

United Spirits Ltd.

24th March 2023

Gearing Up Growth Levers

United Spirits Ltd. (USL) is India's biggest alcoholic beverage (alcobev) company. Its operations span from manufacturing Indian Made Foreign Liquor (IMFL) across all price points, from the Popular segment to Prestige and Above (P&A) division. It also imports and distributes Diageo's (parent of USL) brands as Bottled in India (BII) and Bottle in Origin (BIO) categories that form part of the P&A segment. Both BIO and BII, together, have a share of ~20-25% in the Company's business and form part of the P&A category. Owing to the trend of premiumization, the Company exited a major chunk of the declining Popular segment market by way of a slump sale and franchise agreement. During 9M FY23, the Company exited ~45% of Popular Net Sales Value (NSV) via slump sale and franchise agreement as a result, the P&A segment gained ~8% value share and ~17% volume. Consequently, P&A represented 88% NSV and 79% volume for the concurrent period. Apart from these initiatives, the Company has been renovating, innovating, and launching new products to commission the industry growth drivers. Owing to these factors, we initiate coverage on United Spirits Ltd. with a BUY rating and a target price of Rs. 887 (36x EV/EBITDA on FY24E EBITDA), suggesting an upside of 16%.

Numerous Growth Drivers

The Company has geared up several growth drivers, like expanding P&A volume up to ~80% of the portfolio and reducing the popular segment to ~20% in 9M FY23. Additionally, the Company has guided that the P&A segment may break out by growth rates higher than historic levels of ~7% in value and ~5% in volume. Further, the Company has been actively renovating old brands and introducing new brands. It anticipates that innovation and new launches will be critical for growth for the next 3-5 years.

Policies for Bottled In Origin (BIO) Becoming Favourable

BIO has been heavily tolled to keep foreign brands away from the access of the majority of customers. However, upon the Indian-UK Free Trade Agreement (FTA), it will get massive traction due to price reduction. USL will benefit the most as it is among the top players in BIO, which garners a ~25-30% return on invested capital.

A Management that is Excellent in Execution

After Diageo acquired ~56% stake in the Company, it has provided excellent management to the Company, starting from Mr. Anand Kripalu, who brought a quantum leap in the Company and delivered all guidance. Under his managing directorship, the Company underwent structural and productive changes that reduced debt by more than 96% in 9 years ending FY22 to Rs. 3 Bn. The Company changed its strategy to become asset-light by means of reducing subsidiaries, total manufacturing plants, etc. Even after Hina Nagarajan, who is growth-focused, took over, productivity and cost savings programs have been introduced to reap Rs. 1,300-1,500 Mn monetary benefits from FY26, resultantly increasing operating margins.

View & Valuation

We initiate coverage on United Spirits Ltd. with a BUY rating and a target price of Rs. 887 (36x EV/EBITDA on FY24E EBITDA), suggesting a ~16% upside.

BUY

CMP Rs. 764

TARGET Rs. 887 (+16%)

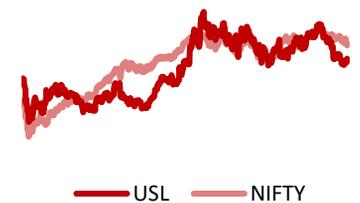
Company Data

MCAP (Rs. Mn)	5,50,858
O/S Shares (Mn)	727
52w High/Low	952/712
Face Value (in Rs.)	2
Liquidity (3M) (Rs. Mn)	806

Shareholding Pattern %

	Dec-22	Sep-22	Jun-22
Promoters	56.73	56.73	56.73
FII	15.98	16.07	16.76
DII	12.09	11.62	10.87
Non-Institutional	15.2	15.58	15.65

USL vs Nifty



Mar, 20	Mar, 21	Mar, 22	Mar, 23
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Source: Keynote Capitals Ltd.

Key Financial Data

(Rs Bn)	FY22	FY23E	FY24E
Revenue	97	107	111
EBITDA	16	16	18
Net Profit	8	11	10
Total Assets	101	115	124
ROCE (%)	14%	17%	18%
ROE (%)	18%	20%	15%

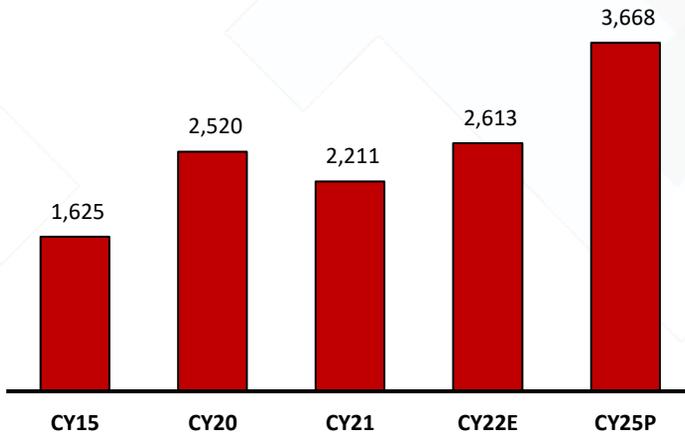
Source: Company, Keynote Capitals Ltd.

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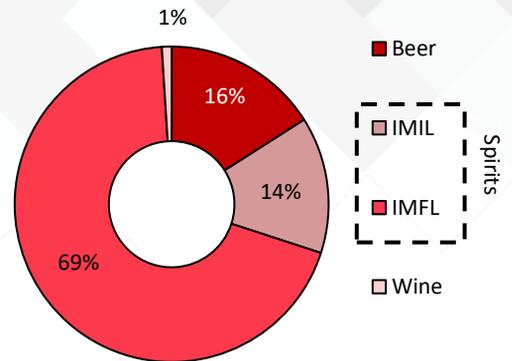
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Indian Alcobev Market

Market Size in Value (in Rs. Bn)



Alcobev Value Split (%) by Beverages in FY22E



Source: Sula Vineyards Ltd. DRHP, Keynote Capitals Ltd.

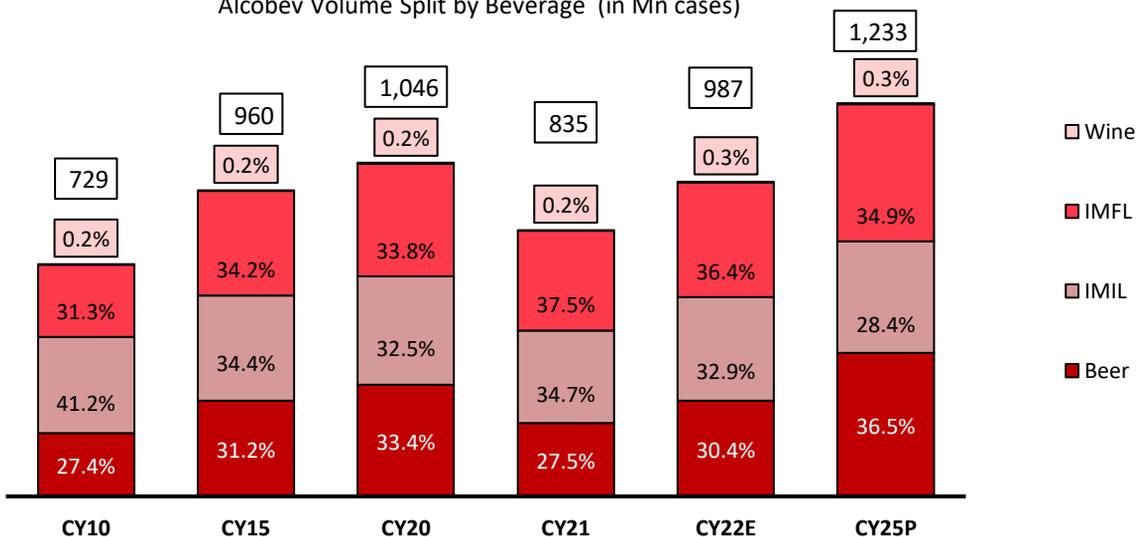
IMIL – Indian-Made Indian Liquor, also known as Country Liquor

IMFL – Indian-Made Foreign Liquor

Source: Sula Vineyards Ltd. DRHP, Keynote Capitals Ltd.

IMFL includes 2% of imported spirits

Alcobev Volume Split by Beverage (in Mn cases)

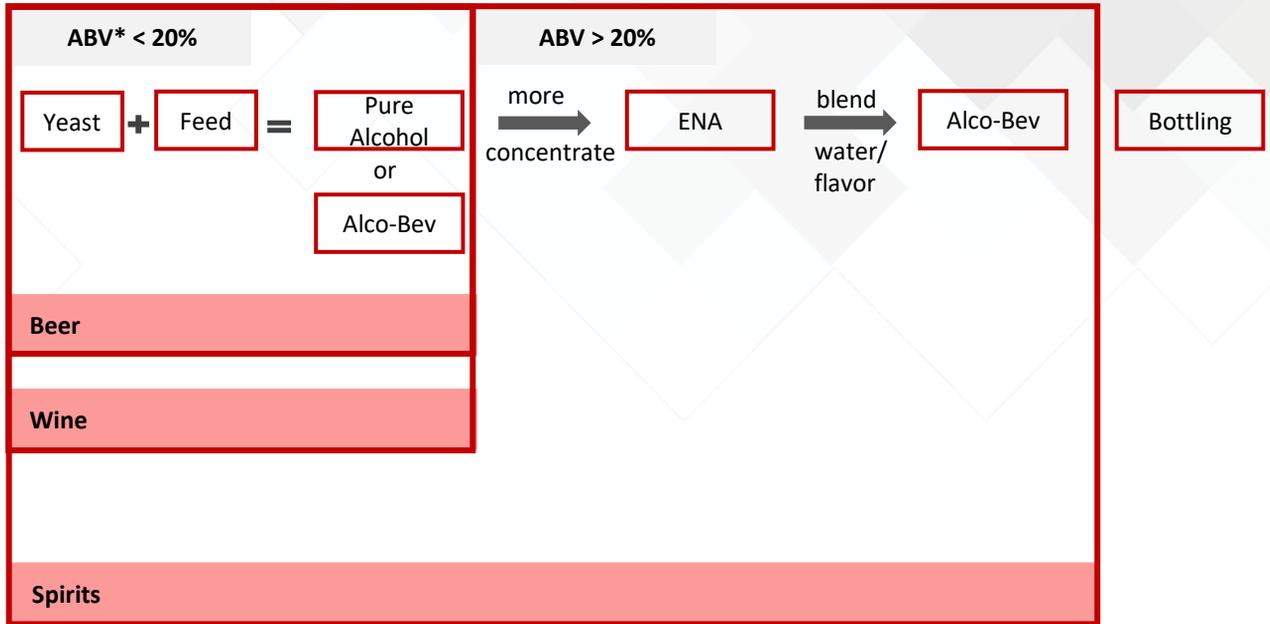


Source: Sula Vineyards Ltd. DRHP, Keynote Capitals Ltd.

India is the third largest alcobev, second largest spirits, and largest whisky and scotch market globally. India's alcobev market has three popular beverages: IMFL, IMIL, and beer. However, socio-economically, IMFL and beer make up India's market, representing ~85% of the value market as of FY22E.

The industry's place of consumption differs from country to country. While India and the USA generate 20% value from on-trade (bars, pubs, etc.) and 80% off-trade (at home), regions like Europe generate 40% on-trade. India's Gross Sales Per Case (GSPC) for the entire alcobev market has risen from ~ Rs. 1,700/case in CY15 to ~ Rs. 2,400/case in CY20 and is further anticipated to reach ~ Rs. 3,000/case by CY25E on the back of premiumization. The worldwide share of online purchases in the FMCG sector is estimated to be less than 10%, and online alcobev revenue is on the same line at ~7% in CY23E. However, country-wise data is dispersed with the USA at less than 2%, India at 0.5%, and China exceeding the world standard at 25% in CY23E.

