Kotak Private Client Research

Initiating Coverage

May 16, 2006

FOR PRIVATE CIRCULATION

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Stock details

BSE code	:	522059
NSE code	:	Not Listed
Market cap (Rsm)	:	3616
Free float (%)	:	62
52-wk Hi/Lo (Rs)	:	455/134
Avg. volume BSE	:	23,065
Shares o/s (m)	:	10.3
Current price	:	351

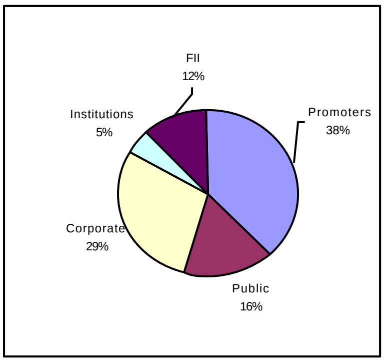
Summary table

Rs mn	FY05	FY06E	FY07E	FY08E
Sales	362	659	1202	1757
Growth (%)	54	82	82	46
EBIDTA	115	181	332	477
EBIDTA (%)	32	27	28	27
Net profit	58	106	176	252
EPS (Rs)	8.7	10.0	16.5	23.6
Growth (%)	97	15	65	43
DPS (Rs)	1.5	1.5	1.5	1.5
ROE (%)	19	16	16	19
ROCE (%)	16	16	19	20
EV/Sales (x)	11.1	6.1	3.3	2.3
EV/EBIDTA (x)	34.8	22.2	12.1	8.4
P/E (x)	39.8	35.1	21.3	14.9
P/BV (x)	7.7	3.6	3.1	2.6

	4QFY05	1QFY06	2QFY06	3QFY06
Sales (Rs mn)	144	78	112	239
EPS (Rs)	3.7	1	1.4	3.7

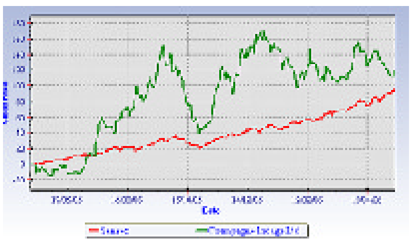
Source: Company & Kotak Securities - Private Client Research

Shareholding pattern as on 31st March 2006



Source: Capitaline

One-year performance (Rel to sensex)



Source: Capitaline

Champagne Indage Ltd

Price: Rs. 351 **Recommendation: BUY**

Target Price: Rs. 472

Champagne Indage is the market leader and the largest producer of wines in Asia. It has more than 35 principal brands under its umbrella and a market share of over 70% in India. The company has a presence in all three segments of wines, namely, still wine, sparkling wine and fortified wine. The industry has experienced a growth of over 30% for the past few years. We expect Champagne Indage's revenues to grow at a CAGR of 71% over FY05-08. Its net profits are expected to grow by 63% over FY05-08 owing to a slight reduction in margins due to a foray into the lower end segment. We recommend a BUY on the stock with a target price of Rs. 472, implying an upside of 35% from the current price. We have arrived at the fair value by assigning the lower end of the one year forward rolling P/E of 20x to FY08 Earnings.

Key Investment positives:

- **Biggest Wine manufacturer in Asia:** Champagne is the biggest wine manufacturer in Asia. It has a market share of over 70% in India. In FY2006 champagne sold 3.1 mn bottles and in FY2007 the company is aiming to sell 7 mn bottles.
- **Per Capita Consumption To Increase Going Forward:** The per capita consumption of wines in India is currently very low at less than one liter per person per annum compared to most of the European countries whose wine consumption is more than 30 liters per year. This is because traditionally in India wine was viewed as a ladies drink. The trend is however now changing and the consumption of wines is witnessing an exponential growth
- **Capacity Expansion To Cater To Growing Wine Demand:** As on March 2005 Champagne Indage had an installed capacity of 2.77 mn lit. However, in order to cater to the growing wine demand the company has increased its installed capacity to 5 mn lit in FY06 and is expected to increase it to a further 8 mn lit by FY07.The capacity expansion will take place at its Narayangaon unit and to some extent in Himachal Pradesh
- **Contract Farming Initiative to Ensure Raw Material Availability:** The company has managed to integrate the resources required for contract farming activity whereby the farmers selected have agreed to grow grapes as per the Company's requirement and supply exclusively to the Company with the support of an established bank to finance both the capital and revenue expenditure. The supplies undertaken by the company indicates the probability of reaching the milestone of 10,000 tons per annum of crushing in the next three to four years.
- **Increased Tourism to Boost Sales:** Tourism in India has been growing at a steady pace in the past few years. Tourist arrivals have grown from 2.2 mn in 1995 to 3.9 mn in 2005. Since the per capita consumption of foreign tourists is manifold higher than the per capita consumption of Indians, we believe the consumption of wine would also increase significantly.

