

United Spirits

Estimate change



TP change



Rating change



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	UNSP IN
Bloomberg Equity Shares (m)	727
M.Cap.(INRb)/(USDb)	425.4 / 5.7
52-Week Range (INR)	743 / 443
1, 6, 12 Rel. Per (%)	-10/-5/-3
12M Avg Val (INR M)	1682

Financials & Valuations (INR b)

Y/E March	2020	2021E	2022E
Sales	90.9	73.4	90.0
Sales Gr. (%)	1.2	-19.3	22.7
EBITDA	15.1	9.7	15.4
Margin (%)	16.6	13.2	17.1
PAT	7.9	4.2	9.0
EPS (INR)	10.9	5.8	12.4
EPS Gr. (%)	16.9	-46.7	114.3
BV/Sh.(INR)	52.4	57.2	69.7
Ratios			
RoE (%)	20.8	10.1	17.9
RoCE (%)	17.3	16.5	24.6
Payout (%)	0.0	0.0	0.0
Valuations			
P/E (x)	54.1	101.4	47.3
P/BV (x)	11.2	10.3	8.5
EV/EBITDA (x)	29.2	44.4	27.6

Shareholding pattern (%)

As On	Jun-20	Mar-20	Jun-19
Promoter	56.8	56.8	56.8
DII	9.4	9.2	7.2
FII	19.7	20.5	22.3
Others	14.2	13.5	13.7
FII Includes depository receipts			

CMP: INR585
TP: INR585
Neutral

EBITDA loss as expected; Return to normalcy uncertain

- United Spirits (UNSP) declared dismal 1QFY21 EBITDA/net loss (albeit lower than our expectations). Importantly, the recovery outlook remains cloudy, especially with on-trade – restaurants, bars and pubs, which contribute ~25% of sales – expected to remain closed for the next few months. Further, Premium & Above segment (P&A) is likely to underperform (unlike previous years) leading to mix deterioration. Also, the full impact of the sharp excise hikes by various states would be felt 2QFY21 onwards. All these factors lead to weak earnings expectations though we do not expect EBITDA losses 2QFY21 onwards.
- Our DCF-based calculations and P/E multiples of 47x FY22E EPS indicate that valuations seem currently lofty given the uncertainty prevailing over earnings growth in the sector. We had downgraded the UNSP stock to **Neutral** in May'20 ([link to note](#)) due to rising concerns on the Alcobev sector's earnings growth in the COVID and immediate post-COVID era.

Lockdown drastically impacts sales leading to EBITDA loss

- Standalone net sales declined 53.6% YoY to INR10.3b** (v/s est. INR9.3b). After adjusting for one-time bulk Scotch sales last year, underlying net sales declined 51%.
- Overall reported volumes declined 49.2%** (v/s est. decline of 56%). P&A and Popular volumes declined 51.5% and 46.7% YoY, respectively.
- Reported gross margin contracted by 570bp YoY to 41.7%**, primarily due to lower franchise income, raw material (RM) inflation and one-off obsolete inventory write-offs during the quarter. After removing the one-time benefit of bulk Scotch sales last year, underlying gross margin declined 508bp.
- With significant gross margin compression, **reported EBITDA margin contracted 2,540bp YoY, to -7.5%** (v/s est. -10.9%). As % of sales, reported other expenses/staff costs were up 1,690bp/550bp YoY, while reported ad spends were down 270bp YoY.
- EBITDA stood at -INR776m** (v/s est. -INR1b and INR4b in 1QFY20).
- Ad spends were down 69.7% on an absolute basis.
- Reported PBT stood at -INR1.8b (v/s est. -INR1.8b and INR3.1b in 1QFY20).
- Adjusted PAT stood at -INR1.4b** (v/s est. -INR1.8b and INR2b in 1QFY20).

Highlights from management commentary

- Factories were fully operational and 80-85% of stores reopened by end-Jun'20. However, the second wave of localized lockdowns in Jul'20 has affected both manufacturing and retail.
- Impact of excise increase in May' will be felt more in subsequent quarters.
- Other operating income was also affected by sharp dip in franchisee income, which impacted gross margin by 160bp. Franchise income stood at INR100m in 1QFY21 (v/s quarterly average of INR500m in pre-COVID period). Expect ~40% decline on this front in the coming days.

