Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Radico Khaitan Ltd

Weak Q4; margins have bottomed-out

Consumer Goods	Sharekhan code: RADICO		
Reco/View: Hold ↔	CMP: Rs. 1,169	Price Target: Rs. 1,250 ↑	

↑ Upgrade ↔ Maintain ↓ Downgrade

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 Updated May 08, 2023	33.41

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

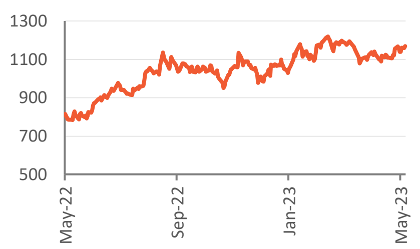
Company details

Market cap:	Rs. 15,623 cr
52-week high/low:	Rs. 1,230 / 769
NSE volume: (No of shares)	2.1 lakh
BSE code:	532497
NSE code:	RADICO
Free float: (No of shares)	8.0 cr

Shareholding (%)

Promoters	40.3
FII	19.3
DII	23.5
Others	16.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.7	-0.8	9.9	43.3
Relative to Sensex	0.6	-6.8	9.5	30.7

Sharekhan Research, Bloomberg

Summary

- Radico Khaitan Limited's (RKL's) Q4FY2023 was affected by dismal performance by regular IMFL segment which registered 23% decline in sales volume and 26% decline in the sales value, resulting in a muted 2.4% growth in revenues lower than our as well as street expectation.
- Sales volumes of Prestige & Above (P&A) segment grew by 17% in Q4 and 19.5% in FY23 (~38% of overall sales volume). The management is confident of maintaining high teen volume growth in P&A segment in FY24.
- OPM has bottomed out in Q4FY23. Backward-integration, price hikes undertaken in the key markets (including UP), softening of few commodity prices and a better mix will help EBIDTA margin to improve to mid-teens in FY24 and will consistently improve with a better mix.
- RKL's current valuation of 51.2x and 37.5x its FY24E and FY25E earnings provides limited upside. We maintain a Hold recommendation with a revised PT of Rs. 1,250.

Radico Khaitan Limited's (RKL's) Q4FY2023 performance was impacted by sustained rationalisation of low margin regular brand volumes in some key states to protect margins. Regular & other brands (~60% of overall sales volume) registered decline of 23% in sales volume and 26% decline in revenues. This resulted in muted 2.4% revenue growth to Rs. 831.8 crore. Muted revenue growth along with higher input cost inflation led to 215 bps y-o-y decline in the gross margins and 31 bps y-o-y decline in OPM to 9.5%. Operating profit was flat while PAT declined by 20% y-o-y to Rs. 37.3 crore (below ours as well as the street's expectation of 57-58 crore) due to higher interest cost. For FY2023, net revenues grew by 9.6% y-o-y to Rs. 3142.8 crore, OPM decreased by 262 bps y-o-y to 11.4% and PAT decreased by 18% y-o-y to Rs. 204.4 crore. The management expects Prestige & Above (P&A) brands to grow by high-teens while overall margins to improve to mid-teens in FY24.

Key positives

- P&A segment's sales volumes grew by 17.4% y-o-y to 2.55 million cases; net revenues grew by 18.2% y-o-y to Rs. 433.6 crore.
- Royalty brands' sales volumes stood at 0.89 million cases in Q4FY23 from 0.15 million cases in Q4FY22.
- Luxury and semi-luxury brands registered revenue growth of 110% and 73% respectively in FY23.

Key negatives

- Regular brands' sales volumes fell by 23% y-o-y to 3.80 million cases affected by rationalisation strategy.
- High input cost resulted in the gross margins declining by 215 bps y-o-y to 40.6%

Management Commentary

- P&A category is expected to continue its high double-digit (15-18%) growth trajectory in FY2024 driven by product launches, better execution and revamping existing brands. Overall volume growth is expected to be ~10% in FY2024.
- With recently received price increases in certain key states, regular volume would also deliver mid-single digit growth in FY2024. Overall revenue growth is expected to be in mid-teens in FY2024.
- Raw material scenario remains volatile, some early signs of deflation in certain commodities has been seen. Inflation has been seen in ENA and glass. Glass cost increased by ~12% from middle of Q3, the full impact of which was visible in Q4FY23. Certain other commodities such as PET and paper have seen early signs of softening.
- In the IMFL segment, the company has recently received price increases in Uttar Pradesh, Rajasthan, Telangana and Karnataka, among others of ~1.8%. In the non-IMFL segment, the company has received price increase in Uttar Pradesh applicable from April 1, 2023.
- Premiumization, price hikes in IMFL and non-IMFL business along with cost-saving from backward integration and improving efficiencies should lead to mid-teen margins in FY2024 and expected to improve.
- Company is expected to have peak debt of Rs. 800 crore in Q2FY2024 and expects deleveraging from FY2025 onwards based on expectation of the strong cash generation. RKL targets to be net debt positive by FY2026.

