Radico Khaitan Limited

(BSE: 532497; NSE: RADICO)

Q2 FY2020 Earnings Conference Call

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Management Participants:

Mr. Abhishek Khaitan, Managing Director

Mr. Dilip Banthiya, Chief Financial Officer

Mr. Amar Sinha, Chief Operating Officer

Mr. Sanjeev Banga, President – International Business

Presentation

Moderator: Ladies and gentlemen, good day and welcome to the Radico Khaitan Q2 FY2020 Earning Conference Call hosted by Emkay Global Financial Services. We have with us today, Mr. Abhishek Khaitan, Managing Director, Mr. Dilip Banthiya, CFO, Mr. Amar Sinha, COO and Mr. Sanjeev Banga, President, International Business.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Amit Zade of Emkay Global Financial Services. Thank you and over to you Sir!

Amit Zade: Thank you Jennies. Good afternoon everyone. I would like to welcome the management of Radico Khaitan and thank them for giving us this opportunity. I would now hand over the call to management for the opening remarks. Over to you Sir!

Abhishek Khaitan: Good afternoon, ladies and gentlemen. Thank you for joining us on our second quarter FY2020 results conference call. Hope you have had a chance to review our earnings presentation and financial results announced yesterday. On today's call, I am joined by my colleagues, Dilip Banthiya, CFO; Amar Sinha, Operating Officer and Sanjeev Banga, President, International Business. During this call, I will first discuss the current industry environment followed by an operational overview and outlook. Then I will hand over the call to Dilip for a detailed discussion on the quarterly performance followed by an interactive Q&A.

During Q2 FY2020, the IMFL industry volume growth was subdued, which is in line with the overall economic slowdown. However, despite a subdued industry performance Radico Khaitan continues to deliver robust growth and outperform the industry. During Q2 FY2020, the IMFL industry in India has remained flat year-on-year. Our volume growth has been broad based across our brand portfolio across key liquor consuming states. In the international market our luxury brands Rampur Indian Single Malt and Jaisalmer Indian Craft Gin continued to gain strong traction and penetrated market in the US and Europe. Jaisalmer Gin is now available in over 20 countries globally.

As you are aware that over the past few quarters raw material prices have increased significantly. ENA prices have increased by 8% to 10% quarter-on-quarter compared to Q1 FY2020 and over 25% year-on-year. However, during the month of October, ENA prices seem to have peaked out and are in consolidation mode. We are hopeful that with the improved monsoon and better crop and sugar season, raw material price scenario should be stable. Glass bottle prices had increased by about 15% year-on-year in FY2019. We expect the glass bottle prices to remain stable at these levels.

Given the improved monsoon and various initiatives undertaken by the government, we expect consumer sentiment to pick up in the coming quarters. With the ongoing product mix changes and price increases, we are confident about maintaining a long-term margin expansion trajectory along with increased operating cash flows. Given the significant cost push, our EBITDA margins are in consolidation phase in FY2019 and from next year onwards, we expect our margin to resume the expansion path.

During Q2 FY2020, Radico Khaitan reported 10.9% volume growth, which was led by Prestige and above category growth of 11.6%. Our revenue from operation increased by 10.1% during the same period. Our recently launched brand such as 8PM Premium Black Whisky and 1965 Spirit of Victory Rum continued a strong growth trajectory and make meaningful contribution. 8PM Premium Black Whisky is currently available in 11 states and after seeing the positive traction, we plan to roll it out in 4 more states in this fiscal year.

Given our ability to maintain the IMFL volume growth credit, we are confident of delivering improved profitability when the industry scenario stabilizes.

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. Thank you everyone for joining this call today.

During Q2 of FY2020, we reported IMFL sales volume of 5.78 million cases representing a growth of 10.9% on Y-o-Y basis. Volume growth was led by a Prestige and above category volume increase of 11.6%. Prestige and above category brands accounted for 28.3% of the total IMFL volumes compared to 28.1% in Q2 of FY2019. Regular category volume growth for the year was 10.6% compared to Q2 of FY2019. In value terms, Prestige and above brands contributed about 48% of total IMFL sales value as compared to 49% in Q2 of FY2019.

Net revenue from operations during Q2 FY2020 was Rs. 570 Crores representing an increase of 10.1% compared to Q2 FY2019. During this period, IMFL sales value growth was 16.4%. As percentage of total revenue IMFL account for 82% of the net revenue from operations as compared to 78% in Q2 of FY2019.

Gross margin declined from 51.4% in FY2019 to 48.4% in FY2020 due to increase in raw material prices and purchase of alcohol from third parties for the manufacture of country liquor given the restricted capacity at our Rampur plant during this quarter. Had the plant operated at full capacity, our gross profit in Q2 FY2020 is estimated to have been higher by about Rs. 8 Crores.

The Company continues to make marketing investment to sustain the growth momentum. During Q2 FY2020 advertising and sales promotion expenses as a percentage of IMFL revenue stood at 8.4% compared to 8.1% for the same period last year and in particular the investment in Prestige and above category is in double digit.