Valuation and view

- Changes to our model have resulted in 15.4%/5.7% reduction in FY21/FY22E EPS, mainly due to the unclear recovery outlook over the next 2-3 quarters.
- As pointed out in our [Alcobev segment downgrade note](#) in May'20, the outlook for the segment is highly uncertain over FY20-FY22E. This is due to (a) lack of clarity on reopening of the on-trade channel (which contributes 25% of sales), (b) weak environment for discretionary consumption, (c) unprecedented steep excise increases in Apr-May'20, (d) possibility of delays in payment by state governments, and (e) capital-intensive nature of the Alcobev business (v/s staples).
- Our DCF-based target price corresponds to lofty valuations at 47x FY22E EPS. Maintain **Neutral**.

Quarterly Performance

	(INR m)											
Y/E March (Standalone)	FY20				FY21				FY20	FY21E	FY21	Var.
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE			1QE	(%)
Volume growth %	6.0	1.0	-1.8	-13.3	-49.2	-22.5	-7.0	27.0	-1.2	-16.0	-56.0	
Total revenues	22,184	22,962	25,825	19,938	10,302	14,925	23,243	24,904	90,909	73,373	9,317	10.6%
YoY change (%)	10.4	3.2	3.4	-11.4	-53.6	-35.0	-10.0	24.9	1.2	-19.3	-58.0	
Gross Profit	10,497	10,325	11,459	8,408	4,291	6,716	10,808	11,716	40,689	33,532	4,286	
Margin (%)	47.3	45.0	44.4	42.2	41.7	45.0	46.5	47.0	44.8	45.7	46.0	
EBITDA	3,971	4,156	4,240	2,714	-776	1,796	3,808	4,828	15,081	9,656	-1,014	-23.5%
Margins (%)	17.9	18.1	16.4	13.6	-7.5	12.0	16.4	19.4	16.6	13.2	-10.9	
EBITDA growth (%)	66.4	-6.2	18.4	-4.3	-119.5	-56.8	-10.2	77.9	17.1	-36.0	-125.5	
Depreciation	500	573	524	678	638	600	610	632	2,275	2,480	500	
Interest	520	452	455	480	499	460	450	403	1,907	1,812	400	
PBT From operations	2,951	3,131	3,261	1,556	-1,913	736	2,748	3,793	10,899	5,364	-1,914	
Other income	101	137	176	41	95	120	150	163	455	528	70	
PBT	3,052	3,268	3,437	1,597	-1,818	856	2,898	3,956	11,354	5,892	-1,844	-1.4%
Tax	1,065	1,022	849	510	-415	188	638	1,263	3,445	1,674	0	
Rate (%)	34.9	31.3	24.7	31.9	22.8	22.0	22.0	31.9	30.3	28.4	0.0	
Adj. PAT	1,987	2,246	2,588	1,087	-1,403	668	2,260	2,693	7,909	4,218	-1,844	-23.9%
YoY change (%)	88.5	-13.2	21.7	-16.9	-170.6	-70.3	-12.7	147.7	16.9	-46.7	-192.8	

E: MOFSL Estimate

Key Performance Indicators

Y/E March (Standalone)	FY20				FY21
	1Q	2Q	3Q	4Q	1Q
Key Metrics					
Sales Volume (m Cases)	19.3	20.6	21.5	18.3	9.8
Volume Growth %	6.0	1.0	-1.8	-13.3	-49.2
Realisation/case (INR)	1,149	1,115	1,201	1,090	1,051
Realisation growth %	4.1	2.2	5.4	2.2	-8.5
EBIDTA/Case (INR)	205.8	201.7	197.2	148.3	-79.2
Segmental performance					
P&A Volumes (m Cases)	10.3	10.8	11.4	8.4	5.0
Popular Volumes (m Cases)	9.0	9.8	10.1	9.9	4.8
P&A Volumes Growth (%)	8.4	2.9	2.7	-20.0	-51.5
Popular Volumes Growth (%)	3.4	-1.0	-6.5	-6.6	-46.7
P&A Sales Growth (%)	9.0	0.0	8.0	-15.6	-52.0
Popular Sales Growth (%)	2.0	-1.0	-5.0	-11.4	-51.0
2Y average growth (%)					
Volume	3.6	5.6	1.0	-6.2	-21.6
Sales	11.6	8.6	6.9	-3.9	-21.6
EBITDA	52.6	27.7	24.5	-0.7	-26.6
PAT	67.1	38.3	32.6	-23.1	-41.0
% of Sales					
COGS	52.7	55.0	55.6	57.8	58.3
Operating expenses	29.4	26.9	28.0	28.6	49.2
Depreciation	2.3	2.5	2.0	3.4	6.2
YoY change (%)					
COGS	16.9	14.1	11.9	-4.2	-48.6
Operating expenses	-15.3	-8.6	-15.5	-25.3	-22.4
Other Income	-24.1	-18.0	-67.0	-65.5	-5.9
EBIT	69.5	-12.2	15.2	-16.4	-140.7