Revision in estimates – We have reduced our earnings estimates for FY24 to factor in lower-than-expected revenue growth in Q4FY2023 and little lower sales volume for regular brand than earlier expected while we have broadly maintained it for FY25 as the company expects to reduce substantial portion of debt in FY25.

Our Call

View - Maintain Hold with a revised PT of Rs. 1,250: RKL's premium brands are expected to consistently grow in high teens in the coming years due to strong traction. Margins have bottomed out and are expected to pick up from Q1FY24 driven by price hikes in key states and improved revenue mix. OPM is likely to consistently improve in the years ahead driven by improved mix with increasing contribution of premium brands. RKL is currently trading at 51.2x and 37.5x its FY2024E and FY2025E earnings, respectively. In view of unfavourable risk-reward ratio, we maintain our Hold recommendation on the stock with revised PT of Rs. 1,250.

Key Risks

Any change in liquor policies in key states/sustained increase in excise rate on liquor or sustained high raw-material inflation would act as a key risk to our earnings growth in the near to medium term.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	2,868	3,143	3,631	4,180
OPM (%)	14.0	11.4	14.5	16.3
Adjusted PAT	249	204	305	416
Adjusted EPS (Rs.)	19.7	16.5	22.8	31.2
P/E (x)	59.3	70.8	51.2	37.5
P/B (x)	7.7	7.1	6.3	5.5
EV/EBIDTA (x)	38.7	45.1	29.8	22.9
RoNW (%)	12.3	9.3	12.4	14.7
RoCE (%)	15.0	9.8	13.6	17.2

Source: Company; Sharekhan estimates

Stock Update

Result Update

Soft Q4 – Revenue growth at 2.4% y-o-y; OPM down 31 bps y-o-y

Net revenues grew by muted 2.4% y-o-y to Rs. 831.8 crore against our expectation of Rs. 858 crore and average street expectation of Rs. 827 crore, impacted by IMFL volume decline of 11% as volume of regular & others category declined by 23.4% y-o-y. Prestige & Above category (40.2% of total IMFL volume and 65.8% of total IMFL revenue) registered volume growth of 17% y-o-y. Gross Margin declined by 215 bps y-o-y to 40.6% due to increased packaging material cost, elevated ENA prices and continued losses in non-IMFL category. Despite a sharp decline in gross margin, OPM fell by just 31 bps y-o-y to 9.5%, led by lower advertisement and other expenses. OPM came in lower than our and average street expectation of 11.6%-11.8%. Operating profit stood flat y-o-y at Rs. 79 crore. This coupled with higher interest and depreciation expense, led to 20% y-o-y decline in the adjusted PAT to Rs. 37.3 crore, lower than our and average street expectation of Rs. 57-58 crore. Reported PAT stood at Rs. 42.6 crore. In FY2023, net revenue grew by 9.6% y-o-y to Rs. 3,142.8 crore, OPM contracted by 262 bps y-o-y to 11.4% and adjusted PAT declined by 17.8% y-o-y to Rs. 204.4 crore. The company has recommended a dividend of Rs. 3.0 per share for FY2023.

P&A brands continue to deliver volume-led growth

P&A brands reported net sales of Rs. 433.6 crore, up 18.2% y-o-y, led by volume growth of 17.4% y-o-y to 2.55 million cases in Q4FY2023. P&A brands' contribution to total IMFL's revenues increased from 55.3% in Q4FY2022 to 65.8% in Q4FY2023 due to a higher volume contribution to 40.2% in Q4FY2023 versus 30.5% in Q4FY2022, in line with the company's strategy to grow its premium portfolio. During FY2023, P&A brands reported net sales of Rs. 1,496.2 crore, up 23.9% y-o-y, led by volume growth of 19.8% y-o-y to 9.35 million cases. P&A brands' contribution to total IMFL's revenues increased from 52.3% in FY2022 to 59.8% in FY2023 due to higher volume contribution to 37.5% in FY2023 versus 30.2% in FY2022. Strong growth in the P&A brands was driven by RKL's core brands such as Magic Moments Vodka which crossed 5 million cases sales, Morpheus Premium Brandy and 1965 Spirit of Victory Premium Rum both crossing a million-case mark in FY2023.

