Radico Khaitan Limited

March 01, 2019

Ratings

Facilities	**Amount (Rs. crore)**	**Rating**[1]	**Rating Action**
Long term Bank Facilities	568.57	**CARE AA- (Double A Minus) (Credit watch with developing implications)**	Placed on credit watch with developing implications
Short term Bank Facilities	60.00	**CARE A1+ (A One Plus) (Credit watch with developing implications)**	Placed on credit watch with developing implications
Total	**628.57 (Rs. Six hundred twenty eight crore and fifty seven lakh only)**		
Commercial Paper Issue^	100.00	**CARE A1+ (A One Plus) (Credit watch with developing implications)**	Placed on credit watch with developing implications

Details of instruments/facilities in Annexure-1
^Carved out of sanctioned working capital limits of the company.

Detailed Rationale& Key Rating Drivers

CARE has placed the ratings assigned to the bank facilities & CP instrument of Radico Khaitan Ltd (RKL) on 'Credit Watch with Developing Implications' following the announcement made by the company wherein they have informed that the Central Pollution Control Board (CPCB) had certain observations on Zero liquid discharge system of one of the plants of the company and following that CPCB has directed them for closure of operations at their Rampur plant. CARE will continue to monitor the developments in this regard and will take a view on the ratings once the exact implications of the above on the credit risk profile of the company are clear.

The ratings of Radico Khaitan Limited (RKL) continues to take into account the improved financial risk profile characterized by enhanced profitability, strengthening of its capital structure and improved liquidity position. This was supported by healthy revenue growth during FY18 (refers to period from April 01 to March 31) on the back of RKL's gain in market share. The ratings also take into account RKL's strong nation-wide presence in the Indian Made Foreign Liquor (IMFL) segment, established brands along with consistent growth in scale of operations. The ratings also factors in the strong parentage, price increases granted by the various state governments, together with continued benefits of efficiency measures undertaken by the company& the softening of the raw material prices. RKL will continue to benefit from its established brand equity and favourable long term volume outlook for the spirits industry combined with changing consumer preferences towards premium brands. The ratings however continue to remain constrained by cyclicality in raw material prices and the company's presence in a highly regulated industry which exposes it to changes in the state policies regarding pricing and sales of country liquor & IMFL.

Going ahead, with no major capex being envisaged, the ability of the company to maintain its enhanced profitability margins and its comfortable capital structure amidst highly regulated industry environment shall be the key rating sensitivities.

Detailed description of the key rating drivers

Key Rating Strengths

Improved financial risk profile: The financial risk profile of RKL is marked by large scale of operations, enhanced profitability margins and interest coverage along with improved capital structure. During FY18 (refers to the period April 1 to March 31), company registered net sales of Rs.1809.85 crore, a growth of 7% over FY17. RKL's continuous focus on prestige & above category has supported its margins in FY18 and is also likely to derive higher margins for the company going forward, with increase in its scale of operations as PBILDT margin in prestige & above category is higher than regular category. The PBILDT margins improved significantly from 13.71% in FY17 to 16.37% in FY18. The Company's profitability improvement was driven by a combination of recent price increases, premiumization, softening of raw material prices and the management's ongoing cost optimization initiatives. Finance cost during the year declined by 15% to Rs. 68.60 Crore on account of repayment of borrowings and reduction in interest rates. The overall gearing of the

[1]*Complete definitions of the ratings assigned are available at www.careratings.com and in other CARE publications.*

company significantly improved from 1.01x as on March 31, 2016 to at 0.78x as on March 31, 2017 & further to 0.52x as on March 31, 2018, on the back of repayment of term liabilities and increased net-worth. The overall gearing improved to 0.33x as on Sep 30, 2018. Going ahead, with no major capex being envisaged, the capital structure of the company is expected to remain comfortable. Better profitability during the period improved the PBILDT interest coverage to 4.32x in FY18 (compared to P.Y: 2.87x) and further to 8.57x as on June 30, 2018. During 9MFY19, the company had achieved a total income of ~Rs.1597 crore (9MFY18: ~Rs.1359 crore) registering a 18% growth. Further the PBILDT margins have improved to 18.06% in 9MFY19 as compared to 16.18% in 9MFY18.

Strong liquidity: The liquidity profile of RKL in FY18 was supported by adequate cash accruals. The company continues to maintain a moderate working capital cycle of 70-80 days as it needs to maintain inventory at various warehouses and provides advances to bottlers to fund operations for its bottling units. For the company's own requirements along with the aforementioned loans, the company has available adequate working capital lines, which the company used at an average utilization level of 61% for 12 months ended Nov 2018. This provides sufficient liquidity buffer for the company's funds requirements. Additionally, RKL maintained a comfortable current ratio of 1.28 times as on March 31, 2018. RKL also has free cash & bank balance of Rs 31.50 crore as on Nov 30, 2018.
Experienced promoters & reputed name in the industry: RKL, promoted and managed by Khaitan family, has been in the business of liquor manufacturing since 1943 (by the name of Rampur Distillery). In 1998, RKL entered the branded liquor segment with launch of 8PM Whisky. Since then company has launched various successful brands and currently RKL is one of the leading players in the Indian Liquor industry. RKL has a distribution agreement with Suntory (Japan) and E.&J.Gallo Winery (USA) for marketing its premium brands in Indian Market.

