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UNITED SPIRITS

Aging Profitably

INITIATING COVERAGE

June 04, 2024

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INITIATING COVERAGE | Sector: Breweries & Distilleries

United Spirits Ltd

Aging profitably

We initiate coverage on United Spirits Ltd/Diageo India (UNSP) with Rs1,320 target price and an ADD rating. Our view is underpinned by the following argument: (1) Alco-Bev consumption opportunity is healthy despite the stringent regulations that govern the sector (2) Premiumization and category additions to aid double digit growth (3) Profitability per case improvement shows an upward trend (4) EBITDA/Earnings to grow at ~15%/13% CAGR over FY24-26E on improved ratios.

Consumption buoyant despite stringent sector regulation

Low per capita consumption coupled with positive demographics and >13mn people added each year to the population eligible for drinking, make India an attractive market for alcoholic beverages. IMFL sales volume is projected to reach 560 cases by FY28 from 385mn cases in FY23, growing at a CAGR of ~8%. Sales by value is estimated at Rs2,206.62bn in FY23 and is projected to reach Rs3,402.18bn by FY28, thus growing at a CAGR of ~9%. Having said that, given the ad-hoc change in route-to-market (RTM) and controlled pricing, actual growth won't be consistently linear.

Management confident of double-digit growth for the portfolio

Post completion of the sale and franchising of select popular brands to Inbrew Beverages Private Limited, UNSP's mix of Prestige & Above (P&A) now stands at ~87% of net sales as on FY24. On a normalized steady-state base, company continues to aspire for double-digit topline growth on the back of 7-8% price mix, driven by consistent premiumisation. Volume growth will be 3-4% on the aggregate portfolio, given the better growth in the P&A portfolio led by focus, renovations/innovations and category additions.

Profitability improving year on year, courtesy of sustained premiumization

In the absence of price flexibility, any major volatility in key commodities like extra-neutral alcohol (ENA) and glass have a bearing on the margins. Premiumization will continue to be a key driver of margin improvement over the medium-to-long term. UNSP is driving premiumization through multiple levers: 1) Within segments; 2) Within P&A; 3) Within trademarks; 4) Within categories. We see mix of Mid & Upper-Prestige to improve further from (together accounted for ~22% in FY24) driven by innovation/renovation work done across brands. We expect NSV/EBITDA per case to improve to Rs1,900/Rs327 by FY26E from Rs1,740/Rs278 in FY24, respectively.

EBITDA/Earnings expected to grow at ~15%/12.9% CAGR over FY24-26E

Over the medium-term, favorable demographics, and improved focus on P&A segment (>85% P&A NSV salience now) are likely to ensure decent growth for this market leader. Diageo's global brands has been doing well post-Covid and since the premium customers are loyal, it is expected to do well going forward as well. UNSP has also embarked on certain transformational projects like multi-year supply agility programme (in addition to efficiency savings), simplifying legal entity footprint, phased removal of mono-cartons starting with premium scotch brands, etc. which will keep key overheads in check (already visible in FY24). While margins continue to face pressure from inflationary headwinds in key commodities, company's premiumization focus, pushing efficiencies through some transformational projects and leverage should support margin expansion in the near to medium term. Over FY24-FY26E, can expect UNSP to deliver EBITDA CAGR of ~15% led by 10.8% revenue CAGR and an EBITDA margin expansion of 120bps (driven by 120bps gross margin expansion).

Initiate coverage on UNSP with an ADD rating and a target price of Rs1,320

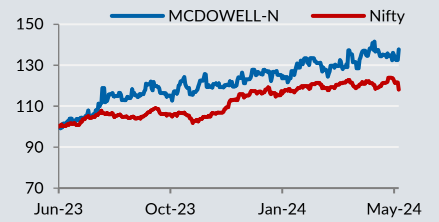
UNSP has recently resumed dividend, after almost a decade, as it wiped out all its accumulated losses in 1QFY24. Cash flow and return ratios have seen a improvement in FY24. The stock is currently trading at ~60x/52x FY25E/FY26E EPS. We initiate coverage on UNSP with a ADD rating and target price of Rs1,320 (targetig ~50x on March'2026E EPS of standalone business + RCSPL).

Reco	:	**ADD**
CMP	:	Rs 1,204
Target Price	:	Rs 1,320
Potential Return	:	+9.6%

Stock data (as on Jun 04, 2024)

Nifty	21,885
52 Week h/l (Rs)	1246 / 865
Market cap (Rs/USD mn)	859074 / 10293
Outstanding Shares (mn)	727
6m Avg t/o (Rs mn):	1,061
Div yield (%):	-
Bloomberg code:	UNSP IN
NSE code:	MCDOWELL-N

Stock performance



	1M	3M	1Y
Absolute return	-0.4%	+3.3%	+37.7%

Shareholding pattern (As of Mar'24 end)

Promoter	56.7%
FII+DII	29.0%
Others	14.4%

∆ in stance

(1-Yr)	New	Old
Rating	ADD	-
Target Price	1,320	-

∆ in earnings estimates (Standalone)

	FY25e	FY26e
EPS (New)	20.1	23.3
EPS (Old)	-	-
% change	-	-

Financial Summary (Standalone)

(Rs mn)	FY24	FY25E	FY26E
Revenue	106,920	118,991	131,158
YoY Growth (%)	3.1	11.3	10.2
EBIDTA	17,080	19,717	22,585
Margins (%)	16.0	16.6	17.2
APAT	13,290	14,587	16,928
EPS	18.3	20.1	23.3
YoY Growth (%)	50.9	9.8	16.0
Pre-tax ROCE (%)	27.4	27.1	29.3
ROE (%)	19.1	20.1	21.3
P/E (x)	65.9	60.0	51.7
EV/EBITDA (x)	50.1	43.1	37.4

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United Spirits Ltd/ Diageo India (UNSP)

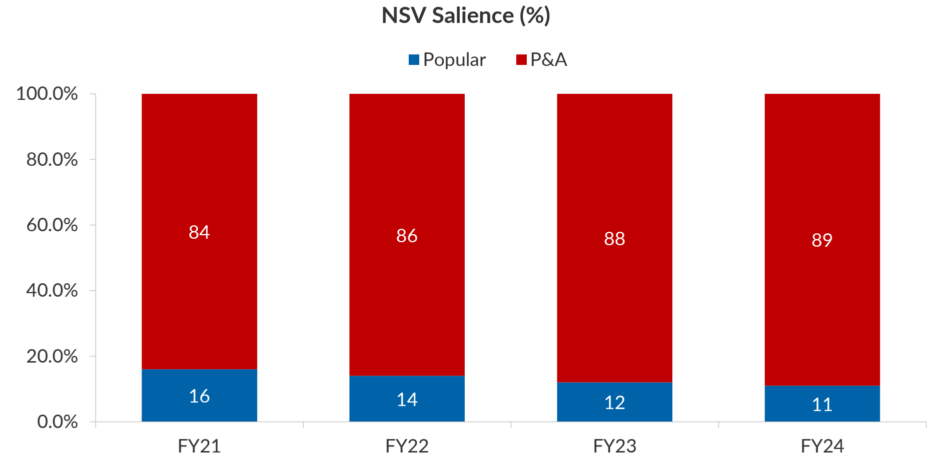
- UNSP is India's biggest alcoholic beverage company and a subsidiary of global spirits leader, Diageo Plc, which holds ~56-57% stake in Diageo India. Its operations involve manufacturing Indian Made Foreign Liquor (IMFL) across all price points, from the Popular to Prestige & Above (P&A) segment.
- UNSP now commands three trademarks McDowell's, Royal Challenge and Johnnie Walker having Rs10bn+ net revenue in FY24 and Signature, Black Dog and Black&White having Rs5bn+ in net revenue. In terms of volumes, UNSP has seven 1mn+ case trademarks now in their portfolio of which McDowell's is 10mn+ volume, Royal Challenge is 5mn+ and then Johnnie Walker, Black Dog, Black & White, Signature and Director's Special whisky at 1mn+ cases.

Exhibit 1: Strong trademark portfolio

Source: Company, YES Sec

- The company has a strong distribution network and point-of-sale coverage; it operates via over 70,000 outlets across India (largest share of business in retail). This leads to a well diversified state mix for the company compared to some smaller peers.
- Post the sale and franchise of large chunk of popular portfolio recently, it now has over 15 brands which includes McDowell's No.1, Royal Challenge, Signature, and Antiquity as well as Diageo's iconic brands such as Johnnie Walker, VAT 69, Black & White, Smirnoff and Ciroc. It has ~37 manufacturing facilities across states and UT's in India (3,000+ employees), and a Technical Centre.
- UNSP has been de-focusing on the Popular brands and hence recently exited a major chunk [~45% of Popular Net Sales Value (NSV)] of the declining Popular segment market by way of a slump sale and franchise agreement. The share of P&A now stands at ~89% of NSV (excludes non-branded revenue) and ~82% of volumes.

Exhibit 2: Strong trademark portfolio



Source: Company, YES Sec; *NSV excludes sales from non-branded revenues

- It also imports and distributes Diageo's (parent of UNSP) brands as Bottled-in-India (BII) and Bottle-in-Origin (BIO) categories that contributes to 20-25% of the overall portfolio (forms part of the P&A segment).
- Due to lack of robust mechanism to capture data, there is no exact way to figure out on-trade & off-trade mix for the company but the mix for India's industry would be roughly 25:75.
- The Group, through one of its wholly owned subsidiaries Royal Challengers Bangalore (RCB), owns the rights to the Bangalore Franchisee of the Board of Control for Cricket in the Indian Premier League (IPL) for men and women.