As of September 30, 2019, net debt was Rs. 355 Crores versus Rs. 319 Crores as on March 31, 2019. During this period, we saw short-term timing delays in receivable collection leading to a temporary working capital build-up in certain corporation markets and CSD. However, we do not see any credit risk with these receivables.

Finance cost for Q2 FY2020 declined by 16.2% on Y-o-Y basis from Rs. 9.16 Crores to Rs. 7.66 Crores.

Management is focused on further strengthening our premium brand portfolio and deleveraging the balance sheet, which coupled with the attractive long-term industry dynamics, places us strongly for a feature growth. With this we will now open the line for interactive Q&A session. Thank you.

Question & Answers

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We take the first question from the line of Chirag Lodaya from ValueQuest. Please go ahead.

Chirag Lodaya: Congratulations on good set of numbers. My first question is on overall growth, so if I look at your regular portfolio, it is growing at 10% for first half, even Prestige has grown at 14% in the environment where we have seen some disruption in Andhra Pradesh, Telangana and some liquidity pressure at northern markets. So, what exactly is driving this growth, which are the markets we are seeing growth as well as some brands, which are pulling all this growth, some details would be appreciated?

Abhishek Khaitan: To answer your question, we are experiencing growth all over the country and as far as liquidity pressure goes like in the northern market especially we had come on policy of strict credit rules about two years back that is why our volume growth in north especially in syndicated markets like Punjab and Haryana was limited. We are experiencing a lot of growth in our flagship brand Magic Moments Vodka, Morpheus Brandy and specially like 8PM Premium Black, which we had launched last year is now on the verge of becoming a million case. Also, our 1965 Spirit of Victory Rum, which is one of the most expensive rums in the armed forces also, which we are now rolling it out nationally, has also seen a good trajectory. So, basically growth is coming from all our Prestige and above brand and as far as the regular brand goes, we are experiencing good growth in markets like UP, certain southern markets like Karnataka, Andhra Pradesh, Telangana.

Chirag Lodaya: And in terms of realization also, regular brands realization is up by 7.5% whereas Prestige is just up by 2.2% for first half as well as the quarter trend, so what is driving this realization improvement in regular?

Abhishek Khaitan: See, in the regular range we are selling only in those states where our brand is profitable. We have not gone across India, we are not chasing volumes, what we are chasing is profitable growth. So our regular range is selling only in selected states where your contribution is higher.

Chirag Lodaya: Sir, second on gross margins, so first half we have seen around 270 bps decline in gross margin and now as I understand our molasses cost is going up and we will be procuring in H2. So how one should expect gross margin moving ahead, will it be in the range of 48% or we may see some decline in coming quarters?

Dilip Banthiya: Gross margin is improving. As you rightly said that in the first half our Prestige and above category brands have grown by 14% and gross price realization per case has improved by 6% on YoY basis. So, the gross margin in this quarter has improved because of the product mix. Secondly, our IMFL business in this quarter has grown by 16.5% whereas non-IMFL business has degrown by around 12%. So there has been an improvement on gross margin because of the product mix as well as more share of IMFL business in the overall revenue.

Chirag Lodaya: Right, going ahead, we do not expect any gross margin pressure, these Q2 gross margins at least are sustainable?

Dilip Banthiya: I think it should be better or here or better from here.

Chirag Lodaya: Sir, debt repayment H1 cash flow from operation has been just Rs. 28 Crores, we have seen increase in receivable as well as other current asset, so what kind of debt levels we are expecting at the year end?

Dilip Banthiya: So, as we said in our opening remark that there has been some timing delay in certain corporation markets and CSD. In particular receivables has gone up so that is why the operating cash flow has been deployed in the working capital. We can afford this credit because of our strong balance sheet and improve sales and brand mix. However, this is temporary phase, and by the year-end we expect that the operating cash profit will be positive and as we guided earlier that the company plans to be deleveraged and debt free company, so by 2021-2022 we will be a debt free company.

Chirag Lodaya: I just trying to understand FY2020 debt level will remain in the range similar to FY2019 or we may see some reduction?

Dilip Banthiya: We will see a reduction, but not as significant as last year because the growth is there, some temporary investment into the receivables is there and still we will see a three-figure plus kind of free cash flow.

Chirag Lodaya: Sir, just lastly on overall other expense line item, we have seen sharp increase this quarter and on H1 also A&P has been a bit muted on a half yearly basis. So going ahead do we see operating leverage coming in and that is why we are confident of 16% margin maintaining for full year?

Dilip Banthiya: This other expenditure has been higher because of one item which is cow cess in UP. We are taking steps to mitigate impact of that and as far as the margins are concerned, we expect this year to be in the range around 16% or so.

Chirag Lodaya: Thank you and all the best.

Moderator: Thank you. Next question is from the line of Sangeeta Puroshottam from Cogito Advisors. Please go ahead.