Valuation:

At the current market price of Rs. 351, the stock is quoting at 21.3x and 14.9x its FY07E and FY08E earnings. On an EV/EBITDA basis the stock is quoting at 12.1x and 8.4x its FY07E and FY08E earnings. We have assigned the lower end of the one-year forward rolling P/E of 20x to FY08 earnings to arrive at our target price of Rs. 472. We recommend a BUY with a target price of Rs. 472.

Background:

Incorporated in 1985 and promoted by Mr S.G. Chougule, Champagne Indage is the market leader and the largest producer of wines in India. It has more than 35 principal brands under its umbrella. The company has a presence in all three segments of wines namely still wine, sparkling wine and fortified wine. The wine segment is relatively new for consumers in India and the company has been instrumental in expanding the wine market.

The industry has experienced a growth of over 30% consistently for the past decade. In the recent past, a few state governments have taken steps to encourage the growth of the wine industry, which includes 100% exemption from excise duty for 10 years. These measures along with recognition of wines as an agro-based industry would make the domestic wine industry a force to reckon with in the global wine industry.

Largest winemaker in Asia with over 70% market share in India

Product Portfolio :

The company has introduced various brands in various price segments to ensure the maximum reach to the market. The structure of pricing, positioning and marketing efforts have helped the company to achieve maximum customer penetration.

Wine Classification	Brand Name
Entry Level	Hammer / Figuieira
Popular	Vin ballet / Riviera
Premium Level	Chantilli
Sparkling	Marquise De Pompadour / Ivy Brut

Source: Company

Key investment arguments:

Raw material availability would not be a major constraint

Contract farming initiative to ensure raw material availability

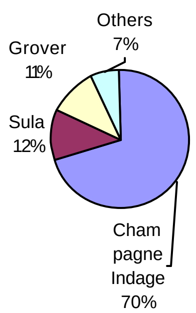
The business of wines rests on the following parameters:

- Availability of grapes
- Processing abilities
- Creating market

The company has managed to integrate the resources required for contract farming activity whereby the selected farmers have agreed to grow grapes according to the company's requirement and supply exclusively to the company. Banks, on the other hand, support both the capital and revenue expenditures. In view of this peculiar relationship, capital is made available timely to the farmer at competitive rates.

For further assurances of quality, the company, through Champagne Vineyards Ltd (an associate concern of the company), has agreed to control and monitor the supplies of planting materials, viticulture practices and fertilizers. The company is also moving towards organic farming so as to enjoy better acceptability and prices in years to come. The supplies undertaken by the company indicate the probability of reaching the milestone of 10,000 tons of crushing per annum in the next two years.

Indian Market Share



Source: Company

Biggest Wine Manufacturer In Asia :

Champagne is the biggest wine manufacturer in Asia. It has a market share of over 70% in India. During FY2006 the company sold 3.1 mn bottles and in FY2007 the company is aiming to sell 7 mn bottles. The company is also planning an aggressive export thrust. In FY2006, exports accounted for 10% of the total sales. However, the management has indicated that exports have the potential to be ramped up to 30-40% of total sales by FY2008.

Per capita consumption to increase going forward

Indian per capita consumption of wine among the lowest in the world

The per capita consumption of wines in India is currently very low at less than 1 liter per person per annum compared to most European countries where wine consumption is more than 30 liter per person per year. This is because wine has traditionally been perceived as a ladies drink in India. This trend is, however, changing now and the consumption of wines is witnessing an exponential growth. Recent surveys indicate the wine industry would grow at over 30% over the next few years.

