22 December 2022

Update | Sector: Consumer

United Spirits

BSE SENSEX	S&P CNX
60,826	18,127

UNITED SPIRITS
A DIAGEO Group Company

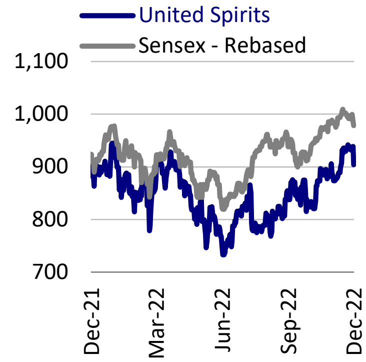
Stock Info

Bloomberg	UNSP IN
Equity Shares (m)	727
M.Cap.(INRb)/(USDb)	652.3 / 7.9
52-Week Range (INR)	958 / 712
1, 6, 12 Rel. Per (%)	3/3/-7
12M Avg Val (INR M)	1418
Free float (%)	43.3

Financials & Valuations (INR b)

Y/E March	2022	2023E	2024E
Sales	93.8	97.9	100.6
Sales Gr. (%)	18.9	4.4	2.8
EBITDA	14.9	16.0	18.4
Margin (%)	15.8	16.3	18.3
PAT	9.1	11.2	12.2
EPS (INR)	12.5	15.4	16.8
EPS Gr. (%)	97.3	22.7	9.1
BV/Sh.(INR)	67.5	73.1	77.9
Ratios			
RoE (%)	18.6	21.0	21.5
RoCE (%)	25.4	26.6	29.7
Payout (%)	0.0	65.0	35.7
Valuations			
P/E (x)	71.7	58.4	53.5
P/BV (x)	13.3	12.3	11.5
EV/EBITDA (x)	43.8	40.6	35.3

Stock's performance (one-year)



CMP: INR898 TP: INR880 (-2%) Neutral

RM cost headwind to hurt near-term earnings, FY24 outlook better

Key takeaways from our meeting with the management of United Spirits (UNSP) to obtain an update on its medium-term and near-term growth prospects:

- Management remains clear that the recently concluded sale of popular brands was essential as the company did not have a right to win in this sub-segment. UNSP has retained McDowell's No.1 and Director's Special (DSP) in the popular segment. While McDowell's No.1 can be premiumized to the P&A category. The management aims to capitalize DSP, which commands great brand equity, in several parts of India.
- Material cost outlook remains challenging in the near term. Neither glass costs nor ENA are showing signs of abating in the near term but FY24 outlook is likely to be better. Natural gas costs are rising, which would hurt glass costs for now. Soda Ash costs are double of last year at the same time. However, non-glass packaging costs are gradually coming down. Raw material volatility and rollback of Delhi excise policy are likely to hit topline and earnings for the next few quarters.
- Potential benefits of the UK-India free trade agreement (FTA): Management elaborated on the potential benefits from the UK-India FTA that appears to be on the anvil. This will benefit both Bottled in Origin (BIO) and Bottled in India (BII), which are ~20-25% of P&A sales annually. The import duties currently comprise ~15% of the retail selling price (RSP) value chain on a national weighted average basis. Depending upon the contours of the eventual announcement, retail price of the imported scotch portfolio will come down by 6-7%. More reduction may happen if states also cut duty on this portfolio.
- Innovation and renovation: The management is happy with the progress on innovation and renovation. End-to-end renovation initiatives on "Signature" have been carried out and the renovated brand is now available nationally. The company is also happy with the response to "Royal Challenge American Pride Bourbon" initiative that has led to healthy sequential growth. "McDowell's No.1" renovation has also been successful.

Valuation and view

- We have kept our forecasts unchanged.
- We had [downgraded UNSP to Neutral in Nov'21] after the stock outperformed our Coverage Universe. Fair valuations post-outperformance, potential near-term headwinds in the form of cost inflation (also highlighted in our [Feb'22 AlcoBev note]), and delays in price increases v/s earlier expectations are likely to keep near-term earnings growth and stock price performance under check even as the outlook in FY24E is projected to be better.
- While we appreciate the potential for growth led by various measures undertaken by the new CEO over the past year, fair near-term valuations lead us to maintain our **Neutral** rating and TP of INR880, premised on 50x Sep'24E EPS.

