Associated Alcohols & Breweries

Going high on the market potential

Business Background

The Company was founded by Late Shri Bhagwati Prasad Kedia in 1989. Associated Alcohols & Breweries Limited is the flagship company of the Associated Kedia Group involved in the manufacture and bottling of liquor. The Company took over the small distillery of the promoter group and grew into one of the largest distilleries of India with a diversified product portfolio comprising IMIL, ENA, IMFL and quality blended products.

The Company has a geographic presence in 4 states – Madhya Pradesh, National Capital Region, Chhattisgarh and Kerala and has achieved an extensive geographical presence (5 states) across the sectoral value chain. The Company's principal revenues are derived from the States of Madhya Pradesh, Delhi and Kerala, cumulatively accounting for 80%+ of the Company's revenues. The Company has 453 employees as on 31st March 2020.

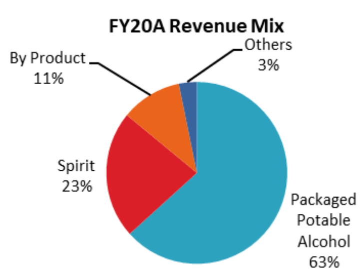
Plant Locations:

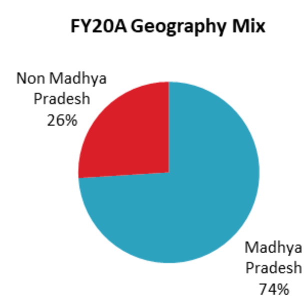
- Distillary: Khodigram, Tehsil- Barwaha, Distt. Khargone – 451115 (Madhya Pradesh)
- Bottling Plant: Udyog Vihar, Chorhata, Rewa, (Madhya Pradesh)
- Contract Manufacturing Unit: Trichur, Kerala

Products

Its product range comprises:

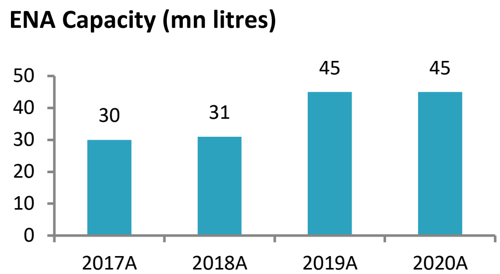
- Premium extra neutral alcohol/ grain spirit
- Indian Made Indian Liquor (IMIL)
- Indian Made Foreign Liquor (IMFL)
- Rectified spirit
- Contract manufacturing partner (Diageo – USL)

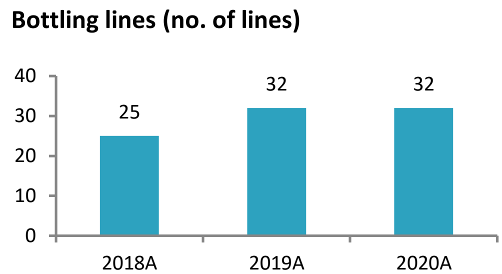


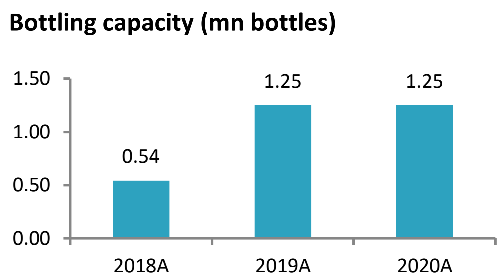


Revenue share of Packaged Potable Alcohol reduced from 72% at the cost of increase in Spirits (higher margin product) which was 17% and By Product which was 9%.

Facilities



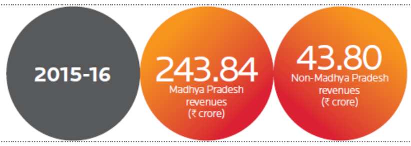


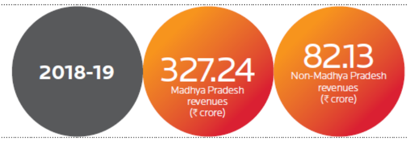


FY20 capacity utilization stands at 75%. Management has proposed 100% expansion of ENA to 90mn litres over an uncertain near-term period (previously estimated to be completed in 2021) at an estimated project cost of ₹120cr, funded by debt, accruals and promoter contribution.