Net debt higher y-o-y

Net debt increased by Rs. 495 crore since March 2022 after capex Rs. 608.9 crore on new projects. It stood at Rs. 611 crore as on March 31, 2023, consisting of long-term debt of Rs. 286.9 crore and short-term debt (including current maturities) of Rs. 409.9 crore, taking the total debt to Rs. 696.8 crore. Cash and cash equivalents as of March 31, 2023, stood at Rs. 85.8 crore.

Capacity expansion on track

RKL successfully commissioned a dual feed plant at Rampur in January 2023 within the committed capex estimate and timelines. In January 2023, the company also commenced the bottling operations at the Sitapur plant, which is the first phase of the green field project. Distillation is expected to start at the Sitapur plant from Q2FY24. The company has incurred capex of Rs. 677.6 crore on Rampur Dual Feed and Sitapur Green Field projects since inception.

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Key conference call highlights

- **Volume growth trajectory in P&A segment to continue:** In FY2023, P&A category volumes remained robust with growth at 150% compared to pre pandemic levels. The company expects the volume growth momentum in the P&A category to continue its high double-digit (15-18%) growth trajectory in FY2024 driven by new product launches, better execution, and revamping existing brands.

- **Raw material prices remain volatile:** The raw material scenario remains volatile and some early signs of deflation in certain commodities has been seen. Inflation has been seen in ENA and glass. Glass cost increased by ~12% from middle of Q3, the full impact of which is visible in Q4, certain other commodities such as PET and paper have seen early signs of softening.
- **Price increase implemented in IMFL and non-IMFL segments:** In the IMFL segment, the company has recently received price increases in Uttar Pradesh, Rajasthan, Telangana and Karnataka, among others. Overall, recent price increases will account for 1.8% of IMFL's case value in FY24. In the non-IMFL business, the company has received price increase in Uttar Pradesh applicable from April 1, 2023.
- **Margins to improve in FY2024:** Premiumization, price hikes in IMFL and non-IMFL business along with cost saving from backward integration and improving efficiencies should lead to mid teen margins in FY2024 and will gradually improve once with consistent improvement in the mix in the coming years.
- **Good response to Ready-to-drink (RTD):** The response for RTD products in Karnataka is very encouraging and that is pushing the company to extend the launch to couple more states in the coming months which is Maharashtra, Daman, and some states in the North. The product has responded very well, and the management hopes to make it a national product in the next one year.
- **Continued launches:** To capitalize upon the traction of 8PM Premium Black Whisky, RKL launched renovated edition of the brand in Q1FY24 into a more contemporary packaging to enhance upon its brand equity and make it more aspirational. The new packaging is focused on differentiating the products by highlighting the eight red nodes. Building upon its luxury portfolio, the company unveiled Sangam World Malt Whisky in Q4FY2023. For the future, the company is looking at a new brand in the luxury segment and the other one in the mid- luxury segment.
- **Debt to peak in Q2FY24:** The company is expected to have peak debt of Rs. 800 crore in Q2FY2024 and expects deleveraging from FY2025 onwards based on expectation of the strong cash generation. RKL targets to be net debt positive by FY2026.

