

United Spirits Ltd.

13th November 2023

Amidst sluggish demand, premiumization to continue

United Spirits Ltd. (USL) sold ~16 Mn cases with a mix of 83:17 in volume and 90:10 in value between Prestige and Above (P&A) and Popular category. The P&A category grew by 3% in volume and ~8% in realisation on a YoY basis. The Popular category experienced a volume decline of ~11% but exhibited an increased net realization per case of around 13% on a YoY basis after adjusting for the eliminated portfolio in Q2 FY23. Overall, the Net Sales Value of P&A category grew by ~12% and Popular for ~1% on a YoY basis. During the quarter, the Company launched Don Julio, the celebrated Tequila brand worldwide. Further, amidst inflationary pressure, the management ran cost optimisation and supply agility program along with leveraging the premiumisation trend.

Initial clues of demand softening

During the first half of Q3 FY24, the management witnessed a slowdown in discretionary spending and demand for beverage alcohol. While the luxury segment continues to see robust demand, the other segments undergo pressure. The observed pattern in the pre-festive season deviates from historical trends observed over the past decades. While the management is hopeful of recovery in demand during Christmas and New Year celebrations, they continue to remain cautious.

Cost inflationary pressures to continue

During the quarter, the beverage alcohol industry underwent inflationary pressure on the back of glass, ENA, grain, etc. USL endeavored to mitigate this via a three-pronged strategy: 1) of removing mono cartons (reaching up to 90% in Q2 FY24), 2) premiumization, and 3) a supply agility program. While the management anticipates the glass prices begin to recede, after three 3 to 4 years of inflationary pressure. However, the industry assumes a sideways trend to continue on the back of the volatility in the Middle-Eastern geography.

Premiumisation, a long-term trend

Beyond short-term fluctuations, the sustained long-term growth in the beverage alcohol industry is evident in terms of volume and value. USL has witnessed a ~34% increase in blended net realization per case and a 47% rise in operating profit per case on a YoY basis. The Company could achieve this on the back of premiumisation and cost optimization initiatives.

View & Valuation

Owing to sluggish demand, before the pre-festive season and cost inflationary pressure, the outlook for USL in the near-term appears dull. However, in the long term, USL is a market leader, carrying the lineage of world spirits leader Diageo, which further strengthens it to grow in an expanding market like India. Therefore, we revise our estimates and maintain our rating of NEUTRAL. Further, we ascribe a 10-year median EV/EBITDA 37x to FY25E EBITDA, giving a target price of Rs. 1,062, implying an upside of ~2%.

NEUTRAL

CMP: 1,045

TARGET Rs. 1,062 (2%)

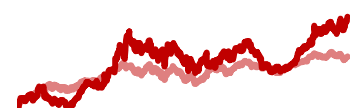
Company Data

| | |
|----------------------------|-----------|
| Bloomberg Code | UNSP IN |
| MCAP (Rs. Mn) | 7,59,715 |
| O/S Shares (Mn) | 727 |
| 52w High/Low | 1,110/731 |
| Face Value (in Rs.) | 2 |
| Liquidity (3M) (Rs. Mn) | 870 |

Shareholding Pattern %

| | Sep-23 | Jun-23 | Mar-23 |
|-------------------|--------|--------|--------|
| Promoters | 56.67 | 56.68 | 56.68 |
| FIIIs | 16.51 | 15.92 | 15.38 |
| DIIIs | 12.33 | 12.65 | 12.71 |
| Non-Institutional | 14.49 | 14.77 | 15.23 |

USL vs Nifty



| | Nov, 20 | Nov, 21 | Nov, 22 | Nov, 23 |
|-------|---------|---------|---------|---------|
| USL | | | | |
| NIFTY | | | | |

Source: Keynote Capitals Ltd.

Key Financial Data

| (Rs Bn) | FY23 | FY24E | FY25E |
|--------------|------|-------|-------|
| Revenue | 106 | 109 | 123 |
| EBITDA | 14 | 18 | 21 |
| Net Profit | 11 | 12 | 14 |
| Total Assets | 96 | 109 | 125 |
| ROCE (%) | 17% | 19% | 18% |
| ROE (%) | 21% | 19% | 18% |

Source: Company, Keynote Capitals Ltd.