Established brands with pan India Presence: RKL's portfolio currently includes four millionaire brands namely 8PM whisky, Contessa Rum, Old Admiral Brandy and Magic Moments Vodka. Apart from this it distributes other successful brands like Whytehall whisky and Brihans range of brands acquired inorganically. In June 2010, RKL launched new brands 'After Dark' and 'Eagles dare' whisky and in May 2012, launched Florence, a super-premium brandy, in the state of Tamil Nadu. In FY13, it launched super premium vodka, Verve along with its flavoured version on pan India basis. Continuing with its trend of launching newer brands, RKL launched a new readymade drink "Electra" during FY15 and three new brands in FY17 under the aegis of Pluton premium bay rum, Rampur single malt and Regal Talons Premium whisky.Recently, RKL launched Jaisalmer Indian Craft Gin, a product in the luxury segment. This brand is positioned in the fast-growing white spirits segment globally. Further in Q1FY19launched premium variant of 8PM whisky – 8PM Premium Black and a superior variant of Morpheus brandy – Morpheus Blue.

Strong hold in defence segment: RKL is one of the largest players in the defence market where its most famous brand is 'Contessa' rum. Two more brands 'After Dark Whisky' and 'Morpheus Brandy' have been approved to supply to Canteen Store Department (CSD). There are stringent conditions for entering into CSD segment leading to entry barriers for new players.

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

Spirits Industry in India: Positive Outlook: After a difficult FY2017, FY18 had a slow start being impacted by demonetization tailwinds, state level prohibitions, a national highway liquor ban and the operational challenges with the implementation of GST. However, in H2FY18 experienced a significantly improved operating environment resulting in a robust industry performance. The Supreme Court relaxed the national highway liquor ban to take city limits out of its purview. While Kerala relaxed its prohibition to allow spirits in three and four star hotels, Bihar allowed spirit manufacturers to export products which were previously left unsold due to the ban. A number of key liquor consuming states have provided price increases thereby improving margins for the manufacturers. Furthermore, recent policy updates led to the change in route-to-market for a few states such as West Bengal moving to a government owned and controlled distribution model. The state of Uttar Pradesh recently announced a new excise policy which is aimed at transparency and improving the operating environment. Growing disposable incomes, increasing rural consumption, greater acceptance of social drinking and a higher proportion of the young population entering the drinking age, are all factors that make India one of top markets for global spirit companies. These demographics also support the case for the growth of aspirational brands and premium products. Consumer needs and preferences are evolving and they are now more focused on quality, convenience, value proposition and personalization to suit their styles and values. India has a young demographic profile with a median age of 28 years and around 67% of the population is within the legal drinking age. These two indicators represent significant growth opportunities for the industry.

Key Rating Weaknesses

Highly regulated industry: Liquor industry is highly regulated in India with each state controlling the production, sales and duty structure independently. As a result, there are difficulties in transfer of production from one state to another along with huge burden of duties and taxes. The state controls the licenses for production, distributorship and retailing also.

Cyclicality in raw material prices: ENA (Extra Neutral Alcohol) forms a major component of the raw materials required for the Company's product portfolio and hence commodity price volatility remains one of the key considerations. ENA is produced from the byproduct molasses in the sugar manufacturing process or from grains. Lower than anticipated sugarcane production and/or any sharp rise in prices of molasses or ENA will have an impact on the company's profitability. ENA prices may also increase due its alternative use in ethanol blending and a more attractive price offered by the petrochemical industry. However, the company's capability to shift to a grain-based distillery insulates it against any significant increase in prices of molasses. The margins are highly susceptible to the volatility in the price of molasses and grains. Raw material prices are governed by various factors including the supply of molasses and grains which is in turn dependent upon production, government regulations, demand from other sectors like biodiesel etc. Also molasses/ENA prices were higher in FY17 due to drought in Maharashtra and the industry had to take a hit. Due to excess sugar production in FY18, prices of molasses and in turn ENA were soft. However, the company maintains a sizable inventory of molasses which insulates it against short and medium term fluctuations in molasses prices. The company has a capacity to store 3 months' equivalent of its molasses requirements. Further, RKL has flexibility to shift its production between grains and molasses with change in prices of each.