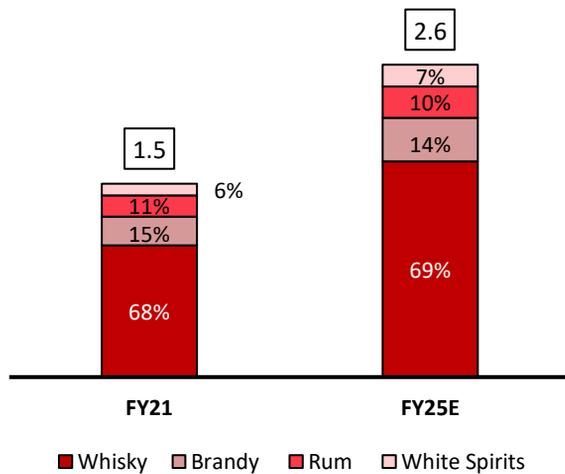
The Process Behind Soft and Hard Liquor



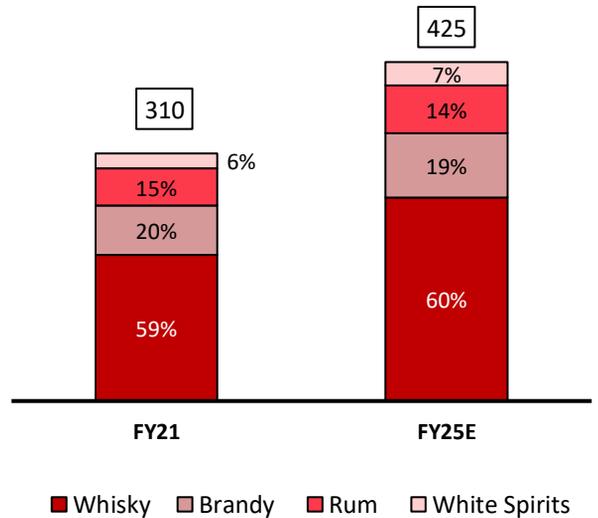
Source: Keynote Capitals Ltd. *ABV – Alcohol by Volume is a percentage of alcohol in a beverage, Feed – E.g., barley for beer, grapes for wine, and grains for spirits, ENA – Extra Neutral Alcohol is a form of more concentrated alcohol

IMFL Market

IMFL Value Split (Rs. Tn)



IMFL Volume Split (Mn cases)



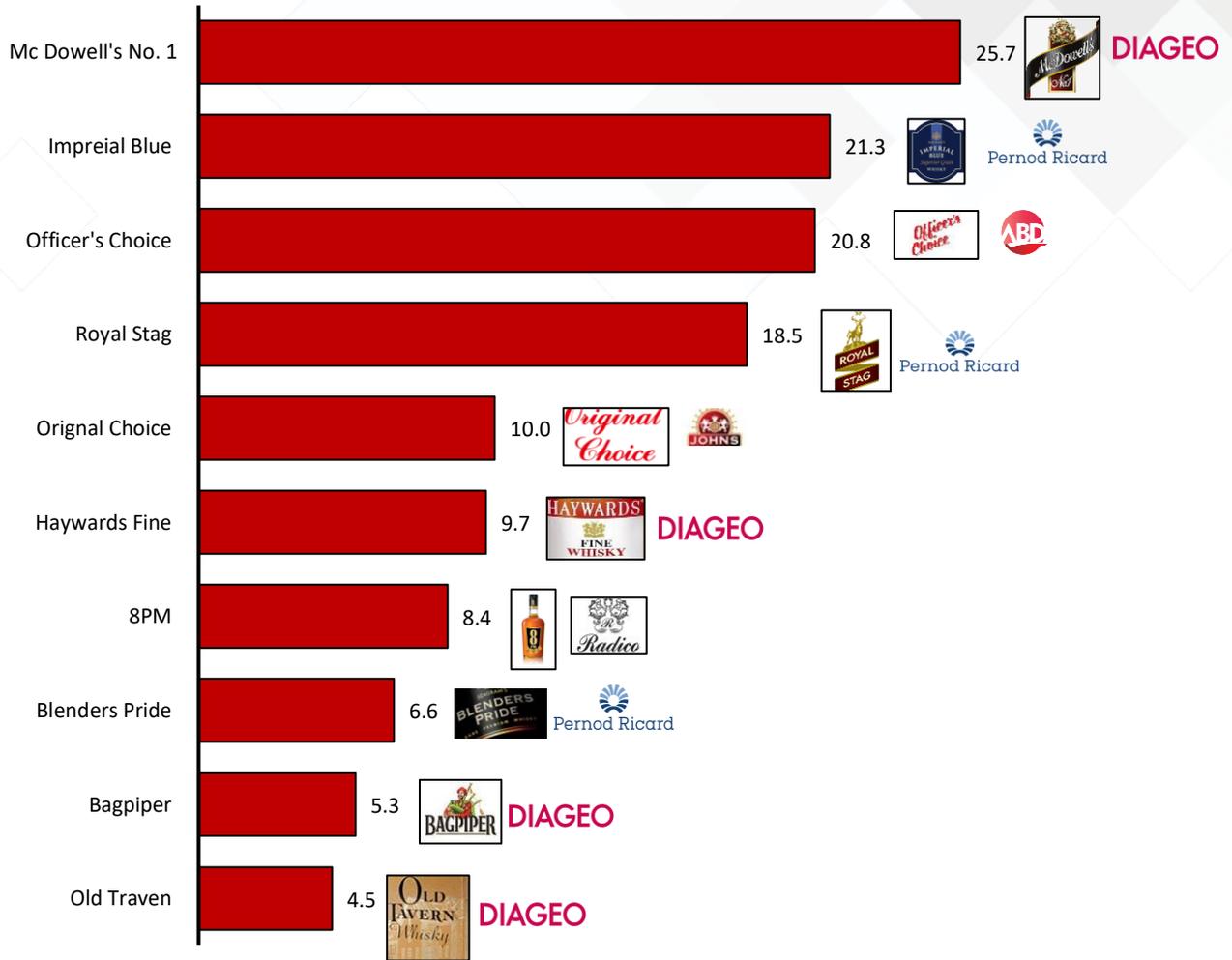
Source: Allied Blenders and Distillers Ltd. DRHP, Keynote Capitals Ltd.
USD converted at ~ INR 74 for FY21 and ~ INR 82 for FY25E

Whisky has the highest Gross Sales Per Case (GSPC) at Rs. 5,500, followed by white spirits at ~Rs. 4,800, brandy at ~ Rs. 3,600, and rum at Rs. 3,500. While whisky and white spirits are expected to undergo premiumization at a ~4% CAGR, brandy and rum are expected to lag at ~3.5-3.7%.

The gross sales split between the state governments and alcobev companies is around 65:35, which makes the net alcobev market at ~Rs 525 Bn in FY21, estimated to grow at ~4% to reach ~ Rs. 900 Bn in FY25E.

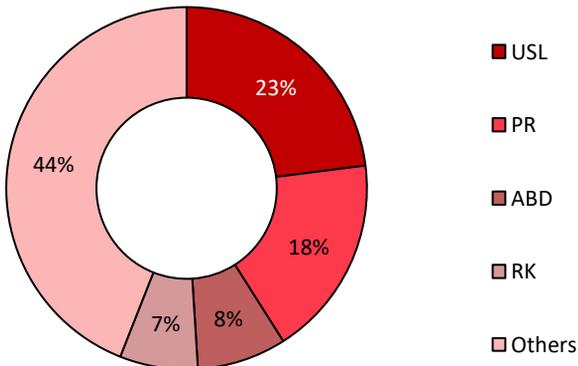
Indian Whisky Brands

India's Top Millionaire Brands in CY20 (Volume in Mn cases)



Source: Technopak Advisors Pvt. Ltd., Keynote Capitals Ltd.

Spirits Volume Market Share in FY21 (%)



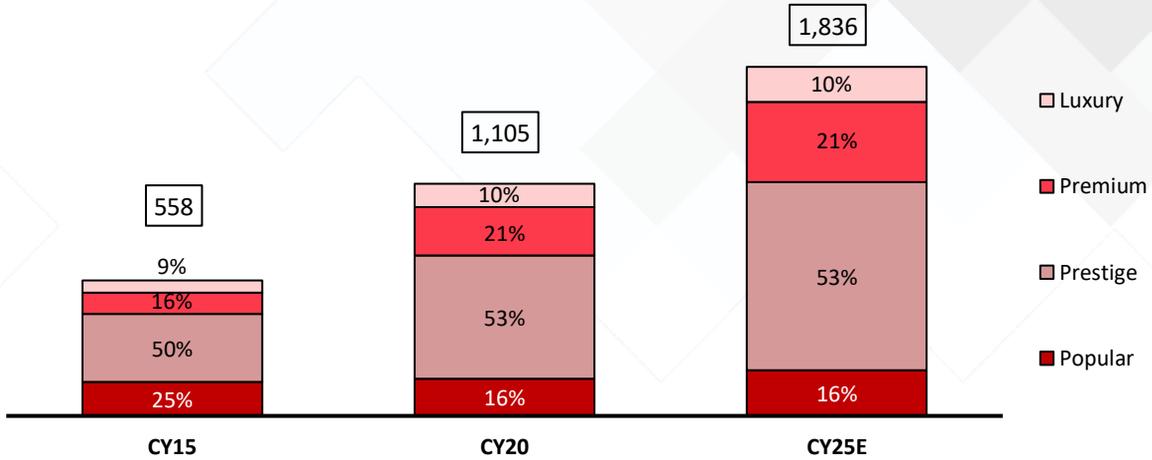
Source: Allied Blenders and Distillers Pvt. Ltd., Keynote Capitals Ltd.

USL – United Spirits, PR – Pernod Ricard, ABD – Allied Blenders and Distillers, RK – Radico Khaitan

Among the top 10 brands that sold more than a million cases in CY20, USL, and PR had 4 and 3 brands, respectively. While the top two companies have foreign promoters, ABD and RK are the biggest India-promoted spirits companies.

Indian Whisky Market – More than Two-Third Spirits Market

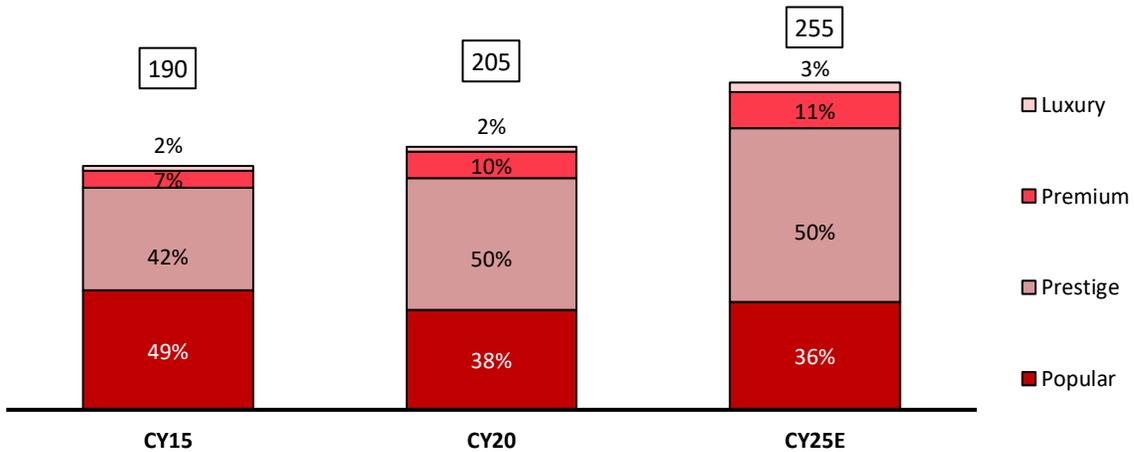
Whisky Price-Based Market Segment Value (Rs. Bn)



Source: Technopak Advisors Pvt. Ltd., Keynote Capitals Ltd.

