

Structural growth drivers playing out

Bank of America 
Merrill Lynch

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Strong Dec Q supported by structural drivers; Buy

Dec Q profit came in at Rs2bn, up 77% yoy. We are encouraged by strong growth in higher margin main line brands, sharp gross margin expansion and halving of interest costs. Miss in earnings was due to lower sales growth and surge in other expenditure. We have cut our FY11-13E estimates and PO by 10-12% to factor in increased overheads. Maintain Buy on attractive valuations for strong earnings CAGR of 75% over FY10-13E led by healthy volume growth and premiumization.

Sales growth in main line brands is encouraging

Dec Q volume growth of 11% yoy was 4% lower than our est on decline in sales of fringe brands. Though overall sales missed our estimates we like the quality of the sales growth. 8PM revived smartly with 26% yoy growth as re-launch has evoked good consumer response. Magic Moments continues its strong growth momentum with 37% yoy growth keeping the premiumization trend intact.

Margins remain flat as overheads offset gross margin gains

Gross margins improved 340bp, in line with our est led by strong premiumization and steady input costs. Key negative surprise was the 230bp jump in overheads due to rise in power and fuel costs. We believe improvement in gross margin is positive and have factored in increased overheads. Molasses output has picked up sharply and we expect price decline to set in following increased supply.

Strong earnings growth with attractive valuation; Buy

Our key thesis of 1) premiumization 2) gross margin expansion and 3) fall in interest costs have played out during the quarter. National launch of *After Dark* premium whisky is running smoothly. Post correction, stock is trading at 20x FY11E and 12x FY12E by far the cheapest stock under our coverage and we believe given the strong earnings growth outlook there is a case for re-rating.

Estimates (Mar)

(Rs)	2009A	2010A	2011E	2012E	2013E
Net Income (Adjusted - mn)	(275)	379	900	1,472	2,015
EPS	(2.70)	3.71	6.87	11.23	15.37
EPS Change (YoY)	NM	NM	85.3%	63.5%	36.9%
Dividend / Share	0	0.694	1.72	2.81	3.84
Free Cash Flow / Share	(14.93)	(3.51)	6.04	5.39	9.40

Valuation (Mar)

	2009A	2010A	2011E	2012E	2013E
P/E	NM	36.73x	19.82x	12.13x	8.86x
Dividend Yield	0%	0.510%	1.26%	2.06%	2.82%
EV / EBITDA*	47.82x	16.74x	12.54x	8.25x	6.61x
Free Cash Flow Yield*	-8.54%	-2.58%	4.43%	3.96%	6.90%

* For full definitions of *iQmethod*SM measures, see page 6.

Stock Data

Price	Rs136.15
Price Objective	Rs200.00
Date Established	2-Feb-2011
Investment Opinion	C-1-7
Volatility Risk	HIGH
52-Week Range	Rs109.25-Rs186.60
Mrkt Val / Shares Out (mn)	US\$389 / 131.1
Average Daily Volume	266,318
BofAML Ticker / Exchange	RKHAF / BSE
Bloomberg / Reuters	RDCK IN / RADC.BO
ROE (2011E)	14.5%
Net Dbt to Eqty (Mar-2008A)	69.4%
Est. 5-Yr EPS / DPS Growth	15.0% / 15.0%
Free Float	48.3%

Key Changes

(Rs)	Previous	Current
Price Obj.	230.00	200.00
2011E EPS	7.72	6.87
2012E EPS	12.54	11.23
2013E EPS	16.23	15.37
2011E EBITDA (m)	1,946.6	1,735.7
2012E EBITDA (m)	2,873.6	2,637.8
2013E EBITDA (m)	3,563.4	3,291.0

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Refer to important disclosures on page 7 to 9. Analyst Certification on Page 5. Price Objective Basis/Risk on page 5. Link to Definitions on page 5. 11015463

iQprofileSM Radico Khaitan

Key Income Statement Data (Mar)	2009A	2010A	2011E	2012E	2013E
(Rs Millions)					
Sales	9,327	11,471	13,517	15,719	18,158
Gross Profit	6,200	7,983	9,887	11,926	13,761
Sell General & Admin Expense	(5,745)	(6,683)	(8,152)	(9,289)	(10,470)
Operating Profit	224	1,044	1,463	2,348	2,985
Net Interest & Other Income	(441)	(581)	(263)	(386)	(297)
Associates	NA	NA	NA	NA	NA
Pretax Income	(217)	463	1,200	1,962	2,687
Tax (expense) / Benefit	(58)	(84)	(300)	(491)	(672)
Net Income (Adjusted)	(275)	379	900	1,472	2,015
Average Fully Diluted Shares Outstanding	102	102	131	131	131