Our view is underpinned on the following arguments:

1) Positive demographics, low per capita consumption, and a growing younger populace amply and ably support long term growth; stiff regulation makes growth non-linear

As per Technopak report, the Indian alco-beverage market crossed more than a billion cases per annum in FY23 divided equally between Country liquor, Indian Made Foreign Liquor (IMFL) and beer with a small contribution from wines in FY23. The industry is projected to reach 1,490mn cases in volume by FY28.

The Indian Alcobev industry is segmented into IMFL (Indian Made Foreign Liquor), IMIL (Indian Made Indian Liquor), Wine, Beer and imported alcohol. Whisky dominates the Indian spirits industry by a very wide margin.

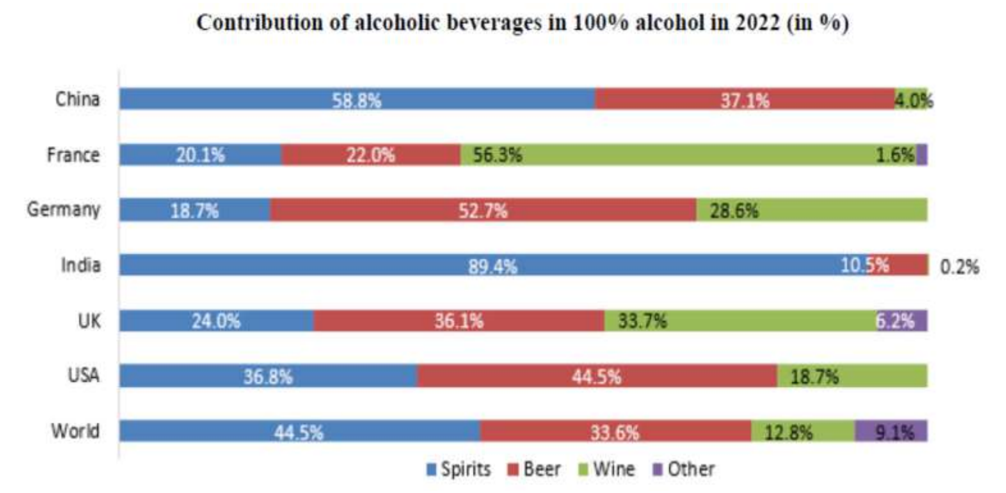
In terms of market share, there is a similar trend across IMFL, beer and wine were the top three players control more than 50% of the market.

IMFL is the largest segment of Indian alco-beverage market both in volume and value terms. IMFL segment recorded sales of 385mn cases in FY23 with a growth of 8% in volume as compared to FY22 sales at 280mn cases. IMFL market has recovered and grown to 385mn cases in FY23 as compared to pre-COVID levels of 355mn cases in 2020. United Spirts Ltd, Pernod Ricard India and Allied Blenders and Distillers are the top three players in the IMFL market.

IMFL is dominated by brown spirits including whisky, rum, and brandy with a small share of white spirits including vodka and gin. This is unlike world markets where white spirits are dominant. On a lower base, white spirits in India are now showing stronger growth.

According to industry data, the overall whisky market in the country is expected to cross USD22 bn by 2027. For Scotch whisky, India stands at No. 5 in the world by sales value. In 2022, sales of Scotch whisky in India increased by 93% to USD340mn, according to industry data. Scotch, however, accounts for just 2% of all whiskies consumed in India currently.

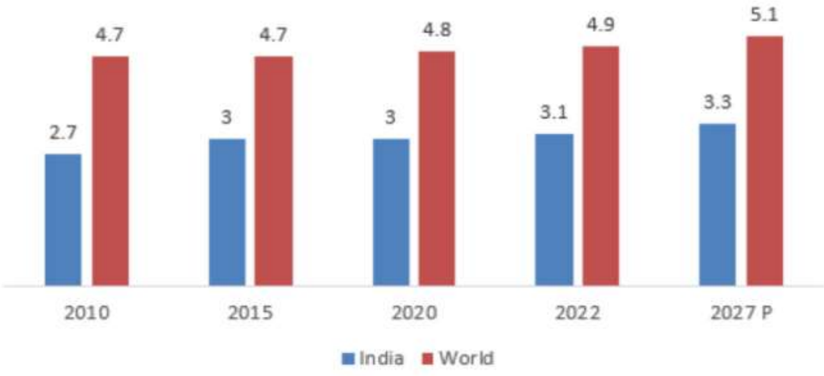
Exhibit 3: India is one of the leading spirits markets with more than 90% of consumption in the form of spirits



Source: Technopak analysis, YES Sec

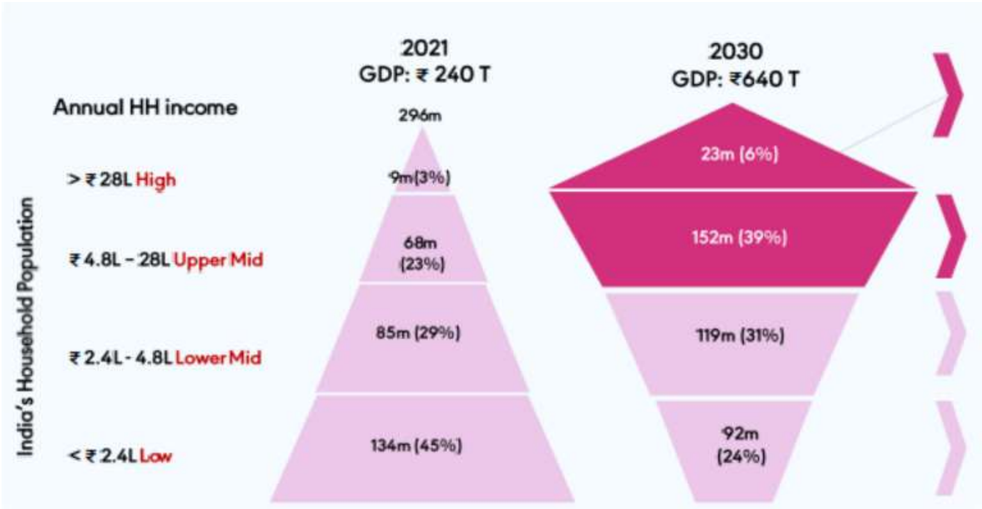
As per the Technopak report, India is one of the fastest growing alcoholic beverage markets in the world growing from a small base of 1.3 litres per capita of recorded consumption (PCC) of pure alcohol in 2005 to 2.7 litres PCC in 2010 and further to 3.1 litres PCC in 2022. But India's per capita consumption is still significantly lower compared to global per capital consumption. Low per capita consumption coupled with positive demographics factors and >13mn people added each year to the population eligible for drinking, make India an attractive market for alcoholic beverages.

Exhibit 4: Per capita consumption of alco-bev in India markedly low vis-à-vis world



Source: Technopak analysis, YES Sec

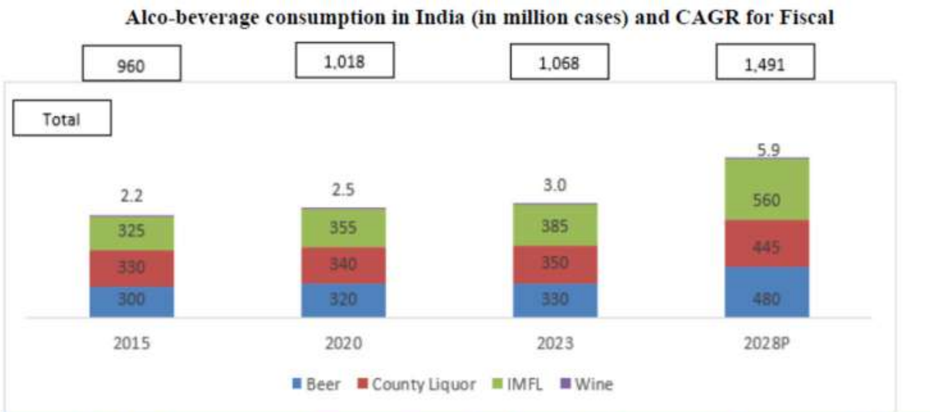
Exhibit 5: Rising affluence provides strong opportunity at the top



Source: Company, YES Sec

IMFL sales volume is projected to reach 560 cases by FY28. Sales by value is estimated at Rs2,206.62bn in FY23 and is projected to reach Rs3,402.18bn by FY28. During FY23-FY28, IMFL sales value and volume are expected to grow at a CAGR of 9% and 8% respectively.