USD-INR exchange rate for the years – CY15(64.13), CY20(74.13), CY25E(82)

Whisky Price-Based Market Segment by Volume (in Mn cases)



Source: Technopak Advisors Pvt. Ltd., Keynote Capitals Ltd.

The Whisky Market – Divided and Driven by Price

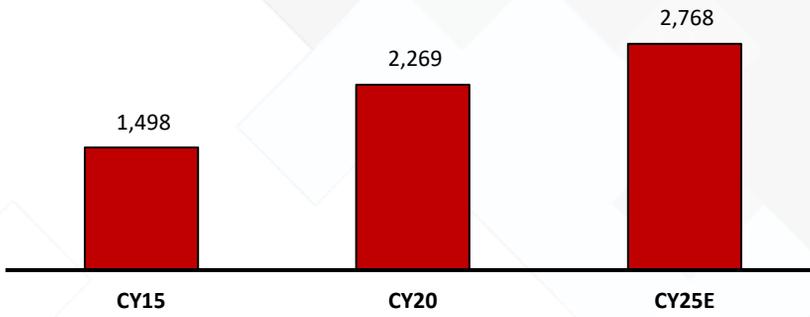
Like all other hard liquors, whisky, the king of spirits with ~60% volume and ~68% value share, is present across all price points starting from Popular (upto Rs. 450) followed by Prestige (Rs. 450-1,000), Premium (Rs. 1,000-2,200) and Luxury (> Rs. 2,200*).

* The prices mentioned are for Karnataka

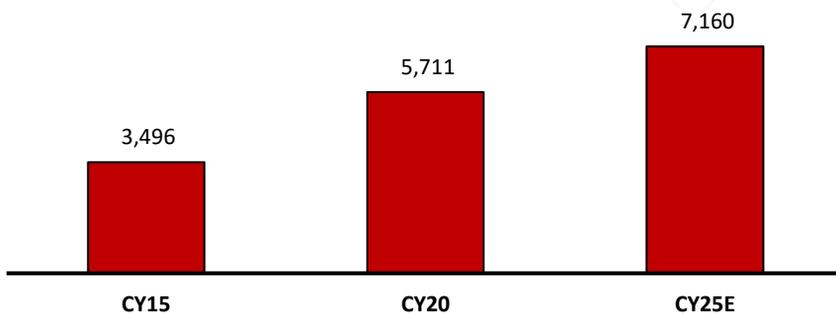
Whisky also includes imported scotch, a kind of whisky that is made in Scotland. Its volume contribution to total whisky consumption is ~2%, and because of its high-end prices, it becomes part of the premium and luxury segment. The split between BIO and BII is ~20:80. However, despite BII being the biggest section of the imported scotch volume, only some of it is bottled, while the majority is mixed in different whiskies, a spoonful at a time.

While all the segments have been prospering under the trend of premiumization, the Popular segment has been declining in volume and value.

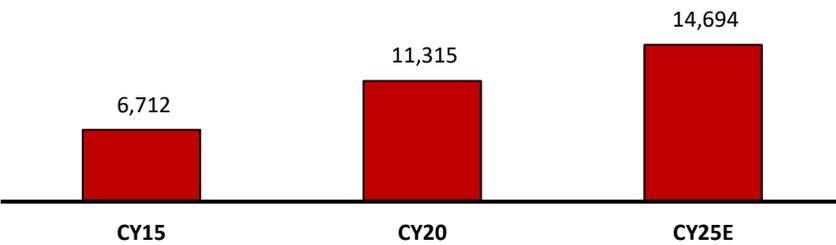
GSPC of Popular Segment (in Rs.)



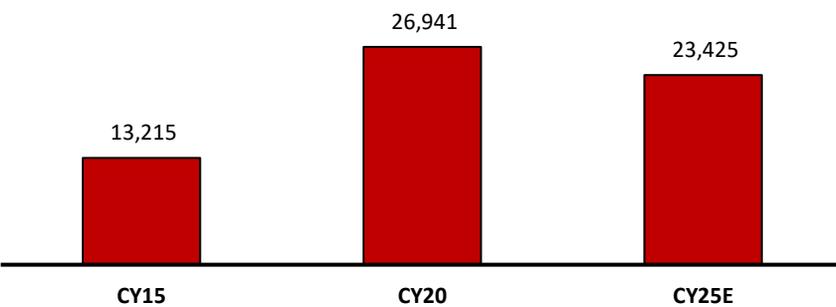
GSPC of Prestige Segment (in Rs.)



GSPC of Premium Segment (in Rs.)



GSPC of Luxury Segment (in Rs.)



Source: Technopak Advisors Pvt. Ltd., Keynote Capitals Ltd.

In the coming years, it is expected that the Luxury segment will be adopted more by customers, leading to volume growth greatly by exceeding value growth. As a result, the GSPC of the Luxury segment for CY25E is expected to drop by ~13% over the base of CY20.

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Segments and Brands

Price for 750 ml	United Spirits	Pernod Ricard	Allied Blenders and Distillers	Radico Khaitan
Popular (< Rs. 450)	Mc Dowell's No. 1	NA	Officer's Choice	8 PM, After Dark
Prestige (Rs. 450-1,000)	Mc Dowell's No. 1	Imperial Blue	Sterling Reserve B7	Whytehall
Premium (Rs. 1,000-2,200)	VAT 69 (BII), Black Dog (BII)	Royal Stag	Sterling Reserve B10	-
Luxury (> Rs. 2,200)	Johnnie Walker (BIO), Godwana	Chivas Regal (BIO), Glenlivet (BIO)	NA	Rampur, Royal Ranthambore

Source: Respective companies, Keynote Capitals Ltd.
NA is Not Applicable

India-UK Free Trade Agreement (FTA) – An Instigator

India has been guarding its liquor market against foreign players with its high and protective import duties for a very long time. In 2007, India slashed import duties from more than 600% to 150%, and since then, it has remained stagnant in the import tariff system.

To open and expand the liquor market, lately, India and the UK have been in talks to prepare a win-win arrangement for players in both camps. An eighth round of discussion was scheduled for March'23 to conclude and bring more clarity to the agreement.

An FTA with the UK for liquor trade is crucial as India is the largest country by volume and fifth largest by value for scotch whisky worldwide (as of CY22).

Indian Spirits and Wines Association of India (ISWAI), a representative of companies like Pernod Ricard, Diageo-United Spirits, Bacardi, Suntory, Brown-Forman, etc., has proposed to cut down tariffs from 150% to 100% in the first year, followed by 50% and 30% in the consecutive years.

According to Mark Kent, Chief Executive, Scotch Whisky Association, Scotland, the export value to India can rise from £ 282 Mn in CY22 to £ 1 Bn in five years post the execution of FTA.

The imported scotch, which accounts for ~2% of whisky volume in India, is anticipated to take 6% of the market on the back of this FTA. Resultantly, BIO brands would be priced equal to or less than BII and other domestic peers. When BIO and BII will become more affordable, premium and luxury domestic brands are expected to face headwinds. While players like Amrut Distilleries are concerned about the change that FTA will bring, companies like Radico Khaitan are interested in commissioning the premiumization trend, placing Royal Ranthambore at Rs. 2,700* up against BIO brands like Johnnie Walker Red Label (Diageo) and Ballentine's (Pernod Ricard) at Rs. 2,100*.

* The prices are for Maharashtra

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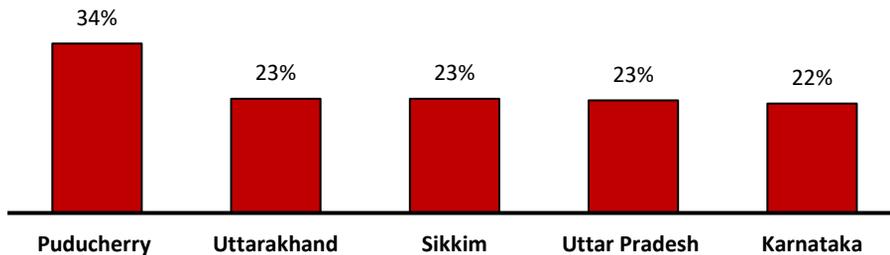
The State of Regulations in the States

In India, the state governments use their discretion to regulate alcohols within their territories. These mandates include production, pricing, taxation, storage, and movement.

Excise Duty

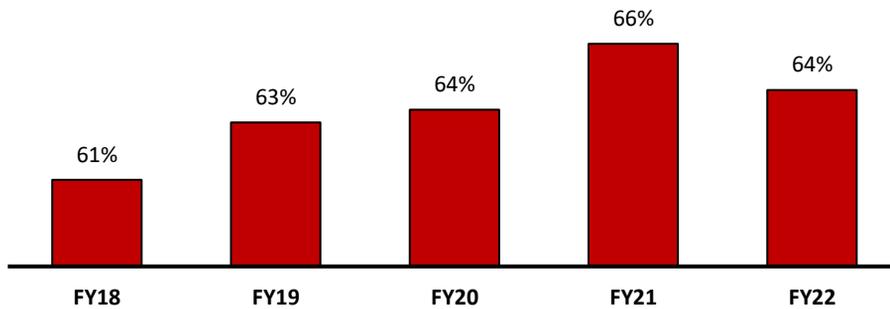
The power to regulate and tax alcohols is vested with states. Excise duty is among the top 3 revenue streams for the states. Due to varying taxes across states, the same alcohol is available at different rates. For example, Ballentine's by Pernod Ricard is priced at ~Rs. 1,500 in Delhi and Rs. 3,500 in Karnataka.

States with Highest Share Excise Duty in Own Tax Revenues in FY22
(Revised Estimates)



Source: RBI, Keynote Capitals.

Industry's Excise Duty as a Percentage of Gross Revenue



Source: Company, Keynote Capitals.

Industry Average is calculated using data of United Spirits Ltd, Pernod Ricard India, Allied Blenders and Distillers, Radico Khaitan, and United Breweries Ltd. Only Allied Blenders and Distillers data is for the period FY17-21.

Price Revisions

The second key challenge that follows is the latent and different frequency of revising selling prices. The general price revision interval is one year. However, price updates can be prolonged for 3-4 years in some states like Kerala and Telangana. Conversely, states like Maharashtra may also welcome new prices in the same year.

Route-to-Market (RTM) Changes

In India, the state governments use their discretion to regulate alcohols within their territories. These mandates include activities like production, pricing, storage, movement, and final consumption. Recently, states like Delhi, West Bengal, and several others have undergone RTM changes.