Sangeeta Puroshottam: Good afternoon and congratulations for a good set of numbers. I actually just wanted to get some deeper understanding about how the price changes work, on a very simplistic basis we have seen that costs have grown particularly raw material costs have grown much faster than the sales, now logically at some point you would be seeking to pass that on as a price increase to neutralize that impact, how does this exactly work in your industry given that there are constraints on your ability to pass on the price increase and how much time does that take, if you could just help me understand that whole process?

Amar Sinha: First of all, yes you are right that the impact of cost increase has been higher than the volume increase across the industry. However, Radico has shown a higher growth in terms increase in sales as compared to the industry. Having said that see what has happened is that the government also is today conscious of the rising costs and most governments in the last one year have been receptive towards increasing selling prices and granting these increases to the various operating companies. So that has already been captured by the industry so far. In the times ahead what we are looking at is further negotiation with the operating governments to increase prices, so lot of discussions are already underway and we hope that the government is going to concede to it, considering the fact that all the state economies find revenues from liquor as the major source of income, so you are right we intent passing on this to the consumer.

Sangeeta Puroshottam: So, it is basically just assuming that we do not see any further price increase, what is your assessment that by when would you be able to neutralize the impact given your ongoing discussions is likely to take a couple of quarters more or what is your sense on the timelines number one, the second related question was that the increase in the excise paid was actually quite substantial was more than the increase in sales. Has there been a significant increase in excise duty in certain states? If you could just explain that also?

Amar Sinha: See, when you have an excise duty increase that does not affect the results of companies because proportionately the price also moves up.

Sangeeta Puroshottam: I understand that, so what it really means is, you know there is an opportunity as far as the consumer is concerned whether it increases from excise or you increase the price he is experiencing a higher purchase price. When government steps in and takes more of that then at least less room for manufacturers to get a price increase, so obviously there has been some price increase, but the government has taken that away is that what has happened?

Abhishek Khaitan: No, actually I will answer this question. There are certain states where you have to pay the excise duty upfront. Out of 28 states there will be about say 8 or 10 states where you have to pay the excise upfront and 10 states you do not have to pay the excise upfront and in those states if your sales go up then the percentage of excise goes up that is why the excise is higher than the net sales.

Sangeeta Puroshottam: So, would that neutralize in the coming quarter because you have already sort of paid upfront?

Abhishek Khaitan: No, let us say for example like Uttar Pradesh. Uttar Pradesh, when you send the material to the distributor you have to pay the excise duty before the material leaves your factory and in Telangana you send to the corporation where the retailer has to pay the excise duty, so it depends on the state mix.

Sangeeta Puroshottam: So, are you saying that there has not been a fundamental increase in the percentage of excise?

Abhishek Khaitan: No, excise duty more or less is the same.

Sangeeta Puroshottam: I see, alright, so the main increase really has been on the cost and there you expect that in sometime, which is what I would like know two quarters, three quarters you would be able to neutralize that impact?

Abhishek Khaitan: Yes, that is what we feel because even the state governments are looking at giving price increases so I think in the next two quarters we should be getting more price increases.

Moderator: Thank you. Next question is from the line of Rahul Ranade from Goldman Sachs. Please go ahead.

Rahul Ranade: Sir, thanks for the opportunity. Just one question. Could you give us a proportion of how much of your revenue has come from free pricing states versus price-controlled states?

Abhishek Khaitan: It is about 20% to 25%.

Rahul Ranade: And what is the kind of price hikes that we have already received in this year?

Abhishek Khaitan: See, the total price hike what we have received is about 1.75%.

Rahul Ranade: And this would be kind of spread across how many states?

Abhishek Khaitan: This would be about 13 to 14 states.

Rahul Ranade: Alright. Thank you.

Moderator: Thank you. Next question is from the line of Harit Kapoor from Investec Capital. Please go ahead.

Harit Kapoor: Good afternoon team. Just two questions, firstly on your credit risk in markets, which are open in terms of private distributors especially in the north, how have we seen that business evolve in the last two quarters? Have we cut back a little bit or what are we seeing especially because you are close to that market, so just wanted to get a sense?

Abhishek Khaitan: As we had told earlier that basically primarily there are only two or three markets like Punjab and Haryana, and two years back Radico has taken a conscious call to cut down the business there. So we work on a strict policy of credit, so that is why the volumes about two years back had gone down in these two states and now it is going up because our discipline of credit is quite strong there. So, we are increasing sales there because our credit is strong and Uttar Pradesh, we are on cash and carry, so it is quite a healthy trend.

Harit Kapoor: Got it, second thing was in the price increase, you said that second half you can expect some price increase coming in, are there any specific states that the industry is targeting that where there is a higher possibility of price increase, I know it is a tough question, but anything?

Abhishek Khaitan: We expect this to come in few southern states, I would not like to name the states as of now because the industry keeps on representing and hopefully, we should get some price increase in the southern states.

Harit Kapoor: Last thing was on, the first half of this year for the industry has been fairly challenging regarding certain state regulatory changes, elections as well as the fact that the demand slow down, but your volume growth has been in double digits. So just wanted to get a sense, how you are seeing the second half of this year especially because some of these issues are not there while demand is slow some of these issues on the regulation and elections, etc., are not there, so do we expect the similar momentum to continue for our company?

