



Radico Khaitan Limited

(BSE: 532497; NSE: RADICO)

Q3 FY2019 Earnings Conference Call

January 24th, 2019

Management Participants:

Mr. Abhishek Khaitan, Managing Director

Mr. Dilip Banthiya, Chief Financial Officer

Mr. Amar Sinha, Chief Operating Officer

Mr. Sanjeev Banga, President – International Operations

Moderator: Ladies and gentlemen good day and welcome to the Q3 FY19 Results Call of Radico Khaitan Ltd. hosted by Emkay Global Financial Services. As a remainder for the duration of this conference all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I would like to hand the conference over to Mr. Anubhav Gupta of Emkay Global. Thank you and over to you sir.

Anubhav Gupta: Good afternoon every one. I would like to welcome the Radico management, and thank them for giving us this opportunity to host them for the third quarter earnings call. From the management, we have with us today, Mr. Abhishek Khaitan, Managing Director; Mr. Dilip Banthiya, CFO; Mr. Amar Sinha, COO and Mr. Sanjeev Banga, President International Operations. I now hand over the call to the management. Over to you sir.

Abhishek Khaitan: Good afternoon ladies and gentlemen. Thank you all for joining us on our third quarter FY19 results conference call. Hope you had a chance to review our earnings presentation and financial results announced yesterday.

During today's call I will first discuss the current industry environment followed by an operational overview and outlook. Then I will hand over the call to our CFO – Dilip Banthiya for a detailed discussion on the quarterly performance, post which we will open up the call for an interactive Q&A.

During Q3 FY19, we continued to build upon the strong growth momentum of the previous quarters and delivered another quarter of stellar performance. These strong numbers are driven by a significantly improved operating environment and price increases received across a number of key IMFL consuming states towards the second half of the last fiscal year. The state of Uttar Pradesh has registered a strong YoY of IMFL growth of 35% during the 9-month period of FY19 and we continued to outperform the industry with market share gains.

As mentioned in our previous interactions we believe that the industry headwinds are behind us and in the near term we expect the demand scenario to be robust coupled with a premiumization trend. Given the recent change in governments ethanol policy, we expect an upward trend in ENA prices. However, given the product mix changes we are confident about maintaining our profitability expansion trajectory.

In the longer-term, growth in the Indian spirit industry will be driven by growing disposable incomes increasing rural consumption, greater acceptance of social drinking and a higher proportion of the young working population entering the drinking age. These demographics also support the case for the growth of aspirational brands and premium products.

I am happy to report another quarter of strong performance led by premium category volumes. We delivered an overall IMFL volume growth of 7.2% year on year during Q3 FY19, led by premium category volume growth of 18.5%. Our revenue from operations increased by 14.6% with a corresponding profitability improvement. EBITDA growth

was robust at 27.2%, with a margin of 17.2% which reflects an improvement of 170 basis points over Q3 FY18.

We generated strong Free cash flows, which enabled us to reduce our net debt by Rs. 277 crores, during the 9 months of the year and we de-levered by Rs. 77 crores in Q3 FY19 alone. At the end of December 2018, our net debt is down to just Rs. 293 crores.

We continue to drive growth in our premium brands with focused marketing investments, which is purely reflected in the increasing market share for our key brands. Our premium portfolio contributes to 28% to our total IMFL volumes and 50% in value terms. Magic Moment Vodka commands over 55% of the overall Indian vodka market. Due to changing consumer preferences flavored Vodka has grown at a faster pace and is expected to grow faster than overall Vodka industry. Radico Khaitan is strongly positioned to capitalize on this growth opportunity.

Our recent launch 8PM Premium Black whisky has been very well received by the consumers as well as the trade and is expected to make a significant contribution to our premium product portfolio. During Q3 FY19, we signed India's youth icon and Bollywood Star Tiger Shroff as the brand ambassador for our 8PM Premium Black whisky.

Going forward we will continue to make investments in our premium brands and launch selective new products to drive a sustainable and profitable growth.