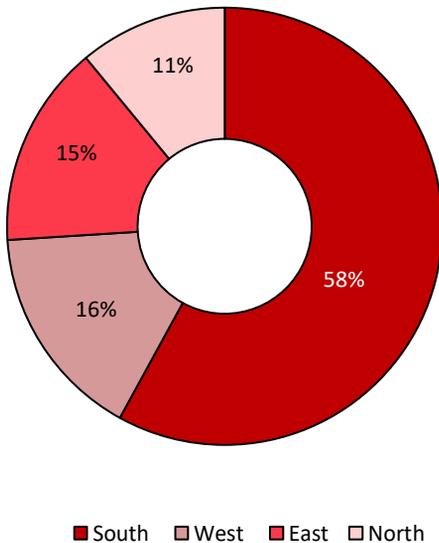
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Market Structure	Description for Distributor	Route to Market (RTM)	Pricing Power with Manufacturer	E.g. of States
Free / Open Market	Apply and get license	Manufacturer > Distributor (P) > Retailer (P)	High	Maharashtra, Goa, Assam
Auction Market	Highest bidder gets the position	Manufacturer > Distributor (P) > Retailer (P)	Medium	Chandigarh, Haryana, Punjab
State-owned / Government Corporations	Govt. itself or set up a corporation distributes	Manufacturer > Distributor (G) > Retailer (P/G)	Low	Chhattisgarh, Delhi, Punjab, Karnataka, Kerala, etc.
Prohibition	Liquor is banned	NA	NA	Bihar, Gujarat

Source: Radico Khaitan Ltd., Keynote Capitals Ltd.
(P) Is Private, (G) is Govt. or Govt. set up corporation

Regional Consumption Pattern in India

IMFL Consumption Split by Region (%)

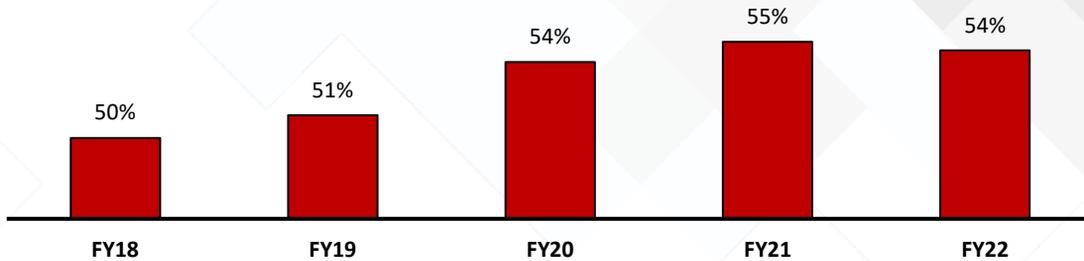


Source: Technopak Advisors Pvt. Ltd., Keynote Capitals.

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Raw Material Analysis

Industry Average COGS as a percentage of Net Sales Value (NSV) (%)



Source: Company, Keynote Capitals.

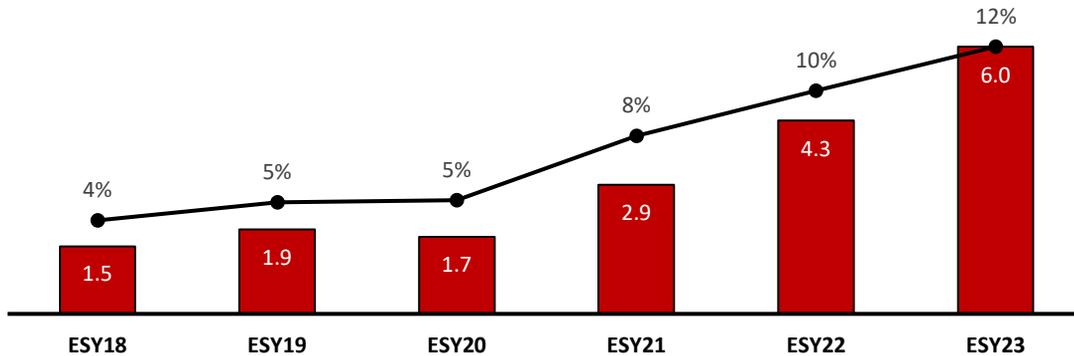
Industry Average is calculated using data of United Spirits Ltd, Pernod Ricard India, Allied Blenders and Distillers Pvt. Ltd. and Radico Khaitan Ltd.

Allied Blenders and Distillers data is for the period FY17-21

Primary raw materials used by distilleries are ENA and glass, and secondary raw materials are gas and packaging materials.

The most crucial component ENA has risen over the years primarily because of cross elasticity of demand for ethanol. India is an ethanol deficit country and needs ~10 Bn liters of ethanol by Ethanol Supply Year (ESY) 2025 to accomplish the Ethanol Blending Policy (EBP) of 20% (E-20, 20% ethanol, and 80% petrol).

Rising Ethanol Supply (in Bn Liters)



Source: Balrampur Chini Mills Ltd, Niti Aayog, Keynote Capitals Ltd.

ESY – Ethanol Supply Year (1st Nov to 31st Oct)

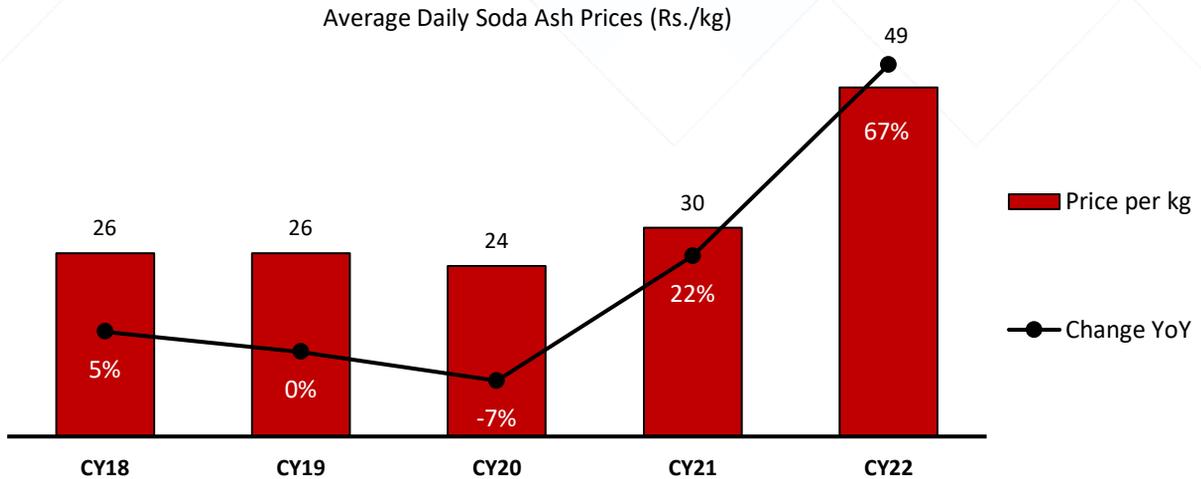
India achieved an average ethanol blending rate of 10% in June 2022. The government has been granting more ethanol projects at subsidized interest rates to promote ethanol supply and equilibrate with its demand.

Before the ethanol blending policy was braced, India had been an ENA-surplus country, making it a buyer's market. However, ENA capacity diverting towards ethanol turned the market in the seller's favor. In addition to the ongoing ENA price hikes, grain inflation caused by the Russia-Ukraine war propped up the prices. Nonetheless, companies like USL find ENA inflation to be a short-term phenomenon.

Currently, molasses-based ENA is between Rs. 55-58 per kg and grain-based ENA is at around ~Rs. 62 per kg.

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Glass price is surging on the back of its raw materials like soda ash, furnace oil, Liquefied Petroleum Gas (LPG), etc. The price of an LPG cylinder was Rs. 899 on March 1, 2022, and it went up to Rs. 1,103 on March 1, 2023, implying a 22% inflation. India imports over 60% of its domestic LPG consumption. The two-year average Saudi Contract Prices, on which domestic LPG prices are based, increased from ~\$ 454/MT (CY19-20) to ~\$ 693/MT (CY21-22), implying inflation of ~53%. These prices were increased further to ~\$790/ MT in February '23. Other raw materials, like paper, PET (polyester), etc., have started to soften.



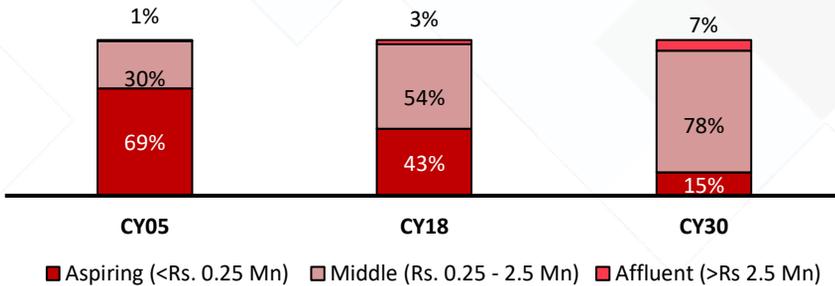
Source: Bloomberg, Keynote Capitals.
Prices are for Mumbai, India

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Growth Drivers of the Industry

Rising Household Income of India

Rising Household Income



Source: Company, Keynote Capitals Ltd.

A study by Knight Frank covered by Fortune India estimates a 63% growth in the number of Ultra High Net-Worth Individuals (UHNIs) from CY21 to CY25.

Increase in Per Capita Alcohol Consumption (Liters)

India's per capita is among the lowest in the world. In CY21, the per capita alcohol consumption of USA was ~100 liters, China's was 42 liters, and India's was ~12 liters. While the world average stood at ~52 liters, India has a huge room to grow.

Other Drivers

- **The structural change in the Industry**– The market is becoming an hourglass, where the popular segment is at the center and declining. Customers at the upper end of the popular segment are up-trading to prestige. Those in the prestige are further up-trading to premium and luxury brands. The customers at the lower end of the popular segment are moving down to IMIL, which is becoming branded from previously non-branded. Premiumization is happening not just in India but worldwide.

In CY22, the USA recorded more than 60% of the revenue of the spirits sector from sales of higher-end and super-premium spirits. In CY21, India received around 30% of revenue from sales of premium and luxury brands.

- **Increase in target market** – India has a median age of 28 years, which makes it the youngest country among the top 10 economies of the world. Besides having the youngest population, India is estimated to add around 100 Mn people to the legal drinking age group by CY25.
- FTA with the UK for spirits and Australia for wine.
- Increase in women drinkers.
- Reduction in social taboo on alcohol consumption.

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About Company

United Spirits Ltd. (USL) is a Diageo-promoted company with a ~ 56% stake. USL is the largest alcohol company in India with ~23% market share in the spirits industry as of FY21.

The Company is into manufacturing, sales, and distribution of spirits. It sells around 80 brands across whisky, brandy, rum, vodka, gin. Some of these brands, like McDowell's No. 1, Royal Challenge, Signature, Antiquity, and Black Dog, are produced in India, whereas others, like Captain Morgan, VAT 69, Johnnie Walker, etc., are imported from Diageo Plc, UK. In addition to this, the Company recently launched a beer product in FY22. The Company has more than 39 manufacturing facilities pan-India and over 60,000 active outlets.

Evolution in Words

Agnus McDowell established McDowell's & Co. in 1826 as a trading company that imported liquor, tobacco products, etc., to serve the needs of the British residing in India.

In 1951, United Breweries acquired the Company. A few years later, in 1959, the Company established the first distillery in India and became the pioneer to manufacture IMFL. Around a decade later, in 1968, the Company's signature product McDowell's No. 1 whisky, was launched. The Company grew leaps and bounds over the next semi-century and recorded an NSV of Rs. 92 Bn in FY12.

Between 2013-14, Diageo Plc. acquired ~56% stake in the Company in a staggered manner. The new promoter broke with the past and undertook steps to make the Company debt-free, asset-light, cost-efficient, and more agile.

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About - Diageo

Diageo is a British multinational alcohol company headquartered in London, United Kingdom. The promoter is present in over 180 countries, with over 200 brands across spirits, wine, and beer.

The promoter company is among the leading global spirits companies in the world, along with French Pernod Ricard, American Brown-Forman, Chinese Kweichow Moutai, etc.