Exhibit 6: IMFL projected to grow at 8% volume CAGR over 2023-2028



CAGR (FY)	Beer	Country Liquor	IMFL	Wine	Total
2015 – 2020	1.3%	0.6%	1.8%	2.6%	1.2%
2020 – 2023	1.0%	1.0%	2.7%	6.3%	1.6%
2023 – 2028P	8.0%	4.9%	8.0%	14.5%	6.9%

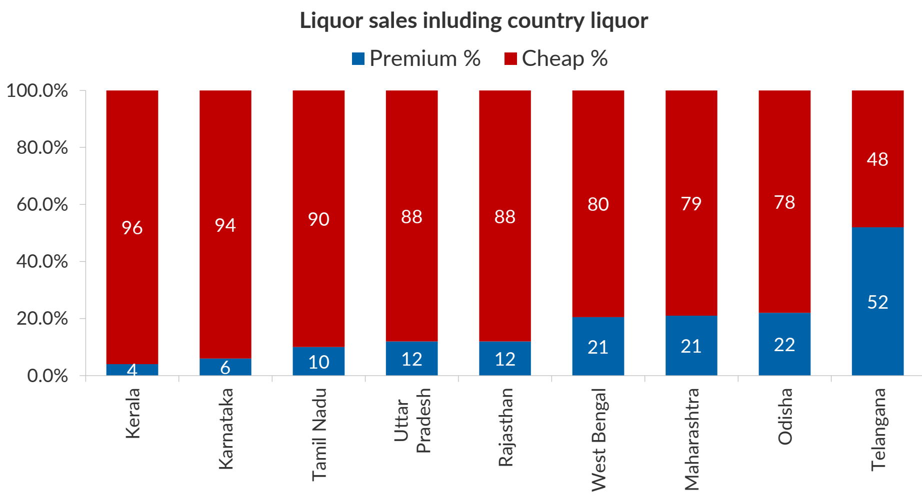
Source: Technopak analysis, YES Sec

But it is important to note that, alcohol in India remains a highly regulated sector which is also changing constantly. Ad-hoc change in route to market and controlled pricing continues to be a significant headwind for industry players. So actual growth for the industry and the players won't be linear in nature.

2) Premiumisation trend supported by UNSP's largest strategic interventions to help drive double-digit growth

As per a report by the International Spirits and Wines Association of India (ISWAI), premium liquor (priced over Rs1,000 per 750ml) is around or less than 20%. For state like Kerala (highest per capita incomes in India and significant tourist inflow), premium share is just 4% and the report attributes it to high taxes, limited access to retail outlets and substandard retail infrastructure, resulting in a poor consumer experience.

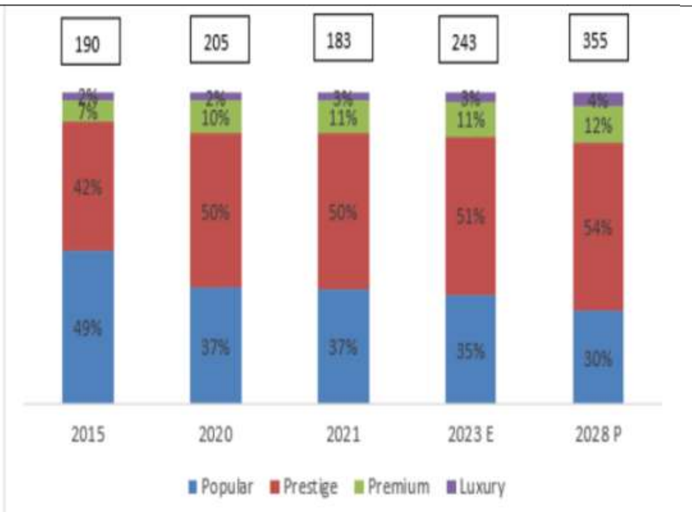
Exhibit 7: Premium versus cheap liquor across key states

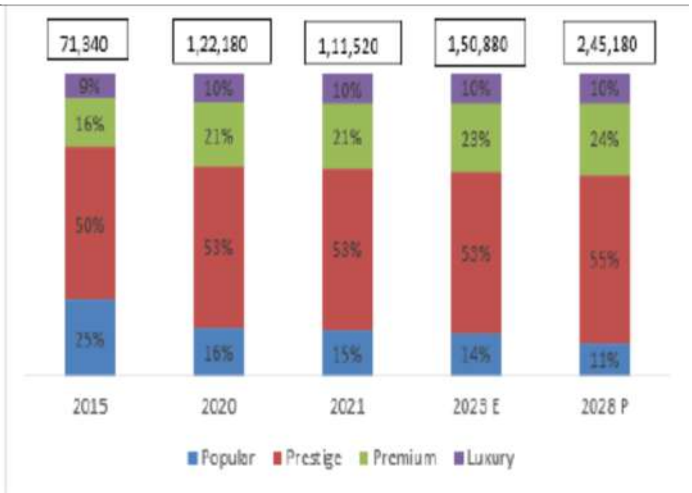


Source: ISWAI, YES Sec

Change in RTM by some states have led to improvement in retail infrastructure but high taxes and restricted number of outlets continues to be a barrier.

Exhibit 8: Segment wise split of whisky sales - volume in mn cases [left] and value in crores [right]





Segment	FY 2015-20	FY 2021-23E	FY 2023E-28P
Popular	-4.0%	12.4%	4.6%
Prestige	5.2%	16.4%	9.1%
Premium	10.1%	17.7%	9.8%
Luxury	4.4%	21.9%	14.3%
Overall	1.5%	15.3%	7.9%

Segment	FY 2015-20	FY 2021-23E	FY 2023E-28P
Popular	1.8%	11.7%	5.0%
Prestige	12.7%	16.2%	11.0%
Premium	17.9%	21.0%	11.1%
Luxury	14.1%	14.9%	10.2%
Overall	11.5%	16.4%	10.2%

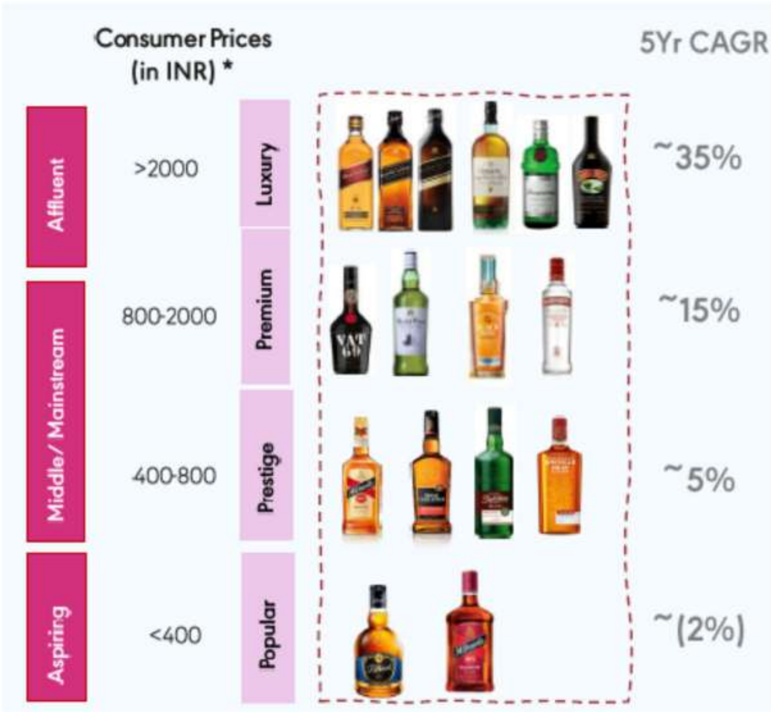
Source: Technopak, YES Sec

Mix of Popular portfolio, specifically for whisky has been gradually coming down for the industry as seen over 2015 till date. Prestige & Above segments are expected to grow in double digits versus a subdued growth at ~5% seen for Popular segment over the next few years.

In the last few years, especially post covid pandemic, consumers have started preferring quality over quantity and thus have led to organic growth of premium portfolio in certain categories within the alcohlic beverages sector.

UNSP benefits from strong brand awareness with a diverse range of products across various price points operating in all segments of popular, prestige, premium and luxury. The company has nine brands that sell more than a mn cases each year, of which one brand sells >25mn cases annually.

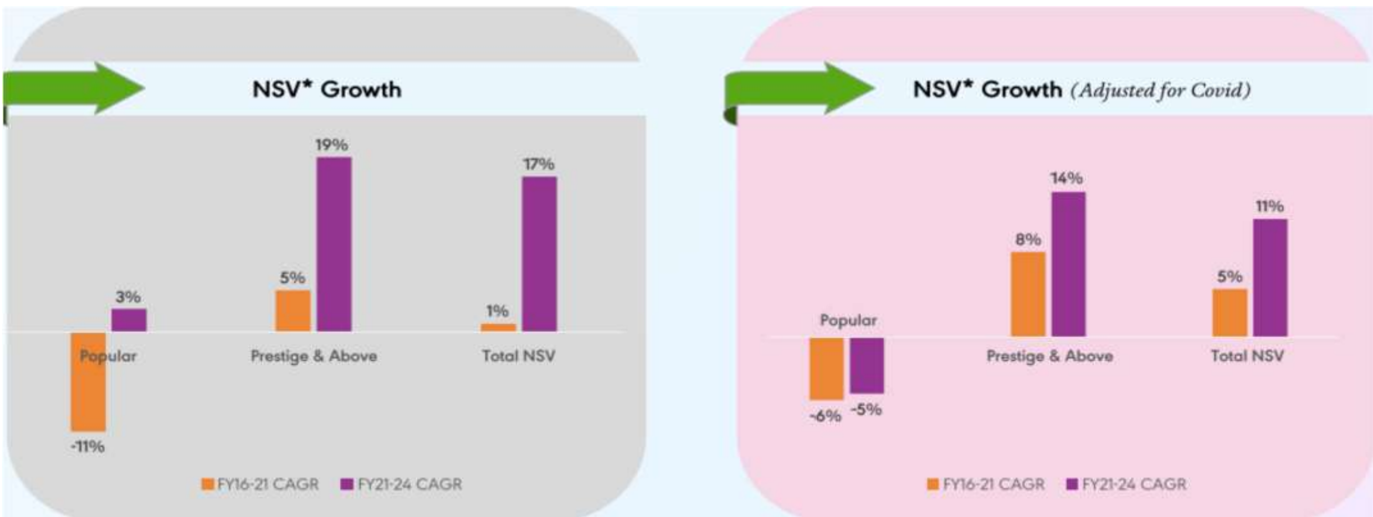
Exhibit 9: Prestige & Above growing at a faster pace