With this I would now like to hand over the call to our CFO for a detailed discussion on the operating and financial performance. Thank you and over to you Dilip.

Dilip Banthiya:

Thank you Abhishek and thank you everyone for joining this call today.

During the quarter we reported IMFL sales volume growth of 7.2% on YoY basis. The volume growth was led by strong premium category volume increase of 18.5%. Premium category brands accounted for 28% for the total IMFL volumes, compared to 25% in Q3 of FY18.

Regular category volume growth for the quarter was 3.4% as compared to Q3 of FY18. In certain market such as Kerala and Tamil Nadu we have reduced our volume, resulting in a flat growth in southern markets. In value terms, premium brands contributed to about 50% of total IMFL sales value compared to 43.3% in Q3 of FY18.

On YTD basis, IMFL volume increased by 12.4% compared to the same period last year. This was led by premium category volume growth of 21.2%.

Volume growth was broad based across all key states and key IMFL brands, primarily driven by price increase and favorable policy environment. A significantly improved operating environment in Uttar Pradesh, continued to drive a strong volume growth and market share increase in this state.

Our profitability improvement was driven by a combination of factors such price in piece, premiumization strategy and significantly improved operating environment. Our growth margin increased from 48.4% in Q3 of FY18 to 49.6% in Q3 of FY19. EBITDA during

the quarter was Rs. 95 crores, representing an increase of 27.2%. EBITDA margin during the same period expanded by 170 basis points to 17.2%.

Selling and distribution expenses have been higher during the quarter as compared to Q3 of FY18 as the Company has been progressively making investment in premium brand portfolio through increasing its on trade presence, digital and TV commercials, in shop visibility, signages and signing new celebrities for our premium brands. Higher marketing spend should enable the company to sustain growth momentum in long-term. During the 9-month period, advertising and sales promotion expenses as a percentage of IMFL revenues stood at 7.7% as compared to 5.2% in the same period last year.

Non-IMFL business contributed about 20% of the total revenue from operation from Q3 of FY19 as compared to 23% in FY18.

We registered a strong all-round growth and solid cash flow generation, resulting in the net debt reduction of Rs. 277 crores during the 9 months' period. Our net debt is down to Rs. 293 crores and we have de-levered by Rs. 654 crores between March 2016 to December 2018. We have a very strong balance sheet and conservative leverage position. I also want to reiterate that we are on course of our plan to become a debt free company in next 1.5 years.

Due to the ongoing debt reduction, our finance cost has also come down significantly and finance cost for the 3rd quarter of this year declined by 54.8% from Rs. 16.9 crore to Rs. 7.6 crores. For the 9 months' period the finance cost declined by 48.1% from Rs. 55.4 crores to Rs. 27.8 crores.

Management is focused on further strengthening our premium brand portfolio and de-leveraging of the balance sheet, which coupled with attractive industry dynamics, places us strongly for the future growth.

With this we will now open the line for interactive Q&A. Thank you.

- Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line of Chirag Lodaya from Valuequest.
- Chirag Lodaya: My first question is on volume growth. If you see Q-o-Q, our volume growth is coming down. Q1 we see 19% and then 12% and now 7%. So, I just wanted to understand how one should look at volume growth over the next 1 or 2 years.
- Abhishek Khaitan: Q-o-Q depending on the seasonality volumes keep differing. We are more concerned on a yearly basis. Going forward we expect our volumes to grow by about 8% to 9%. Whereas our premium portfolio should grow about 13% to 15%.
- Chirag Lodaya: Secondly in terms of realization. If you see last year Q4 FY18 onwards we are seeing the realization improving by almost 10% to 12% Q-o-Q. Now this realization is into the base. So, going ahead is its fair understanding, that with 7% to 8% kind of volume growth we would have at least 1% or 2% realization growth. So 10 to 12% of volume growth that one should look at.