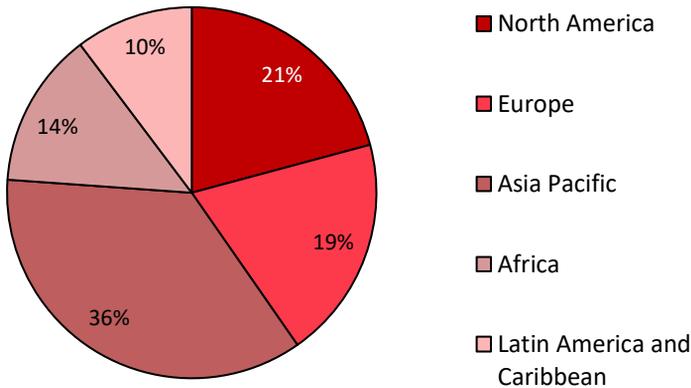
The promoter company's signature brands in spirits are Johnnie Walker, Tanqueray, Captain Morgan, Smirnoff, Gordon's gin, etc.

In the Total Beverage Alcohol (TBA) market, Diageo holds ~4% as of CY20 and aspires to capture ~6% TBA by CY30.

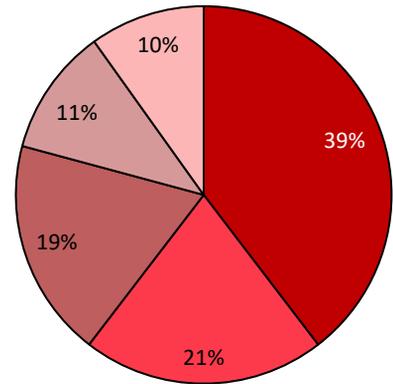
Diageo is a world leader in scotch whisky with ~37% share in CY22, whereas the second largest player in the industry has ~20% market share.

The promoter company is an excellent practitioner of productivity. From FY19 to 22, it saved ~ £ 1.6 Bn, ~10% of cumulative operating profit before exceptional items.

Volume Split by Region in CY22 (%)



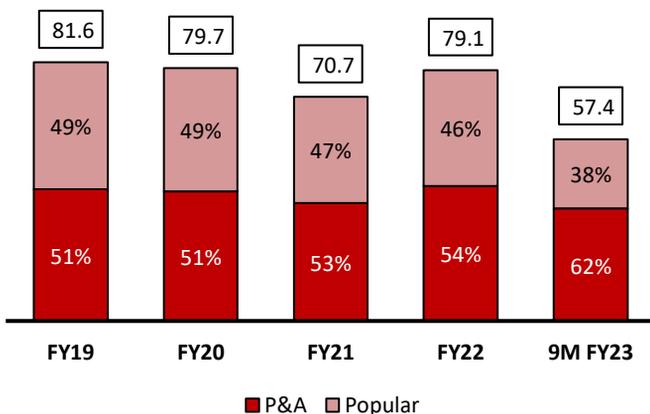
Net Sales Split by Region in CY22 (%)



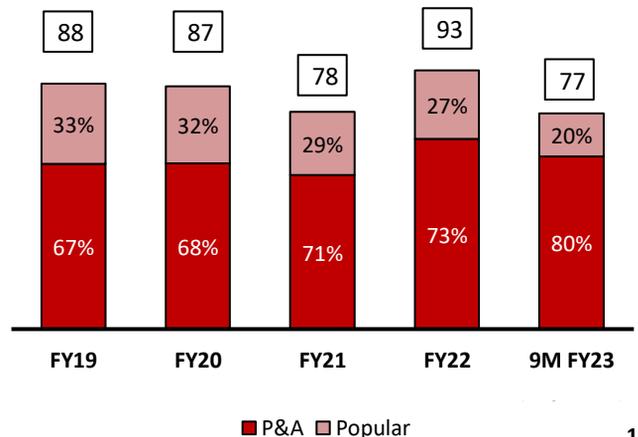
Source: Diageo, Keynote Capitals Ltd.

USL's Product Segments

Volume Sold (in Mn cases)



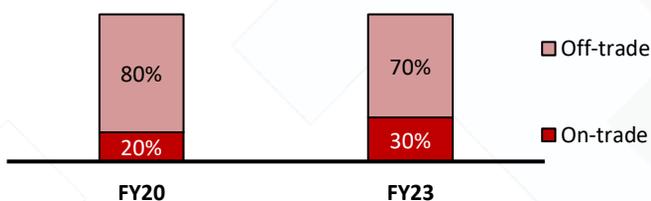
Net Sales Value Split (Rs. Bn)



Source: Company, Keynote Capitals Ltd.

Distribution Model

NSV Split by Distribution of Products (%)



Source: Company, Keynote Capitals Ltd.

Renovation and New Launches

Year	Brands	Description
Renovations		
FY21	Royal Challenge Whisky	Improved liquid and packaging
FY21	McDowell's no. 1 Whisky	Improved liquid and packaging
FY22	Black Dog	Introduced 14-Year-Old variant and Super Gold Reserve
FY22	Signature	Crafted 100% from natural ingredients
New Launches		
FY20-23	Hipster introduced for Black Dog, Black and White, VAT69, Smirnoff vodka, J&B whisky, etc.	Pocket-size packaging
FY22	Royal Challenge American Pride	Bourbon-based IMFL
FY22	Epitome Reserve	A 100% rice grain IMFL whisky
FY22	Guinness	Beer launched in India
FY23	Godawan	India's first crossed single malt
FY23	Johnnie Walker Blonde	Light-scotch (BIO) from the house of Johnnie Walker
Minority Acquisition in Nao Spirits in FY22		
FY22	Hapusa Gin	An IMFL made of Himalayan shrub – juniper
FY22	Greater than Gin	A London dry gin

Source: Company, Keynote Capitals Ltd.

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All the products have been very well received by the market. Mc Dowell's No. 1 and Black Dog were among the products to see stellar traction within the first year of its launch. With improved mixes, the Company is able to charge a premium over the competitive brands. This helps improve margins and mitigate inflation.

The Company boosts awareness and sales of these products via surrogate advertisements and promotion. Between FY21 and 9M FY23, the cumulative A&P spend has been ~Rs. 18 Bn or ~7% of NSV for the corresponding period. The Company has guided that innovations and new launches will play a material role in fetching growth in the next 3-5 years.

Foraying Into the Future - Sale of Popular

The Company sold 32 brands of its Popular segment in a slump sale for Rs. 8,200 Mn (1.08 times P/S) to Inbrev Beverages Pvt. Ltd. (IBPL) in Q2 FY23. This included brands like Hayward, Old Traven, White Mischief, Honey Bee, etc. Further, the Company entered into a five-year franchise agreement for 11 brands and granted rights to IBPL to convert the fixed-term franchise agreement or acquire the brands upon fulfilling certain conditions. The purchase of the 11 brands is offered for Rs. 13,310 Mn, of which Rs. 12,930 is supposed to be paid at the time of exercising the option, while the remaining Rs. 370 Mn during the assignment of the brands. The payment deposit is arranged equally between the 6th and 10th year or 20 quarters.

Agreement	No. of Brands	Brands
Slump Sale	32	Amber, Black Stallion, Bombay Deluxe, Derby, Diplomat, Doctor's Brandy, Doctor's Special, Doctor's Day and Night, Golconda, Gold Medal, Golden Grape, Green Label, Haywards, Honey Bee, JohnExShaw, Joi De Franc, Kerela Malted, Kissan, Louis Vernant, Louis 30, Majestic, Men's Choice, Men's Club, Old Traven, Old Adventurer, Royal Crest, Romanov, VIN, White Mischief, French VSOP, Bonaparte VSOP, and Tiger
Franchise	11	Bagpiper, Black Riband, Blue Riband, Carew's, Duet, Gold Riband, Old Cask, Red Riband, Silk Riband, Silver Riband and White Riband

Source: Company, Keynote Capitals Ltd.

The Company's parent Diageo had performed a similar transaction in North America wherein they sold 17 tail brands to Sazerac Company and triggered growth in the product portfolio. Aside from these brands, the Company retains brands like Mc Dowell's No. 1 and Director's Special, equal to ~42% of NSV share.

FY22	Pre-Slump Sale	Post-Slump Sale
Volume	79 Mn cases	56 Mn cases
NSV	Rs. 93 Bn	Rs. 80 Bn
P&A NSV Share*	74%	85%
Popular Brands	47	15

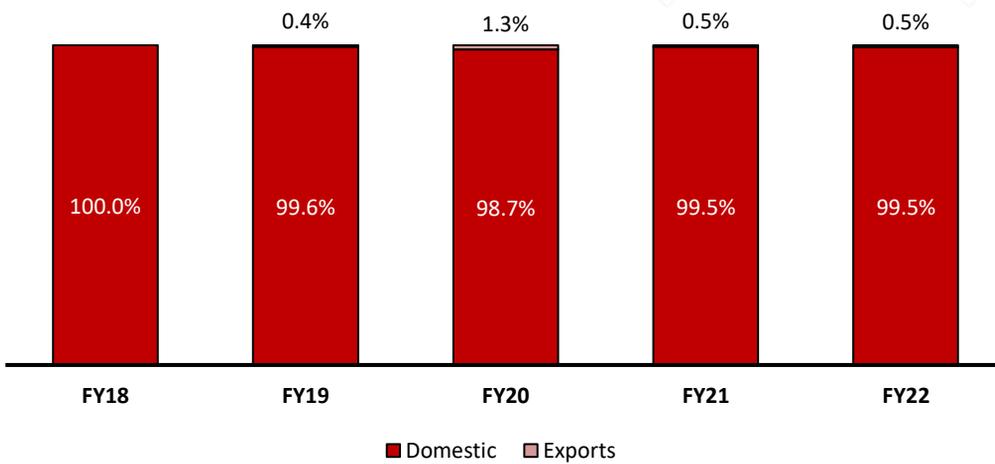
Source: Company, Keynote Capitals Ltd.
P&A NSV Share is calculated ex. Other Income
The above figures are standalone

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Both legs of the transaction – the slump and franchise – are a hybrid of two models: (1) direct and serve and (2) franchise. From the former model, the Company made 11-12% EBITDA margins, while the royalty from the franchise side, which directly went from NSV to EBITDA, increased the margins to 14-15%. Irrespective of healthy profitability, the Company decided to pursue the P&A segment, which is the industry's future, and pass on the popular segment, which is a healthy (in terms of operating margins) but declining industry. The Company expects to recoup the lost NSV of Rs. 7,600 Mn in the slump sale in the next 4-6 quarters.

India is the Sole Destination for USL's Business

Gross Sales Split by Region (%)

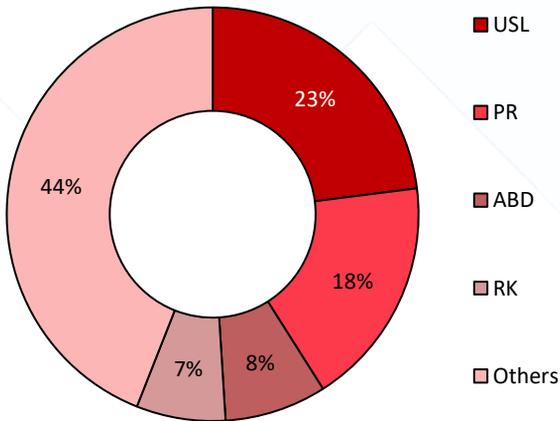


Source: Company, Keynote Capitals Ltd.