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Q2 FY24 Result Update

Result Highlights (Rs. Mn)

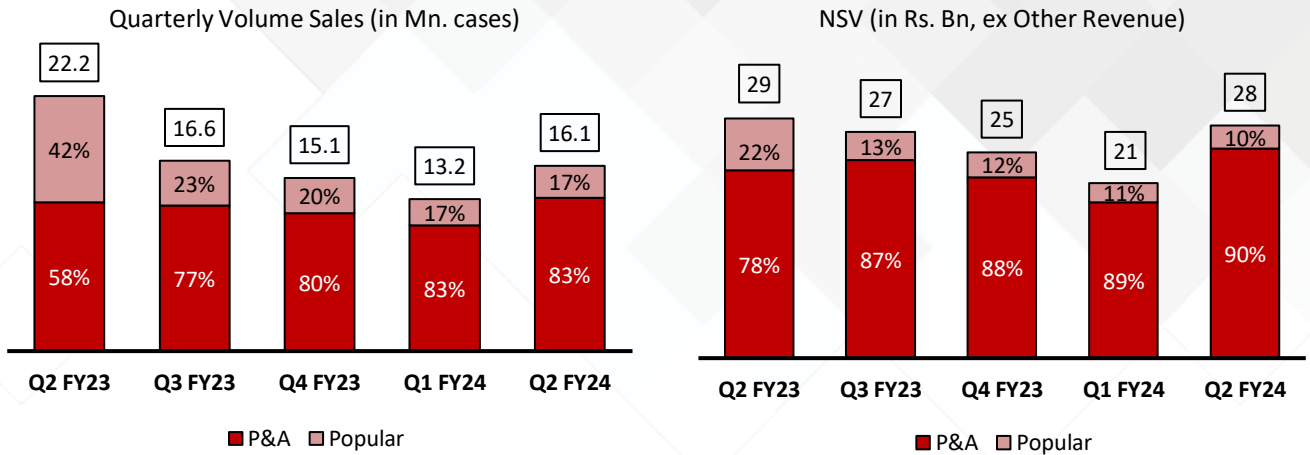
| Particulars | Q2 FY24 | Q2 FY23 | Change % (Y-o-Y) | Q1 FY24 | Change % (Q-o-Q) | H1 FY24 | H1 FY23 | Change % (Y-o-Y) | FY23 |
|--------------------------|--------------|--------------|------------------|--------------|-------------------|---------------|--------------|------------------|---------------|
| Net Sales | 28,674 | 29,110 | -1% | 26,678 | 7% | 55,352 | 53,301 | 4% | 1,06,116 |
| COGS | 16,210 | 17,629 | -8% | 12,245 | 32% | 28,455 | 30,582 | -7% | 60,641 |
| Gross Profit | 12,464 | 11,481 | 9% | 14,433 | -14% | 26,897 | 22,719 | 18% | 45,475 |
| Gross Profit % | 43% | 39% | 403 bps | 54% | -1,063 bps | 49% | 43% | 597 bps | 43% |
| Employee Benefit Expense | 1,439 | 1,526 | -6% | 1,258 | 14% | 2,697 | 3,249 | -17% | 6,100 |
| Other Expenses | 6,358 | 5,582 | 14% | 6,040 | 5% | 12,398 | 11,374 | 9% | 25,206 |
| EBITDA | 4,667 | 4,373 | 7% | 7,135 | -35% | 11,802 | 8,096 | 46% | 14,169 |
| EBITDA % | 16% | 15% | 125 bps | 27% | -1,047 bps | 21% | 15% | 613 bp | 13% |
| Depreciation | 653 | 659 | -1% | 743 | -12% | 1,396 | 1,490 | -6% | 2,825 |
| EBIT | 4,014 | 3,714 | 8% | 6,392 | -37% | 10,406 | 6,606 | 58% | 11,344 |
| Finance Cost | 262 | 210 | 25% | 43 | 509% | 305 | 435 | -30% | 1,039 |
| Other Income | 401 | 76 | 428% | 217 | 85% | 618 | 338 | 83% | 731 |
| PBT | 4,153 | 3,580 | 16% | 6,566 | -37% | 10,719 | 6,509 | 65% | 11,036 |
| Share of Associate | -4 | -5 | -20% | -5 | -20% | -9 | -8 | 13% | -14 |
| Exceptional Item | 307 | 3,815 | -92% | -171 | -280% | 136 | 3,431 | -96% | 1,764 |
| Tax | 1,063 | 1,913 | -44% | 1,623 | -35% | 2,686 | 1,844 | 46% | 1,528 |
| PAT | 3,393 | 5,477 | -38% | 4,767 | -29% | 8,160 | 8,088 | 1% | 11,258 |
| EPS | 4.78 | 7.80 | | 6.71 | | 16.01 | 11.55 | | 16.01 |