- Dilip Banthiya:** Actually, with the product mix and other price increase and all that and the premiumization we expect around 6% of the differential between our volume growth and the value growth.
- Chirag Lodaya:** On gross margins, if I look at Q-o-Q, your gross margins have actually come down. And this quarter viz a viz Q2, overall P&A contribution is higher and P&A growth is also higher in this quarter. So, why is this Q-o-Q compression in gross margins?
- Dilip Banthiya:** Gross margin has been marginally down. There has been some increase in the ENA price in this quarter on sequential basis. YoY basis it was stable, and as you are talking about, we are at a 49 to 50 percent gross margin level. So, the continuity of the gross margin as well as the EBITDA margin, with the premiumization going on after offsetting these raw material increases will continue next year as well.
- Chirag Lodaya:** In this last quarter also we have seen an inflation of 8% to 10%. So, what is giving this confidence of next year also improving margins. Because after 2 years of benign input cost environment, we are now seeing cost inflation coming into play. So, what is giving us confidence of gross margin improvement, coming into next year.
- Abhishek Khaitan:** See the confidence is on the premiumization. On the regular segment as we said that, in Kerala and Tamil Nadu, where our realization is low, we have purposely not had volume growth there. So, we are concentrating on the states where our contribution is higher, especially with our premiumization drive and with the new brands like 8PM Black etc. coming, we expect that in spite of that ENA price increase and glass price increase, our margin should be in the upward trend.
- Chirag Lodaya:** And are we looking to increase our A&P spend going ahead or is his optimum range one should look at?
- Abhishek Khaitan:** See our A&P spend will be in the range of about 7% to 8% of IMFL sales.
- Moderator:** Thank you. The next question is from Sangeeta Purshottam from Cogito Advisors. Please go ahead.
- Sangeeta Purshottam:** I just wanted you to comment a little bit in what you see as the likely trend in the raw material prices. And the second this is, when you say that you are going to be spending 7% to 8% of your revenue on selling and distribution, is this you are talking of the total revenue, or are you netting off excise and then saying 7% to 8%?
- Abhishek Khaitan:** As far as the raw material price goes, with the new ethanol pricing, we expect that the ENA prices should go up by about 2 to 3 rupees a liter going forward. And we have already witnessed about 6-7% increase in the glass prices. Glass should not go up significantly now. But definitely ENA will go up.
- As far as the A&P spend goes, this is net of excise on the IMFL revenue.
- Sangeeta Purshottam:** So, what you are saying is, despite the ENA going up, you are confident of improving your margins, as per what was your earlier guidance. I think you had indicated an improvement of 100 to 150 basis points per annum for the next couple of years. That

continues to be on track despite ENA going up because of the benefits of premiumization. Is my understanding correct?

Dilip Banthiya: In 2017-18 our EBITDA margins were 14.7% and we guided that we will improve our EBITDA margin by 100 to 150 basis point every year for next 3 years and thereby coming to 2021 in late teens. So, we can talk about these quarter by quarter. But ultimately the company's journey and internal plan is such that by premiumization and product mix, we will keep improving these margins and by 2021 we will be in the range of margin of late teens.

Sangeeta Purshottam: Do you see any impact or any disruption or any positive impact which happens on liquor sales during elections?

Abhishek Khaitan: Overall, we don't see much of an impact, except, few of the dry days. But that is not a significant impact on the liquor consumption.

Sangeeta Purshottam: So, because of a few dry days there is some level of volumes just come off a little bit in that interim period of a couple of months.

Abhishek Khaitan: No. Not at all. Because they stock it up also. So, before the dry day, they buy a higher amount.

Sangeeta Purshottam: Okay so there is no impact basically. Okay.

Moderator: Thank you. The next question is from Vaibhav Chaudhary from Niveshaay. Please go ahead.

Vaibhav Chaudhary: Sir I wanted to know that after paying off debts in the next 2 quarters, what are our plans for growth in the utilization of cash flow. I wanted to understand our future capital allocation strategy. Are we looking for ROC growth or something like that?