**Management commentary highlights****Performance and outlook**

- During 24th Mar'20 to 3rd May'20, there was a complete ban on manufacturing and sales of alcohol.
- 80-85% of off-trade outlets are now operational, although some are only open for home delivery in cities like Mumbai.
- On-trade is important for P&A and since they were closed, P&A was affected more than the 'Popular' segment.
- Factories were fully operational by end-Jun'20, but the second wave of localized lockdowns in Jul'20 has affected both manufacturing and retail.
- Across the board tax increases are also a deterrent to performance. Only Delhi and Odisha have rolled back the hikes.
- Impact of tax increases will be felt even more in the subsequent quarters.
- Online delivery is still at a very nascent stage.
- Sentiment is improving but cannot be extrapolated given the volatile situation, particularly for the alcohol business in India.

Margins impact and outlook, state government delays

- Impact of INR210m obsolescence of inventory in the quarter affected gross margin by ~150bp.
- Other operating income was also affected by the sharp dip in franchise income, which additionally impacted gross margin by 160bp. Franchise income stood at

INR100m in 1QFY21 (v/s INR500m in pre-COVID period). Expect ~40% decline in franchise income in the coming days.

- ENA costs have been flattish. Glass industry was also under lockdown and prices are expected to increase gradually.
- 70% of sales are to the state governments. Some states are delaying payments. Ageing of inventory at corporation level due to the lockdown has led to some provisions. There is no credit risk with these corporations.
- UNSP has been able to reduce receivables over Mar'20 levels.

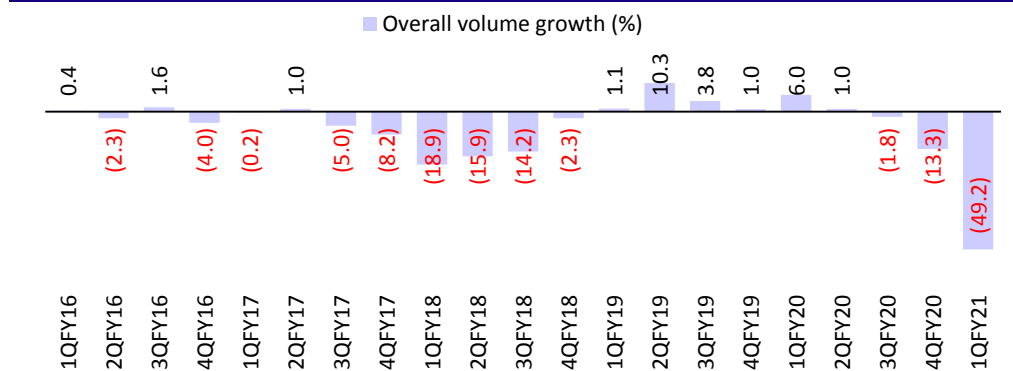
Other points

- UNSP is wooing consumers that would buy from duty-free shops. However, the prices are much higher and there is little evidence of a material shift from duty-free to duty-paid consumption. Nevertheless, management believes that there will be some shift in the coming days.
- Spirits' companies are likely to benefit over beer companies. This is due to the fact that it is easier to carry spirits home (v/s beers). Bars and pubs, which are shut, also have higher beer salience. The company is surprised by the extent of shift from beer to spirits in recent months.
- Home delivery has helped but contribution is still relatively small, especially in areas where over-the-counter sales are allowed. On the other hand, the contribution is decent where only home delivery is allowed.
- UNSP received price increases from the government in 7-8 states in recent months; however, the quantum was modest.
- Consumer behavior trends: Larger SKUs are being sold because of improving and higher in-home consumption. No material down-trading has been witnessed yet.
- No material restrictions are affecting scotch imports.