Results (Consolidated) Rs cr

Particulars	Q4FY23	Q4FY22	Y-o-Y %	Q3FY23	Q-o-Q %
Net Sales	**831.8**	**812.5**	**2.4**	**792.2**	**5.0**
Raw material cost	494.4	465.5	6.2	461.0	7.3
Employee cost	46.8	37.4	25.0	45.5	2.7
Advertisement & Publicity	83.2	98.5	-15.5	78.6	5.9
Other expenses	128.5	131.5	-2.3	110.2	16.6
Total operating expenses	752.9	732.9	2.7	695.3	8.3
Operating profit	**78.9**	**79.6**	**-0.9**	**96.8**	**-18.5**
Other income	1.4	2.1	-35.1	2.7	-49.0
Interest expense	9.0	2.3	-	6.1	48.0
Depreciation	19.9	16.4	21.5	17.1	16.7
Profit before tax	**51.4**	**63.1**	**-18.6**	**76.4**	**-32.8**
Tax	14.1	16.6	-14.8	19.4	-27.2
Adjusted PAT (before MI)	**37.3**	**46.5**	**-19.9**	**57.0**	**-34.7**
Minority interest (MI)	5.4	3.7	47.3	4.2	28.3
Reported PAT	**42.6**	**50.2**	**-15.0**	**61.2**	**-30.3**
EPS (Rs.)	2.8	3.5	-19.9	4.3	-34.7
			bps		**bps**
GPM (%)	40.6	42.7	-215	41.8	-125
OPM (%)	9.5	9.8	-31	12.2	-274
NPM (%)	4.5	5.7	-124	7.2	-272
Tax rate (%)	27.5	26.3	120	25.4	211

Source: Company; Sharekhan Research

Segment-wise performance

Particulars	Q4FY23	Q4FY22	Y-o-Y %	Q3FY23	Q-o-Q %
IMFL Volumes (Million cases)					
Prestige & Above	2.6	2.2	17.0	2.6	-1.5
Regular & Others	3.8	5.0	-23.4	3.5	7.6
Total Volume	**6.4**	**7.1**	**-11.1**	**6.1**	**3.8**
Prestige & Above as % of Total IMFL Volume	40.2	30.5		42.3	
Royalty brands	0.9	0.2	-	0.9	-
Total IMFL volume	7.2	7.3	-0.7	7.0	3.6
Revenue Break up (Rs. crore)					
IMFL (A)	658.8	663.6	-0.7	634.7	3.8
-Prestige & Above	433.6	369.4	17.4	402.5	7.7
-Regular & Others	217.5	291.5	-25.4	225	-3.3
-Others	7.7	2.7	185.2	7.2	6.9
Non IMFL (B)	172.9	149.0	16.0	157.5	9.8
Revenue from Operations (Net) (A+B)	**831.7**	**812.6**	**2.4**	**792.2**	**5.0**
Prestige & Above as % of Total IMFL Revenue	65.8	55.7		63.4	
IMFL as % of Total Revenue	79.2	81.7		80.1	

Source: Company; Sharekhan Research

Outlook and Valuation

Sector Outlook – Structural change in the alcohol industry

Indian Made Indian Liquor (IMIL) is evolving from a restricted quota-based, commoditised market to a consumer-driven brand-based industry. Its main attractiveness lies in its sizeable base, comprising SEC-D, below which could translate into ~40% of the total population (excluding the Below Poverty Line). Growth in this segment is expected to be driven by a growing consumer base, rising rural income, consumption, conversion from illicit/toddy to IMIL with increasing awareness about health and quality, conducive regulatory policies, and growth in population. In the short run, the IMIL industry could benefit from lower discretionary incomes, which would push up demand for lower-priced liquor. The government is targeting to achieve 20% blending of ethanol by 2025, which would result in higher demand for grain-based molasses in the coming years.