Source: Company, YES Sec; as on June'23

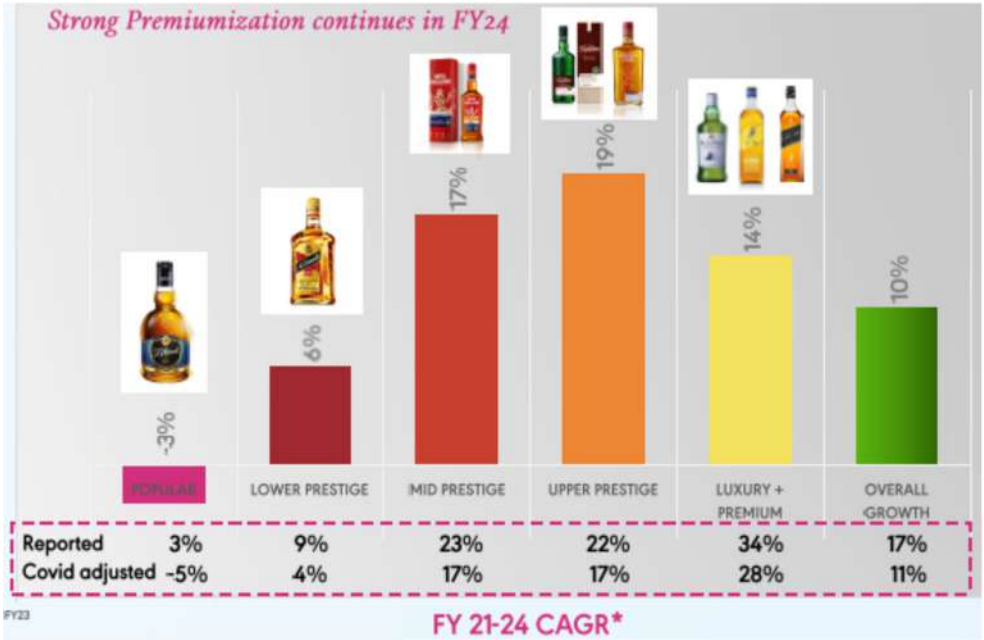
Over the last 7-8 years, ever since Diageo's acquisition of United Spirits Ltd, one of its primary vectors for repositioning its portfolio was focused on premiumisation. With this aim, the company also recently exited a major chunk [~45% of Popular Net Sales Value (NSV)] of the declining Popular segment market by way of a slump sale and franchise agreement, to focus on P&A. Post completion of the sale and franchising of select popular brands to Inbrew Beverages Private Limited, UNSP's mix of Prestige & Above (P&A) now stands at ~89% of NSV (excludes non-branded revenue) and ~82% of volumes.

Exhibit 10: P&A NSV momentum remains healthy



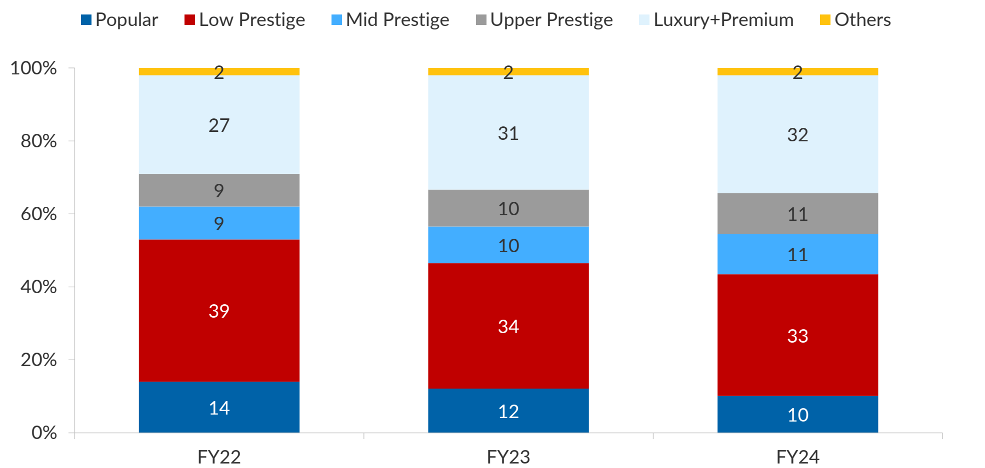
Source: Company, YES Sec; *NSV excludes Andhra Pradesh, Slump Sale & Franchise

Exhibit 11: Within P&A, Mid Prestige, Upper Prestige and Luxury+Premium continues to grow faster in FY24 as well



Source: Company, YES Sec

Exhibit 12: Luxury+Premium, Upper-Prestige and Mid-Prestige gained about three percentage points of salience in FY24 versus FY23



Source: Company, YES Sec; Note: NSV excludes impact of Covid, AP, Slump Sale & Franchise; All accounts referred as 'Rebased' are Reinstated for PDL merger as well as adjusted for slump sale and franchising of the strategically reviewed popular portfolio for a like for like comparison.

UNSP has been actively renovating old brands & introducing new products both in whisky and non-whisky categories (creating a portfolio for future consumers). In FY23, UNSP accelerated the reach of its innovations like *Royal Challenge American Pride* (launched in FY22) and the renovated offerings including *Royal Challenge* and *Signature* which added to the mix benefit. In FY24, *Royal Challenge American Pride*, which was launched in FY22 within Upper Prestige has already become 8% of the *Royal Challenge* trademark.

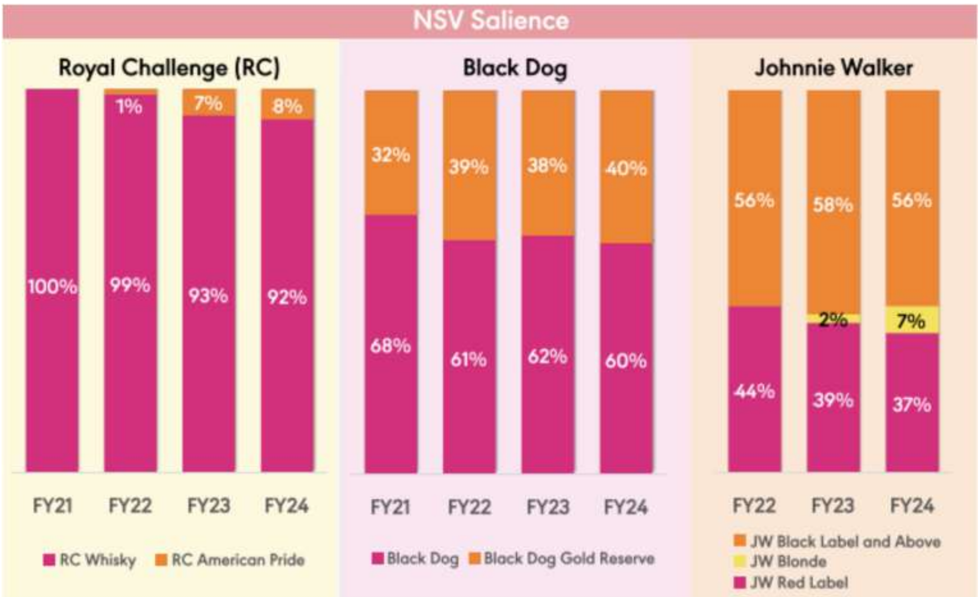
It also improved portfolio execution on salient segments and brands such as *Black & White*, *Black Dog* and *Royal Challenge*. Black Dog Triple Gold Reserve, which is the more premium variant within Black Dog is now 40% of the overall trademark in FY24 (up from 32% in FY21).

During FY23, UNSP introduced *Johnnie Walker Blonde*, a light scotch variant for the next-generation non-scotch consumer. Saliency of Johnnie Walker Blonde, which was the latest addition to the Johnnie Walker family positioned in between Red and Black Lable, now forms 7% of the trademark in FY24.

Exhibit 13: Transforming the core portfolio through renovation and product upgrade

Source: Company, YES Sec

Exhibit 14: Premiumization within trademarks improving



Source: Company, YES Sec

In addition to this, recently UNSP stretched its trademark McDowell's to Indian Single Malt and McDowell's X Series- unique range of rum, gin, and vodka. McDowell's X series recently launched in Goa and will be launched in other markets at Mid to Upper Prestige price points in the coming 3-4 quarters.