Key Exhibits

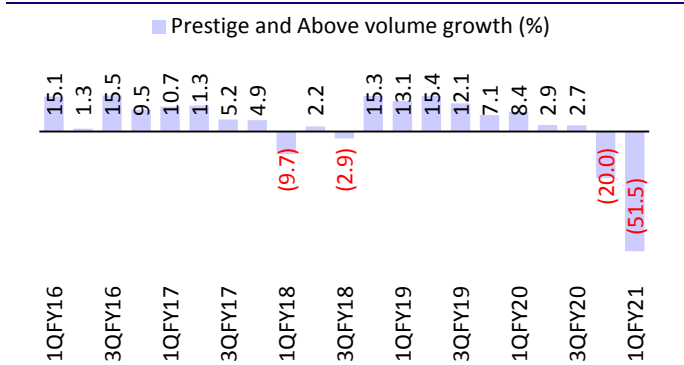
- P&A volumes declined 51.5% YoY while ‘Popular’ segment volumes declined 46.7% YoY.
- In 1QFY21, net sales of P&A declined 52% YoY, while that of ‘Popular’ dropped 51% YoY.
- Net sales of ‘Popular’ segment in priority states declined 46% in 1QFY21.

Exhibit 1: Overall volumes fell 49.2% YoY to 9.8m cases in 1QFY21 v/s 19.3m in 1QFY20