Abhishek Khaitan: We could see in the first half the industry has grown by 3% whereas Radico has grown in terms of volume by about close to 10.5% and now we have seen the consumer demand picking up and we feel the second half as of now what we can see looks better than the first half in terms of volume growth. Also, we have concentrated lot of on innovative marketing where we have increased a lot of spend on our ATL, etc., so which is giving great results for the brands, so the second half definitely looks better in terms of the volume growth.

Harit Kapoor: Very clear, Sir. Thanks, and all the best.

Moderator: Thank you. Next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Thank you very much for the opportunity. Taking the question forward on the volume growth, since you mentioned that the second half should be better and we are already at 10% to 11%, so overall for the year we should be targeting about 12% to 14% that range as compared to what we have been targeting about 9% to 10% right?

Abhishek Khaitan: See, as a guidance I will talk about 9% to 10%, but yes, right now the trend looks quite positive, so we are quite optimistic about it, but as far as the guidance goes our guidance is 9% to 10%.

Deepak Poddar: And given your price hike as well right that will add to your value growth, so overall on that value growth may be 3% to 4% addition growth on the value front?

Abhishek Khaitan: Yes, that is right.

Deepak Poddar: On the margin front you have mentioned that this is a year of consolidation, so from next year onwards FY2021 what we have been talking about 100 to 150 basis point improvement every year till we or till we reach high teens by FY2022, so is that what we are still maintaining or targeting?

Dilip Banthiya: As we are improving our product mix and Prestige and Above category growing in 13% to 14% we expect the margin, which is consolidating in this year to remain in 16% range and next year onwards again it will be on expansion. So we expect with our business model that our margins will be expanding around 100 to 125 basis points on annual basis, so by 2021-2022 we should be in teens.

Deepak Poddar: That is it from my side. Thank you.

Moderator: Thank you. Next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Sir, thank you for the opportunity. Just referring to this point number 6 of your notes wherein the Center Pollution Control Board has restored the capacity of Molasses plant from 77 KLD to 200. So that the capacity was 200 and it was brought down due to some environmental clearance pending?

Dilip Banthiya: Yes, there was two months period where we were restricted to operate at 77 KLPD and we have been producing in general around 150 KLPD on normal course which we have restored. But our rated capacity is 200 KLPD so they have restored to 100% of the rated capacity.

Saket Kapoor: So, government requirement was 150 and we were operating at 77?

Dilip Banthiya: In this period we were procuring some ENA from outsourcing and utilizing that ENA for our country liquor business. So our topline didn't suffer; however, because of our ENA outsourcing we have suffered on our margin and that is why in our remark we said that the impact of that was Rs. 8 Crores, otherwise our EBITDA would have been higher by Rs. 8 Crores to Rs. 94 Crores for this quarter, 16.5% operating margin.

Saket Kapoor: And this payment of Rs. 7 Crores is for full and final, on what terms you have decided and is it done away with or any review?

Dilip Banthiya: This is full and final.

Saket Kapoor: Sir, coming to your raw material basket, is it only the Molasses that constitute the majority, if you could give me the mix?

Dilip Banthiya: See, all the products in Prestige and above category, which is 48% of our revenue are grain based. Our alcohol mix is around 60% from grain and 40% from molasses.

Saket Kapoor: Did not get the last point, come again?

Dilip Banthiya: The composition of raw material is 60% from the alcohol made out of grain and 40% from molasses-based alcohol.

Saket Kapoor: Sir, coming to this UP government. I think so upping of the molasses percentage also from 12.5% to 16% for this sugar season 2019-2020, so will this be aiding to your margins because I think these are the quota system being availed by the liquor manufacturer like you?

Abhishek Khaitan: Yes, actually it is not 16%, they have upped it to 18%, definitely it will ease the situation of molasses then it will be better for the liquor.

Saket Kapoor: Sir, what have been the price front for molasses currently, there has been some price increase year-on-year, if you could give some trend lines for molasses prices?

Dilip Banthiya: In the molasses, the new sugar cycle is yet to start from November. We are getting molasses prices around Rs. 300 to 350 currently; however, most of our molasses based ENA is used in country liquor, so there is a levy molasses, so not much impact on business on account of that.

Saket Kapoor: What is the price difference from the government quota and the market prices if you could give that?

Dilip Banthiya: Heavy molasses in the range Rs. 75 to 85 whereas free sale of molasses will be in the range of Rs. 300 to 400 it depends on the sugar season when it starts slower then goes up.

Saket Kapoor: So, availability of molasses would not be an issue for this year also?

Abhishek Khaitan: No, absolutely not.

Saket Kapoor: Sir, last point on the other expenses you were explaining that if you compare it from the last year same quarter from Rs. 58 Crores to Rs. 68 Crores, there was one of some adjustment I missed that point, if you could give it again?

Dilip Banthiya: That was specific Cess in UP that was not there last year, so this has been charged. It is around Rs. 6 Crores approximately in this period because of that there has been an increase of Rs. 10 Crores on YoY basis.