With the thrust on innovation, and to strengthen its craft and premium portfolio, the company invested Rs450mn to set up its Innovation Hub, "The Good Craft Co.", in Ponda, Goa last year. The company has also entered the Indian craft segment under brands such as *Epitome Reserve*, *Godawan* and *Signature*.

UNSP is also creating categories through Don Julio (Tequila) and now Pistola (Agave Spirit). In 2QFY24, it also announced the launch of their global Tequila trademark *Don Julio* in India and most recently it also made investment in Pistola (15% stake for Rs56.5mn) to promote craft spirits (first Indian-aged 100% Agave spirit). White spirits are just ~5% of the total market. The company expects the strong growth momentum to continue in this segment. This innovations/new launches and their on-ground execution will be critical for medium to long term growth.

Exhibit 15: Premiumization through new category introduction & creation

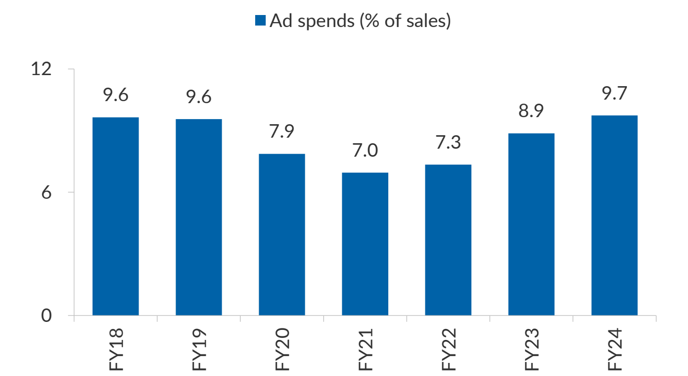
Source: Company, YES Sec

On a steady-state base, company continues to aspire for double-digit topline growth on the back of 4-5% volume growth & 6-8% pricing+mix growth in P&A while holding Popular portfolio flat.

3) Profitability per case continues to improve at a decent rate

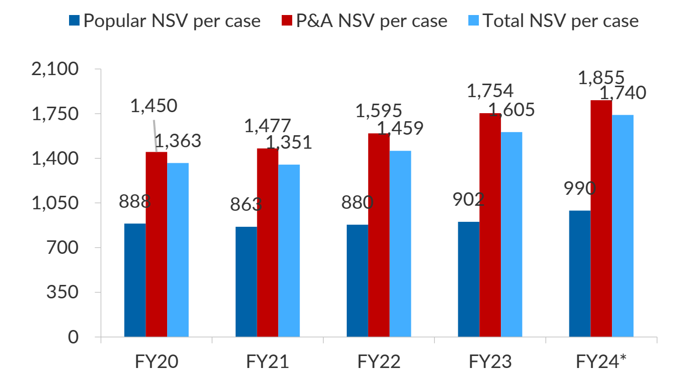
UNSP operates in a highly regulated industry with state-specific policies, which not only impact industry volumes but also does not give control on pricing. In the absence of free price flexibility, any major volatility in key commodities like extra-neutral alcohol (ENA) and glass (together constitutes ~2/3rd of the company's raw material basket) have a immediate and sharp bearing on the margins. Premiumization has been a key driver of improvement in NSV per case and will continue to be a key driver of margin improvement over the medium-to-long term.

Exhibit 16: Sustained high A&SP behind innovations/renovations has driven premiumization..



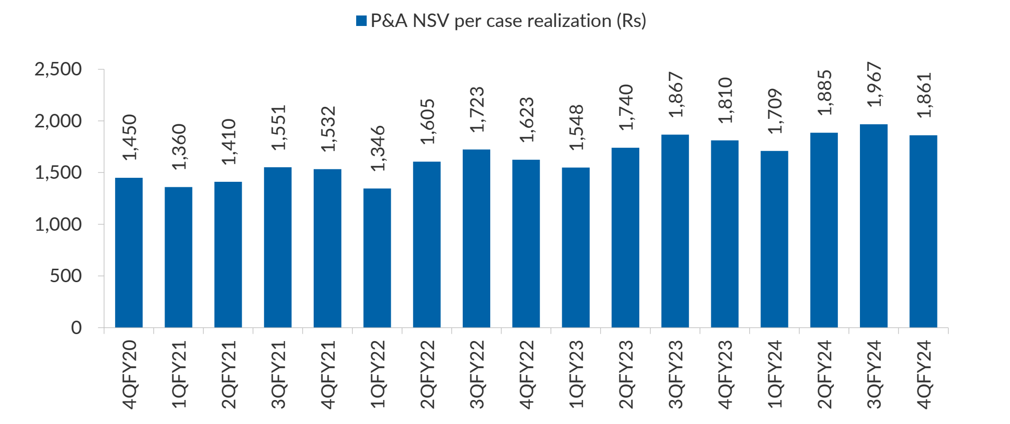
Source: Company, YES Sec

Exhibit 17: ..leading to improved NSV per case realization over the last few years



Source: Company, YES Sec; *FY24 NSV per case for Popular and P&A estimated

Exhibit 18: P&A NSV per case realization continues to improve in recent quarters



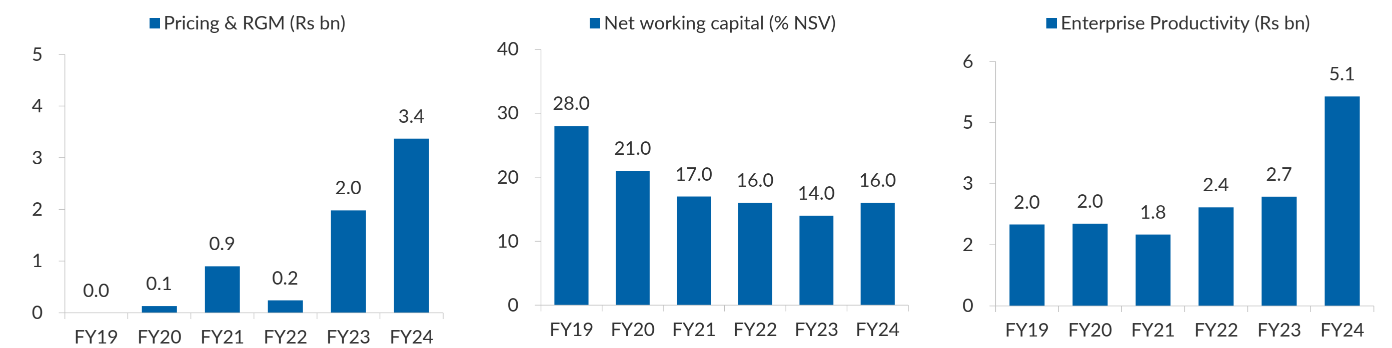
Source: Company, YES Sec

Overall scotch salience (in value terms) of BIO & BII ranges 20-25% (BIO & BII is 50% each). For Pernod Ricard, ~15% of its sales comes from the imported product, which are bottled in origin (BIO) products. Even in current environment, the demand on the luxury side and the premium brand remained robust. The salience will continue to increase going forward for industry & UNSP as the portfolio is growing faster than other portfolios on the back of higher consumption. While distribution margin is only ~10% in the BIO portfolio (which is governed by the global transfer pricing norms), it is accretive at an EBITDA/case level, giving boost to company level margins. It is also accretive on ROI basis, as no investment has been made in fixed or long-term assets and the working capital engagement is also fairly consistent across the ladder for UNSP.

In recent times, UNSP has also embarked on certain transformational projects like multi-year supply agility programme (in addition to efficiency savings), simplifying legal entity footprint, phased removal of mono-cartons starting with premium scotch brands (benefit of around Rs1.6-1.7bn in FY24), etc. which will help key overheads at bay.

UNSP has enjoyed improved headline pricing in last couple of years which is expected to moderate in FY25. While revenue growth managemnt (RGM) interventions on account of trade spend productivity should lend some support. Net working capital as a % of NSV has seen good improvemennt over the last 4 years but has gone up a little in FY24 due to industry-wide issues. Enterprise productivity saw a huge bump in FY24 of around Rs5.14bn as there is a one-time effect on account of the mono-carton removal project which is close to about Rs1.6bn to Rs1.7bn. Excluding this, productivity for the year still saw a significant increase to Rs3.4bn versus the last year of Rs2.68bn.

Exhibit 19: Along with premiumization UNSP has been ramping up effeciencies across the value chain (1) Pricing & Revenue Growth Managemnt (RGM) (2) Net Working Capital (% of NSV) (3) Productivity



Source: Company, YES Sec

United Spirits Ltd

United Spirits (UNSP) has witnessed a remarkable turnaround in its margins since its control was taken by Diageo, a global leader in alcohol beverage. EBITDA margins have improved from ~8.4% in FY15 to ~16% in FY24 (~87bps average improvement every year) this is despite the strong

inflationary pressure in key raw materials (especially ENA) being witnessed by the industry and the company. The company's strong focus on premium segments has yielded considerable results, with the Prestige & Above (P&A) segment now contributing around 88-89% to its overall sales in FY24, up from around 45%-50% around the time of its acquisition (July 2014).

To get a sense of relative performance, we also have a closer look at the financials of its closest peer Pernod Ricard India Pvt. Ltd. (Pernod). Profitability gap between Pernod and UNSP has come down sharply over the last 6 years till FY24 (Pernod FY24 nos compared based on our estimation). A larger part of EBITDA margin gap reduction has been driven by overheads followed by gross margin gap reduction (Pernod's gross margin profile has taken a sharp hit over the last 5-6 years).