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Reasons for sale of the popular business

- The popular business may not have taken a lot of the management's bandwidth but Diageo–UNSP did not have the right to win in this category.
- UNSP has retained McDowell's No.1 and Director's Special (DSP) in the popular segment.
- McDowell's No.1 can be premiumized to the P&A category.
- The management aims to capitalize DSP, which commands great brand equity, in several parts of India.

Growth and margin prospects

- Stability on inflation and macros is required before the management can guide for a sharper growth.
- The demand on lower Prestige segment continues to be a problem currently because of high inflation.
- Neither glass costs nor the ENA are showing signs of abating in the near term but FY24 outlook is likely to be better. Natural gas costs are rising, which would hurt glass costs for now. Soda Ash costs are double of last year at the same time. However, non-glass packaging costs are gradually coming down.
- Raw material volatility and rollback of Delhi excise policy are likely to hit topline and earnings for the next few quarters.
- In West Bengal, benefits of the RTM change will start getting lapped up and therefore the benefits will normalize going forward.
- Management indicated that while near-term material costs are high, it would ideally want a little more A&P for growth but will continue to take calibrated calls depending on the overall situation.

How could the India-UK FTA help the company?

- This FTA will benefit both BIO and BII, which are ~20-25% of P&A sales on an annual basis.
- The import duties comprise ~15% of the RSP value chain on a national weighted average basis.
- UNSP is stronger than peers in the super-premium as well as in the lower end of the P&A category.
- Depending upon the contours of the eventual announcement, retail price of the imported scotch portfolio will come down by 6-7%. More reduction may happen if states also cut duty on this portfolio.
- Currently, the state duties comprise about 30-35% of the RSP value chain, which has come down from earlier levels. The company could look to pass on any further reductions, if that eventuates.
- Both BIO and BII categories (Diageo Brands, where bulk scotch comes from Scotland) are equally profitable with ~10% distributor margin. BII also has Black Dog and Smirnoff that are highly margin accretive.
- Despite 10% distributor margin cap, gross profit and EBITDA profit per case on BIO and BII are much higher and RoI is also superior to rest of the portfolio.
- On the high base of high duty-paid scotch sales in the last two years, there would be some reversals as the global travel recovers. Nevertheless, the opportunity to grow duty-paid sales is large and the company is focused on growing this segment on the high base.

Innovations and renovation

- End-to-end renovation initiatives on “Signature” have been carried out and the renovated brand is now available nationally.
- The company is also happy with the response to “Royal Challenge American Pride Bourbon” initiative that has led to healthy sequential growth.
- “McDowell’s No.1” renovation has also been successful.

Price increases

- The company continues to realize pricing gains from additional states.

Spirits v/s beer taxation

- Management does not see any clear trend in favor of relatively lower taxation on beer v/s spirits.

Why retain RCB?

- Cricket is getting bigger, especially IPL, which is tailor-made for TV audience. This gels with the celebration platform for UNSP.
- RCB is highly valuable and is now one of the leading sports leagues in the world on media rights per game.
- As BCCI expands IPL (e.g.: it has already announced the Women’s IPL), additional growth opportunities will emerge. UNSP’s management will evaluate such opportunities based on merit.

Reduction in number of distilleries

- The company has around 45 distilleries now which have come down from nearly 100 at the time of the Diageo acquisition.

India single malt and gin

- Godawan is not just doing well in India but also offers potential in terms of sales to Indian diaspora.
- Out of the 65,000 outlets selling spirits in India, the company is targeting to sell Godawan in the top 2,000 outlets. Expanding Indian single malt is a slow burn and the company is committed to the gradual ramp up.
- Management remains open to other opportunities, such as Nao Spirits, especially in the Craft segment; which it believes is a better way of building the portfolio. In addition to acquiring brands, the company has also activated sales of gin brands such as Tanqueray and Gordon from the parent portfolio.