Per Capita Consumption of Wine

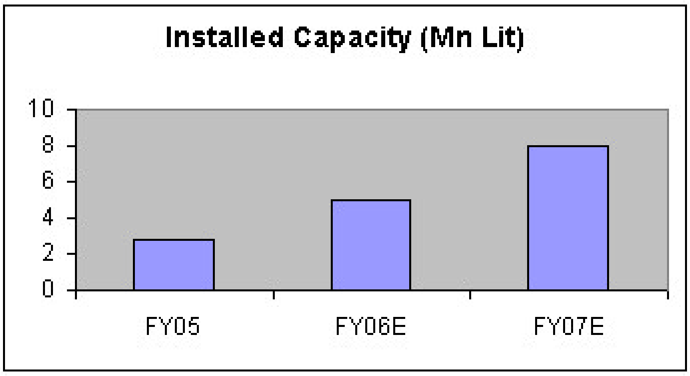
Country	Per capita consumption in liters
France	60
Italy	53
Portugal	47
Switzerland	41
India	Less than 1

Source : Wine Institute, California

Capacity expansion to cater to growing wine demand

Huge capacity expansion would lead to volume led growth

As on March 2005, Champagne Indage had an installed capacity of 2.77 mn liters per annum. However, in order to cater to the growing wine demand, the company has increased its installed capacity to 5 mn liters per annum in FY06. It is expected to increase to 8 mn liters per annum by FY07E. The capacity expansion will take place at its Narayangaon unit and also in Himachal Pradesh. The management has indicated that the current capacity expansion will entail a capex of around Rs. 150 mn in FY06. The company, in the previous financial year, had issued 2.4 mn shares at a price of Rs. 83 on a preferential basis to investors, which included Reliance Capital. The company had further issued 1.2 mn shares at aprice of Rs. 235 to Arisaig Partners. We believe that this equity dilution wil take care of the company's capex funding.



Source: Company

Industry growth rates projected at over 30%

Wine industry among the fastest growing industries

The wine industry has grown at more than 30% for the past few years. In the last fiscal, the wine industry grew by a massive 60%. We believe that the industry is in an evolving stage and supernormal growth rates can continue for the next few years mainly on account of the tremendous growth the per capita consumption can witness.

Exports to be revenue growth driver:

looking at overseas markets to capitalize on its winemaking expertise

The sales mix of the company has been changing continuously in favour of exports for the past couple of years. In FY 2006, exports were at 10% of the total sales. However, exports are expected to account for 30% of the total sales by FY08E. This is because the company is tying up with distributors in countries like the United Kingdom, Germany, United States and others and the same is expected to materialize in FY07. Although margins in exports are more or less the same as compared to the domestic markets, we feel exports volumes would increase significantly and thus shore up the revenues.

Source: Company

Benign government stance to boost net profits:

The Maharashtra state government has given an excise duty exemption of 10 years to wineries located in the state. The government has also accorded it the status of an agro industry. The wine industry has made a presentation to the government to bring it under the 4% VAT regime. Currently, the industry attracts an effective sales tax of 20%. If this proposal is accepted, wine consumption would become more affordable and volumes would get a thrust.

Introduction of cheaper versions to expand market:

In a bid to expand the wine market in India, the company has introduced a new brand of wine called vino priced at Rs. 99 for 750 ml. The move is aimed at luring customers towards wine as compared to other alcoholic beverages. The company is aiming at more such portfolio introductions in the near future in a bid to expand the market as well as gain more market share.

Higher disposable income to lead to higher consumption:

In the past few years, there has been a discerning shift in the demographics of the country. The proportion of people in the consuming class has gone up drastically in the past few years. Since wine consumption is typically higher among the aspirant class, we believe wine companies could see a substantial rise in off-take in the coming years.

Increased tourism to boost sales:

Tourism in India has been growing at a steady pace in the past few years. Tourist arrivals have grown from 2.2 mn in 1995 to 3.9 mn in 2005. Since the per capita consumption of foreign tourists is much higher than the per capita consumption of the Indian public, we believe the wine sector will piggyback on the growth of the local tourism sector.

