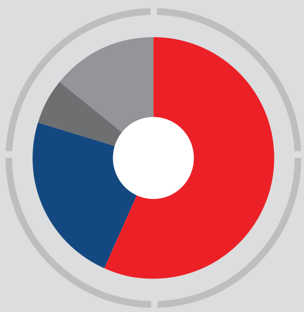
United Spirits Ltd.

CMP: Rs 640	Rating: BUY	Target: Rs 735

Company Information	
BSE Code	532432
NSE Code	MCDOWELL-N
Bloomberg Code	UNSP IN
ISIN	INE854D01024
Market Cap (Rs. Cr)	45895
Outstanding shares(Cr)	72.7
52-wk Hi/Lo (Rs.)	801.0 / 438.2
Avg. daily volume (1yr. on NSE)	1,049,299
Face Value(Rs.)	2.0
Book Value	33.3

Shareholding pattern as of September 2018



Promoters 56.8%
FII 23.0%
DII 6.2%
Others 14.0%

Company overview

United Spirits Ltd. (USL) is one of the largest spirits company in India engaged in the business of alcoholic beverages. It has leading brands across all categories and price segments. Its product portfolio includes whisky, vodka and rum segments, and caters to various consumers through luxury, premium, prestige and popular spirits categories. Its brand portfolio includes Johnnie Walker, Black Dog, McDowell's No.1, Royal Challenge, Signature and Antiquity. It has 18 millionaire brands of the nearly 140 brands that company owns. The company sold 78.5mn cases in FY18. It has over 80 (74 excluding Royalty and Franchise units) manufacturing facilities spread across approximately 20 states and over three union territories in India supported by a vast distribution and marketing network across the country. Diageo's stake in USL now stands at 58.5%.

Investment Rationale

Improving demand drivers

India is the world's third largest liquor market with an estimated Indian Made Foreign Liquor (IMFL) market size of 450mn cases at FY18 end. Increase in disposable incomes, higher discretionary spending, increasing urbanization and favourable demographics are the major reason for increasing liquor market in India. Discretionary spending has a high correlation with disposable incomes which is a function of economic growth and lynchpin for new jobs creation. Urbanisation will improve standard of living and recovery in urban growth which will enhance disposable incomes, further aided by GDP revival (IMFL volume to surge 1.5x GDP when GDP growth revives). Per capita consumption of liquor in India is one of the lowest in the world, implying immense headroom for growth to liquor companies, particularly to players with a strong hold in India underpinned by a wide distribution network. India's per capita consumption is at 2.2 litre/year/person versus 4.5 world average. India is slated to become the youngest country in the world by 2020 with the median age declining to 29 years and about 64% of its population in the working age group from 50% now. Country liquor holds a majority share in India's alcohol market but now steady conversion from country liquor to IMFL due to rise in incomes (particularly in rural areas) and increasing aspirations provides huge scope for IMFL to grow in India. USL being one of the leading liquor manufacturers in India will be the prime beneficiary from these demand drivers.

New offerings to drive growth

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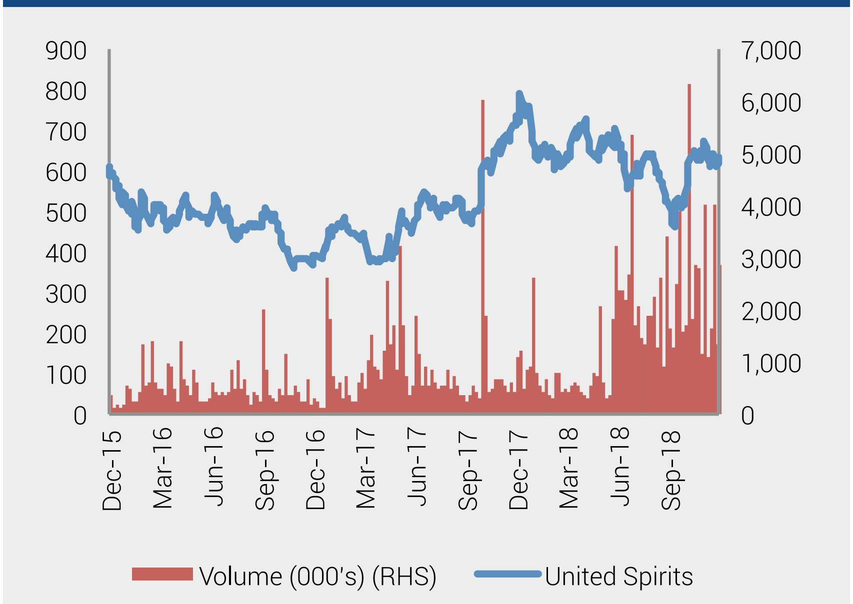
In the past couple of years, Diageo-United Spirits has launched three major product variants, including Captain Morgan original rum, McDowell's No 1 Luxury and Black & White 12-year old whisky. USL is aiming to double its share of business from new products and variants over the next three to four years in line with other markets where its parent Diageo Plc. operates.