Why we believe, Pernod Ricard enjoys high margins–

- Created P&A segment of this category absolutely unchallenged for the last 2-3 decades
- Clean business model and manufacturing footprint (~75% outsourced)
- Four brands with high NSV and also driving A&SP efficiencies
- Largely aligned bottling partner
- High brand equity

Compared to UNSP, there will be ~2-3% delta on A&P spends for next few years. Difference on account of manufacturing costs, we believe will even out in next few years and the rest is on account of portfolio advantage that Pernod Ricard has at the Upper-Prestige and Mid-Prestige segment (~70% share).

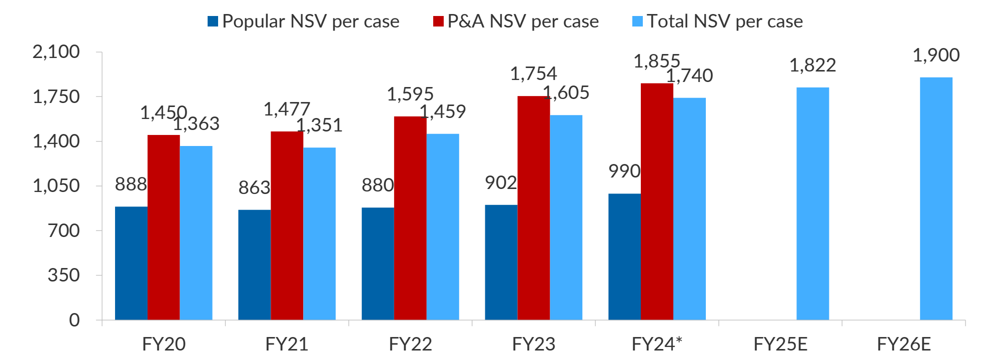
Exhibit 20: Pernod Ricard India Pvt Ltd (June-ending) gap over UNSP Standalone business (Mar-ending) remains but reducing especially on profitability

Rs mn	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24E
Gross Sales	-49%	-39%	-29%	-25%	-28%	-26%	-9%	6%
Net Revenue	-24%	-11%	-5%	-1%	-2%	2%	11%	20%
GM (%)	5.5	3.5	2.4	4.1	2.6	2.9	1.8	1.9
EBITDA	51%	73%	62%	37%	58%	35%	39%	42%
EM (%)	11.1	11.9	9.9	6.3	7.6	5.1	3.4	3.0
APAT	146%	151%	93%	99%	154%	62%	53%	25%

Source: Company, YES Sec

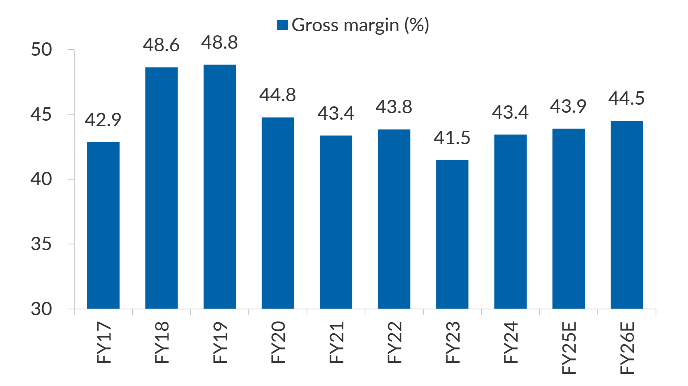
Over the medium-term (3-5 years), in a stable-state environment, with the ongoing wave of premiumization along with RGM, some pricing, effeciencies and leverage, we believe UNSP can deliver 150-250bps improvement in operating margin.

Exhibit 21: We expect total NSV per case to improve to Rs1,900 by FY26E



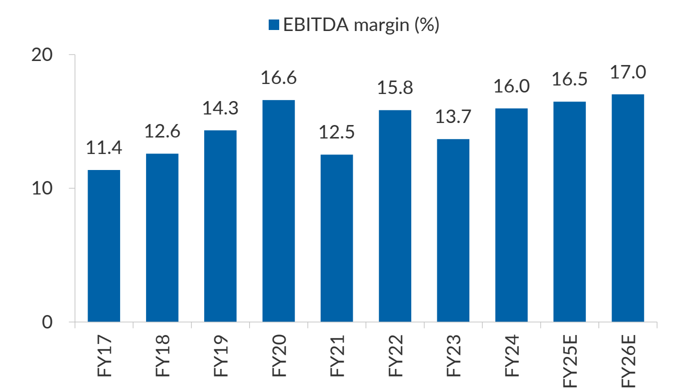
Source: Company, YES Sec; *FY24 NSV per case for Popular and P&A estimated

Exhibit 22: Pricing, RGM & Premiumization benefit still not fully visible in GM due to ongoing ENA inflation



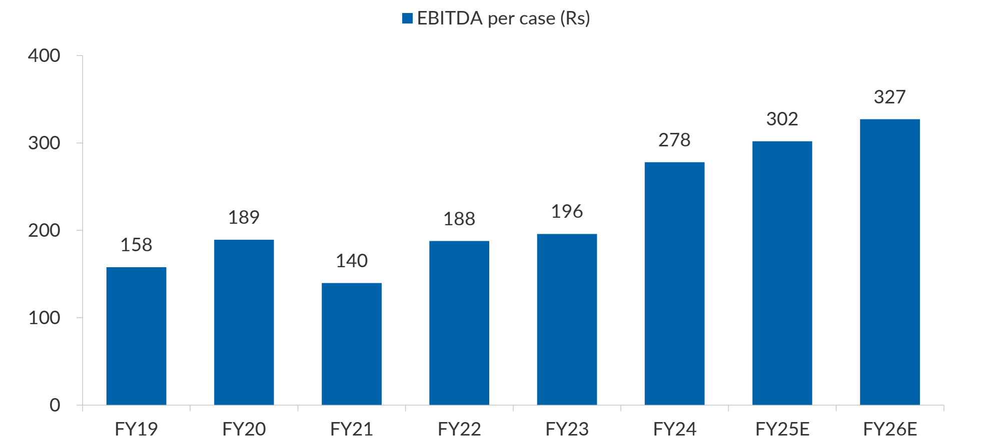
Source: Company, YES Sec

Exhibit 23: Gradual GM improvement, efficiencies and leverage should help improve EM profile further



Source: Company, YES Sec

Exhibit 24: Premiumization and company's own initiatives reflecting in improved EBITDA per case for the company



Source: Company, YES Sec

Strong promoter group

Business synergies, financial flexibility and strengthened governance with ~56-57% stake held by Diageo Plc have yielded results over the past 4-5 years. Strong execution capabilities and Diageo's superior capital management ability complement UNSP's scale of operations.

Ms. Hina Nagarajan is currently heading (MD and CEO). She was the managing director of the Africa Regional Markets (ARM) at Diageo (Diageo's ARM comprised operations in Ghana, Cameroon, Ethiopia, the Indian Ocean, Angola and several other countries) and joined UNSP as the CEO-Designate from April 1, 2021 (formally took over from Mr. Anand Kripalu on 1st July 2021). She is also part of the Diageo Global Executive Committee and her long-term incentives are linked to sustainability KPI's. The company is very much committed to keep sustainability at the center of all the decisions taken.

We expect ~15% EBITDA growth over FY24-26E for the standalone business

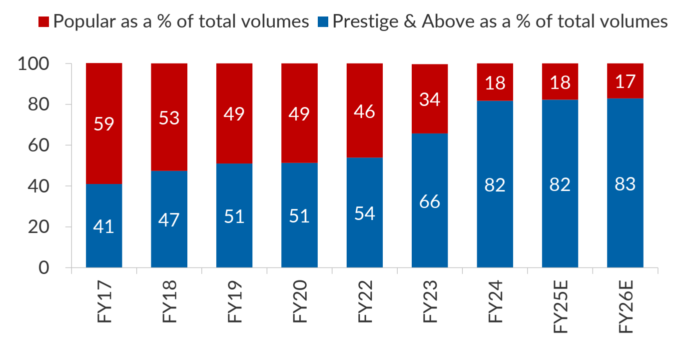
Over the medium-term, favorable demographics and improved focus on P&A segment (>85% P&A NSV salience now) is likely to provide decent growth for the market leader. Diageo's global brands has been doing well post-Covid and since the premium customers are sticky, it is expected to do well going forward as well.

While margins continue to face pressure from inflationary headwinds in key commodities, company's premiumization focus, and efficiencies emanating from transformational projects and leverage should support margin expansion in the near-to-medium term. Over FY24-FY26E, we can expect UNSP to deliver EBITDA CAGR of ~15% led by 10.8% revenue CAGR and an EBITDA margin expansion of 120bps (driven by 120bps gross margin improvement), leading to a 12.9% earnings CAGR of the same period (APAT growth impacted by high base due to other income and low tax rate in FY24).