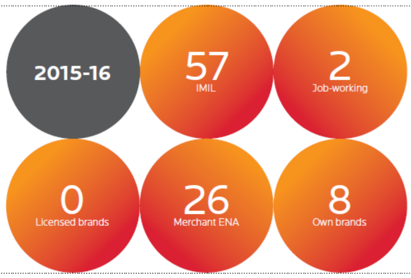
Clientele

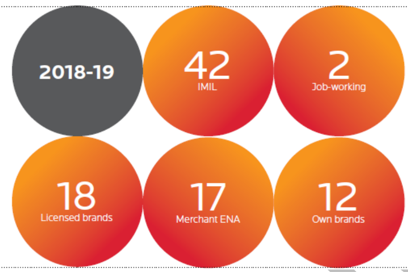
- Diageo/ United Spirits Limited
- Kerala State Beverages (M&M) Corporation
- Government-regulated retail contractors/agencies (Both IMFL and IMIL)





Moving towards value-added products (share of revenues in %)





Brands

The Company holds portfolio for manufacturing International Brands like Bagpiper Whisky, MC Dowell No. 1 Celebration Rum, White Mischief Vodka, Blue Riband Gin and Director Special Black.

Lincesed brands/ franchised brands	 Bagpiper Deluxe Whisky	 Directors Special Whisky	 Flavoured White Mischief	 Director's Special Gold Whisky	 DSP Black Special Whisky	 McDowell's No. 1 XXX Rum.
Proprietary products	 James McGill Whisky	 Central Province Whisky	 Jamaican Magic Rum	 Bombay Special Series	 Super Man Series	 Titanium Triple Distilled Vodka with Orange and Green Apple flavor

Among the in-house brands, Central Province Superior Grain Whisky and Titanium Triple Distilled Vodka are the most coveted in terms of demand.

Manufactures potable alcohol and blended liquor and are awarded with the franchise agreement for manufacturing and selling of series of certain popular brands of United Spirits Ltd (USL), India's largest distiller.

SWOT Analysis

<u>Strengths</u>

- Possesses an integrated business model - from ENA manufacture to bottling to marketing
- Diverse portfolio of proprietary, franchise and licensed brands
- Low customer concentration with top 5 customers contributing only 27% of revenues
- Ability to market excess ENA to generate merchant revenues protects against short-term demand shocks
    - Merchant ENA sales is currently 45%
- Historically been able to reinvest capital at a best-in-class rate of return (vs. Mean of peers) of ROE = 28.7% (17.9%), ROIC = 27.0% (21.4%) and ROCE = 34.5% (21.7%)
- Strong balance sheet allows for reinvesting without debt
- Relatively short working capital cycle of ~55 days (adjusted working capital (TR + Inv - TP) cycle of 40 days) vs industry median of 85 days for the industry

<u>Weaknesses</u>

- High concentration of revenues from Madhya Pradesh
- High margin business of proprietary brands have low recognition and availability and revenue comes from low margin products
- Unable to pass on cost increases to its customers due to the majority of the product (ENA) being a commodity and the spirits market being highly competitive

<u>Opportunities</u>

- 42% of the Indian population is under 25 with 17mn new potential consumers entering into the legal drinking age of 25 every year
- Rising social acceptance for alcohol consumption and women entering the market is expected to drive growth among existing population
- Per capita consumption of alcohol is relatively low in India (5.9 litres per annum vs 9.3-9.8 litres in the US and 7.1-7.4 litres in China)
- Expected to be able to address 100% power requirements in-house once the next phase of capacity expansion is completed in 2021/22
- Strong partnership with Diageo/USL and increasing incidence of international brands shifting to the franchisee model of operations

<u>Threats</u>

- Geographic revenue concentration is high at 74% coming from Madhya Pradesh
- High risk of rise in tax incidences and prohibition
- Industry is exposed to multiple regulatory risks emanating from state taxes, adverse ruling from courts and changes in regulations
- Operating margins are highly dependent on the price of raw materials, most of which is grain
- Company is in a capital hungry phase of the company life cycle
- Economic slowdown is expected to reduce the consumption of alcohol especially in the branded and premium segment

Porter's 5 Forces Industry Analysis – Total Score: 8/10

Threat of new entrants – Low

- Highly regulated industry with significant approvals required to start business
- Relatively large investment in working capital and capacities required to match the scale of existing companies
- Brand loyalty is quite high for branded spirits which makes it difficult for new entrants to carve their own space
  - Diageo, which is a client, also has a very strong customer base for its products
- Customers don't really get a display of all products and generally have to buy what they already know, what they can see or what the vendor recommends

Threat of substitutes – Low

- No substitute for ENA in manufacture of spirits
- No legal substitutes to alcohol with none expected to become legal any time soon
  - All substitutes have a larger taboo factor to them than alcohol