Segmental Highlights

| Particulars | Q2 FY24 | Q2 FY23 | Change % (Y-o-Y) | Q1 FY24 | Change % (Q-o-Q) | H1 FY24 | H1 FY23 | Change % (Y-o-Y) | FY23 |
|--------------------------|---------|---------|------------------|---------|------------------|---------|---------|------------------|----------|
| Net Revenue | | | | | | | | | |
| Beverage Alcohol | 28,647 | 29,108 | 2% | 21,719 | 32% | 50,366 | 51,054 | 1% | 1,03,737 |
| Sports | 33 | 2 | -94% | 4,986 | -99% | 5,019 | 2,266 | -55% | 2,442 |
| EBITDA | | | | | | | | | |
| Beverage Alcohol | 4,701 | 4,413 | -6% | 3,850 | 22% | 8,551 | 7,107 | -17% | 14,230 |
| Sports | -34 | -40 | 18% | 3,285 | -101% | 3,251 | 989 | -70% | -61 |
| EBITDA Margin (%) | | | | | | | | | |
| Beverage Alcohol | 16% | 15% | 125 bps | 18% | -132 bps | 17% | 14% | 306 bps | 14% |
| Sports | -103% | -2000% | 1,89,697 bps | 66% | -16,891 bps | 65% | 44% | 2,113 bps | -2% |

Source: Company, Keynote Capitals Ltd.

USL | Quarterly Update



Source: Company, Keynote Capitals Ltd. estimates

Q2 FY24 Conference Call Takeaways

- The Company experienced strong performance from its brands, Signature and the revamped Royal Challenge, in the recent quarter. Black Dog exhibited robust growth, affirming the success of the premiumization strategy, notably with Black Dog Triple Gold Reserve outperforming Black Dog Black Reserve. The recently introduced American Pride is achieving an impressive 90% repeat rate.
- During the quarter, the Company introduced its globally acclaimed Tequila brand, Don Julio, to the Indian market. The Company intends to introduce various brand variants, commencing with the core range, Blanco and Reposado, and extending to the iconic Don Julio 1942. The Company holds a positive outlook for this brand, considering the global trend where Tequila has surpassed vodka to become the second-largest beverage alcohol by sales in the past 4-5 years. Management anticipates that the brand will emerge as a substantial contributor over the next 5-7 years.
- Throughout the quarter, the Company faced notable inflationary pressures on the input side. Despite this challenge, the Company successfully mitigated the impact through various initiatives, including eliminating mono cartons (reaching up to 90% removal), focusing on premiumisation, and implementing a supply agility program. Regarding glass inflation, the management anticipates the onset of a downcycle.
- The Company has intensified its A&P expenditures, allocating ~Rs. 2 Bn, reflecting a YoY growth of ~51%. Additionally, the Company serves as an associate sponsor for the 2023 ICC World Cup tickets. Furthermore, there are plans to enhance visibility through increased investments in the A&P, targeting an expenditure of ~10% of sales in the near term. Consequently, the management guides the EBITDA margin to be marginally upwards of ~15% going forward.
- With a July-June year, the split between the two halves stands at 55:45.
- As of September 2023, the Company holds a cash balance and financial assets worth ~ Rs. 10 Bn, and it is willing to deploy these resources for inorganic growth opportunities.
- In the first 40 days of Q3 FY24, the management has observed a deceleration in demand compared to the customary purchasing patterns leading up to the pre-festive season. Although the luxury segment maintains strong demand, other segments are experiencing continued pressure.