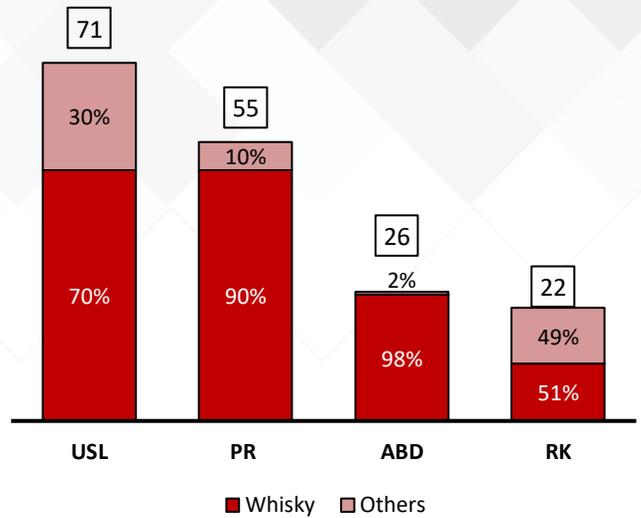
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Peers – Operating Metrics

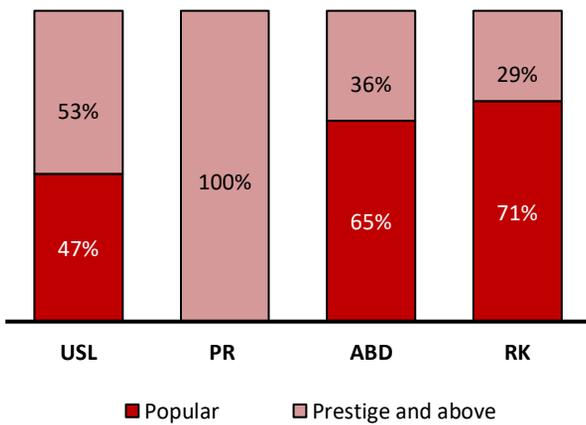
Volume Market Share (%) in FY21



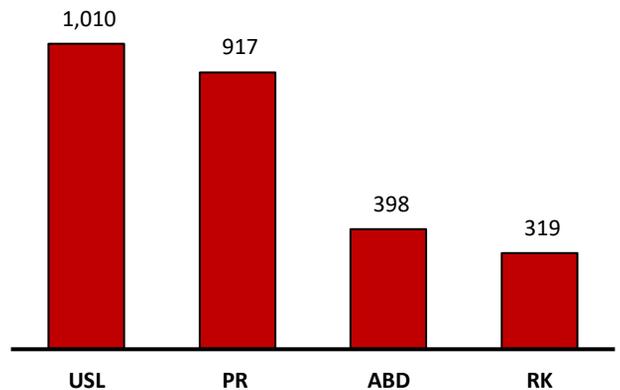
Volume Sold in FY21 (in Mn cases)



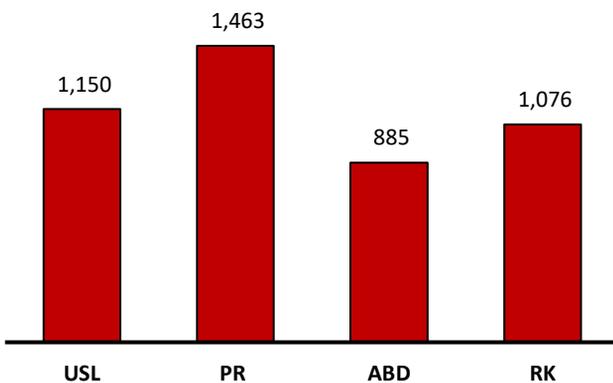
Segment Concentration in Volume Sold in FY21 (%)



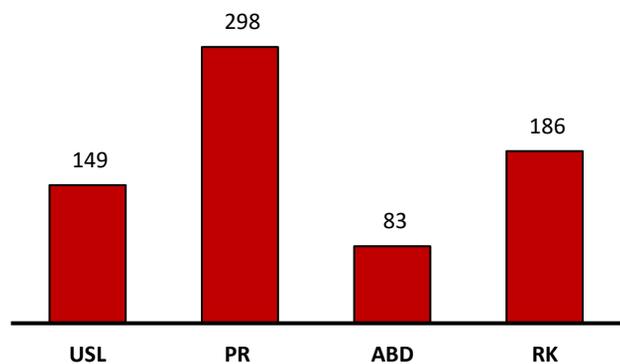
Volume Sold Per Outlet in FY21 (in cases)



Realization Per Case in FY21 (Rs.)



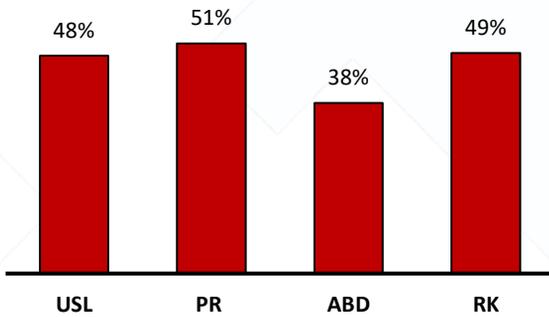
EBITDA Per Case in FY21 (Rs.)



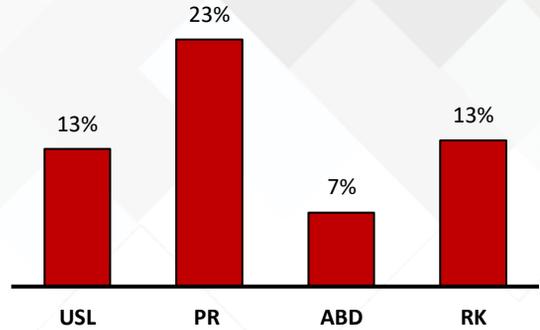
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Peers – Financial Metrics

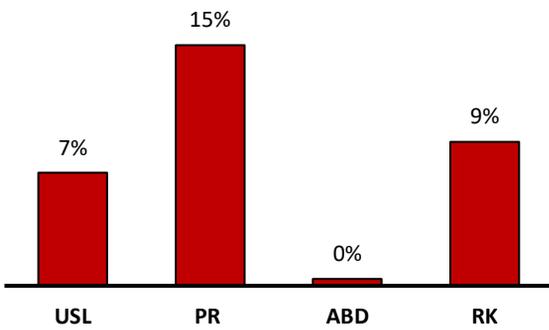
Five-Year Average Gross Margin (%)



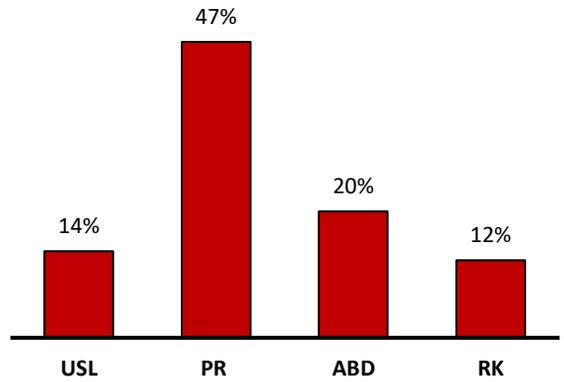
Five-Year Average Operating Margin (%)



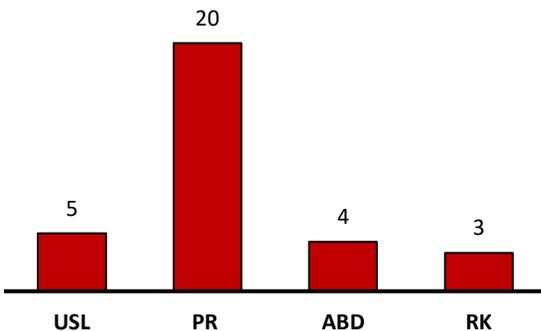
Five-Year Average Profit Margin (%)



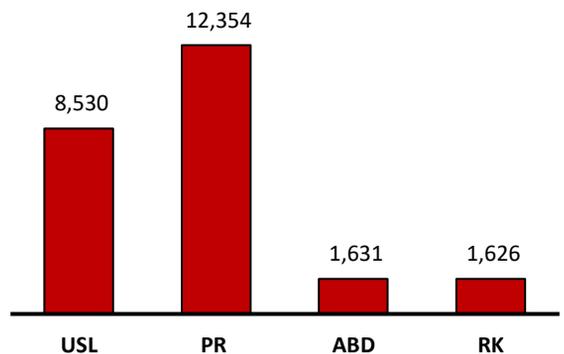
Five-Year Average ROCE (%)



Five-Year Average Fixed Asset Turnover (FAT in times)



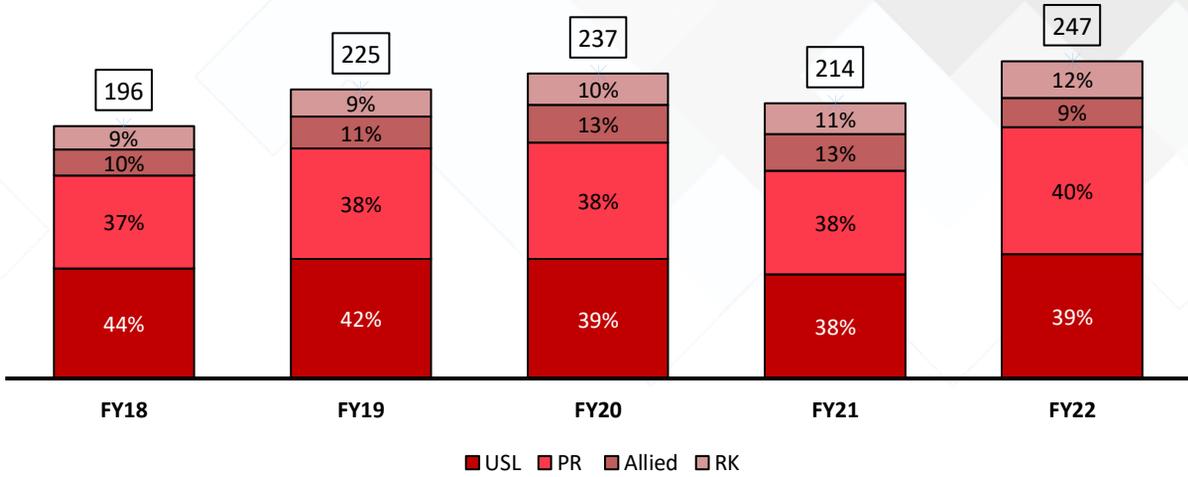
Five-Year Average FCFF (Rs. Mn)



PR has the highest FAT because it is an extremely asset-light company. Its average (FY18-22) share of fixed asset to total assets has been ~8%, while USL has ~20%, ABD and RK at 31%.

Source: Company, Allied Blenders, and Distillers Ltd. DRHP, Keynote Capitals Ltd.
The data period for ABD is FY17-21, and for USL, PR, and RK is FY18-22

NSV Split Between Peers (Rs. Bn)



Source: Company, Allied Blenders and Distillers Ltd. DRHP, Keynote Capitals Ltd.
 Data Period for ABD is FY17-21, and for USL, PR and RK is FY18-22

Management Analysis

The Management team of USL consists of industry veterans who bring immense expertise and relevant experience of working with large entities.

Name	Designation	Previous Associations	Experience with USL (Yrs.)
Hina Nagrajan	Managing Director and CEO	Managing Director, Diageo Africa Emerging Markets	2 years
Pradeep Jain	Chief Financial Officer	CFO at Pidilite Industries Ltd, Several Senior positions at PepsiCo Asia	6 years
Mahendra Kumar Sharm	Chairman and Independent Director	NA	6 years

Source: Company, Keynote Capitals Ltd.

Promotor Holding and Management Compensation

Particulars	FY20	FY21	FY22	Q3 FY23
% Promoter Holding	56.76%	56.76%	56.73%	57%
MD's salary (Rs Mn)	234	137	358*	-
As a % of PAT	3.5%	3.6%	4.3%*	-

Source: Company, Keynote Capitals Ltd.

* Includes remuneration of Hina Nagrajan and Anand Kripalu

Shareholders holding > 1%

Stakeholders	FY20	FY21	FY22	Q3 FY23
USL Benefit Trust	2.38%	2.38%	2.38%	2.38%
Aditya Birla Sun Life Trustee Pvt. Ltd.	-	1.15%	-	1.61%
Government of Singapore	-	-	-	1.06%
Deputy Director, Directorate of Enforcement, Mumbai	1.72%	1.72%	-	-
Franklin India Flexi Cap Fund	-	1.04%	-	-
ICI Prudential Life Insurance Company Ltd.	-	1.53%	1.05%	-
Motilal Oswal Most Focused Fund Multicap 35 Fund	1.15%	-	-	-
Total 1% and above holding	5.25%	7.82%	3.43%	5.05%

Source: Company, Keynote Capitals Ltd.

