

**Associated Alcohols and Brewries** by Ravi K. Yendru  
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## ***Overview of the Company***

The Company is into Liquor Manufacturing in Central India. It's into Country Liquor (IMIL), Foreign Liquor (IMFL), Franchise and has it's own brands. It's the flagship company of the Associated Kedia group (Liquor Conglomerate). The Company was Founded in 1989.

Mr. Anand Kumar Kedia (30 Years exp) and Mr. Prasann Kumar Kedia(26 Years exp) are key promoters of the group

# **Observations from Annual Report**

## **Chairman's Report:**

Talks about increasing scale and value

The company sees increase in consumption since people are eating out a lot (COVID is making this the other way)

Penetrating into states (currently 5) and plan for one state at a time

Clear defined goals and tracking

Most Revenue from MP but the expansion to other states is fast

Besides its own Proprietary Brands the company is also

Its into Franchise for IMFL.

Outsourcing Manufacturing Partner with Diageo – United Spirits

## **Management Discussion:**

Global Alcohol market is expected to grow at 2-3%

Indian Alcohol market is growing at a CAGR of 8.8%

Segmented into two:

IMFL (Indian Made Foreign Liquor) – In India 93% market share

IMIL (Indian Made Indian Liquor)

Whiskey constitutes 60% of IMFL (7% Growth)

The popularity and Wine and Vodka are increasing at a CAGR of 21.8 and 22.8.

Beer is the fastest growing segment (7.5% growth)

## ***Observations from Annual Report Contd...***

### **Management Discussion Contd...:**

The states of Andhra Pradesh, Telangana, Kerala, Karnataka, Sikkim, Haryana and Himachal Pradesh are amongst the largest consumers of alcohol in India

ENA (Extra Neural Alcohol) expected to grow at 6.1% CAGR

IMFL Growing at 5.2% CAGR

The MDI we can see Michael Porter's Five force analysis (This shows the management has a very good understanding of strength's, weakness and areas of Improvement.

AABL is into Franchise (Diageo), IMIL, IMFL, ENA and By Products

# Products

Franchise and  
Own Brands



**Threat of New Entry**

1. Time and cost of entry: There will be time and cost and strict regulations needs to be cleared
2. Specialist Knowledge: Food Scientists, Chemical Engineers are needed who are specialized in Alcohol industry
3. Economies of Scale: It does not have yet but the company's plan is to expand state by state (Kerela seems to be a success for them)
4. Cost Advantages: No cost advantages exist for new Entrants. They have to setup the machinery and workforce which can be effort taking
5. Technology Protection: A brand has its own speciality and the company is striving for acheive this.

**SUMMARY:** It's not easy to enter the Alcohol Industry

**Competitive Rivalry**

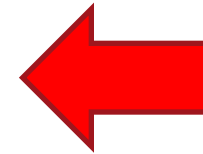
1. Compititors range from indian to foreign companies
2. Products are differentiates as per Brands
3. No Cost of switching products. Customers can go for a rival brand
4. Customer loyalty: Yes it exists in the business
5. Costs of exiting markets are big because the machinary will be sold at very less. So companies won't exit that easily.

**SUMMARY:** Good Competitive Rivalry exists. Lot of players exist.

Threat of New Entry

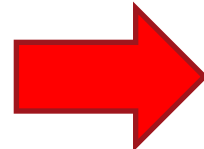


Competitive Rivalry



Buyer Power

Supplier Power



**Supplier Power**

Suppliers: Agricultural Raw Materials (Sugarcane, Barley etc)

1. Number of Suppliers are mid range and no issue in increasing and reducing supplies
2. Size of suppliers ranges from small to big
3. No uniqueness of Service
4. Suppliers can be substituted but there will not be any price difference.
5. Cost of substituting is not much.

**SUMMARY:** Overall there is not much of supplier power because most of them are Farmers. But the Prices of the Raw materials which are fluctuating can affect Margins

**Buyer Power**

Buyers: Consumers and Retailers

1. Number of Cosumers are Increasing with increasing young urban population
2. Orders are Medium to Large.
3. Buyers are quality and price sensitive. Brand is key here.
4. Can easily go to Substitute product but a brand loyalty exists
5. No Cost of substituting except the time for switching

**SUMMARY:** Overall there is a scope for buyer power to develop. It already exists for the Franchise part of the business. But for the core business which is country liquor Buyer power does not exist.