Key Cash Flow Statement Data

Net Income	(275)	379	900	1,472	2,015
Depreciation & Amortization	231	256	273	289	306
Change in Working Capital	(778)	(984)	(32)	(705)	(740)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	359	35	0	0	0
Cash Flow from Operations	(463)	(315)	1,141	1,057	1,582
Capital Expenditure	(1,062)	(146)	(350)	(350)	(350)
(Acquisition) / Disposal of Investments	(190)	(368)	0	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(1,252)	(514)	(350)	(350)	(350)
Shares Issue / (Repurchase)	(79)	3,293	(93)	(93)	0
Cost of Dividends Paid	0	(102)	(253)	(414)	(567)
Cash Flow from Financing	1,524	648	(977)	(688)	(1,217)
Free Cash Flow	(1,525)	(461)	791	707	1,232
Net Debt	6,584	4,129	3,684	3,485	2,820
Change in Net Debt	1,794	(2,362)	(445)	(200)	(665)

Key Balance Sheet Data

Property, Plant & Equipment	4,777	4,669	4,746	4,807	4,851
Other Non-Current Assets	459	669	669	669	669
Trade Receivables	1,700	2,356	2,501	2,892	3,323
Cash & Equivalents	420	332	146	165	180
Other Current Assets	3,710	4,294	4,617	5,270	5,981
Total Assets	11,066	12,320	12,680	13,804	15,004
Long-Term Debt	7,004	4,461	3,831	3,650	3,000
Other Non-Current Liabilities	367	451	451	451	451
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	1,359	1,455	1,892	2,232	2,633
Total Liabilities	8,729	6,368	6,174	6,333	6,084
Total Equity	2,337	5,952	6,506	7,471	8,920
Total Equity & Liabilities	11,066	12,320	12,680	13,804	15,004

iQmethodSM - Bus Performance*

Return On Capital Employed	2.3%	8.6%	10.4%	16.0%	18.9%
Return On Equity	-11.3%	9.1%	14.5%	21.1%	24.6%
Operating Margin	2.4%	9.1%	10.8%	14.9%	16.4%
EBITDA Margin	4.9%	11.3%	12.8%	16.8%	18.1%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	NM	-0.8x	1.3x	0.7x	0.8x
Asset Replacement Ratio	4.6x	0.6x	1.3x	1.2x	1.1x
Tax Rate (Reported)	NM	18.2%	25.0%	25.0%	25.0%
Net Debt-to-Equity Ratio	281.7%	69.4%	56.6%	46.6%	31.6%
Interest Cover	0.5x	1.7x	5.0x	5.6x	9.0x

Key Metrics

* For full definitions of iQmethodSM measures, see page 6.

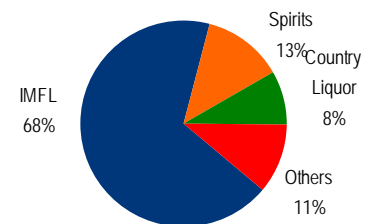
Company Description

Radico Khaitan is India's second largest spirits player. In FY08, it sold 13.4m cases of IMFL which gives it a volume share of around 8%. The company also sells country liquor which account for about 15% of its volumes.

Investment Thesis

We have a Buy rating on Radico. We believe business fundamentals are structurally improving on 1) revival of volume growth, 2) margin gains on product portfolio upgrade and input cost declines, and 3) sharp reduction in debt levels. With earnings expected to post large gains over FY10-12E with significantly lower business risk, we expect a strong re-rating for the stock.

Chart 1: Sales breakdown (FY11E)



Source: Company, BofA Merrill Lynch Research Estimates

Stock Data

Price to Book Value 2.7x

Results highlights

Table 1: Summarized quarterly results highlights

	3Q FY10A	3Q FY11E	% chg
IMFL - mn case	3.7	4.1	11.2%
Net sales	3163	3633	14.9%
Raw mat	1215	1234	1.6%
% of sales	38.4%	34.0%	-4.4%
Staff	135	162	20.2%
Selling & distn	347	466	34.2%
% of sales	11.0%	12.8%	1.8%
Other expenditure	322	456	41.8%
EBIDTA	360	412	14.3%
EBIDTA margin	11.4%	11.3%	-0.1%
Depreciation	63	72	
Interest	156	80	-49.0%
Other income	0	15	
PBT	142	275	93.9%
Tax	26	70	
PAT	115	205	77.5%