Saket Kapoor: Rs. 6 Crores is towards the UP Cow Cess?

Dilip Banthiya: Yes.

Saket Kapoor: I will come in the queue, I have a few more questions, but I will come in the queue. Thank you.

Moderator: Thank you. We next the question from the line of Chirag Lodaya from Value Quest. Please go ahead.

Chirag Lodaya: Sir, in the beginning of the year you have mentioned this year inventory will go up by Rs. 60 Crores to 70 Crores on account of higher molasses prices, so H1 we have seen your inventory has actually come off, so can we expect this increase in inventory, which should happen in H2 with new procurement of molasses being considered?

Dilip Banthiya: It is an annual phenomena that in March when the season is there we buy the molasses, which is at the cheapest price at that point of time for the next three to four months and it starts depleting and by September the inventory of molasses come down and in the sugar season again then we will build up. However, even after that meeting capex and everything we will be plus by RS. 100 Crores on our operating cash flow to reduce our debt, which will take care of inventory increase as well as the capex and other things.

Chirag Lodaya: There will be no negative impact of this molasses procurement in H2?

Dilip Banthiya: That is right.

Chirag Lodaya: And just lastly, non-IMFL business, what kind of growth one should assume because there have been lot of volatility between the quarters. On a full year, basis the revenues are more or less stagnant in the last two to three years?

Dilip Banthiya: So, non-IMFL business is decreasing continuously in alcohol business, which used to be there around 8% to 10% is now negligible. Only to our tie-up units. As far as other business that is PET business is concerned, that is also degrowing because we are using internally and as far as the country liquor is concerned that is roughly around 12% to 13%, so overall mix the non-IMFL will continue to shrink because we are using all the alcohol for our IMFL business.

Chirag Lodaya: On a full year basis, this number should be flat that is fair understanding?

Dilip Banthiya: The non-IMFL will decrease on a year-on-year basis and full year basis.

Chirag Lodaya: Thank you and all the best.

Moderator: Thank you. Next question is from the line of Pankaj Kumar from Kotak Securities. Please go ahead.

Pankaj Kumar: Good afternoon Sir. Sir, you indicated that you would be generating some Rs. 100 Crores of operating cash flow in the year, so how much you would utilize for capex and debt for the year, if you could give us some sense on that?

Dilip Banthiya: This is after taking care of capex that we are thinking about this Rs. 100 Crores worth of operating free cash flow. The capex is in the range around Rs. 65 Crores to 70 Crores, which is maintenance capex. This year we have increased our capacity of malt by triple from a million liter to 2.5 million liter, bottle printing for Magic Moments, Morpheus and kind of brands, so these are all in the range of Rs. 65 Crores to 70 Crores.

Pankaj Kumar: So, balance we can assume like Rs. 30 Crores to 35 Crores would be utilized for reduction in debt?

Dilip Banthiya: No, I am talking about after taking care of capex we will be plus Rs. 100 Crores because this receivable in the H1, which has increased by more than RS. 100 Crores in these markets, so this situation, will ease out.

Pankaj Kumar: So, what would be the debt reduction for the year, any sense on that?

Dilip Banthiya: So, as I said this will be somewhere around Rs. 100 Crores debt reduction is expected on a full year basis.

Pankaj Kumar: Sir, on the market side, if you look at, how is the UP market done in this year, last year it was quite strong, so on that base, how it has done this year?

Abhishek Khaitan: See, the UP market is growing by about 10% and last year it grew by about 30%. So I think go forward I feel that UP market will go to grew by 8% to 10% year-on-year.

Pankaj Kumar: Have we gained market share in UP in this year as well?

Dilip Banthiya: Yes, we are the largest company in the UP as of now as far as market share goes and we have a market share close to about 30% in UP.

Pankaj Kumar: Sir, lastly on the regular category side, which all brand have done well because we have seen 10% plus kind of growth, so which all brand has done well?

Abhishek Khaitan: See, 8PM positively has done very well and Old Admiral Brandy has done well, so primarily these are the two brands, which are really contributed.

Pankaj Kumar: And how about Magic Moment in the P&A?

Abhishek Khaitan: Yes, Magic Moment also is growing and that has also done very well.

Pankaj Kumar: Is it double digit?

Abhishek Khaitan: Yes, double digit.

Pankaj Kumar: Thank you.

Moderator: Thank you. Next question is from the line of Harshal Mehta from ICICI Direct. Please go ahead.

Harshal Mehta: Sir, my question is regarding the recent commentary of our bigger competitor, in which it has said that they did not go for volume push in certain channels fearing bad receivables, so did Radico face a situation wherein it was easier to push volumes on certain trade channels given that our competitor was not ready to throw that volumes to those trade channels?

Abhishek Khaitan: As explained earlier also, there are certain northern markets where Radico Khaitan two years back had already pulled out the volumes like especially Punjab, Haryana, so we were not giving credit to the trade channels and we have been maintaining a strict discipline of outstanding, so we have not pushed any material into any private channels in this quarter, so for us it is not relevant.