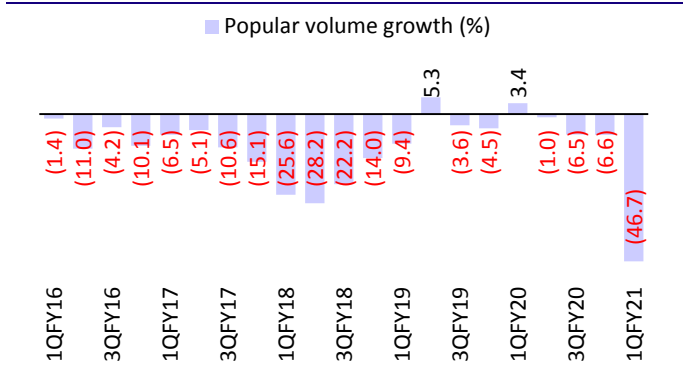
Source: Company, MOFSL

Exhibit 2: P&A volumes declined 51.5% YoY



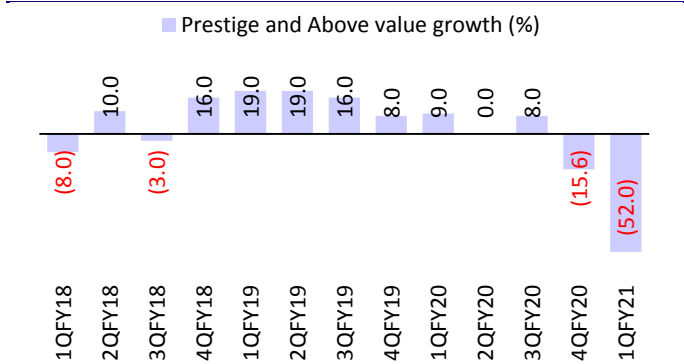
Source: Company, MOFSL

Exhibit 3: Popular volumes declined 46.7% YoY in 1QFY21



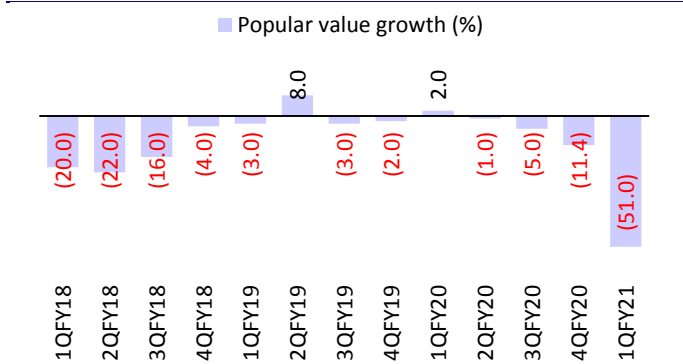
Source: Company, MOFSL

Exhibit 4: P&A value growth declined 52% YoY



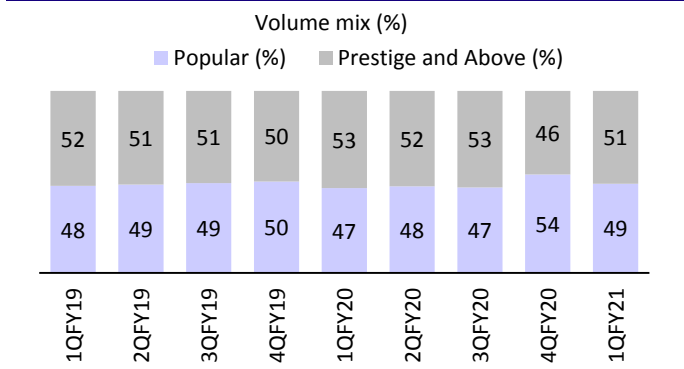
Source: Company, MOFSL

Exhibit 5: Popular plunged 51% YoY (value) in 1QFY21



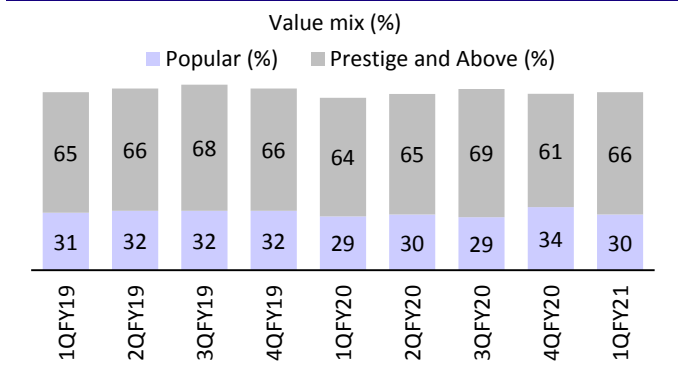
Source: Company, MOFSL

Exhibit 6: P&A volume contribution increased to 51%...



Source: Company, MOFSL

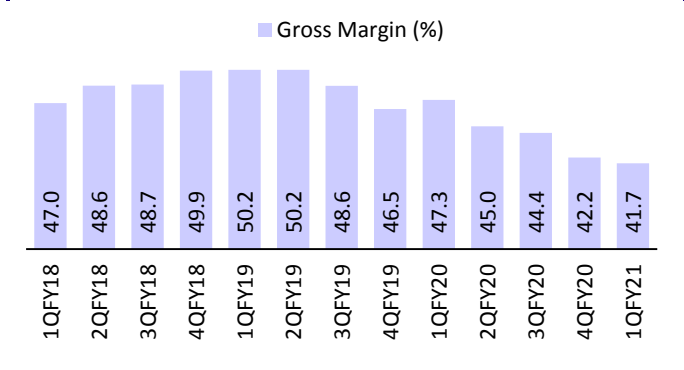
Exhibit 7: ...and NSV contribution was 66% in 1QFY21



Source: Company, MOFSL

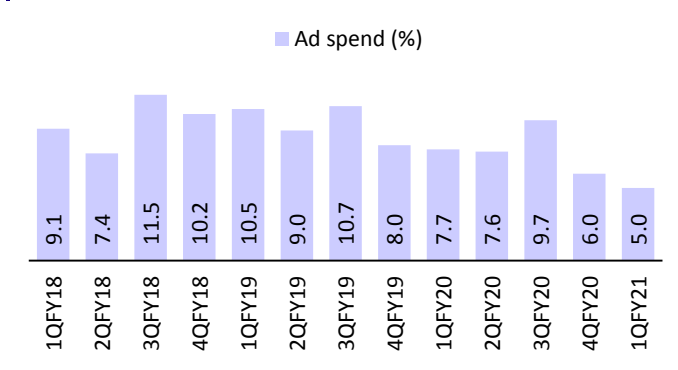
- **Reported gross margin contracted by 570bp YoY to 41.7%**, primarily due to lower franchise income, RM inflation and one-off obsolete inventory write-off during the quarter. After removing the one-time benefit of bulk Scotch sales last year, underlying gross margin decline was 508bp.
- With significant gross margin compression, reported EBITDA margin contracted 2,540bp YoY to -7.5% (v/s est. -10.9%). As % of sales, reported other expenses and staff costs were up 1,690bp YoY and 550bp YoY, respectively, whereas reported ad spends were down 270bp YoY.
- Reported EBITDA stood at -INR776b (v/s est. -INR1b and INR4b in 1QFY20).
- Ad spends were down 69.7% on an absolute basis.