Bargaining power of Suppliers – Low

- Small size of suppliers at a large market, most of whom are farmers or agricultural wholesalers
- Raw material is an absolute commodity and can be replaced

Bargaining power of Buyers – High

- Buyers comprise of spirit manufacturers and state beverage corporations, both of whom have high negotiating power
- Product is commodity based with minimal expertise to
- Buyers can easily substitute between competitors within the industry
- High switching costs for spirit manufacturers due to limited number of manufacturers with similar scale and serviceability

Rivalry amongst competitors – Low

- Large number of global players offering their own separate brands of spirits whereas ENA has a limited number of organized players
- Both the ENA and spirits industries are dominated by a few players with established brands which reduces the competition
- Substantial quality of difference among the different product offerings

- Heavy barriers to exit due to the regulatory approvals in entering in the first place, establishing the brand and building capacities
- Switching costs are relatively low both for ENA and spirit consumers

Management Overview

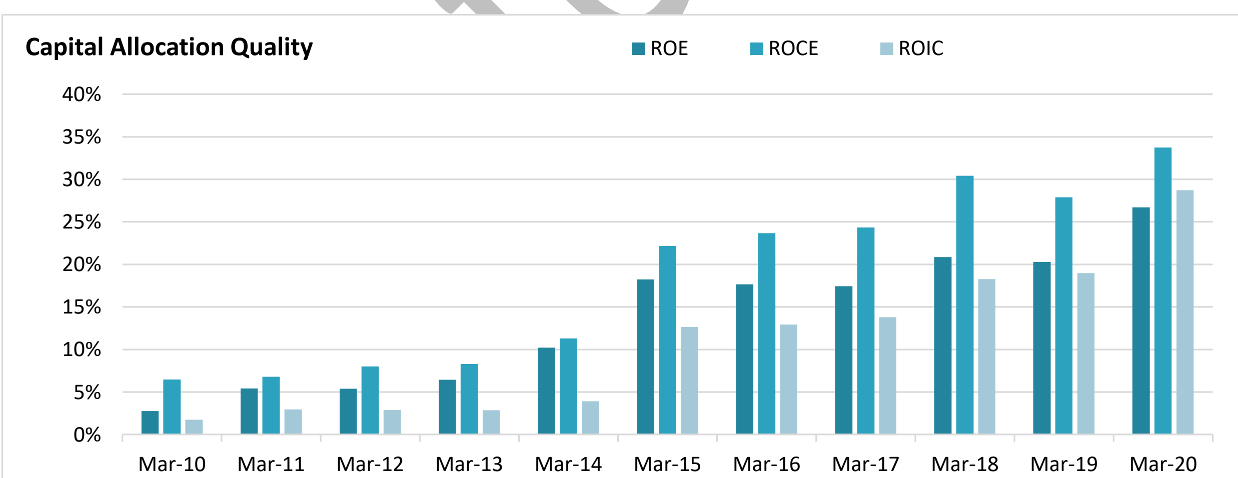
Anand Kumar Kedia – Chairman; Prasann Kumar Kedia – Vice Chairman, Operation and Business Development; Tushar Bhanari, MD

The promoters possess more than three decades of experience. The promoters of the Company comprise Mr. Anand Kumar Kedia (Chairman – Business Promotion and Development) and Mr. Prasann Kumar Kedia (Vice Chairman – Operation and Business Development).

Tushar Bhanari is the MD and Whole Time Director at the Company for over 7 years, prior to which he was associated with Kotak Mahindra Bank.

Total promoter holding is at 54.5% which predominantly belongs to the members of the Kedia family.

Director / Management Remuneration	Remuneration (₹ Cr)	% of Net Profit
Anand Kumar Kedia (Chairman)	3.00	5.7%
Prasann Kumar Kedia (VC)	3.00	5.7%
Tushar Bhandari (MD and Director)	0.37	0.7%
Sanjary Kumar Tibrewal (CFO)	0.34	0.7%