Harshal Mehta: So, we do not fear any bad receivable?

Abhishek Khaitan: Absolutely not.

Harshal Mehta: Thank you Sir.

Moderator: Thank you. Next question is from the line of Aditya Joshi from Karma Capital. Please go ahead.

Aditya Joshi: Thanks for giving me an opportunity, Sir and congrats on a good set of numbers. My question is related to Magic Moments and vodka in particular, so what would be the premiumization strategy there and going ahead, how many more launches we have been fairly gaining market share and that has been stable when it comes to White Liquor, but premiumization has been slow, so what could be the strategy there?

Amar Sinha: It is like this that Magic Moment today commands more than 56% market share across the vodka category. So, in other words the vodka category and Magic Moments have become synonymous. Having said that we are right now upscaling the Magic Moment brand equity higher and higher. We recently launched the premium segment of Magic in the form of Magic Moments Verve, cross lined with some of the international brands like Smirnoff and there within a short span we have been able to get a market share of almost 18% to 20%. We are now also looking at further premiumization by bringing in new flavors. Flavors are in great demand in the vodka category in India right now and there are quite a few new developments happening on that scale and we hope that we will eventually keep up scaling till we optimize the equity of brand Magic.

Aditya Joshi: Got it Sir, and out of the total entire vodka market if you see, what would be the premium portfolio in that, what percentage?

Amar Sinha: Basically, right now as I said we command 56% of the vodka category, we are in the premium price segment as it is, so bulk of the vodka market is actually the premium range, which is growing, the lower end of the vodka category is actually declining and vanishing. 90% will be in the premium price point.

Aditya Joshi: Got it Sir, next question is related to most premium brand that we have in the portfolio, which is Rampur and Jaisalmer, how has been the response there and what has been response in the international market?

Sanjeev Banga: With response we have seen exceedingly well both in terms of Rampur as well as Jaisalmer. We launched Rampur three years ago and from there we have four expressions in the market and the response to all of them has been very encouraging including the latest one that we launch the Signature Reserve, which is a limited release of only 400 bottles one of the oldest malt from India retailing at about £1000 a bottle. Similarly, for Jaisalmer, the response from the European and US market has been very good and travel retail is showing exceedingly well acceptance of Jaisalmer. We are looking at adding more excursions of Jaisalmer exclusively for travel retail in the coming quarters. We are also planning to launch Jaisalmer in India very soon.

Aditya Joshi: Got it Sir. That would be great. Sir, next question is pertaining to the road safety rules and increase in the fines, of drink and drive, have you seen any kind of impact in any of your geographies that you operate?

Dilip Banthiya: No, this is industry campaign, which has been going on for years together. I think this responsible drinking is the biggest slogan from the industry, this is continuous and we want to promote the responsible drinking.

Amar Sinha: So, most liquor companies are actually promoting this and it is good for the industry, but it has nothing to do with volume.

Aditya Joshi: Got it Sir and what kind of raw material inflation do we expect for the entire year FY2020?

Dilip Banthiya: So, we have seen the peaking of the raw material prices and I think with good monsoon we are expecting that grain prices will come down from by 8% to 10%, so is the molasses prices in the sugar season we expect in 2019-2020 to come down. So, I think the work is over on the raw material side.

Aditya Joshi: Got it Sir and last question related to the Electra that we have in our portfolio, how has been the pick-ups in the sales volume there and how has been the response from the consumers?

Amar Sinha: So, Electra is a category that we have experimented with so far and launched it in very few states, but going forward we feel that it will add to the Magic Moments Brand equity in totality and it is targeted at the right target audience, which is the youth who is beginning the alcohol drinking journey with low content alcoholic beverage, so in the year ahead we do have plans to promote this and grow the brand. Right now it has been very selective.

Aditya Joshi: Thanks a lot, and all the best.

Moderator: Thank you. We take the next question from the line of Ambar Taneja from Vachi India. Please go ahead.

Ambar Taneja: Could you give some indication as to the sales numbers like in terms of rupees for two premium brands that you have, which is the Rampur and Jaisalmer and also how much capital expenditure you are doing to increase the capacity of these two brands because as per your previous calls, there is more demand than capacity, so I am just wondering as a kind of a multiple, what kind of growth are you looking forward to 3x or 5x or 20% or 50% and some kind of base number would be appreciated to get an idea of the contribution to total sales?

Sanjeev Banga: Honestly, we do not share the volume numbers for these two premium brands. The only thing that we can say is whatever we can produce we are selling that and we enhance all capacity three times but obviously it will take some time before the actual product goes out into the market because it requires a long aging process. In terms of Jaisalmer, we have already done the capex in terms of setting up a new gin distillation process, so that capex has already been done and thankfully for gin we do not have an aging so we do not have a volume issue on the gin

Abhishek Khaitan: Plus we have invested about close to Rs. 50 Crores for tripling the malt plant capacity in the storage, which has been operational from last month.

Ambar Taneja: How would sales volume for Rampur compared to the other two single malts from India, John Paul and Amrut, is this a larger brand than two of them or comparable or too smaller?