Looking to grow inorganically:

Acquisitions and tieups abroad will lead to huge exports in coming years

The company is in advanced stages of negotiation to sign an MoU with UK-based Harvey Miller Wine Agencies Ltd (HMWA) for the acquisition of a wine distribution business called McKinley Vintners (MV). As a part of its business plans:

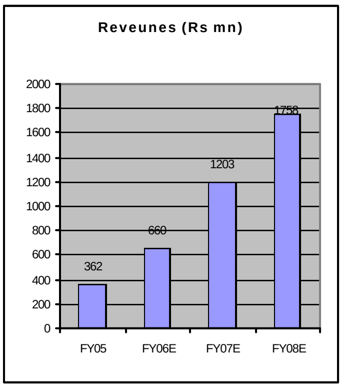
- HMWA will undertake its best efforts to import, sell and promote suitable brands of Champagne Indage in the UK on a preferential basis.
- HMWA and MV will merge into a single business in three years with valuations carried out by independent auditors.

The company shall be a holding company and will control at least 51% of the said merged entity.

Imports not a threat:

Imported wines currently attract customs duty of over 100%. Also, the Maharashtra government levies an additional unbundling charge of Rs. 200 per liter. This takes the price of imported wines to a minimum of Rs. 300 compared to Rs. 250 per liter for the company's products. Hence, imports do not pose a threat for cheaper wines.

FINANCIAL ANALYSIS:



Source: Company & Kotak Securities - Private Client Research

Revenues to grow at a CAGR of 71% over FY05-08

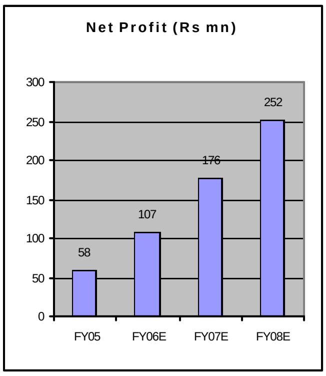
We expect Champagne's revenue to grow at a CAGR of 65% over FY05-08 aided by a strong volume growth and thrust on exports. The company is planning to raise its installed capacity from 2.77 mn liters in FY05 to about 11 mn liters in FY08. The capacity expansion will take place at its Narayangaon winery and also at its Himachal Pradesh unit. The company has also zeroed in on states like Punjab, Andhra Pradesh, Assam and others to open up wineries in an attempt to reduce the logistics cost.

Earnings to grow at a CAGR of 63%

We expect Champagne Indage's earnings to grow at a CAGR of 63% over FY05-08 aided by revenue growth of 71%. We expect earnings growth to lag revenue growth primarily because the company is targeting the mass markets and is focusing on the introduction of low-end wines to expand the market.

High inventory days

Since mature wines command a premium to normal wines, hence the company keeps aside some portion of its production to mature. Due to this, its realization improves. However, this also leads to higher inventory. The company's inventory is almost equal to one times its sales.



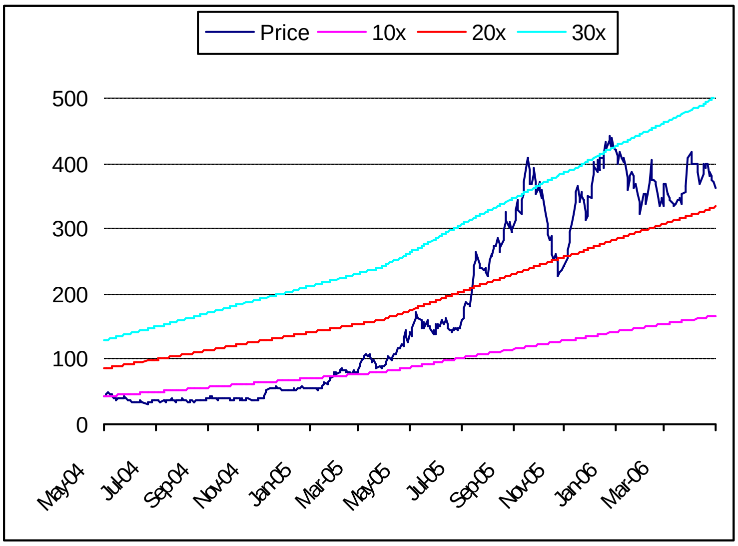
Source: Company & Kotak Securities - Private Client Research

Key Concerns:

- Any adverse government regulation on promotion, distribution or selling of wines can adversely affect the company.
- Since the company is planning to ramp up its exports to 30% of sales by FY2008E, hence any adverse forex movement can hurt its margins.
- Since there is an exponential volume growth expected, hence sourcing of grapes on such a large scale can be a concern.
- Delay in implementation of capacity expansion might hamper growth.