Source: Company, BofA Merrill Lynch Research Estimates

Summarized financial highlights

Table 2: Summarized Profit and Loss estimates

	FY09A	FY10A	FY11E	FY12E
IMFL Volume	12.9	14.6	17.1	19.8
Total net sales	9,327	11,471	13,517	15,719
%chg	7%	23%	18%	16%
Raw material	3,127	3,487	3,629	3,793
% of sales	33.5%	30.4%	26.9%	24.1%
Packaging	3,031	3,499	4,325	4,951
Distribution cost	697	556	676	755
Selling costs	557	797	1,081	1,226
% of sales	6.0%	7.0%	8.0%	7.8%
Employee cost	552	540	595	660
Others	907	1,292	1,474	1,696
EBIDTA	455	1,300	1,736	2,638
EBIDTA Margin	4.9%	11.3%	12.8%	16.8%
Depreciation	231	256	273	289
EBIT	224	1,044	1,463	2,348
% chg	-59%	367%	40%	61%
Interest	451	617	295	420
Profit before OI	(228)	427	1,168	1,929
Other Income	11	36	33	34
Profit before tax	(217)	463	1,200	1,962
% chg	-168%	-313%	159%	63%
Total Tax	58	84	300	491
Tax Rate	-27%	18%	25.0%	25.0%
Net Profit	(275)	379	900	1,472
% chg	-207%	-238%	138%	63%
Extro Income / (Expense)	359	35		
Reported Profit	83	414	900	1,472
Share O/s (year end)	102.2	131.1	131.1	131.1
EPS	-2.7	2.9	6.9	11.2
% chg	-207%	-207%	138%	63%

Source: Company, BofA Merrill Lynch Research Estimates

Table 3: Summarized Balance Sheet estimates

	FY09A	FY10A	FY11E	FY12E
Assets				
Net Fixed Assets	4,777	4,669	4,746	4,807
Investments	526	894	894	894
Inventories	1,084	1,230	1,284	1,462
Debtors	1,700	2,356	2,501	2,892
Other Current Assets	2,559	2,839	3,109	3,584
Cash at year end	420	332	146	165
Total Current Assets	5,764	6,757	7,040	8,104
Total Current Liabilities	1,359	1,455	1,892	2,232
Net Current Assets Excl Cash	3,985	4,970	5,001	5,706
Total Assets	9,708	10,865	10,788	11,572
Liabilities				
Share Capital	205	264	264	264
Share Premium Account	678	3,917	3,824	3,731
General Reserve	1,329	1,652	2,299	3,357
Net Reserves	2,101	5,662	6,217	7,181
Total Shareholders Equity	2,337	5,952	6,506	7,471
Debt	5,178	2708	2300	3650
FCCB	1826	1531	1531	0
Total Debt	7,004	4,461	3,831	3,650
Deferred Tax	367	451	451	451
Total Liabilities	9,708	10,865	10,788	11,572

Source: Company, BofA Merrill Lynch Research Estimates

Table 4: Summarized Cash Flow estimates

(Rs mn)	FY09A	FY10A	FY11E	FY12E
Profit after tax	83	414	900	1,472
Add depr	231	256	273	289
Cash bef W Cap changes	314	670	1,173	1,761
Working cap change	(778)	(984)	(32)	(705)
(Incr) / Decr in Inventories	(317)	(146)	(54)	(178)
(Incr) / Decr in Debtors	(311)	(655)	(145)	(392)
(Incr) / Decr in Loans	(215)	(280)	(270)	(475)
Incr / (decr) in liabilities	65	96	437	340
Cash from operations	(463)	(315)	1,141	1,057
(Incr) / Decr in Fixed Assets	(1,062)	(146)	(350)	(350)
(Incr) / Decr in Investments	(190)	(368)	-	-
Free cash flow	(1,715)	(828)	791	707
Incr / (decr) in Equity	(79)	3,293	(93)	(93)
Incr / (decr) in Debt	1,603	(2,542)	(631)	(181)
Dividend & Div tax payout	-	(102)	(253)	(414)
Total Cash from financing	1,524	648	(977)	(688)
Total cash flow	(191)	(180)	(186)	19

Source: Company, BofA Merrill Lynch Research Estimates

Table 5: Key Ratios

	FY09A	FY10A	FY11E	FY12E
ROE	-12%	6%	14%	20%
ROCE	0%	8%	10%	16%
Gearing	300%	75%	59%	49%
Net Gearing	282%	69%	57%	47%
Net Working Cap as % of sales	43%	43%	37%	36%