Analytical approach:
Consolidated

Applicable Criteria
[Criteria on assigning Outlook to Credit Ratings]
[CARE's Policy on Default Recognition]
[Criteria for Short Term Instruments]
[Financial ratios – Non-Financial Sector]
[Rating Methodology for manufacturing companies]

About the Company
RKL is engaged in manufacturing Rectified Spirit (RS), Extra Neutral Alcohol (ENA), Country Liquor and IMFL. The company has one of the largest distilleries in India at Rampur with molasses based distilling capacity of 75 million litres per annum and grain-based distillation capacity of 27 million litres per annum. The company also has tie-ups with 23 bottling units spread across the country in addition to its five own bottling units. In Maharashtra, RKL has tied up with its subsidiary Radico NV (36% shareholding) for bottling operations. The company has three distilleries and one JV (Radico NV Distilleries Maharashtra – 36% stake – two distilleries) with total capacity of 157 mn liters. RKL has developed its entire brand portfolio over the years. The Company launched ten new brands over the past decade. Of these new brands, nine brands are in the premium category. RKL currently has four millionaire brands in terms of number of cases sold in their portfolios which are 8PM Whisky, Contessa Rum, Old Admiral Brandy and Magic Moments Vodka.
Further, the Central Pollution Control Board (CPCB) has made certain observations on Zero liquid discharge system of one of the plants of the company and following that CPCB has directed RKL for closure of its operations at their Rampur plant. As discussed with the management, the findings of the CPCB were in respect of one of the molasses plants whose contribution is less than 10% of its total operations. However, CARE will continue to monitor the developments in this regard and will take a view on the ratings once the exact implications of the above on the credit risk profile of the company are clear.

Brief Financials (Rs. crore)	FY17 (A)	FY18 (A)
Total operating income	1690.05	1809.85
PBILDT	231.69	296.36
PAT	80.17	123.96
Overall gearing (times)	0.78	0.52
Interest coverage (times)	2.87	4.32

A: Audited

Status of non-cooperation with previous CRA:
Not Applicable

Any other information:
Not Applicable
Rating History for last three years: Please refer Annexure-2
Note on complexity levels of the rated instrument: *CARE has classified instruments rated by it on the basis of complexity. This classification is available at www.careratings.com. Investors/market intermediaries/regulators or others are welcome to write to care@careratings.com for any clarifications.*

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Annexure-1: Details of Instruments/Facilities

Name of the Instrument	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. crore)	Rating assigned along with Rating Outlook
Non-fund-based - ST-BG/LC	-	-	-	60.00	CARE A1+ (Under Credit watch with Developing Implications)
Fund-based-Long Term	-	-	-	525.00	CARE AA- (Under Credit watch with Developing Implications)
Term Loan-Long Term	-	-	Dec 2021	43.57	CARE AA- (Under Credit watch with Developing Implications)
Commercial Paper	-	-	7 to 364 days	100.00	CARE A1+ (Under Credit watch with Developing Implications)

Annexure-2: Rating History of last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating history			
		Type	Amount Outstanding (Rs. crore)	Rating	Date(s) & Rating(s) assigned in 2018-2019	Date(s) & Rating(s) assigned in 2017-2018	Date(s) & Rating(s) assigned in 2016-2017	Date(s) & Rating(s) assigned in 2015-2016
1.	Non-fund-based - ST-BG/LC	ST	60.00	CARE A1+ (Under Credit watch with Developing Implications)	1)CARE A1+ (17-Sep-18) 2)CARE A1 (06-Apr-18)	-	1)CARE A1 (23-Jan-17)	1)CARE A1+ (03-Nov-15) 2)CARE A1+ (26-Oct-15)
2.	Fund-based-Long Term	LT	525.00	CARE AA- (Under Credit watch with Developing Implications)	1)CARE AA-; Stable (17-Sep-18) 2)CARE A; Stable (06-Apr-18)	-	1)CARE A; Stable (23-Jan-17)	1)CARE A+ (03-Nov-15) 2)CARE A+ (26-Oct-15)
3.	Term Loan-Long Term	LT	43.57	CARE AA- (Under Credit watch with Developing Implications)	1)CARE AA-; Stable (17-Sep-18) 2)CARE A; Stable (06-Apr-18)	-	1)CARE A; Stable (23-Jan-17)	1)CARE A+ (03-Nov-15) 2)CARE A+ (26-Oct-15)
4.	Commercial Paper	ST	100.00	CARE A1+ (Under Credit watch with Developing Implications)	1)CARE A1+ (25-Dec-18) 2)CARE A1+ (11-Sep-18) 3)CARE A1 (06-Apr-18)	-	1)CARE A1 (23-Jan-17)	1)CARE A1+ (03-Nov-15) 2)CARE A1+ (26-Oct-15)

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