Dilip Banthiya: First of all, our first aim is to get de-levered in 1.5 years. And thereafter, the cash accrual sitting in the balance sheet will be utilized between the higher payout or any other options which are there to create the shareholder value at large. So, we will debate whatever suitable options available are at the board and we will take the appropriate decision at that point in time.

Vaibhav Chaudhary: So we don't have any plans right now, like after 1.5 years as to say?

Dilip Banthiya: Right. In 1.5 years we will definitely be a debt free company and there after the options are higher payout of dividend or buy back or something else. But what makes sense for the shareholder at large will be discussed at detail and decision will be taken at that point of time.

Vaibhav Chaudhary: Any programs for inorganic growth? Are we thinking of acquiring any brands of some specific sort or we are not looking at that strategy?

Abhishek Khaitan: See, at Radico we have majorly grown organically, and we feel there is a tremendous scope in the organic growth and we will be looking at launching 2 brands in the premium segment in the brown spirits space in the next 2 years.

- Vaibhav Chaudhary: The next question is regarding our sales at airport duty free area. So, our 2 premium brands, Rampur and Jaisalmer, mainly what I get to know is that we are focusing on export segment from these 2 brands? So, what is the momentum over there and what are the growth plans?
- Sanjeev Banga: Yes there is lot of focus on travel retail of these 2 premium brands and currently they are be available only in the overseas market. Today as far as the Rampur single malt goes, it's strictly on allocation basis because the demand is outstripping the supply. We have already enhanced our malt capacity, but you know, it's very long process of aging and all. As far as Jaisalmer gin is concerned, that is not a problem. And we are focusing a lot in the European and US markets and the travel retails. We would soon be launching them in India as well.
- Vaibhav Chaudhary: What are the cash flows which we can expect or what are the margins overall. Are there going to be higher or in the range of P&A itself?
- Sanjeev Banga: They are very healthy margins on these super premium products. So, we would like to spend behind these brands as well. And the margins would remain very healthy.
- Vaibhav Chaudhary: Any quantifiable numbers of EBITDA.
- Sanjeev Banga: No I am afraid, we will not be able to share those details.
- Moderator: Thank you. The next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.
- Saket Kapoor: Firstly, if you could give the break-up of the raw material basket? What constitute our raw material basket?
- Dilip Banthiya: There are two main ingredients in the raw material. One is grain and another is molasses. So as far as Radico's portfolio is concerned around 55% to 60% of the product are grain-based alcohol and around 45% are from molasses-based alcohol.
- Saket Kapoor: Currently sir, we are also looking for converting one of our molasses distillery plant to grain spirit based one. So, what is the thought process behind it and when that happens, what will be the mix?
- Dilip Banthiya: Actually, as our proportion of the premium portfolio is growing and in our mother plant, the proportion in future is going to be higher, we are preparing ourselves for the future to create more grain-based captive capacity.
- Saket Kapoor: That will be a value addition that you are trying to say. How are we sourcing this availability of grain?
- Abhishek Khaitan: Grain is available in 100 km vicinity by the mandis in abundance. And there are mills from where we can source the broken rice, etc. So, there is no problem.
- Saket Kapoor: Regarding molasses, how is the availability of molasses with ethanol pricing and all, the B-Grade molasses being up by Rs. 5, how are the molasses priced remained over the last quarter?