Source: Company, BofA Merrill Lynch Research Estimates

Price objective basis & risk

Radico Khaitan (RKHAF)

Our price objective is Rs200/share. We value Radico on target P/E of 18x FY12E and EV/EBITDA multiple of 11x FY12E. This is at 20% discount to the FMCG sector which we believe is justified given the cyclical nature of its earnings, smaller business scale and weaker market share. This multiple we believe is justified given 1) earnings growth is set to rise 2) balance-sheet health is now not a cause for concern, and 3) the company is strategically improving its product/brand portfolio. Upside risks: Higher-than-expected fall in molasses prices, stronger-than-expected volume growth and a better pick up in new product launches. Downside risks: Lower-than-expected fall in molasses prices and failure of new product launches.

Link to Definitions

Consumer & Retail

Click [here](#) for definitions of commonly used terms.

Analyst Certification

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India - Consumer Coverage Cluster

Investment rating	Company	BofA Merrill Lynch ticker	Bloomberg symbol	Analyst
BUY				
	Asian Paints	XAPNF	APNT IN	Anuj Bansal
	Colgate India	CPIYF	CLGT IN	Anuj Bansal
	Dabur India	DBUIF	DABUR IN	Anuj Bansal
	Godrej Consumer Products Ltd.	XGOCF	GCPL IN	Anuj Bansal
	ITC Limited	ITCTF	ITC IN	Anuj Bansal
	K S Oils Limited	XKSOF	KSO IN	Prasad Deshmukh
	Mcleod Russel India Ltd.	XCVFF	MCLR IN	Prasad Deshmukh
	Pantaloon	PFI AF	PF IN	Anuj Bansal
	Radico Khaitan	RKHAF	RDCK IN	Anuj Bansal
	Titan Industries Ltd	TTNIF	TTAN IN	Anuj Bansal
	United Spirits	UDSRF	UNSP IN	Anuj Bansal
UNDERPERFORM				
	Hindustan Unilever	HINLF	HUVR IN	Anuj Bansal
	Nestle India	XNTEF	NEST IN	Anuj Bansal
	Shoppers' Stop	XPQUF	SHOP IN	Anuj Bansal

iQmethodSM Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) * (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} * \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Sales} + \text{Other LT Liabilities}$	
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

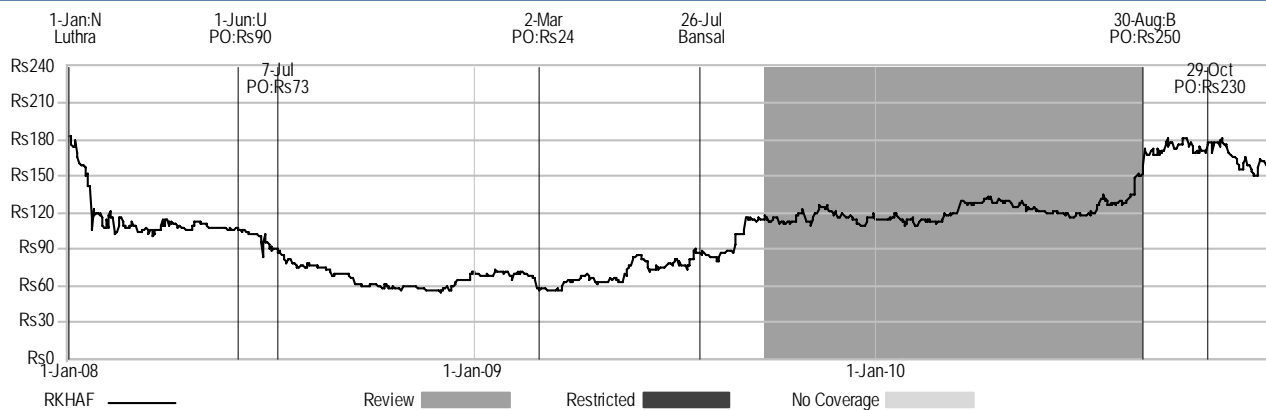
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Important Disclosures

RKHAF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid, NR: No Rating

Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of December 31, 2010 or such later date as indicated.

Investment Rating Distribution: Beverages - Alcoholic Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	26	70.27%	Buy	9	47.37%
Neutral	8	21.62%	Neutral	5	71.43%
Sell	3	8.11%	Sell	2	66.67%

Investment Rating Distribution: Global Group (as of 01 Jan 2011)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	2011	53.86%	Buy	874	48.31%
Neutral	925	24.77%	Neutral	444	52.30%
Sell	798	21.37%	Sell	276	36.75%

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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BofA Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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