Financials and valuations

Income Statement							(INR m)
Y/E March	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024E**
Net Sales	**81,269**	**89,322**	**90,565**	**78,652**	**93,441**	**97,924**	**1,00,633**
Other Operating Inc	432	484	344	240	376	0	0
Total Revenue	**81,701**	**89,806**	**90,909**	**78,892**	**93,817**	**97,924**	**1,00,633**
Change (%)	-4.4	9.9	1.2	-13.2	18.9	4.4	2.8
Gross Profit	**39,725**	**43,857**	**40,689**	**34,210**	**41,121**	**41,324**	**47,298**
Margin (%)	48.6	48.8	44.8	43.4	43.8	42.2	47.0
Other Expenditure	-29,446	-30,983	-25,608	-24,333	-26,256	-25,362	-28,882
EBITDA	**10,279**	**12,874**	**15,081**	**9,877**	**14,865**	**15,962**	**18,416**
Change (%)	5.9	25.2	17.1	-34.5	50.5	7.4	15.4
Margin (%)	12.6	14.3	16.6	12.5	15.8	16.3	18.3
Depreciation	-1,351	-1,445	-2,275	-2,493	-2,542	-2,542	-2,669
Int. and Fin. Charges	-2,675	-2,200	-1,907	-1,658	-893	-509	-255
Other Income	1,080	952	455	478	415	602	812
Profit before Taxes	**7,333**	**10,181**	**11,354**	**6,204**	**11,845**	**13,512**	**16,305**
Change (%)	26.3	38.8	11.5	-45.4	90.9	14.1	20.7
Margin (%)	9.0	11.3	12.5	7.9	12.6	13.8	16.2
Tax	2,433	3,416	3,445	1,587	2,734	2,338	4,109
Tax Rate (%)	33.2	33.6	30.3	25.6	23.1	17.3	25.2
Adjusted PAT	**4,900**	**6,765**	**7,909**	**4,617**	**9,111**	**11,175**	**12,196**
Change (%)	26.1	38.1	16.9	-41.6	97.3	22.7	9.1
Margin (%)	6.0	7.5	8.7	5.9	9.7	11.4	12.1
Non-rec. (Exp)/Income	717	-179	-862	-1,514	-1,413	0	0
Reported PAT	**5,617**	**6,586**	**7,047**	**3,103**	**7,698**	**11,175**	**12,196**

Balance Sheet							(INR m)
Y/E March	**2018**	**2019**	**2020**	**2021**	**2022**	**2023E**	**2024E**
Share Capital	1,453	1,453	1,453	1,453	1,453	1,453	1,453
Reserves	23,585	29,862	36,644	39,815	47,564	51,670	55,147
Net Worth	**25,038**	**31,315**	**38,097**	**41,268**	**49,017**	**53,123**	**56,600**
Loans	32,505	25,825	15,195	7,134	2,637	1,137	637
Deferred Tax Liabilities	-856	-1,878	-1,590	-1,711	-1,478	-1,478	-1,478
Capital Employed	**56,687**	**55,262**	**51,702**	**46,691**	**50,176**	**52,782**	**55,759**
Gross Block	13,561	16,406	19,315	20,093	20,978	21,978	22,978
Less: Accum. Depn.	-3,540	-5,124	-5,968	-7,085	-7,966	-10,508	-13,177
Net Fixed Assets	**10,021**	**11,282**	**13,347**	**13,008**	**13,012**	**11,470**	**9,801**
Capital WIP	980	1,171	1,187	865	897	897	897
Investments	2,775	2,984	2,526	2,021	4,390	4,390	3,890
Curr. Assets, L&A	**71,778**	**69,308**	**66,895**	**63,807**	**64,376**	**71,098**	**76,931**
Inventory	18,694	18,767	18,361	19,810	20,771	20,564	21,133
Account Receivables	26,998	25,181	22,835	21,601	23,021	26,829	27,571
Cash and Bank	1,198	588	345	553	328	1,062	169
Others	24,888	24,772	25,354	21,843	20,256	22,643	28,058
Curr. Liab. and Prov.	**28,867**	**29,483**	**32,253**	**33,010**	**32,499**	**35,073**	**35,759**
Account Payables	13,935	13,360	11,712	13,813	15,048	16,442	15,819
Other Liabilities	11,490	12,346	16,196	13,743	12,743	14,017	15,419
Provisions	3,442	3,777	4,345	5,454	4,708	4,614	4,522
Net Current Assets	**42,911**	**39,825**	**34,642**	**30,797**	**31,877**	**36,025**	**41,172**
Application of Funds	**56,687**	**55,262**	**51,702**	**46,691**	**50,176**	**52,782**	**55,759**