Sanjeev Banga: You see, Amrut started the single malt thing about 15 years ago and John Paul did about 8 years ago, so they have been in the market for a longish period and they obviously have more malt under maturation for the single malt category. We have been in the business of single malt only for three years now, we still have a lot more malt, which is under maturation so only once they are ready because we do not want to change volumes on a single malt. We want to ensure the quality that goes to the consumer as the finest, so it is more of the quality product that goes to the lips of a consumer than cases.

Ambar Taneja: Could this become a sizable part of the business in the next three to five years or will it always remain the same?

Sanjeev Banga: Now, especially with the expansion of our malt capacity both in terms of distillation and storage, we expect this to become a sizable business in the coming years both for Single Malt as well as Craft gin.

Ambar Taneja: That is it from me. Thank you.

Moderator: Thank you. Next question is from the line of Arjun Asher from Envision Capital. Please go ahead.

Arjun Asher: What would be our current capacity utilization?

Dilip Banthiya: On the distillation side it is almost 100% whatever we have an operational capacity. On bottling side we have sufficient capacity and it can also be outsourced, so that is not a constraint.

Arjun Asher: So, you mentioned certain amount of maintenance capex for the year earlier, but are we on the cusp of another leg of major capex cycle, so I am talking from a five-year perspective?

Dilip Banthiya: It depends on the opportunity, but at this point of time whatever capex are being undertaken these are undertaken for our IMFL business, so not being considering much bigger capex on the distillation side or commodity side.

Arjun Asher: There would come certain point because if you are currently growing your volumes in range of around 10%, so would not there be like a major bottleneck where you need a major leg of capex going forward in the next five years?

Abhishek Khaitan: See, there are two parts to it, one is the distillation part and one is the bottling part. So we outsource our bottling so enough capacity is available throughout the country to bottle our products and as far as distillation goes today also we are buying a lot of spirit from outside, we buy close to about 5 lakhs liters of spirit from outside parties. So we can always increase that, so as of now it looks that there is no need for a major capex.

Arjun Asher: Alright and few questions back you mentioned that 25% to 30% of your sales is coming from unregulated markets in terms of pricing, right?

Abhishek Khaitan: Yes, that is right.

Arjun Asher: And apart from UP, which would be the major states where there is regulated pricing for you?

Abhishek Khaitan: See, all the regulatory pricing is like the government corporation is there, they review the pricing and it is done like Andhra Pradesh, Telangana, Kerala, Karnataka all these markets. Rajasthan.

Arjun Asher: Is there any kind of a timeline after which you will be able to communicate certain kind of metric in terms of volumes or topline for Rampur and Jaisalmer combine say three years down the line or four years down the line, is there any kind of time horizon for that?

Sanjeev Banga: Well, as we said we were chasing volume numbers, but next five years down the line it will be a significant portion of our top and bottom line.

Arjun Asher: Sure. Thanks a lot. That is all from my side.

Moderator: Thank you. Next question is from the line of Nikhil Upadhyay from Securities Investment. Please go ahead.

Nikhil Upadhyay: Thanks for the opportunity. Just two questions, one is the clarification, so you said if we would have continued the Rampur distillery at full utilization, the gross margins would have been higher by Rs. 8 Crores in the first half, is that a right understanding?

Dilip Banthiya: Yes, in this quarter the gross margin would have been higher by Rs. 8 Crores, so the EBITDA margin was at 16.5% if we add that, due to the restricted capacity of ours producing the molasses alcohol.

Nikhil Upadhyay: This Rs. 6 Crores Cess, which we were talking of is in the other expenses, is it a one off item or is it a regular item now?

Dilip Banthiya: Actually, this is the item, which has been started from April 2019 and we are taking step to mitigate this because this is mainly on account of export out of India.

Nikhil Upadhyay: So, that full impact is reflected in this quarter or it was there in previous quarter also?

Abhishek Khaitan: Yes, so when the volumes of export in particular quarter goes up, the impact of that is higher, so in this quarter also the export has also done well. So this is from April, but the Rs. 5 Crore is for this quarter.

Nikhil Upadhyay: Now, more on the selling and distribution cost, so I think what we are looking at is, we are trying to grow our whisky portfolio with 8PM Premium and couple of more new launches in Rampur and all, but if we have to understand, the spends behind the selling and distribution and the promotions of the brand, so would a Magic Moment with 56% to 57% market share require equal amount of investments in order to keep growing at this 8% to 10% or is it the incremental investments are more behind these new organic opportunities, which we have just launched over last two to three years. If you can just give some colour in terms of where the higher spend is going to it?

Abhishek Khaitan: See, as a philosophy like we try to keep our marketing spends between 8% to 9% of the IMFL sales and then each brand strategy is developed. So we would not be able to comment on each brands because these are internal matters, but on a corporate level we will keep our total marketing spend at 8% to 9% of the IMFL sales.

