

IPO Note

IPO Details

Face Value	Rs. 10
Price Band (Rs)	Rs. 350-400
Issue Opens	1-Nov-2007
Issue Closes	6-Nov-2007
BRLM	Almondz Global Securities
Registrar to issue	Cameo Corporate Services
Shares on offer for sale	4.8 mn

Pre issue shareholding pattern

Shareholders	% Stake
Promoters	98.3
Others	1.7

Post issue shareholding pattern

Shareholders	% Stake
Promoters	73.5
Public	25.3
Others	1.3

Segmented Allocation

QIBs	2,400,000
Non-Institutional	720,000
Retail	1,680,000

IPO Details (In mn)	Lower End	Upper End
Price Band (Rs.)	350	400
Equity Shares prior to issue	14.2	14.2
Fresh Issue of shares	4.8	4.8
Total Equity Shares	19.0	19.0
Share Capital (Rs.)	190.0	190.0
Implied market cap (Rs.)	6,651.4	7,601.6
Debt (Rs.) (as on 30/06/07)	1,076.8	1,076.8
Cash (Rs.) (as on 30/06/07)	27.6	27.6
Implied EV (Rs.)	7,700.6	8,650.8

Empee Distilleries Ltd

Do not subscribe

Empee Distilleries Limited (EDL) is engaged in the manufacturing of Indian Made Foreign Liquor (IMFL) products under its own brand portfolio as well as under tie-up arrangements with other companies, since 1984.

The Company has an installed capacity of 5,184,000 cases p.a. for FY06 at its manufacturing facilities in Mevalookuppam, Tamil Nadu and Kanjikode, Kerala.

Empee is planning to raise Rs. 1,680 mn - 1,920 mn by offering 4.8 mn shares at a price band of Rs. 350-400 for Rs. 10 face value share. EDL plans to expand its business activities by means of both backward and horizontal integration and extend its operations to Andhra Pradesh and Karnataka. It also intends to enter into real estate development and bio-mass power industry.

Valuation and Recommendation

We believe the EDL's concentrated and limited geographical presence, rigorous competition in the industry, no control over pricing & distribution of its products, and the nature of liquor industry which remains highly controlled and regulated by government agencies offer limited growth opportunities.

Moreover, the Company's operating and profit margins have been low, coupled with a fluctuating ROE. Its ROA has been declining over the years. The Company's FY07E P/E (adjusted for non recurring items) of 55.3x and 63.2x, at the lower and upper price band, is at a substantial premium to its peers.

In the light of the above factors, we believe the issue is over priced. We recommend the investors not to subscribe to the issue.

IPO

Issue details

EDL will mobilize Rs. 1,680 mn to Rs. 1,920 mn through an IPO of 4.8 mn equity shares. The promoters hold 98.3% of the issued and paid-up share capital of the Company. After the issue, the promoters will own 73.5% of the post-issue paid-up equity share capital. The Company has allocated 2.4 mn shares of the net issue for QIBs, 0.7 mn shares for non-institutional buyers and 1.7 mn shares for retailers. The issue will constitute 25.3% of the fully diluted post-issue paid up capital of the Company.

Issue objective

The Company plans to diversify and expand its business activities by means of both backward and horizontal integration and to achieve economies of scale in its existing business activities. The issue proceeds will be used for:

- Setting up of
 - 60 KLPD grain based distillery unit at Nellore District, Andhra Pradesh, involving an outlay of Rs. 611.4 mn
 - Blending & bottling IMFL Plant at Nellore District, Andhra Pradesh with a capacity of 0.70 lakh cases per month, with an investment of Rs. 218.8 mn
 - 7.5 MW bio-mass based power plant at Aranthangi Taluk, Tamil Nadu, involving a capex of Rs. 347.6 mn
- Development of 2 lacs sq ft of residential space in Mevalorkuppam, Tamil Nadu, for Rs. 310.7 mn
- Expansion of existing distillery unit at Mevalookuppam, Tamil Nadu by augmenting the capacity of the extra neutral alcohol plant from 20KLPD to 70KLPD, involving an amount of Rs. 179.3 mn
- Expansion of existing distillery unit by augmenting the capacity of the said distillery to handle 5 lacs cases per month from the present 3.2 lacs cases per month, with an investment of Rs. 50.9 mn
- Relocation of Plant & Machinery purchased from Appollo Alchobev Ltd to Arabikothanur, Karnataka along with expanding the existing capacity from 0.5 lacs cases per month to 1 lacs cases per month at a cost of Rs. 102.1 mn
- To meet general corporate purposes and issue expenses

Promoters

MIL was promoted by Mr. M.P. Purushothaman and Ms. Nisha Purushothaman.

Mr. M.P. Purushothaman, the Chairman and Managing Director of the Company, has 20 years of experience in the liquor industry. He has promoted over 20 companies in the Empee Group which pertain to various industry areas such as sugars, hotels, education, property development, transport, and power including alternative sources and generation of power.

Ms. Nisha Purushothaman is the joint Managing Director of the Company.

Rationale

High dependence on government agencies

The Company depends entirely on the monthly orders placed by Tamil Nadu State Marketing Corporation Limited (TASMAC) and Kerala State Beverages (Manufacturing & Marketing) Corporation Limited (KSBC) for the sale of its products in Tamil Nadu and Kerala respectively. These agencies regulate the production, distribution or marketing of IMFL products and impose restrictions which may limit the free availability and marketability of Company's products to outside states also.