E: MOSL Estimates

Financials and valuations

Ratios

Y/E March	2018	2019	2020	2021	2022	2023E	2024E
Basic (INR)							
EPS	**6.7**	**9.3**	**10.9**	**6.4**	**12.5**	**15.4**	**16.8**
Cash EPS	8.6	11.3	14.0	9.8	16.0	18.9	20.5
BV/Share	34.5	43.1	52.4	56.8	67.5	73.1	77.9
DPS	0.0	0.0	0.0	0.0	0.0	10.0	6.0
Payout %	0.0	0.0	0.0	0.0	0.0	65.0	35.7
Valuation (x)							
P/E	133.2	96.5	82.6	141.4	71.7	58.4	53.5
Cash P/E	104.4	79.5	64.1	91.8	56.0	47.6	43.9
EV/Sales	1.9	1.7	1.6	1.7	1.4	1.3	1.3
EV/EBITDA	66.3	52.4	44.1	66.6	43.8	40.6	35.3
P/BV	26.1	20.8	17.1	15.8	13.3	12.3	11.5
Return Ratios (%)							
RoE	19.6	21.6	20.8	11.2	18.6	21.0	21.5
RoCE	11.6	14.7	17.3	16.8	25.4	26.6	29.7
RoIC	11.3	14.9	18.2	12.1	21.6	24.4	24.2
Working Capital Ratios							
Asset Turnover (x)	1.4	1.6	1.8	1.7	1.9	1.9	1.8
Leverage Ratio							
Debt/Equity (x)	1.3	0.8	0.4	0.2	0.1	0.0	0.0

Cash Flow Statement **(INR m)**

Y/E March	2018	2019	2020	2021	2022	2023E	2024E
OP/(loss) before Tax	8,403	9,914	11,347	4,690	10,240	13,512	16,305
Int./Div. Received	205	1,245	-559	1,887	2,248	-602	-812
Depreciation and Amort.	1,351	1,445	2,275	2,493	2,542	2,542	2,669
Interest Paid	1,708	1,775	1,626	1,428	377	509	255
Direct Taxes Paid	-3,898	-8,238	-5,658	-1,253	-4,463	-2,338	-4,109
Incr/Decr in WC	1,694	2,434	-2,361	8,036	-2,059	-3,413	-6,041
CF from Operations	**9,463**	**8,575**	**6,670**	**17,281**	**8,885**	**10,211**	**8,267**
(Incr)/Decr in FA	41	-656	-1,978	-1,062	-778	-1,000	-1,000
Free Cash Flow	**9,621**	**8,332**	**6,331**	**16,410**	**8,277**	**9,812**	**8,079**
(Pur)/Sale of Investments	213	319	0	0	-2,221	0	500
Other investing items	1,174	-142	599	993	554	196	-4,359
CF from Invest.	**1,545**	**-66**	**260**	**122**	**-2,275**	**-202**	**-4,047**
Issue of Shares	0	0	0	0	0	0	0
Incr/Decr in Debt	-7,902	-7,004	-5,572	-15,981	-6,558	-1,500	-500
Dividend Paid	0	0	0	0	0	-7,265	-4,359
Others	-2,431	-2,115	-1,601	-1,214	-277	-509	-255
CF from Fin. Activity	**-10,333**	**-9,119**	**-7,173**	**-17,195**	**-6,835**	**-9,274**	**-5,114**
Incr/Decr of Cash	**675**	**-610**	**-243**	**208**	**-225**	**734**	**-894**
Add: Opening Balance	523	1,198	588	345	553	328	1,062
Closing Balance	**1,198**	**588**	**345**	**553**	**328**	**1,062**	**169**

E: MOSL Estimates

NOTES

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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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