Nikhil Upadhyay: But now currently we are around 12% to 13%, so a larger increase is because of the launches like three or four launches, which have happened in subsequent year like in two to three years we have launched multiple newer brands, so I think is that either we are seeing a much higher increase and once they start stabilizing this probably come back to the 9% to 10% or how should one understand it over a longer period?

Dilip Banthiya: For the A&P expenditure has remained at 8.4% in this quarter. As far as the Prestige and above brands are concerned, which is around 48% of the volume and most of the expenditure in A&P is catering to the Prestige and above category, so we can very well assume that the A&P expenditure as expenditure to the Prestige and above brands, value terms would be in much higher, it would be on 12% to 13%.

Nikhil Upadhyay: And lastly on the Prestige where we are seeing strong growth, is it because, so if we have to divide it between new launches and the organic businesses, which we have been doing so would the organic businesses be growing at equal rate or is it like the new launches have stepped up the growth for us?

Dilip Banthiya: It is a mix of both the existing brand in Magic Moment, Morpheus are already in the market leader with 56% plus kind of market and continues to have that journey of 8% to 10% growth; however, as we said that 8PM Premium and 1965 Rum both are also adding up, so these brands are maturing and more and more states we are rolling out so in future they will also be good driver, our journey of Prestige and above and our reason and strategy to go in the range of 12% to 15% in three to five years, so it is a combination of both existing as well as new brands.

Moderator: Thank you. Next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Thank you for the opportunity. This time the debtor cycle has worsened for us, what should be the normal course, I think the receivables have gone up significantly, so generally what is the cycle and how soon it will be getting restored?

Dilip Banthiya: Generally, our cash to cash cycle of working capital is between the 50 to 55 days. So this is an abnormal situation and I am talking about working capital to the gross sales, but this period last quarter we have seen abnormal high in certain corporation market and so is the CSD, so this situation should ease out in the Q3 and Q4 because the state government are equally interested in that because they heavily depend on the revenue from the excise. So, easing out of the receivable condition of the brand owner is really interest of the state as well.

Saket Kapoor: Sir, you told that our raw material mix 60% from grains and 40% from molasses this is what the point, Sir?

Abhishek Khaitan: Yes.

Saket Kapoor: And this is going to get more skew towards the grains are going forward as earlier told that in technology also?

Abhishek Khaitan: Yes, it looks like that and it will continue to skew in towards the grain side.

Saket Kapoor: Sir, what is exciting about the grain part, why are we looking for this grain as an offering because there the price volatility of the raw material is also significantly higher? So what is the moot point behind it and secondly one of your competitor is also coming up with some capex if I name them India Glycols in the UP market itself. So what kind of market share do you think with their capex your market share will degrow or whether you will be able to maintain it to 30%?

Dilip Banthiya: Actually, can you repeat your specific question?

Saket Kapoor: My specific question was the reason for skew towards the grain moving away from molasses and secondly, we reported market share of 30% in the UP market and it has been observed that one of your competitor is putting up more capex in that segment only. So how are you going to maintain your market share going forward as they are putting capex, what is your strategy behind it, I am talking about India Glycols.

Abhishek Khaitan: See, to first answer your first part, grain alcohol is always used for premium brands, we are using grain for all our Prestige and above brand and as far as the second question goes, I think IGL is not in the IMFL business in Uttar Pradesh.

Saket Kapoor: They are not in the IMFL business?

Abhishek Khaitan: Yes.

Saket Kapoor: Then they are catering to which market, country liquor only?

Abhishek Khaitan: Yes.

Saket Kapoor: We do not have a presence in the country liquor?

Abhishek Khaitan: So, IGL's plan in grain will always remain as suppliers of grain spirit because of the growing demand for grain in the Prestige and above brand, they will continue to supply to companies like us who have established brands.

Saket Kapoor: And what kind of capacity, are we sourcing sprit we are sourcing from IGL in particular?

Abhishek Khaitan: No, we are not sourcing spirit from IGL. We have got the largest plant in Uttar Pradesh where we are producing close to 10 million liters of alcohol and whatever we are producing we are selling in IMFL and consuming it internally.

Saket Kapoor: Lastly to conclude H2 looks better and this abnormality that has happened due to excise cess and the exceptional items would not be there affecting the H2 numbers, so overall the bottom line will be also looking flat if we take the last H2 number as a guidance for the last year?

Dilip Banthiya: We are expecting volumes to pick up as the industry has remained flat. Next H2 we expect the industry to again come back on 7% to 8% kind of growth, and consumer demand picking up with the economic activity. So as Radico has always been maintaining and having a bigger growth than the industry, so we expect our topline to be better in H2.

Saket Kapoor: Thank you.

Moderator: Thank you. Ladies and gentlemen, that was the last question for today. I would now like to hand the conference back to the management for closing comments.

Dilip Banthiya: Thank you very much for joining us this call today and any specific question our IR team will take it over in greater length if it would not be answered today with the paucity of time. Thanks once again.

Moderator: Thank you very much. On behalf of Emkay Global Financial Services we conclude today's conference. Thank you for joining. You may now disconnect your lines now.

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Note: This transcript has been edited to improve readability.

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