VALUATIONS:

One Year Forward Rolling P/E Band



Source: Company

Peer Comparison:

Company Name	Revenues (Mn) (FY05)	P/E (FY07E)	RoE(%)
Constellation Brands	4087 (US$)	14.3	10.3
Vincor Wines	654 (CA$)	18.2	7.5
MGguigan Simeon Wines	368 (AU$)	15.0	10.3
Majestic Wines	163 (GBPound)	15.0	25.2
Champagne Indage	362 (INR)	21.3	19.0

Source: Bloomberg

We recommend a BUY with a fair value of Rs. 472

The wine industry in India is currently in a nascent stage and the company is experiencing exponential growth rates. Hence we believe the DCF method of valuation would not be the right method as the company is still in an evolving phase. We have used P/E methodology to value the company. Based on the one-year forward rolling band we have attached a P/E of 20x and arrived at our target price of Rs. 472, an upside of 30% from the current levels over a 12-month horizon.

Profit and loss statement (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
Revenues	**362**	**660**	**1203**	**1758**
% change YoY	54	82	82	46
EBIDTA	**116**	**181**	**332**	**477**
%change YoY	115	57	83	44
Other income	5	10	15	20
Depreciation	7	14	19	26
EBIT	109	167	312	451
Net Interest	45	34	47	72
Profit before tax	63	133	265	379
% change YoY	98	111	99	43
Extra Ordinary items	0	0	0	0
PBT after E.O. items	63	133	265	379
Tax & def. Tax	5	27	89	127
as % of PBT	8	20	34	34
Net profits	**58**	**107**	**176**	**252**
Shares outstanding (mn)	7	10.3	10.3	10.3
EPS (Rs)	8.7	10.0	16.5	23.6
DPS (Rs)	1.5	1.5	1.5	1.5
CEPS (Rs)	10	11	18	26

Balance sheet (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
Cash and cash equivalents	14	49	39	35
Accounts receivable	101	182	309	401
Inventories	398	676	1149	1494
Others	47	85	153	191
Current assets	559	992	1651	2122
LT investments	69	69	69	69
Net fixed assets	338	479	675	873
Misc expr	0	0	0	0
Total assets	**966**	**1539**	**2394**	**3064**
Current liabilities	122	220	308	462
Deferred tax	19	28	81	157
ST debt	164	50	400	500
LT debt	347	200	400	500
Equity & reserves	314	1041	1206	1446
Total liabilities	**966**	**1539**	**2394**	**3064**

Cash flow statement (Rs mn)

Year end March	FY05	FY06E	FY07E	FY08E
PAT	58	107	176	252
Depreciation	7	14	19	26
Change in NWC	-96	-299	-581	-322
Operating Cash Flow	**-32**	**-179**	**-385**	**-44**
Capex	-160	-155	-215	-224
Investments	58	0	0	0
Investing Cash Flow	**-101**	**-155**	**-215**	**-224**
Loans Raised	262	-261	550	200
Dividend	-12	-12	-12	-12
Financial Cash Flow	**250**	**-273**	**538**	**188**
Equity raised	0	633.4	0	0
Other Financial Adjustments	**1.4**	**8.6**	**53.0**	**75.9**
Change in Cash	2.4	35.3	-9.5	-4.1
Opening Cash	**11.1**	**13.5**	**48.8**	**39.3**
Closing Cash	13.5	48.8	39.3	35.2

Ratio analysis

Year end March	FY05	FY06E	FY07E	FY08E
EBIDTA margin (%)	31.9	27.5	27.6	27.2
EBIT margin (%)	30.0	25.4	26.0	25.7
Net profit margin (%)	16.0	16.2	14.7	14.4
Receivables (days)	90	78	74	74
Inventory (days)	421	389	372	340
Sales/ Assets (%)	52.5	61.0	70.6	75.0
Interest coverage (x)	2.4	4.9	6.6	6.3
Debt/equity ratio(x)	1.3	0.6	0.5	0.7
ROE (%)	19.3	15.7	15.7	19.0
ROCE (%)	16.0	15.8	19.0	20.3
EV/Sales (x)	11.1	6.1	3.3	2.3
EV/EBIDTA (x)	34.8	22.2	12.1	8.4
Price to earnings (x)	39.8	35.1	21.3	14.9
Price to book value (x)	7.7	3.5	3.1	2.6

Source: Company & Kotak Securities Ltd Private Client Research

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