- Dilip Banthiya: If you see the tender floated and most of the bids have come from C-Heavy molasses only. A very few and small quantity is towards the B-Heavy molasses. Till 2019-20 also the molasses scene in UP especially is comfortable. And we will see from 2021 onwards how does the sugarcane crop takes place. There is some impact that we have talked about. That price increase has already happened in the ENA, and going forward some more can happen. But that has all been factored into when we talk about our future of profitability and future growth.
- Saket Kapoor: So we are needing the Grade-C molasses for our purpose?
- Dilip Banthiya: Yes, we buy C-Heavy.
- Saket Kapoor: and the prices that are up by the government I think are B-Heavy segment.
- Dilip Banthiya: Yes. The C-Heavy prices have been rather, once they have been increased from 41 to 43 but later on, they were marginally reduced.
- Saket Kapoor: As you told that the lowering of finance cost had added to our bottom line so for an annual figure, for the next year and as well for this year, what should we work out our number for finance cost sir? For this year nine months we have done 28 crores approximately.
- Dilip Banthiya: It will be like, for this quarter it was Rs. 7.26 crores. So 4th quarter also it will be near to that range. So that annual number will be between Rs. 34 crores to 35 crores. And next year when further de-leveraging takes place it will go down further.
- Saket Kapoor: Lastly, if you could give us the sense, what has been the positive changes that has happened in the industry over the last 2 to 3 years because the way the financials have improved and we have been able to de-leverage. What were the steps and what were the changing points that has happened over the period from 2016 – 2018 that has contributed to it. And how much is the sustainability going forward?
- Dilip Banthiya: First of all the premium brand in the industry is growing in a higher double-digit. So that is the recent trend which is happening. Here Radico is poised for a growth in our premium portfolio for a bouquet of brands. Secondly, as we have talked about, that Uttar Pradesh has been opening up of the market has taken a big leap in the industry volume and our industry in the first 9 months is up by 30% to 35%. And then some price increases have happened in the Southern states where it was very tight margin so the supplies were not being made but now with better margins the supplies are being taken by the national companies there also. So, these are the positive environmental changes. And consumption in our opinion as the industry is growing by 8% to 10% is back.
- Saket Kapoor: Right sir. And our advertisement costs are clubbed in the selling in the selling and distribution expenses of 72 crores for this quarter? Advertisement is being clubbed in that category or any other item?
- Dilip Banthiya: Yes, that is in the selling and distribution.
- Moderator: Thank you. The next question is from the Prashant Kutti from Sundaram Mutual Fund. Please go ahead.

- Prashant Kutti: Just one question on the industry growth rates. You said that UP specifically has grown by about 30-35%. You think most of that growth is largely done I am sorry for extrapolating this, but if you look at the growth rates every quarter, the first 2 quarters we saw a very strong growth rate, in the regular segment and that seems to have come off. Is that specifically because of UP or is it being an industry-wide phenomenon where the growth rates generally in the Q3 has been weak?
- Abhishek Khaitan: The growth rates have been kind of same, but for Radico specific as we said the states like Kerala and Tamil Nadu, where our realization is very low, there we have not sold much of the regular range. As far as Uttar Pradesh goes, like 35%, is a one-off. But going forward I think the growth rate in the UP would be in the range of about 10% to 12%.
- Prashant Kutti: When you say going forward that means as early as next quarter, because most of that gains is largely done right?
- Abhishek Khaitan: No, I am talking about next year, 2019-20.
- Prashant Kutti: As such nothing specific as to why this quarter, why in this overall growth rate in the industry was lower because even if anyone was to look at the market leader, even his growth rates also came-off.
- Dilip Banthiya: The industry has been growing in the range of 8% to 10% only. We talked about as a Radico specific in the regular category which is 3.4% growth; otherwise my Prestige and above brands are 18.5%. Growth has been there, but because we have actually not supplied regular category brands in Tamil Nadu and Kerala hence, our growth rate is in the 7.2%. This is specific about the two states.
- Prashant Kutti: This is specifically in this quarter you are saying?
- Dilip Banthiya: Yes this has been this quarter and when we find that the pricing in these states are not lucrative at the regular category, we are concentrating and deploying our working capital somewhere else where we can make better money.
- Prashant Kutti: Any specific state left where you can probably take up pricing because incrementally most of the states are largely done.
- Abhishek Khaitan: See, as an industry what we keep on representing for increase in prices and like you know, passing on the cost push to us so that is a regular affair.
- Moderator: Thank you. The next question is from Amit Zade from GIC. Please go ahead.
- Amit Zade: A couple of questions. As we see, you are moving towards grain-based distillery. So, what should be the CAPEX for the same in next 2 years, and second question is, as you are moving towards premiumization, how should the sales from regular category pan out for the next 2 years?
- Abhishek Khaitan: As far as the CAPEX goes, we are outsourcing about 50% of our requirements. So, we are going on asset-light model. So, the next 2 to 3 years the CAPEX in Radico would be in the range of Rs. 40 crores to Rs. 50 crores, which is basically maintenance CAPEX.