McDowell's No 1 Luxury and Black & White 12-year old whisky. USL is aiming to double its share of business from new products and variants over the next three to four years in line with other markets where its parent Diageo Plc. operates. Of Diageo's overall business, the share of new products in India is just about 5% while in regions such as the US, Europe and Africa new products contribute about 17%, 10% and 24% respectively. As per the management, the company has managed to improve the turnaround time on new products. Earlier, product innovation used to take 2.5-3 years which has currently reduced to 18 months. Product innovations are more fitting for the premium product segment and the company focus will be in area where USL has slightly lagged in growth. So, the company's innovation efforts would now be on premium rum, and the company has launched a new variant of dark rum under "Captain Morgan". Post national rollout the management is pleased with its acceptability and performance in the market. As per the management, the company is ready to introduce more new products to take on its rivals and improve its revenue from new products.

United Spirits Price Chart



Franchisee model for popular segment

In a bid to focus on the more expensive blends in its portfolio, USL has franchise out some brands from its popular business segment in some states. The strategy is to deploy the model in states where the company anticipates a real constraint on margins or growth opportunity. In such states, the advantage has come from cost and a franchisee will be able to operate at a much lower cost than USL both in terms of manufacturing and particularly in terms of overheads. This will helps the company to ensure margin stability in the segment, reduce working capital requirement for popular brands such as Bagpiper, Director's Special and Haywards whiskies and McDowell's No 1 rum while throwing more weight behind the 'prestige and above' business that now accounts for about 60% of net sales, thereby will improve the market share of the segment. As the franchise model in the popular segment is already implemented in 13 states, going forward, the company will look at other states provided they get better partners.

Strong performance in Q2FY19

USL reported strong set of numbers for Q2FY19 beating consensus estimates. Revenue from operations in the quarter increased by 14.2% YoY and 10.7% QoQ supported by strong performance of the Prestige & Above segment and healthy volume growth of 10% as well as the benefit from low base due to the highway ban. Prestige & Above segment net sales grew by 19% YoY and volume grew by 15% to 10.5 million cases while Popular segment grew by 8% YoY and volume grew by 5% to 9.9 million cases. Prestige & Above segment accounted for 66% while Popular segment accounted for 32% of net sales during the first half of the year. Growth was broad-based across states and segments. Reported EBITDA increased by 36.1% YoY while EBITDA margin improved by 313 bps YoY at 19.41% due to increased gross profit, lower employee costs and lower other expenses. Brand investments continued (A&P was up 38% YoY or 157bps) and is paying off through higher premiumisation. Higher EBITDA growth coupled with lower interest cost resulted in 69% YoY and 218.2% QoQ growth in net profitability. PAT margin during the quarter also improved by 376 bps YoY at 11.61%

Key Risk

- Steep increase in excise duties by the state governments.
- Increase in prices of molasses, ENA and glass prices can impact profit margins.
- Increase in taxes, changes in the distribution structure, prohibition of liquor in any state could hit volume and revenue.

USL has targeted to double the share of business from new products and variants over the next 3 to 4 years in line with other markets where its parent Diageo Plc. operates.

Valuation

USL is one of the largest liquor company in India and one of the best bet on India's liquor industry given its robust market share and benefits from management control of Diageo. Post Diageo took the management control in USL, the combined entity began to focus on ways to expand the business. FY19 has continued to remain strong in sync with the management target to achieve double digit growth in Premium & Above segment. Company continues to focus on Premiumisation which is likely to improve the margins. Further, company's ability to carry forward the price hike from FY18 to FY19 would positively impact the margins. Low per capita consumption of alcohol <2 litre in India is one of the biggest driver for domestic alcohol industry. Further, USL has targeted to double the share of business from new products and variants over the next 3 to 4 years in line with other markets where its parent Diageo Plc. operates. Since, Diageo took the control of USL management, the company has done a dramatic turnaround which has already reflected in company's financial performance in past few years. Through series of prudent measures, management has been able to reduce balance sheet leverage which boost the RoCE and RoE for the company. Further, company continues to hive off its non-core assets and would use the proceedings to further reduce its debt obligations. The premiumisation focus and maintaining leadership in popular brands with consecutive price hikes across states are the key catalysts for the stock going ahead. Thus we recommend our investors to BUY the scrip from 12 months investment perspective. Currently the scrip is valued at P/E multiple of 39x on FY21E Bloomberg consensus EPS of Rs 16.4.

Particulars (in Rs Cr)	FY18	FY19E	FY20E	FY21E
Net Sales	8590.6	9750.3	10822.9	11905.2
Growth (%)	-2.6	13.5	11.0	10.0
EBITDA	1200.7	1462.5	1710.0	2000.1
EBITDA Margin (%)	14.0	15.0	15.8	16.8
Net profit	651.9	789.8	984.9	1190.5
Net Profit Margin (%)	7.6	8.1	9.1	10.0
EPS (Rs)	43.6	10.9	13.6	16.4

Consensus Estimate: Bloomberg, Ashika Research

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