Exhibit 8: Reported gross margin stood at 41.7%



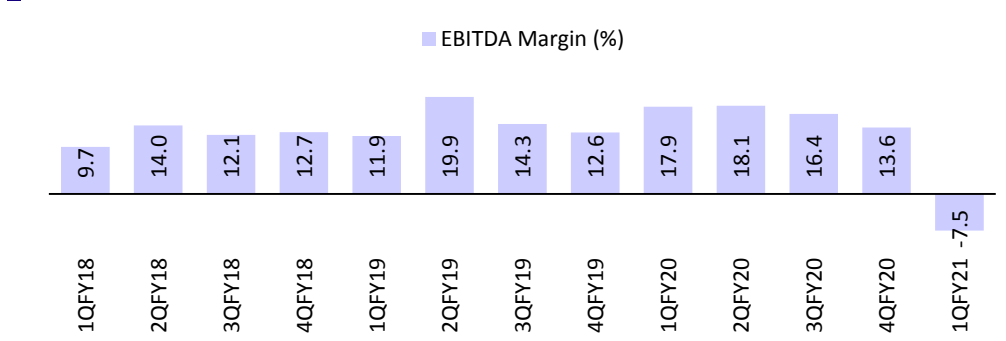
Source: Company, MOFSL

Exhibit 9: Advertising expenses were down in 1QFY21 (-270bp YoY to 5% of sales; down 69.7% YoY on absolute basis)



Source: Company, MOFSL

Exhibit 10: EBITDA margin contracted 2,540bp YoY to -7.5% in 1QFY21



Source: Company, MOFSL

Valuation and view

Diageo gaining control has led to a dramatic turnaround since FY15

- **Weak revenue growth but strong profitability improvement:** Over FY15-20, sales CAGR stood at 2.7%. However, EBITDA CAGR was strong at 17.8% with PBT/PAT CAGR being more impressive at 38.8%/32.7%.
- **Portfolio realignment given priority:** Over FY15-18, UNSP realigned its portfolio with higher focus on the more profitable P&A segment. Contribution of P&A segment to revenues has jumped from 40% in FY15 to ~68% in FY20. However, the overall pace of sales growth was lower than expected.
- **Mix improvement led to sharp margin expansion:** Reorganization of the portfolio toward the more profitable P&A segment, has led to EBITDA margin expanding from 9.1% in FY14 to 16.6% in FY20.
- **Continuous efforts on cost reduction and improving efficiencies:** Working capital reduction, sale of non-core assets, limited capex and improved profitability has led to net debt declining and interest cost reducing by 57% during FY15-20. This has driven the largest chunk of PBT growth over the past five years.

Multiple headwinds led by COVID makes us cautious on UNSP

- Changes to the model have resulted in 15.4%/5.7% reduction in FY21/FY22E EPS, mainly due to an unclear outlook on recovery over the next 2-3 quarters.
- As pointed out in our [Alcobev segment downgrade note](#) in May'20, the outlook for the segment is highly uncertain over FY20-FY22E. This is due to (a) lack of clarity on reopening of the on-trade channel (which contributes 25% of sales), (b) weak environment for discretionary consumption, (c) unprecedented steep excise increases in Apr-May'20, (d) possibility of delays in payment by state governments, and (e) capital-intensive nature of the Alcobev business (v/s staples).
- Our DCF-based target price corresponds to lofty valuations at 47x FY22E EPS. Maintain **Neutral**.