Threat of Substitution

**Threat of Substitution**

This Depends on:

1. Substitution depends on quality plus pricing power of substitutes.
2. No cost of substituting

**SUMMARY:** Threat of Substitution is a problem for Speciality Chemicals and Pharma

# **SWOT Analysis**

## **Strengths:**

A set business model of expansion to specific states one by one

Focus on value based products which can build brands

## **Weakness:**

Heavy Competition

Yet to establish brands

Most of the revenue comes from Madhya Pradesh

## **Opportunities:**

Young population of India (42% Indian population < 25 years)

Growing Urbanization

## **Threats:**

Government Regulations wherein heavy taxes can be imposed (Elections years have been seen good for Liquor Business 😊)

Prices of Agriculture Raw materials going to the higher side will impact Margins

## **Balance Sheet Observations**

### **Negatives:**

Cash is reducing

Equity diluted/split once in FY16 in the past 10 years

### **Positives:**

Low Debt

Common Size analysis looks good

**Overall,** it's a healthy Balance Sheet

\* TD/NW ~ Total Debt/Net Worth



## ***P&L Observations***

### **Negatives:**

NA

### **Positives:**

Sales, Operating Profit Margin, Net Profit showing good numbers

EPS is growing good

Common size analysis looks good

**Overall** it's a healthy P&L

## **Cash Flow Observations**

### **Negatives:**

Latest FY10 FCF is negative

FCF Growth is not consistent

5/10 times CAPEX is more than CFO. But Net CAPEX is lower than CFO but its near to CFO.

### **Positives:**

CFO is mostly growing

Overall CFO is greater than Net Profit, Investing and Financing activities

**Overall,** it's a Okies Cash Flow

# Ratio Analysis

## Negatives:

*Activity Ratios:* Inventory days are raising of late from FY17

*Liquidity Ratios:* Cash Conversion Cycle is raising

## Positives:

*Activity Ratios:* Receivable days are reducing, Payable days are increasing

*Liquidity Ratios:* Current Ratio is raising

## DuPont Analysis:

### Positives:

Financial Leverage --> Low

Net Profit Margin --> Increasing

Asset Turnover --> Increasing

### Negatives:

NA

### Neutral:

**Overall,** the ROE average for 10 years is around 15% (14.7%) and ROCE is 17%. Notably these performances are improving over the past 5 years

It indicates a good management

## Valuations

Intrinsic Value Range		
ASSOCIATED ALCOHOLS & BREWERIES LTD		
	Lower	Higher
<u>Dhandho</u>	130.85	226.07
<u>Ben Graham</u>	691.05	1,258.36
<u>DCF</u>	138.41	
<u>Expected Return</u>	532.77	
<b>CMP</b>	<b>253.00</b>	

As per Ben Graham which is based on Growth Rate. DCF and Dhandho which are based on FCF and Excess Cash its out of Range. Expected Return is more for MOAT companies and for a holding scenario, so I will not consider it for AABL as of now.

If I do Reverse DCF the market is expecting a growth of 22% for five years and 15% for the next 5 years at a discount rate of 10% which is achievable see the past PAT growth (Again Past is not future reflection 😊)

# Management Analysis

**Promoters:** Anand Kumar Kedia and Prasann Kumar Kedia

Tushar Bhandari – Director (he was CFO till 2016)

## **Negatives:**

- The Management's qualification is not much known except the Director who was the CFO till 2016
- Management Salaries: Combined salary is 10% of net Profit which is on the higher side. The limit is 11% and this is below that. Interesting Point to note is till last year FY18 it was way more >20% (Mainly two Promoters - Anand Kumar Kedia and Prasann Kumar Kedia). So from FY19 Management understood their mistake.
- In 2017 (Post Demonitization there were allegations about Black Money, Shell Companies and Income Tax Raid)
- The promoters were involved in a similar company "Mount Everest Breweries Limited"
- In 2013 a subsidiary VEPL was formed and the company got only 50% stake even though they invested 90%
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## **Positives:**