Administered price regime

Prices of IMFL products are fixed by the state government after negotiation with the manufacturers. However, state government may not consider the inflationary effect in the same proportion as the increase in input cost. For example, KSBC has not increased the prices of IMFL products on account of increase in prices of the basic raw material viz. extra neutral alcohol, which had grown by 70%. Consequently, the Company had to curtail its production in Kerala on economic grounds. Similarly, Andhra Pradesh State Government has not given any price increase for the past many years.

Installed Capacity

Products	Particulars (c/s p.a.)	For Period ended September 30,		
		2003-04	2004-05	2005-06
Tamil Nadu	Licensed capacity	3,024,000	3,024,000	3,024,000
	Installed capacity	3,024,000	3,024,000	3,024,000
	Capacity Utilisation	1,132,565	1,869,976	2,758,468
	Capacity Utilisation%	37.5%	61.8%	91.2%
Kerela	Licensed capacity	2,160,000	2,160,000	2,160,000
	Installed capacity	2,160,000	2,160,000	2,160,000
	Capacity Utilisation	967,957	665,059	417,703
	Capacity Utilisation%	44.8%	30.8%	19.3%
Wind Mill	Licensed capacity	2MW	2MW	2MW
	Installed capacity	2MW	2MW	2MW
	Capacity Utilisation	1MW	1MW	1MW
	Capacity Utilisation%	50.0%	50.0%	50.0%

Concentrated market

In Tamil Nadu, the government has been following the policy of not permitting any new entrants other than the existing licensees and manufacturers for manufacturing and marketing of IMFL products. As a result, Tamil Nadu solely accounts for 87% of EDL's sales of IMFL products for September ended 2006. Any change in government policies may erode the Company's market share.

Share of Tamil Nadu and Kerela in Production and Sales

	2005-06		2004-05		2003-04	
	Tamil Nadu	Kerela	Tamil Nadu	Kerela	Tamil Nadu	Kerela
Production	86.8%	13.2%	73.8%	26.2%	53.9%	46.1%
Sales	87.0%	13.0%	74.1%	25.9%	53.7%	46.3%

Fierce competition

EDL has two brands in medium segment and one in premium segment. The Company plans to start operations in Karnataka and Andhra Pradesh and improve its market share in the medium and premium segment by introducing more brands. These segments are characterized by intense competition from established national players such as United Spirits, Radico Khaitan, Jagatjit

Industries etc. With a ban on advertising of liquor products, brand promotion is mainly carried out through retail discounts. The Company may as a result find it difficult to promote new brands without spending a considerable amount on selling and marketing of its products.

Execution risks

The Company plans to use the IPO proceeds for its expansion and diversification plans. Though a bulk of money so raised will be utilized for IMFL business, the Company has earmarked Rs. 347.6 mn and Rs. 310.7 mn for real estate and bio-mass projects. The ability of the management to handle several diversified projects entails implementation risks, given the poor financial position of some of its group companies.

Outlook

The liquor industry is a highly taxed and regulated industry. Distribution, pricing, and marketing of liquor products are controlled by state agencies, which lead to inefficiencies in manufacturing and prevent economies of scale in production. Governmental complexities have seen the Company operate at 19.3% capacity utilization in Kerela for FY06. Share of Kerela in revenues has fallen from 46.3% in FY04 to 13% in FY06. Tamil Nadu, thus, accounts for almost 87% of its revenues from IMFL products.

EDL intends to extend its operation to highly competitive but large markets of Andhra Pradesh and Karnataka and introduce new brands in the medium and premium segments. Intense competition from MNCs and national players in these segments and markets may put pressure on the operating margins of the Company. Diversification into real estate development and bio-mass power industry also carries with it execution risks.

The Company registered net sales CAGR of 37.7% over the last three years. However, the operating and profit margins have been low and fragile, coupled with an erratic ROE. Its ROA has been declining over the years. The Company's FY07E P/E (adjusted for non recurring items) of 55.3x and 63.2x, at the lower and upper price band, is at a substantial premium to its peers. Considering the above factors, we believe the issue is over priced. We recommend the investors not to subscribe to the issue.

Company Background

Part of the Empee group, EDL is engaged in the manufacturing of Indian Made Foreign Liquor (IMFL) products under its own brand portfolio as well as under tie-up arrangements with other companies, since 1984.

Its brand portfolio includes Old Secret XXX Rum, Power XXX Rum, Power Brandy, Mc Lene Ordinary Brandy, Mclene XXX Ordinary Rum, Power Whisky, Empee Napoleon Premium Brandy, Empee Fine Brandy, Commando XXX Rum, Club Polo Dry Gin, Club Royal Whisky, Elcanso Dark XXX Rum, and Old Secret Brandy. The brands under tie up arrangements are Brihans Napoleon Premium Brandy and Brihans Premium Whisky.

The Company is one of the major suppliers of IMFL products to the Tamil Nadu State Marketing Corporation Limited (TASMAC) and one of the top ten selling brands of IMFL 180 ML Pack.

The distilleries are set up at Mevalooruppam (Tamil Nadu) and at NIDA (Kerala). The Company also has a wind mill energy plant at Pariakumarapalayam, Coimbatore District, Tamil Nadu for export of surplus power to the Tamil Nadu State Electricity Board.

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