Exhibit 11: We have cut PAT forecast for FY21/FY22E by 15.4%/5.7%

INR M	New		Old		% Change	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Total Income	73,373	90,043	74,534	91,483	-1.6%	-1.6%
EBITDA	9,656	15,397	10,405	15,644	-7.2%	-1.6%
Adjusted PAT	4,218	9,041	4,986	9,591	-15.4%	-5.7%

Source: Company, MOFSL

Exhibit 12: DCF-derived price target of INR585 implies 1% downside

INR m	2020
Total Revenue	90,909
EBITDA	15,081
Other income	455
Tax	-3,445
WC change	-2,361
Capex	-1,978
FCF	7,752
Sum of PV of FCF	255,972
Terminal value	1,304,537
PV of terminal value	183,869
EV	439,841
Net debt	14,850
Equity value	424,991
No of shares	727
Per share value	585

Source: Company, MOFSL

Financials and valuations

Income Statement							(INR m)	
Y/E March	2016	2017	2018	2019	2020	2021E	2022E	
Total Revenue	82,482	85,476	81,701	89,806	90,909	73,373	90,043	
Change (%)	3.7	3.6	-4.4	9.9	1.2	-19.3	22.7	
Gross Profit	34,076	36,632	39,725	43,857	40,689	33,532	43,221	
Margin (%)	41.3	42.9	48.6	48.8	44.8	45.7	48.0	
Other Expenditure	-25,212	-26,922	-29,446	-30,983	-25,608	-23,876	-27,824	
EBITDA	8,864	9,710	10,279	12,874	15,081	9,656	15,397	
Change (%)	33.2	9.5	5.9	25.2	17.1	-36.0	59.5	
Margin (%)	10.7	11.4	12.6	14.3	16.6	13.2	17.1	
Depreciation	-1,017	-1,323	-1,351	-1,445	-2,275	-2,480	-2,802	
Int. and Fin. Charges	-4,469	-3,690	-2,675	-2,200	-1,907	-1,812	-1,141	
Other Income	1,057	1,111	1,080	952	455	528	633	
Profit before Taxes	4,435	5,808	7,333	10,181	11,354	5,892	12,087	
Change (%)	101.3	31.0	26.3	38.8	11.5	-48.1	105.1	
Margin (%)	5.4	6.8	9.0	11.3	12.5	8.0	13.4	
Tax	2,358	1,923	2,433	3,416	3,445	1,674	3,046	
Tax Rate (%)	53.2	33.1	33.2	33.6	30.3	28.4	25.2	
Adjusted PAT	2,076	3,884	4,900	6,765	7,909	4,218	9,041	
Change (%)	8.1	87.1	26.1	38.1	16.9	-46.7	114.3	
Margin (%)	2.5	4.5	6.0	7.5	8.7	5.7	10.0	
Non-rec. (Exp)/Income	-858	-2,186	717	-179	-862	-750	0	
Reported PAT	1,219	1,699	5,617	6,586	7,047	3,468	9,041	
Balance Sheet							(INR m)	
Y/E March	2016	2017	2018	2019	2020	2021E	2022E	
Share Capital	1,453	1,453	1,453	1,453	1,453	1,453	1,453	
Reserves	15,687	17,925	23,585	29,862	36,644	40,112	49,154	
Net Worth	17,140	19,378	25,038	31,315	38,097	41,565	50,607	
Loans	37,082	40,407	32,505	25,825	15,195	6,695	4,695	
Deffered Tax Liabilities	-1,539	-1,241	-856	-1,878	-1,590	-1,590	-1,590	
Capital Employed	52,683	58,544	56,687	55,262	51,702	46,670	53,712	
Gross Block	17,389	14,091	13,561	16,406	20,746	21,246	22,746	
Less: Accum. Depn.	-6,627	-2,219	-3,540	-5,124	-7,399	-9,879	-12,681	
Net Fixed Assets	10,762	11,872	10,021	11,282	13,347	11,367	10,065	
Capital WIP	2,449	851	980	1,171	1,187	1,187	1,187	
Investments	93	3,238	2,775	2,984	2,526	3,326	8,326	
Curr. Assets, L&A	67,082	70,763	71,778	69,308	66,895	67,319	75,471	
Inventory	18,999	18,538	18,694	18,767	18,361	15,408	18,909	
Account Receivables	23,140	29,605	26,998	25,181	22,835	24,123	29,603	
Cash and Bank	3,362	523	1,198	588	345	2,684	-614	
Others	21,581	22,097	24,888	24,772	25,354	25,104	27,573	
Curr. Liab. and Prov.	27,703	28,180	28,867	29,483	32,253	36,529	41,337	
Account Payables	10,018	11,798	13,935	13,360	11,712	11,634	13,124	
Other Liabilities	14,643	13,345	11,490	12,346	16,196	20,115	22,956	
Provisions	3,042	3,037	3,442	3,777	4,345	4,780	5,257	
Net Current Assets	39,379	42,583	42,911	39,825	34,642	30,790	34,133	
Application of Funds	52,683	58,544	56,687	55,262	51,702	46,670	53,712	