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Opportunities

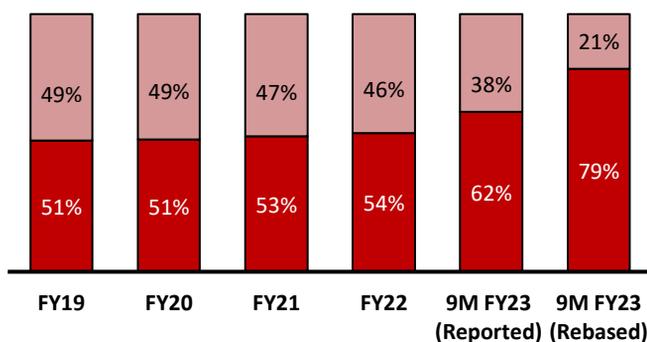
Numerous Growth Drivers

- **Recalibration of the portfolio** - As part of the strategy refresh, the Company sold 32 brands of popular in slump sale and 11 brands in franchise agreement for five years, open for extension or outright sale on meeting certain conditions. This has led to a loss of business worth Rs. 7,500 Mn, which the Company estimates to recoup by FY24-25 from the P&A segment.
- **Premiumization** – In India, premiumization has been taking place for over 8-10 years, with top-tier brands growing faster than middle and lower-tier brands. USL being the market leader, has been benefitting from the trend. Owing to this, the Company’s P&A volume increased from accounting for around 51% in FY19 to ~79% in 9M FY23, and P&A value increased from ~66% to ~86% over the same period.

The P&A segment volume grew at 4.5% CAGR, and value expanded at 7.4% CAGR between FY13-22. During 9M FY23, the segment’s value increased by ~23% and volume by ~12% over the corresponding period. The Company expects the segment to undergo break-out growth higher than the historical rates in the coming years.

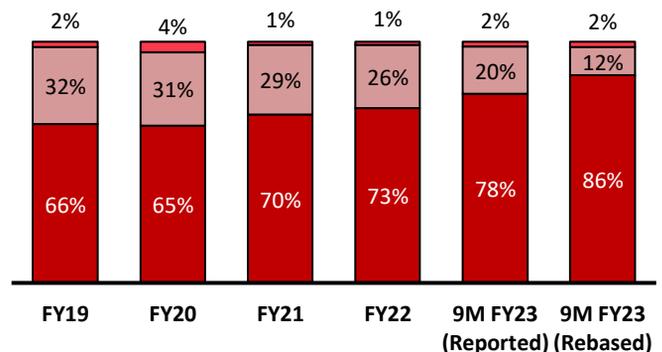
- **Renovation and Innovation** – The renovation of old brands Royal Challenge, Signature, and Black Dog and the innovation/introduction of new brands like Epitome Reserve, Godwana, Royal Challenge American Pride, and Johnnie Walker Blonde are in line with the above strategy, where the Company is placing them in upper-prestige and luxury segment. The high-end brands originating from India are margin accretive and are expected to increase the margins of the Company. Apart from the spirits, the Company launched its world-renowned black beer Guinness in India in FY22. The Company has guided that the innovation will make a material contribution to the Company’s growth for the next 3-5 years. In line with this strategy, the Company bought a minority stake of ~23% in FY22 in Nao Spirits, which owns Greater than Gin and Hapusa Gin.

Volume Split (%)



■ P&A ■ Popular

NSV Split (%)



■ P&A ■ Popular ■ Others

Source: Company, Keynote Capitals Ltd. The popular segment’s slump sale and franchise agreement happened in Q2 FY23, which is why for 9M FY23, rebased figures (net of the sold and franchised business) are also presented.

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Policies for BIO becoming Favourable

BIO has been heavily tolled to keep foreign brands away from the access of the majority of customers. However, with India-UK FTA, USL will expand prominently. As Pernod Ricard, the second largest player, is a French company, USL would be the only company to have camps in both countries, making Diageo the most significant benefactor and beneficiary. In India, BIO has just a 2% share in the whisky business, which makes ~ Rs. 44 Bn as of CY21 but is expected to turn around the market in its favor. The share of BIO and BII in USL's portfolio is ~22-24%, which is likely to increase after the agreement. The operating margins for the segment is at ~10%, but its return on invested capital is around 25-30%. In addition to the actions taken by the central government, state governments like Delhi, Maharashtra, Rajasthan, Madhya Pradesh, etc., have reduced BIO scotch duties over the past 3-4 years. When Maharashtra, the state with the highest prices, reduced duties, the prices fell by 35-40%, which led to excellent traction.

A Management that Excels in Execution

Diageo Plc acquired a ~ 56% stake in USL in 2013 in a staggered accumulation of shares and brought Mr. Anand Kripalu as Managing Director in FY13 to bring a sea change to the Company. In his tenure, the Company undertook a quantum leap in terms of capital structure, product segment split, operating assets contribution to total assets, efficient operations across the supply chain, and several more.

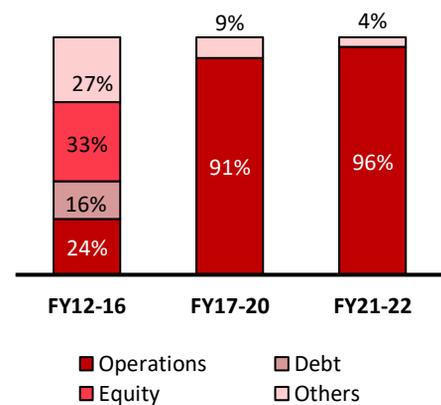
In FY15, the Company decided to undertake a cost savings program to save ~ Rs. 5 Bn to reinvest in brands in 3 years. On the contrary, the Company ended up accumulating the decided amount in 2 years. In 2016, the Company began franchising some of its popular brands in several states. The slump sale and franchise agreement undertaken in FY23 Q2 is an extension of the same strategy. This helped the Company to become asset-light.

USL downsized its borrowings by more than 96% from ~ Rs. 83 Bn in FY13 to ~ Rs. 3 Bn in FY22 by means of reducing non-current assets (fixed assets) from ~ Rs. 80 Bn (~50% of total assets) in FY13 to ~ Rs. 20 Bn (~19% of total assets) in FY22. Additionally, USL decreased the number of subsidiaries from 73 in FY15 to 12 in Q3 FY23. All these steps further made the Company asset-light.

The number of manufacturing facilities stood at 91 in FY13, which dropped to 39 in Q3 FY23. As a result, the fixed asset turnover ratio grew from 1.3 times (FY13) to ~5 times (FY22). Similarly, the inventory turns increased from 1.4 times (FY13) to 2.5 times (FY22). Productivity is one of the measures opted for by the management to offset annual inflation by almost half. The Company's productivity initiatives have reaped tremendous results, like the 3-year average share of fixed cost overheads to NSV decreased from ~39% in FY14-16 to ~35% in FY17-19 to ~31% in FY20-22. The Company introduced Radical Liberation Sprint in FY22, where they found ways to work more efficiently and save more than 100,000 man-hours, equivalent to 55 full-time employees redirecting it to growth-supporting activities. In response to this initiative, the Company saved up to 150,000 man-hours by means of decreasing the number of vendors, increasing spending limits, etc.

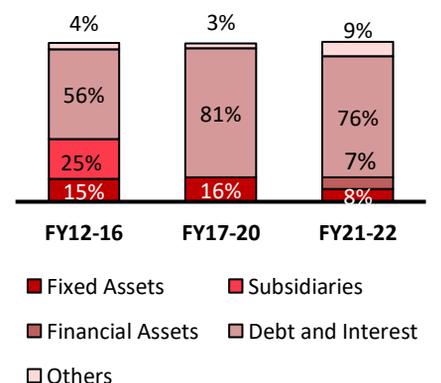
The Company has further planned a 3-year supply agility program whose cost will be Rs. 5,000 Mn, with an approximately 60:40 split between cash and non-cash expenses. Once finished, the initiative will produce yearly gains of Rs. 1,300-1,500 Mn. The Company has guided mid-to-high teen EBITDA margins.

Sources of Funds Over Different Periods



Source: Company, Keynote Capitals Ltd.

Application of Funds Over Different Periods



Source: Company, Keynote Capitals Ltd.

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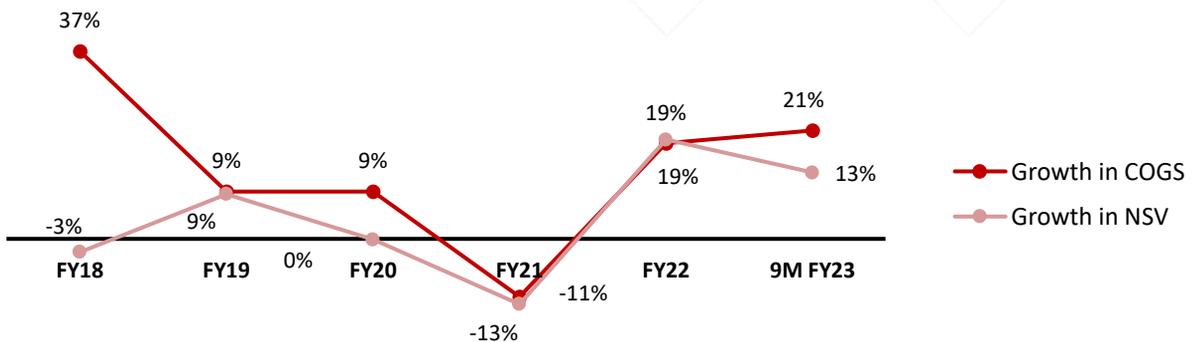
Challenges

Lack of Bargaining and Pricing Power

Two challenges that summarise the majority of the problems that an alcohol beverage company engages in are a need for more pricing power over distributors and no bargaining power over raw materials suppliers.

An increase in raw materials or cost of goods sold (COGS) and Net Sales Value (NSV) is a blend of volume and value growth. Over the past five years (FY17-22), USL's NSV has grown at 2% CAGR, while RM has magnified at ~11% CAGR, contracting gross margins by around 1,600 bps (16 percentage points) from ~65% in FY17 to ~49% in FY22.

YoY Growth in NSV and COGS



Source: Company, Keynote Capitals Ltd.

The industry's average COGS grew at ~10%, higher than the growth rate of NSV at ~6% between FY17-22.

While the industry's average gross margin fell from ~55% to 46%, USL's margins fell from 66% to 46% over the same period.

USL's 66% raw material constitutes glass and ENA, while 34% represents crude-based derivatives like paper, packaging, PET, etc.,

The Company has been operating on a trio of pricing, mix, and productivity to combat this constant commodity inflation. In pricing, the Company engages in annual excise, wherein the state government opens a window for price revision. This is a stringent activity to persuade governments for price increases; however, in the past year, the authorities have been supportive, which gave the Company a price mix. In over past 12 months, the Company received price increases from Haryana, Punjab, Andhra Pradesh, West Bengal, Maharashtra, Karnataka, Rajasthan, Odisha, Assam, Delhi, etc. Additionally, occasional RTM changes also disturb the market supply and sales of the Company for a quarter or two. This explains the lack of limited pricing power of the Company over distributors.

The Company also practices rigorous productivity initiatives to offset the inflation by half. Further, the Company has planned the removal of outer cardboard boxes in upper-prestige and premium brands in a phased manner. This will help in margins but also help to serve a sustainable environment.