Financial Statement Analysis

Income Statement

| Y/E Mar, Rs. Mn | FY22 | FY23 | FY24E | FY25E | FY26E |
|---------------------------------|---------------|-----------------|-----------------|-----------------|-----------------|
| Net Sales | 97,124 | 1,06,116 | 1,09,079 | 1,22,819 | 1,38,322 |
| Growth % | 19% | 9% | 3% | 13% | 13% |
| Raw Material Expenses | 52,915 | 60,641 | 61,084 | 68,778 | 77,461 |
| Employee Expenses | 6,531 | 6,100 | 5,672 | 6,387 | 7,193 |
| Other Expenses | 21,726 | 25,326 | 23,997 | 27,020 | 30,431 |
| EBITDA | 15,952 | 14,049 | 18,325 | 20,634 | 23,238 |
| Growth % | 52% | -12% | 30% | 13% | 13% |
| Margin % | 16% | 13% | 17% | 17% | 17% |
| Depreciation | 3,038 | 2,825 | 2,766 | 2,909 | 3,070 |
| EBIT | 12,914 | 11,224 | 15,560 | 17,725 | 20,168 |
| Growth % | 71% | -13% | 39% | 14% | 14% |
| Margin % | 13% | 11% | 14% | 14% | 15% |
| Interest Paid | 880 | 1,039 | 202 | 202 | 202 |
| Other Income & exceptional | -1,168 | 2,615 | 1,000 | 1,000 | 1,000 |
| PBT | 10,866 | 12,800 | 16,357 | 18,522 | 20,966 |
| Tax | 2,760 | 1,528 | 4,089 | 4,631 | 5,241 |
| PAT | 8,106 | 11,272 | 12,268 | 13,892 | 15,724 |
| Others (Minorities, Associates) | 180 | 91 | -14 | -15 | -15 |
| Net Profit | 8,286 | 11,363 | 12,254 | 13,877 | 15,709 |
| Growth % | 116% | 37% | 8% | 13% | 13% |
| Shares (Mn) | 727 | 727 | 727 | 727 | 727 |
| EPS | 11.41 | 15.64 | 16.86 | 19.10 | 21.62 |

Balance Sheet

| Y/E Mar, Rs. Mn | FY22 | FY23 | FY24E | FY25E | FY26E |
|---------------------------------------|-----------------|---------------|-----------------|-----------------|-----------------|
| Cash, Cash equivalents & Bank | 603 | 8,833 | 19,530 | 30,932 | 43,444 |
| Current Investments | 2,221 | 2,558 | 2,558 | 2,558 | 2,558 |
| Debtors | 23,736 | 24,340 | 25,634 | 28,862 | 32,506 |
| Inventory | 21,567 | 22,300 | 24,434 | 27,511 | 30,984 |
| Short Term Loans & Advances | 15,153 | 2,578 | 2,578 | 2,578 | 2,578 |
| Other Current Assets | 1,791 | 1,737 | 1,737 | 1,737 | 1,737 |
| Total Current Assets | 65,071 | 62,346 | 76,470 | 94,179 | 1,13,807 |
| Net Block & CWIP | 19,765 | 17,095 | 15,747 | 14,435 | 13,163 |
| Long Term Investments | 0 | 301 | 287 | 272 | 257 |
| Other Non-current Assets | 16,235 | 16,300 | 16,300 | 16,300 | 16,300 |
| Total Assets | 1,01,071 | 96,042 | 1,08,804 | 1,25,186 | 1,43,528 |
| Creditors | 15,821 | 17,825 | 18,333 | 20,838 | 23,471 |
| Provision | 21,082 | 6,560 | 6,560 | 6,560 | 6,560 |
| Short Term Borrowings | 3,392 | 0 | 0 | 0 | 0 |
| Other Current Liabilities | 11,525 | 11,858 | 11,858 | 11,858 | 11,858 |
| Total Current Liabilities | 51,820 | 36,243 | 36,751 | 39,256 | 41,889 |
| Long Term Debt | 9 | 3 | 3 | 3 | 3 |
| Deferred Tax Liabilities (net) | -995 | -1,122 | -1,122 | -1,122 | -1,122 |
| Other Long Term Liabilities | 1,490 | 923 | 923 | 923 | 923 |
| Total Non Current Liabilities | 504 | -196 | -196 | -196 | -196 |
| Paid-up Capital | 1,453 | 1,455 | 1,455 | 1,455 | 1,455 |
| Reserves & Surplus | 48,083 | 58,540 | 70,794 | 84,671 | 1,00,380 |
| Shareholders' Equity | 49,536 | 59,995 | 72,249 | 86,126 | 1,01,835 |
| Non Controlling Interest | -789 | 0 | 0 | 0 | 0 |
| Total Equity & Liabilities | 1,01,071 | 96,042 | 1,08,804 | 1,25,186 | 1,43,528 |

