improving presence of each brand in key markets and emergence of favourable liquor policies in key states would help in faster growth of branded liquor products in the near to medium term. Demand environment remained strong in most of the key markets. The company expects double-digit volume growth in the P&A segment to sustain in Q3. It continues to gain market share in some of its top states (including Uttar Pradesh), while it is focusing on expanding base in some of the newly entered states. Inflationary pressure will continue to put stress on the margins in the near term. However, management has maintained its medium-term guidance of achieving high teens OPM over the next two to three years due to better revenue mix with P&A's volume contribution expected to increase to 34-35%.

■ Valuation – Maintain Buy with a revised PT of Rs. 1,475

The liquor industry is expected to reach close to FY2020 levels by the end of FY2022 with improvement in demand in Q2 and Q3 (especially in the premium segment). RKL will be one of the key beneficiaries of improving Indian demographics, consumer preference to premium brands, and reviving liquor policies in various states. The stock has delivered returns of ~40% in the past three months (since our initiation of the stock on October 6, 2021). The stock is trading at 43.4x/34.3x its FY2023E/FY2024E EPS. Strong earnings visibility and strengthening balance sheet will keep the stock under favour among investors. We maintain our Buy recommendation on the stock with a revised price target (PT) of Rs. 1,475.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21E	FY22E	FY23E
Globus Spirits	31.4	20.9	14.7	17.6	12.6	9.7	26.8	32.4	33.0
Radico Khaitan	60.6	58.8	43.4	41.3	37.3	28.6	17.4	17.2	20.7

Source: Company, Sharekhan estimates

About company

RKL, formerly known as Rampur Distillery, commenced its operations in 1943. Over the years, the company has evolved from being just a distiller of spirits for others to a leading IMFL company. The company's brand portfolio spans whiskey, brandy, rum, and white spirits, including *Rampur Indian Single Malt Whisky*, *Magic Moments Verve Vodka*, *Morpheus Premium*, *Morpheus Blue Brandy*, *8 PM*, *8 PM Premium Black Whisky*, *Contessa Rum*, and *Old Admiral Brandy*, among others. Currently, the company has five millionaire brands, which are *8 PM Whisky*, *8PM Premium Black Whisky*, *Contessa Rum*, *Old Admiral Brandy*, and *Magic Moments Vodka*. RKL has three distilleries in Rampur (Uttar Pradesh) and two in joint venture with RNV in Aurangabad (Maharashtra) in which RKL owns 36% equity. The company operates five own and 28 contract bottling units spread across the country with a combined capacity of 160 million litres. RKL is one of the largest providers of branded IMFL to CSD and exports its products to more than 85 countries.

Investment theme

RKL has transformed itself into a leading IMFL brand player from just a distillery player with premiumisation at the core of its growth strategy. The company's prestige and above brands reported a CAGR of 16% over FY2017-FY2021, contributing to 30% to sales volume IMFL (50% to sales value), helping OPM to improve by 430 bps to 17% in FY2021. Increased preference for premium products aided the company to post double-digit volume growth, ahead of the industry's growth over FY2017-FY2020. Efficient working capital management and improved profitability would help the company to generate high free cash flows (FCF) in the coming years. With no major capex on books, higher cash generated will be utilised for developing more premium brands and higher payouts to shareholders. We expect RoE/RoCE of the company to improve to 17.8%/23.1% from 15.1%/17.4% in FY2021.

Key Risks

- ♦ **Decline in demand for the company's products:** The slowdown in global economic growth and other declines or disruptions in the Indian economy in general may result in a reduction in disposable income of consumers and slowdown in the IMFL industry. This could adversely affect the company's business and financial performance.
- ♦ **Risk due to stringent regulation norms:** The Indian spirit industry is highly regulated and complex as each state has its own regulations governing the manufacture and sale of spirits. Any change in rules and regulations by the respective state governments and non-compliance with laws and regulations could adversely impact the business.
- ♦ **Increased raw-material prices:** ENA and packaging materials are two key raw material components. Any price volatility in the price of these components may have a bearing on the company's profitability.

Additional Data

Key management personnel

Dr. Lalit Khaitan	MD and Chairman
Abhishek Khaitan	MD
Amar Sinha	COO
Dilip K Banthiya	CFO
Dinesh Kumar Gupta	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TIMF Holdings	5.82
2	HDFC Asset Management Co. Ltd.	3.26
3	Nippon Life India Asset Management Ltd.	3.22
4	Aditya Birla Sun Life Asset Management Co. Ltd.	2.74
5	Tata Asset Management Ltd.	2.66
6	Vanguard Group Inc.	2.12
7	DSP Investment Managers Pvt. Ltd.	2.02
8	Massachusetts Institute of Technology	1.64
9	IDFC Sterling Pvt. Ltd.	1.54
10	IDFC Mutual Fund	1.43

Source: Bloomberg

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Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and deteriorating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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