Peer Comparison

S.No.	Name	CMP Rs.	Mar Cap Rs.Cr.	EV / EBITDA	P/E	PEG	NPM Ann %	Asset Turnover	Debt / Eq	ROE %	ROIC %	ROCE %	Sales Var 5Yrs %	Profit Var 5Yrs %	CMP / FCF	OPM %	WC Days
1	United Spirits	585.2	42,523	44.6x	156.1x	7.4x	7.1%	1.5x	0.7x	17.5%	16.3%	20.8%	0.2%	21.2%	54.3x	12.5%	104.1
2	United Breweries	972.4	25,710	56.5x	172.9x	16.5x	6.6%	1.7x	0.1x	12.8%	14.4%	16.7%	6.8%	10.5%	114.7x	9.1%	83.48
3	Radico Khaitan	390.25	5,211	15.8x	22.3x	0.8x	9.5%	1.3x	0.3x	17.3%	15.9%	18.4%	11.3%	26.9%	30.2x	15.7%	183.85
4	G M Breweries	402.9	736	9.4x	13.6x	0.4x	14.5%	1.1x	0.0x	17.5%	40.7%	23.4%	8.8%	31.7%	9.8x	18.0%	209.21
5	**Assoc.Alcohols**	**261.4**	**473**	**5.7x**	**9.6x**	**0.3x**	**9.4%**	**2.6x**	**0.0x**	**28.7%**	**27.0%**	**34.5%**	**11.9%**	**35.2%**	**24.7x**	**14.7%**	**41.66**
6	Globus Spirits	157.75	454	4.2x	7.7x	0.2x	5.1%	1.9x	0.3x	13.5%	14.1%	16.0%	14.7%	52.5%	6.2x	11.4%	-4.01
Mean			12,518	22.7x	63.7x	4.3x	8.7%	1.7x	0.2x	17.9%	21.4%	21.7%	8.9%	29.7%	40.0x	13.6%	103.0
Median			2,974	12.6x	17.9x	0.6x	8.3%	1.6x	0.2x	17.4%	16.1%	19.6%	10.1%	29.3%	27.5x	13.6%	93.8

- Best in class return ratios for ROE and ROCE mainly driven by high Asset Turnover and second in class ROIC
- **Advantageous metrices:** EV/EBITDA, P/E, PEG, NPM, Asset Turnover, Debt to Equity, ROE, ROCE, Sales Growth, Profit Growth, Operating Margin and Working Capital Days
- **Disadvantageous metrices:** none

Valuation (Price as on 17/08/20: ₹261.2)

Discounted Cash Flow Total Valuation	EBITDA Method	Perpetuity Method
Total of Present Value of Cash Flows (₹cr)	78.75	78.75
Present Value of Terminal Value (₹cr)	701.50	953.24
Total Enterprise Value (₹cr)	**780.25**	**1,032.00**
Net Debt, Non-controlling interests, preferred securities (₹cr)	0.86	0.86
Equity Value (₹cr)	**779.39**	**1,031.14**
Adjusted Share Count (millions)	1.87	1.87
Estimated Equity Value per Share	**417.79**	**552.73**

Conclusion (Bigger picture)

AABL has grown revenue in 8 out of its previous 10 FYs and at an average rate of 19%. This can be strongly attributed to the strong drivers of the industry which are intact and expected to stay that way for a long time barring regulatory issues. The key drivers include:

- **Population and age:** India with a population of more than 1.37 bn people is the second largest in the world has one of the youngest populations
- **Urbanization:** Growing urbanization is introducing a larger consumer group, mainly young men and women, to alcoholic beverages and has resulted in more consumers willing to try new products.
- **Growing income:** India's per capita income has doubled in the past decade and with growing income and increasing acceptance of alcoholic beverage consumption, the market will continue to grow.
- **Rural consumption:** There has been steady rise in the rural consumption of alcohol owing to growing rural prosperity in the past few years.
- **Increased acceptance as a social beverage**
- **Premiumization:** Indian consumers increasingly prefer consumption of premium brands in the alcoholic beverage space. The growth of the premium brands remained largely unaffected despite there a slowdown in the economy.
- **Per capita consumption:** India ranks 101 in terms of per capita alcoholic beverages consumption in the world which creates a large gap to bridge
- **Home deliveries:** Keeping in mind the pandemic situation, a number of states allowed the home delivery of alco-beverage products. This is expected to drive the industry in the coming years.

Management going in for rapid expansion over recent years gives further confidence over the demand outlook. Additionally management's strong focus on Working Capital is also advantageous to generating free cash flows.

The main couple of threats to the industry are prohibition and higher taxes owing to the Coronavirus pandemic. The loss of its key contracts with UBL could also impact the Company adversely. Over the long-term the rise in awareness of health consequences of alcohol could lead to a structural slowdown as seen in developed countries.

The performance of the Company on both the top and bottom line has beaten the FMCG sector (however with much higher standard deviation) with Return ratios nearing the same level as companies like Dabur and Godrej Consumer. AABL also seems grossly underpriced in comparison to companies within its own industry despite the improving product mix, the potential to push its proprietary brands using the cash from its ENA business and growth track record.

Overall this is a Company that's well placed among its peers with a great track record and vast opportunity lying ahead of it, mainly driven by the industry and market potential. Additionally the Company is currently trading at a very good valuation.