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Recently, when there was scotch inflation due to its scarcity, the company reduced its supply till it got pricing from the states. This action in Q1 FY23 led to impacting ~ Rs. 600-700 Mn or ~6% points growth on the P&A segment.

Such rigorous efforts and initiatives result from exceptional execution, without which the margins would go haywire. However, despite such actions, inflation remains ahead of pricing.

Changes in Route to Market (RTM)

Delhi had state-owned distributors and retailers until November 2021, after which 849 private vendors were licensed to operate in the city. However, with opposition parties questioning the moral grounds of the new excise policy, the state government withdrew it and brought the government vendors back into the market.

When the new excise policy 2021-22 was introduced, the market underwent a slowdown in Q2 FY22 because the retailing party would change from November '21 onwards. Post the execution, USL performed well as Delhi, which is 4-5% of P&A NSV, is BIO inclined, and contributed 3-4% to USL's national growth. However, with the old policy returning in September '22, Delhi contributed -1% to -2% growth since Q3 FY23. The Company has been recouping the lost sales from other states and salient brands and expects the situation to return to normalcy by Q4 FY23. However, such changes affect a couple of quarters of companies.

Similarly, positive RTM changes affect the industry's supply chain and the Company.

Financial Statement Analysis

Income Statement

Y/E Mar, Rs. Mn	FY21	FY22	FY23E	FY24E	FY25E
Net Sales	81,313	97,124	1,06,553	1,10,849	1,24,745
Growth %	19%	10%	13%	4%	13%
Raw Material Expenses	44,556	52,915	61,375	62,851	70,731
Employee Expenses	5,564	6,531	6,393	6,651	7,485
Other Expenses	20,666	21,726	22,909	23,833	26,820
EBITDA	10,527	15,952	15,876	17,514	19,710
Growth %	52%	0%	10%	13%	13%
Margin%	13%	16%	15%	16%	16%
Depreciation	2,991	3,038	2,964	3,091	3,229
EBIT	7,536	12,914	12,912	14,423	16,481
Growth %	71%	0%	12%	14%	14%
Margin%	9%	13%	12%	13%	13%
Interest Paid	1,876	880	755	755	755
Other Income & exceptional	-247	-1,168	2,544	-887	-887
PBT	5,413	10,866	14,701	12,781	14,838
Tax	1,779	2,760	3,675	3,195	3,710
PAT	3,634	8,106	11,026	9,585	11,129
Others (Minorities, Associates)	202	180	130	130	130
Net Profit	3,836	8,286	11,156	9,715	11,259
Growth %		116%	35%	-13%	16%
Shares (Mn)	726.6	726.6	726.6	726.6	726.6
EPS	5.28	11.41	15.35	13.37	15.49

Balance Sheet

Y/E Mar, Rs. Mn	FY21	FY22	FY23E	FY24E	FY25E
Cash, Cash equivalents & Bank	839	603	9,164	17,962	26,850
Current Investments	0	2,221	2,221	2,221	2,221
Debtors	21,872	23,736	26,638	27,712	31,186
Inventory	20,519	21,567	25,777	26,398	29,707
Short Term Loans & Advances	11,493	15,153	15,153	15,153	15,153
Other Current Assets	3,578	1,791	1,791	1,791	1,791
Total Current Assets	58,301	65,071	80,744	91,237	1,06,908
Net Block & CWIP	19,739	19,765	18,186	16,536	14,929
Long Term Investments	75	0	0	0	0
Other Non-current Assets	15,815	16,235	16,235	16,235	16,235
Total Assets	93,930	1,01,071	1,15,165	1,24,008	1,38,072
Creditors	14,172	15,821	19,020	18,407	21,472
Provision	19,234	21,082	21,082	21,082	21,082
Short Term Borrowings	8,745	3,392	3,392	3,392	3,392
Other Current Liabilities	11,497	11,525	11,525	11,525	11,525
Total Current Liabilities	53,648	51,820	55,019	54,406	57,471
Long Term Debt	22	9	9	9	9
Deferred Tax Liabilities	-1,450	-995	-995	-995	-995
Other Long Term Liabilities	1,121	1,490	1,490	1,490	1,490
Total Non Current Liabilities	-307	504	504	504	504
Paid-up Capital	1,453	1,453	1,453	1,453	1,453
Reserves & Surplus	39,745	48,083	59,109	68,694	79,823
Shareholders' Equity	41,198	49,536	60,562	70,147	81,276
Non Controlling Interest	-609	-789	-919	-1,049	-1,179
Total Equity & Liabilities	93,930	1,01,071	1,15,165	1,24,008	1,38,072

Cash Flow

Y/E Mar, Rs. Mn	FY21	FY22	FY23E	FY24E	FY25E
Pre-tax profit	5,413	10,866	14,701	12,781	14,838
Adjustments	5,810	5,531	2,989	3,117	3,254
Change in Working Capital	8,035	-2,053	-3,914	-2,307	-3,719
Total Tax Paid	-1,068	-4,570	-3,675	-3,195	-3,710
Cash flow from operating Activities	18,190	9,774	10,101	10,395	10,665
Net Capital Expenditure	-1,383	-956	-1,385	-1,441	-1,622
Change in investments	-20	-2,135	0	0	0
Other investing activities	411	-36	600	600	600
Cash flow from investing activities	-992	-3,127	-785	-841	-1,022
Equity raised / (repaid)	0	0	0	0	0
Debt raised / (repaid)	-3,405	-7,315	0	0	0
Dividend (incl. tax)	0	0	0	0	0
Other financing activities	-2,253	-1,523	-755	-755	-755
Cash flow from financing activities	-5,658	-8,838	-755	-755	-755
Net Change in cash	11,540	-2,191	8,561	8,798	8,888

Valuation Ratios

	FY21	FY22	FY23E	FY24E	FY25E
Per Share Data					
EPS	5	11	15	13	15
Growth %		116%	35%	-13%	16%
Book Value Per Share	57	68	82	95	110
Return Ratios					
Return on Assets (%)	4%	8%	10%	8%	9%
Return on Equity (%)	10%	18%	20%	15%	15%
Return on Capital Employed (%)	11%	14%	17%	18%	17%
Turnover Ratios					
Asset Turnover (x)	0.9	1.0	1.0	0.9	1.0
Sales / Gross Block (x)	2.7	3.1	3.2	3.2	3.5
Working Capital / Sales (x)	2%	9%	18%	28%	35%
Receivable Days	100	86	86	89	86
Inventory Days	163	145	141	151	145
Payable Days	104	101	97	108	98
Working Capital Days	159	129	130	133	133
Liquidity Ratios					
Current Ratio (x)	1.1	1.3	1.5	1.7	1.9
Interest Coverage Ratio (x)	4.2	15.2	17.9	19.9	22.6
Total Debt to Equity	0.2	0.1	0.1	0.0	0.0
Net Debt to Equity	0.2	0.1	-0.1	-0.2	-0.3
Valuation					
PE (x)	105.4	77.9	48.5	55.7	48.1
Earnings Yield (%)	1%	1%	2%	2%	2%
Price to Sales (x)	5.0	6.6	5.1	4.9	4.3
Price to Book (x)	9.8	13.0	8.9	7.7	6.6
EV/EBITDA (x)	39.2	40.6	34.2	31.0	27.5
EV/Sales (x)	5.1	6.7	5.1	4.9	4.4

Source: Company, Keynote Capitals Ltd. estimates

USL's valuation

Valuation	
(in Rs. Mn, otherwise stated)	FY24
EBITDA	17,514
Median EV/EBITDA Multiple	36
EV	6,30,504
Net Debt	(14,561)
Market Capitalization	6,45,065
No. of Outstanding shares	727
Target Price	887
Current Market Price	764
% Upside/(Downside)	+16%

Source: Company, Keynote Capitals Ltd. Estimates

The historic (FY13-22) volume growth in the P&A segment has been ~5% CAGR and value growth of ~3% CAGR, giving a value growth of ~7%.

After eliminating the outgoing business of the Popular segment, P&A accounts for ~80% of volume and 88% of value for 9M FY23. However, the Company has guided to recoup the lost business from the P&A by FY24-25.

Going forward, in FY24E, we believe that the P&A segment can grow at a 12-13% value growth, with ~4% volume growth and ~8% price growth owing to premiumization.

Because the Company retains only a few brands of Popular, contributing 20% to volume and 12% to value, we believe that the Popular segment will degrow by ~35% in FY24E, giving a blended growth rate on NSV at ~4%.

We estimate the value of the Company to be Rs. 6,45,065 Mn, 36x EV/EBITDA on FY24E EBITDA, suggesting a target price of Rs. 887 and a 14% upside.

Our Recent Reports

KEYNOTE

ZEE | Initiating Coverage Report

Zee Entertainment Enterprises Ltd.
3rd Feb 2023

Progressing Towards a Brighter Future

BUY
CMP Rs. 221
TARGET Rs. 225 (+2.0%)

Company Data

Company Name	Zee Entertainment Enterprises Ltd.
ISIN	INE069A01010
Market Cap	₹1,15,747
Revenue (₹ Cr)	1,00,000
EBITDA (₹ Cr)	10,000
Net Profit (₹ Cr)	5,000
EPS (₹)	1.00

Shareholding Pattern %

Category	Shareholding %
Public	68.00
Private	32.00

Key Financial Data

Year	Revenue	EBITDA	Net Profit
2021	90,000	8,000	4,000
2022	1,00,000	10,000	5,000

Key Takeaways: ZEE is a leading entertainment company in India, offering a wide range of content across various platforms. The company has shown strong growth in its core business and is well-positioned to capitalize on the growing demand for entertainment content in the Indian market.

KEYNOTE

Balkrishna Industries Limited | Initiating Coverage Report

Balkrishna Industries Limited
20th Jan 2023

Aiming for 10% Global Market Share in Off-Highway Tyres

BUY
CMP Rs. 2,222
TARGET Rs. 2,499 (+12.6%)

Company Data

Company Name	Balkrishna Industries Limited
ISIN	INE069A01010
Market Cap	₹1,15,747
Revenue (₹ Cr)	1,00,000
EBITDA (₹ Cr)	10,000
Net Profit (₹ Cr)	5,000
EPS (₹)	1.00

Shareholding Pattern %

Category	Shareholding %
Public	68.00
Private	32.00

Key Financial Data

Year	Revenue	EBITDA	Net Profit
2021	90,000	8,000	4,000
2022	1,00,000	10,000	5,000

Key Takeaways: Balkrishna Industries is a leading manufacturer of off-highway tires in India, with a strong focus on innovation and quality. The company is well-positioned to capture a larger share of the growing off-highway tire market in India and globally.

KEYNOTE

Motilal Oswal Financial Services | Initiating Coverage Report

Motilal Oswal Financial Services Limited
30th Dec 2022

Opportunities to drive growth, valuations to follow

BUY
CMP Rs. 886
TARGET Rs. 926 (+4.5%)

Company Data

Company Name	Motilal Oswal Financial Services Limited
ISIN	INE069A01010
Market Cap	₹1,15,747
Revenue (₹ Cr)	1,00,000
EBITDA (₹ Cr)	10,000
Net Profit (₹ Cr)	5,000
EPS (₹)	1.00

Shareholding Pattern %

Category	Shareholding %
Public	68.00
Private	32.00

Key Financial Data

Year	Revenue	EBITDA	Net Profit
2021	90,000	8,000	4,000
2022	1,00,000	10,000	5,000

Key Takeaways: Motilal Oswal Financial Services is a leading financial services provider in India, offering a wide range of products and services. The company is well-positioned to capitalize on the growing demand for financial services in the Indian market.

Zee Entertainment Enterprises Ltd.

Balkrishna Industries Ltd.

Motilal Oswal Financial Services Ltd.

Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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USL | Initiating Coverage Report

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