Good Capital Allocation

The current CEO's letter and Management Discussion and Analysis are very good. Indicates the management is doing some good ground work

**Overall:** There are some Red Flags.

## **Checklist**

**Less is More checklist:**

**Negatives:** Future Profitability and high CAPEX

**Positives:** Simple Business, Good EPS Growth, Capital Allocation

**Things to watch out for (Possible Cover-up's):** None Observed

**Financial Shenanigans (Earnings Manipulations - Red Flags to watch out for):**

None in the Latest Annual Report

**A Business I Understand** -> Yes

**Good Long-Term Economics** -> Depends if some Brands are established. But not as of now

**Good Financial Strength** -> Yes, but its it involved good CAPEX

**Psychological Checklist** -> Completed

# Peer Comparison

Peer Comparison					
Balance Sheet	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
D/E	0	0.190600697	0.256300668	0.066427537	0.898193146
Share Dilution	3 Times(2015,17,19)	Once (2016)	3 Times (2011, 15, 18)	3 Times (10, 11, 12)	2 Times (11, 14)
Cash	0.061235648	0.299225664	0.662293853	1.746217852	1.947006194
P&L	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
Sales Growth (Avg)	12%	17%	12%	13%	5%
Material Cost (Common Size Avg)	39%	51%	36%	17%	41%
Employee Cost (Common Size Avg)	2%	4%	8%	6%	8%
Net Profit (Common Size Avg)	10%	4%	6%	5%	-3%
Dividend (Common Size Avg)	0.92%	0.21%	0.82%	0.62%	0.16%
Cash Flow	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
FCF	Positive	Positive	Positive	Positive	Positive
OCF>Investing	Yes (Except 2Times)	Yes (Except 5Times)	Yes (Except 4 Times)	Yes (Except 2 Times)	Yes (Except 4Times)
OCF>Financing	Yes (Except 0 Times)	Yes (Except 3 Times)	Yes (Except 1 Times)	Yes (Except 2 Times)	Yes (Except 3 Times)
OCF>Net Profit	Yes (Except 2 Times)	Yes (Except 4 Times)	Yes (Except 3 Times)	Yes (Except 1 Times)	Yes (Except 1 Times)
Ratios (Average)	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
Inventory Days (Lower is better)	33.4	91.7	164.1	265.2	219.7
Receivable Days (Lower is better)	0.5	23.9	121.3	78.1	87.2
Current Ratio (Higher is better)	0.8	1.5	1.9	1.3	0.9
Cash Conversion Cycle (Lower)	19.0	36.7	176.6	161.7	167.8
Net Profit Margin (Higher)	10.39%	4.41%	6.14%	5.60%	-3.82%
Asset Turnover (Higher)	1.62	1.43	0.75	1.17	0.83
Financial Leverage (Lower)	1.63	2.41	2.28	2.25	4.36
Return on Equity	23.7%	14.70%	10.40%	14.30%	-13.10%
Valuation	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
CMP	403.85	190.35	311.95	914.45	540.85
DCF	536.38	104.14	386.22	233.37	178.69
Dhando	In Range	Out of Range	In Range	Out of Range	Out of Range
Expected Returns	Lesser Value	Lesser Value	Lesser Value	Greater Value	Greater Value
Ben Graham	In Range	In Range	In Range	Out of Range	Out of Range
Promoter Holding	G M BREWERIES LTD	ASSOCIATED ALCOHOLS	RADICO KHAITAN LTD	UNITED BREWERIES L	UNITED SPIRITS LTD
% (Higher is better)	74.43	58.45	40 (38 - Unpledged)	57 (47 - Unpledged)	57 (56 - Unpledged)

Associated Alcohols is the 2<sup>nd</sup> best. In the case of GM Breweries the Profit growth of late has not been good





## ***Investment Decision***

**Overall**, Alcohol is a sin Industry and will exist for long time.

AABL has grown well in the past

AABL has some red flags w.r.t. Management in the past (But rectification seems to be happening). Also Country liquor which is a very regulated business and good amount of Government Intervention. The company is trying to expand to different states and also into Franchises and has good understanding of the Industry.

I will put the company in my Watchlist for the time being