E: MOFSL Estimates

Financials and valuations

Ratios							
Y/E March	2016	2017	2018	2019	2020	2021E	2022E
Basic (INR)							
EPS	2.9	5.3	6.7	9.3	10.9	5.8	12.4
Cash EPS	4.3	7.2	8.6	11.3	14.0	9.2	16.3
BV/Share	23.6	26.7	34.5	43.1	52.4	57.2	69.7
Valuation (x)							
P/E	206.1	110.2	87.3	63.3	54.1	101.4	47.3
Cash P/E	138.3	82.2	68.5	52.1	42.0	63.9	36.1
EV/Sales	1.3	1.3	1.3	1.1	1.0	1.1	0.8
EV/EBITDA	52.1	47.8	44.4	35.0	29.2	44.4	27.6
P/BV	25.0	22.1	17.1	13.7	11.2	10.3	8.5
Return Ratios (%)							
RoE	11.4	21.3	19.6	21.6	20.8	10.1	17.9
RoCE	6.7	11.4	11.6	14.7	17.3	16.5	24.6
RoIC	6.7	11.1	11.3	14.9	18.2	11.8	22.4
Working Capital Ratios							
Asset Turnover (x)	1.6	1.5	1.4	1.6	1.8	1.6	1.7
Leverage Ratio							
Debt/Equity (x)	2.2	2.1	1.3	0.8	0.4	0.2	0.1
Cash Flow Statement							
Y/E March	2016	2017	2018	2019	2020	2021E	2022E
(INR m)							
OP/(loss) before Tax	3,155	2,546	8,403	9,914	11,347	5,892	12,087
Int./Div. Received	1,567	-413	205	1,245	-559	-528	-633
Depreciation and Amort.	1,017	1,323	1,351	1,445	2,275	2,480	2,802
Interest Paid	3,990	3,488	1,708	1,775	1,626	1,812	1,141
Direct Taxes Paid	-1,637	-1,943	-3,898	-8,238	-5,658	-1,674	-3,046
Incr/Decr in WC	-5,826	1,732	1,694	2,434	-2,361	6,190	-6,641
CF from Operations	2,266	6,733	9,463	8,575	6,670	14,172	5,710
(Incr)/Decr in FA	-2,222	-1,509	41	-656	-1,978	-500	-1,500
Free Cash Flow	1,232	5,476	9,621	8,332	6,331	14,200	4,843
(Pur)/Sale of Investments	8,686	111	213	319	0	-800	-5,000
Other investing items	2,140	-2,973	1,174	-142	599	-750	0
CF from Invest.	9,792	-4,119	1,545	-66	260	-1,522	-5,867
Issue of Shares	0	0	0	0	0	0	0
Incr/Decr in Debt	-6,606	-3,325	-7,902	-7,004	-5,572	-8,500	-2,000
Dividend Paid	0	0	0	0	0	0	0
Others	-4,487	-2,128	-2,431	-2,115	-1,601	-1,812	-1,141
CF from Fin. Activity	-11,093	-5,453	-10,333	-9,119	-7,173	-10,312	-3,141
Incr/Decr of Cash	965	-2,839	675	-610	-243	2,339	-3,298
Add: Opening Balance	2,397	3,362	523	1,198	588	345	2,684
Closing Balance	3,362	523	1,198	588	345	2,684	-614

E: MOFSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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