Plus, a little bit increases in our malt capacity, because in Rampur Single Malt demand has really increased so this would be our plan.

As far as the volume goes, we expect in the next 2 years our volume to grow in the range of 8% to 9%. That is the overall volume. Whereas the premium portfolio should grow in the range of about 14% to 15%.

Amit Zade: And about regular categories?

Abhishek Khaitan: 5% to 6%.

Moderator: Thank you. The next question is from the line of Devanshu Damani from Emkay Global. Please go ahead.

Devanshu Damani: I just wanted to ask two questions. One is regarding the raw material prices. Can you share the outlook on molasses and grain ENA prices for FY20? And secondly, I missed the price hike question-answer. So, is there any anticipation of price hike in coming quarter in any states?

Abhishek Khaitan: To answer about your grain prices and the ENA prices, we expect that it should be up by about Rs. 2 to Rs. 3 per liter, from the current levels. And about any price hikes in the coming quarter as of now it is not visible.

Moderator: Thank you. The next question is from Anubhav Gupta from Emkay Global. Please go ahead.

Anubhav Gupta: There are few questions from the FIIs. They couldn't be on the call because of the time zone difference. So, I will like to ask on their behalf.

So, the first question is, the sales volume growth in Prestige and Above category has been so strong in the first 9 months. Could you let us know, which brands did well in vodka or rum categories so that we have some sense on which brands are doing well?

Dilip Banthiya: Actually, our established and most successful brands like Magic Moment Vodka, has continued to drive our Prestige and Above category growth driver. Morpheus is also growing very well and is now also available in Northern and Eastern India. Earlier it used to be in southern India only. So, we are spreading it out to pan India basis. Then there are couple of more brands which has been launched in last 2 to 3 years, particularly this year, 8PM Premium Black. So, these are the areas where we find that the 18.5% and 21.2% growth in the first 9 months have come. Another brand, which is the super-premium Verve, which is the higher version of Magic Moment, is also growing after our re-packaging and a new shape. So, we have a bouquet of brands which is driving this growth in Prestige and Above category.

Anubhav Gupta: Second is the follow-up question on the 8PM Black whisky launch. So, what is the strategy in particular regarding this product, since whisky has not been very strong for Radico, vs Vodka or rum or brandy?

Abhishek Khaitan: See, for us the 8PM Premium Black Whisky, we have test marketed it and we have launched it in 8 states. And the initial consumer response is quiet encouraging. And we

have also signed up Tiger Shroff as the brand ambassador. And very soon we will be unveiling the campaign for our 8PM Black Whisky, and in the next year, 2019-20, we will be taking it national. We hope the brand should do very well.

Anubhav Gupta: So I believe the products which you just named, in last few minutes, this will take growth to 12% to 15%, the target which you were guiding for. And are you also working on other new products which could complete the portfolio for Radico in particular?

Abhishek Khaitan: Yes, we are working on 2 brown spirits in the premium space, which we are going to launch in the next 2 to 3 years.

Anubhav Gupta: Lastly, is it fair to assume that the company will have zero debt in FY20?

Abhishek Khaitan: In the next one and a half year.

Moderator: Thank you very much. We will take that as the last question. I would now like to hand the conference back to the management team for closing comments.

Dilip Banthiya: Thank you for joining us in this call. And we are pleased to answer any of your query off line and by mail between me and Mukesh Agarwal – our Investor Relations Head, for any further specific questions. Thank you.

Moderator: On behalf of Emkay global financial services that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.

Note: This transcript has been edited to improve readability.

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