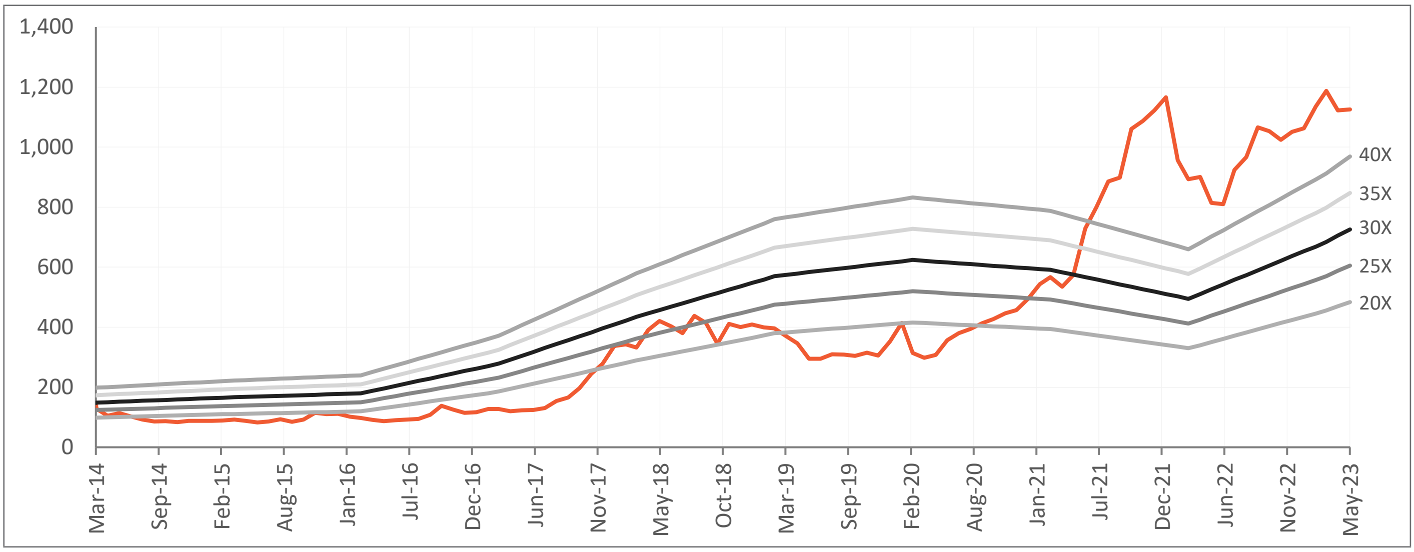
Company Outlook – Premiumisation remains the key growth driver

RKL posted soft performance in FY2023, with net revenue growing by 9.6% y-o-y, OPM lower by 262 bps y-o-y and adjusted PAT declining by 17.8% y-o-y. 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. The company expects double-digit volume growth in the P&A segment to sustain in the medium term due to strong traction to its premium brands. Inflationary pressure will continue to put stress on margins in the near term. However, the management has maintained its medium-term guidance of achieving high-teen OPM over the next 2-3 years due to improved mix of the P&A segment and backward integration to secure raw-material supply in the long run.

Valuation – Maintain Hold with a revised PT of Rs. 1,250

RKL's premium brands are expected to consistently grow in high teens in the coming years due to strong traction. Margins have bottomed out and are expected to pick up from Q1FY24 driven by price hikes in key states and improved revenue mix. OPM is likely to consistently improve in the years ahead driven by improved mix with increasing contribution of premium brands. RKL is currently trading at 51.2x and 37.5x its FY2024E and FY2025E earnings, respectively. In view of unfavourable risk-reward ratio, we maintain our Hold recommendation on the stock with revised PT of Rs. 1,250.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	FY23	FY24E	FY25E	FY23	FY24E	FY25E	FY23	FY24E	FY25E
United Spirits	71.7	59.4	44.2	44.8	38.9	31.6	20.3	21.2	23.3
Globus Spirits	26.3	14.4	11.0	13.1	8.6	6.5	15.7	21.8	23.8
Radico Khaitan	70.8	51.2	37.5	45.1	29.8	22.9	9.8	13.6	17.2

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. Currently, the company has five millionaire brands, which are 8PM 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 157 million litres. RKL is one of the largest providers of branded IMFL to Canteen Stores Department (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 P&A segment reported a 19% CAGR over FY2017-FY2022, contributing 31% to IMFL's sales volume (53% to IMFL's sales value). Going ahead as well, the company expects the strong growth trajectory in premium brands to continue. Efficient working capital management and improved profitability would help the company generate high free cash flows (FCF) in the coming years. The company is investing Rs. 740 crore (mix of debt and internal accruals) in backward integration to secure extra neutral alcohol (ENA) supply (largely grain-based). It will help to retain its guidance of high-teen margins over the next two years.

Key Risks

- **Decline in demand for the company's products:** Slowdown in global economic growth and other declines or disruptions in the Indian economy, in general, may result in 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 prices 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
Dilip K Banthiya	CFO
Dinesh Kumar Gupta	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	TIMF Holdings	4.63
2	Tata Asset Management Pvt Ltd	3.96
3	Nippon Life India Asset Management Company	3.10
4	Aditya Birla Sun Life AMC Ltd	2.99
5	Vanguard Group Inc	2.27
6	HDFC AMC	2.19
7	Classic Fintrex Pvt Ltd	1.93
8	PGIM India Asset Management Pvt Ltd	1.87
9	DSP invesment Managers Pvt Ltd	1.58
10	Massachusetts Institue of Technology	1.56

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 detoriating 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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