Royal Challengers Sports Private Limited (RCSPL): In addition to the business of manufacture, purchase and sale of beverage alcohol and other allied spirits, the Group holds perpetual rights to the Royal Challengers Bangalore (RCB) cricket franchise of Indian Premier League (IPL) and has also acquired franchise rights for the Women's Premier League (WPL) in January 2023. The media right auction happens once in five years. Even while the company continue to drive some accretive revenue growth management, local sponsorships, etc. the P&L is more or less capped for five years. At the bottomline, RCSPL fundamentally should do a profit of Rs3bn from men's IPL and Rs0.9 bn loss for WPL (Rs2.1bn pofit net-net), which will stay for five years. Similar to Men's IPL team, management expects women's IPL team to hit the inflection point in 8-10 years.

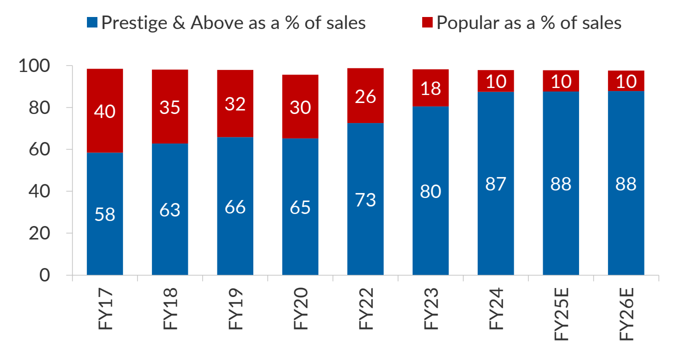
STORY IN CHARTS

Exhibit 25: Faster growth in P&A segment and company's own strategic initiatives have meant that P&A now forms ~82% of volumes in FY24



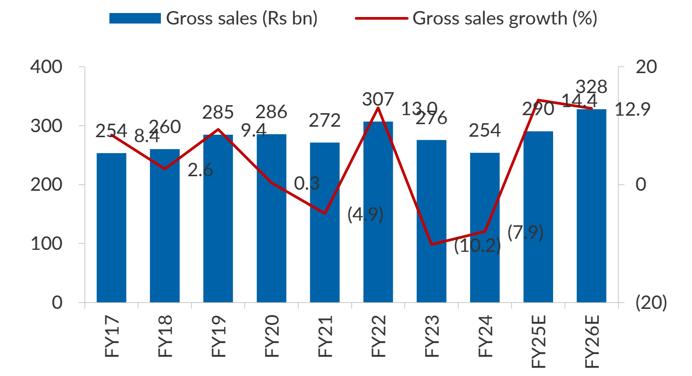
Source: Company, YES Sec

Exhibit 26: ..and with higher realizations per case, P&A contribution to sales stands even higher at ~87% in FY24; lower base for Popular means we don't see any major change for FY25 & FY26



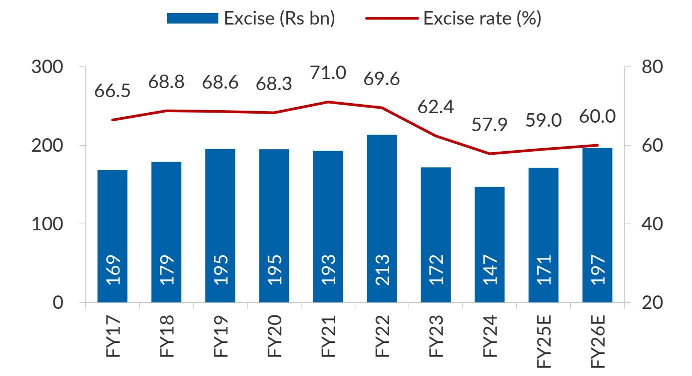
Source: Company, YES Sec

Exhibit 27: Gross sales are expected to grow by 13.6% over FY24-FY26E



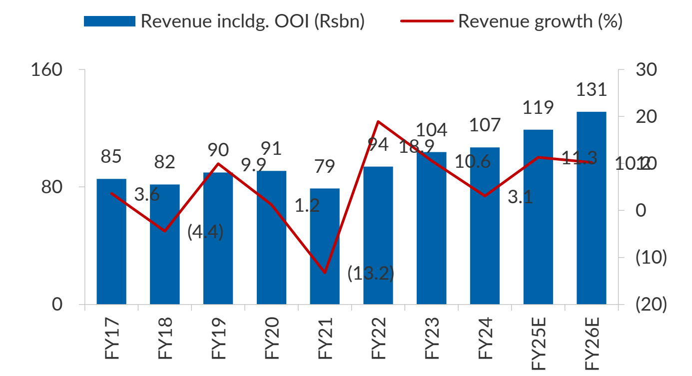
Source: Company, YES Sec

Exhibit 28: To be conservative, we build increase in excise rate in FY25 & FY26 from FY24 levels



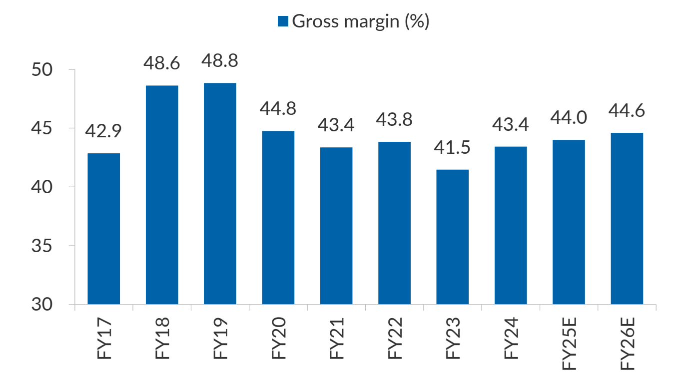
Source: Company, YES Sec

Exhibit 29: We thus expect revenue to grow at 10.8% CAGR over FY24-26E



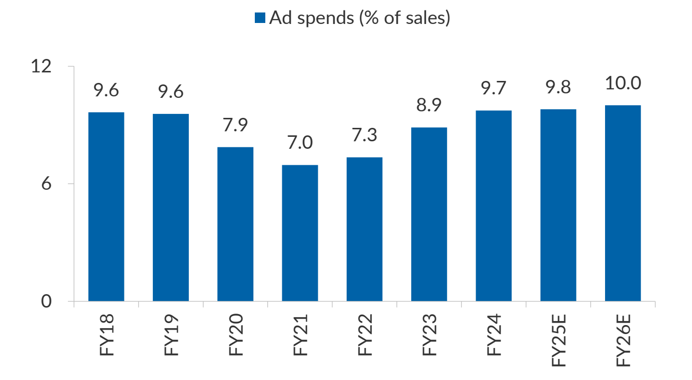
Source: Company, YES Sec

Exhibit 30: Gross margin is expected to improve by ~120bps over FY24-26E to 44.6% level



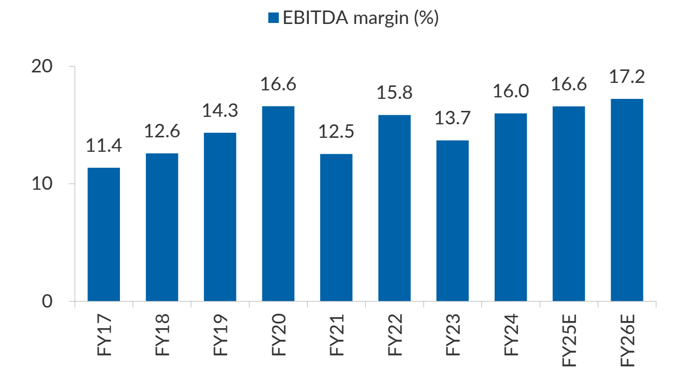
Source: Company, YES Sec

Exhibit 31: We expect UNSP to maintain high spends on A&SP at 9-10% levels on innovation/renovation and building new categories



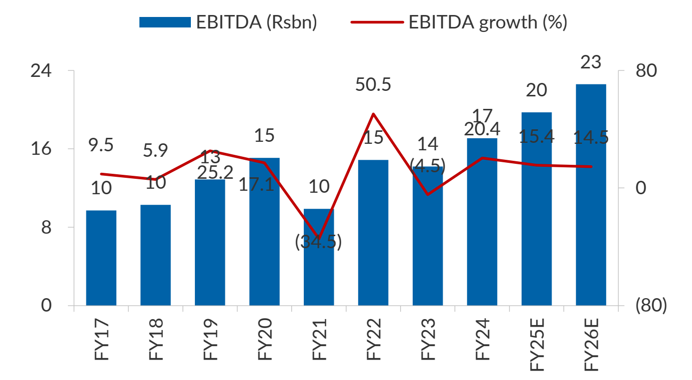
Source: Company, YES Sec

Exhibit 32: Thus, building EBITDA margin expansion of ~120bps to 17.2% by FY26E



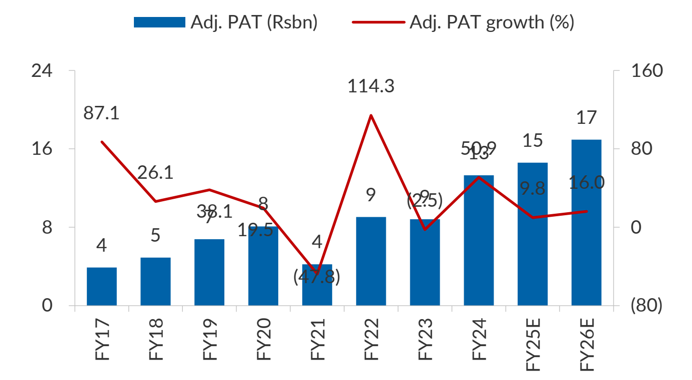
Source: Company, YES Sec

Exhibit 33: EBITDA likely to grow at ~15% CAGR over FY24-26E..