Source: Company, Keynote Capitals Ltd. estimates

Cash Flow

| Y/E Mar, Rs. Mn | FY22 | FY23 | FY24E | FY25E | FY26E |
|--|---------------|---------------|---------------|---------------|---------------|
| Pre-tax profit | 10,866 | 12,800 | 16,357 | 18,522 | 20,966 |
| Adjustments | 5,531 | 1,689 | 1,968 | 2,111 | 2,272 |
| Change in Working Capital | -2,053 | -5,653 | -2,919 | -3,801 | -4,484 |
| Total Tax Paid | -4,570 | -2,675 | -4,089 | -4,631 | -5,241 |
| Cash flow from operating Activities | 9,774 | 6,161 | 11,317 | 12,202 | 13,513 |
| Net Capital Expenditure | -956 | -1,101 | -1,418 | -1,597 | -1,798 |
| Change in investments | -2,135 | -8,087 | 0 | 0 | 0 |
| Other investing activities | -36 | 8,656 | 1,000 | 1,000 | 1,000 |
| Cash flow from investing activities | -3,127 | -532 | -418 | -597 | -798 |
| Equity raised / (repaid) | 0 | 0 | 0 | 0 | 0 |
| Debt raised / (repaid) | -7,315 | -5,371 | 0 | 0 | 0 |
| Dividend (incl. tax) | 0 | 0 | 0 | 0 | 0 |
| Other financing activities | -1,523 | -1,603 | -202 | -202 | -202 |
| Cash flow from financing activities | -8,838 | -6,974 | -202 | -202 | -202 |
| Net Change in cash | -2,191 | -1,345 | 10,697 | 11,403 | 12,512 |

Valuation Ratios

| | FY22 | FY23 | FY24E | FY25E | FY26E |
|--------------------------------|------|------|-------|-------|-------|
| Per Share Data | | | | | |
| EPS | 11 | 16 | 17 | 19 | 22 |
| Growth % | 116% | 37% | 8% | 13% | 13% |
| Book Value Per Share | 68 | 83 | 99 | 119 | 140 |
| Return Ratios | | | | | |
| Return on Assets (%) | 8% | 12% | 12% | 12% | 12% |
| Return on Equity (%) | 18% | 21% | 19% | 18% | 17% |
| Return on Capital Employed (%) | 14% | 17% | 19% | 18% | 17% |
| Turnover Ratios | | | | | |
| Asset Turnover (x) | 1.0 | 1.1 | 1.1 | 1.0 | 1.0 |
| Sales / Gross Block (x) | 3.1 | 3.5 | 3.7 | 4.0 | 4.3 |
| Working Capital / Sales (x) | 9% | 19% | 30% | 39% | 46% |
| Receivable Days | 86 | 83 | 84 | 81 | 81 |
| Inventory Days | 145 | 132 | 140 | 138 | 138 |
| Payable Days | 101 | 100 | 104 | 99 | 100 |
| Working Capital Days | 129 | 115 | 119 | 119 | 119 |
| Liquidity Ratios | | | | | |
| Current Ratio (x) | 1.3 | 1.7 | 2.1 | 2.4 | 2.7 |
| Interest Coverage Ratio (x) | 15.2 | 11.6 | 81.8 | 92.5 | 104.6 |
| Total Debt to Equity | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net Debt to Equity | 0.1 | -0.1 | -0.3 | -0.4 | -0.4 |
| Valuation | | | | | |
| PE (x) | 77.9 | 70.2 | 65.1 | 57.4 | 50.7 |
| Earnings Yield (%) | 1% | 1% | 2% | 2% | 2% |
| Price to Sales (x) | 6.6 | 7.5 | 7.3 | 6.5 | 5.8 |
| Price to Book (x) | 13.0 | 13.3 | 11.0 | 9.3 | 7.8 |
| EV/EBITDA (x) | 40.6 | 57.0 | 43.7 | 38.8 | 34.5 |
| EV/Sales (x) | 6.7 | 7.5 | 7.3 | 6.5 | 5.8 |

KEYNOTE Rating History

| Date | Rating | Market Price at Recommendation | Upside/Downside |
|--------------------------------|---------|--------------------------------|-----------------|
| 24 th March 2023 | BUY | 764 | +16% |
| 22 nd May 2023 | NEUTRAL | 824 | +8% |
| 24 th July 2023 | NEUTRAL | 978 | +2% |
| 13 th November 2023 | NEUTRAL | 1,045 | +2% |

Source: Company, Keynote Capitals Ltd. estimates

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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