Source: Company, YES Sec

Exhibit 34: ..and APAT to grow by 12.9% over the same period



Source: Company, YES Sec

Recent Quarters (4QFY24) Result Highlights

- **Headline performance:** Standalone net sales grew 6.9% YoY to Rs26.7bn. EBITDA grew by 7.4% YoY to Rs3.6bn. Adjusted PAT (APAT) grew by 93.0% to Rs4.2bn bumped by higher other income (higher treasury income, dividend from 100% subsidiary RCSPL & income tax refund).
- **Volumes**: Overall volumes for the quarter grew by ~3.7% YoY to 15.6mn cases.
  - **Prestige & Above** (P&A; 86.6% of net sales) volumes grew by ~3.7% YoY to 12.4mn cases with value growth of ~6.5% YoY.
  - **Popular** (11.6% of net sales) volumes up ~4.0% YoY to 3.2mn cases leading to ~3.3% YoY value growth.
- **Excise duty** was up ~140bps YoY to 56.9% as a % of gross sales in 4QFY24.
- **Gross revenue per case** for the quarter was up by 6.6% YoY from Rs3,847 in 4QFY23 to Rs4,100 in 4QFY24 (it was Rs4,218 in 3QFY24).
- **Net revenue per case** for the quarter was up by 3.1% YoY from Rs1,659 in 4QFY23 to Rs1,710 in 4QFY24 (it was Rs1,814 in 3QFY24).
- **Margins**: Overall gross margin down ~200bps to 43.3% (flattish QoQ). A&SP was down 160bps YoY and other overheads were down 60bps YoY. Thus, EBITDA margin was up ~10bps YoY to 13.6%.
- **EBITDA per case** stood at Rs232 vs Rs224 in 4QFY23.

Exhibit 35: Standalone quarterly result snapshot

Particulars (Rs mn)	4QFY23	3QFY24	4QFY24	YoY (%)	QoQ (%)	FY23	FY24	YoY (%)
Net Sales	24,940	29,893	26,660	6.9	-10.8	103,740	106,919	3.1
Gross margin %	45.3	43.4	43.3	-2.0	-0.1	41.5	43.4	2.0
Employee costs	1,220	1,410	1,340	9.8	-5.0	6,070	5,428	-10.6
% of sales	4.9	4.7	5.0	0.1	0.3	5.9	5.1	-0.8
A&P	3,440	3,277	3,260	-5.2	-0.5	9,200	10,408	13.1
% of sales	13.8	11.0	12.2	-1.6	1.3	8.9	9.7	0.9
Other expenses	3,270	3,378	3,330	1.8	-1.4	13,560	13,518	-0.3
% of sales	13.1	11.3	12.5	-0.6	1.2	13.1	12.6	-0.4
EBITDA	3,370	4,914	3,620	7.4	-26.3	14,190	17,086	20.4
EBITDA margin %	13.5	16.4	13.6	0.1	-2.9	13.7	16.0	2.3
Depreciation	680	628	710	4.4	13.1	2,710	2,641	-2.5
EBIT	**2,690**	**4,286**	**2,910**	**8.2**	**-32.1**	**11,480**	**14,445**	**25.8**
EBIT margin %	10.8	14.3	10.9	0.1	-3.4	11.1	13.5	2.4
Interest expense	360	164	290	-19.4	76.8	1,040	759	-27.0
Other income	170	461	2,290	1,247.1	396.7	740	3,348	352.4
Exceptional items	-110	0	-310	-	-	1,710	-170	-
PBT	**2,500**	**4,583**	**4,910**	**96.4**	**7.1**	**11,180**	**17,034**	**52.4**
Tax	350	1,102	760	117.1	-31.0	2,370	3,740	57.8
Effective tax rate %	14.0	24.0	15.5	1.5	-8.6	21.2	22.0	0.8
PAT	2,040	3,481	3,840	88.2	10.3	10,520	13,124	24.8
Adj PAT	2,150	3,481	4,150	93.0	19.2	8,810	13,294	50.9
PAT margin %	8.6	11.6	15.6	6.9	3.9	8.5	12.4	3.9
EPS	**3.0**	**4.8**	**5.7**	**93.0**	**19.2**	**12.1**	**18.3**	**50.9**

Source: Company, YES Sec

Detailed pointers from United Spirits Ltd (UNSP) latest (4QFY24) Earnings Call & Presentation

- **Demand environment**: Growth has moderated in the past 2 years coupled with sustained pressure in the lower end of the consumer spectrum. Last couple of quarters have been slightly better. However, premiumization is intact. The consumers are not down-trading but are rationalizing the number of socializing occasions. The first half would be impacted due to high base effect, but the overall double-digit growth guidance remains intact. There was no impact on demand due to elections. There has been no incremental update on Delhi market (lower base of volumes remains stable).
- **Commodity Inflation**: ENA saw inflation of 11-12% in FY24 and expected to remain inflationary due to governments blending policy. Glass prices saw deflation in the quarter and will continue to remain deflationary. On an overall basis commodity inflation has moderated. Hence, UNSP does expect headline pricing to moderate as well.
- **Interventions in Popular portfolio**: UNSP earlier had taken steep price increase in their key market Karnataka which led to decline in volumes. Company has now reset the value equation in this market. It has also invested in little bit of media and A&P in the portfolio to stem the decline and reverse the momentum. Ideally, it would like to hold the portfolio to close to flattish levels.
- **Receivables**: Higher receivables were due to buildup of receivables in one state. However, the company is working with industry associations and expect it to normalize in FY25.
- **Guidance**: The company has maintained its aspiration of 4-5% volume growth along with 6-8% pricing mix growth in P&A while holding Popular portfolio flat. This should lead to a double-digit topline growth at company level for the full year.
- **Productivity**: Enterprise productivity saw a huge bump in FY24 of around Rs5.14bn. There is a one-time effect on account of the mono-carton removal project which is close to about Rs1.6bn to Rs1.7bn. Excluding this, productivity for the year still saw a significant increase to Rs3.4bn versus the last year of Rs2.68bn.
- **Strategic initiative in Prestige & Above (P&A)**: The company is stretching its Trademark McDowell's to Indian Single Malt and McDowell's X Series- unique range of rum, gin, and vodka. Both the products are showing early positive signs. McDowell's X series recently launched in Goa and will be launched in other markets at Mid to Upper Prestige price points in the coming 3-4 quarters.
- **Premiumization levers**:
  - **Popular upgrades to P&A**: P&A now stand at 89% of NSV (excluding sales from non-brand revenue), compared to 84% in FY21.
  - **Within sub-segments of P&A**: Growth in the luxury premium portfolio has accelerated significantly from FY21 with this segment now contributing to more than one-third of NSV salience. Mid-Prestige and upper-Prestige have gained well during the said period.
  - **Trademarks**: UNSP had intensified its brand innovations over the last few years, bringing premium variants of existing trademarks. This have gained meaningful saliency within the trademarks in a short span of time. Royal Challenge American Pride is now 8% of the Royal Challenge (RC) Trademark in FY24 (compared to just 1% in FY22) with growth normalizing on a high growth base. Black Dog Gold Reserve salience is now 40% in FY24 compared to 32% in FY21. JW Blonde is now 7% of the Johnnie Walker Trademark (2% in FY23).
  - **New categories (Tequila and Agave Spirit)**: UNSP is also creating categories through Don Julio (Tequila) and now Pistola (Agave Spirit). It has launched 4 products in India under the Don Julio brand (global Diageo brand). Tequila is the fastest growing spirit in the world and is gaining strong traction in India. It acquired 15% stake in Indian Agave based spirit company named Pistola for Rs56.5mn. White spirits are just ~5% of the total market. The company expects the growth momentum to continue in this segment.

- **Lower Prestige**: Lower prestige performing competitively over the last three years. Overall segment growths are lower over the last couple of years so not seeing upgrades from Popular compared to earlier years, but McDowell's continue to perform competitively.
- **Luxury & Premium:** UNSP has seen significant shift in NSV saliency post new strategy. Growth in the luxury premium portfolio has accelerated significantly from FY21 with this segment now contributing to more than 1/3rd of NSV salience. Johnnie Walker (JW) & Singleton are the growth bets in the BIO portfolio while BII remains strong with B&W and Black Dog growing well.
- **Bottled-in-India Scotches**: Black & White was the fastest growing premium scotch in the market. India remains the largest Black & White market in the world. Black Dog remains the No. 1 brand equity in its segment indexed at 121 compared to its nearest competitor and 196 indexed to its 2nd largest competitor.
- **Gross margin**: Ever after seeing strong expansion in FY24, company's intent remains to expand gross margin from current levels through the combination of headline pricing, revenue growth management, sustained productivity and premiumization offsetting inflation leading to gross margin enhancement.
- **EBITDA margin**: Management believes, in FY24 UNSP has covered two years of margin expansion in just 1 year. It has given guidance of moderate margin expansion.
- **Other income**: Out of Rs2.25bn other income, Rs700mn was income tax refund along with interest (Rs750 for full year FY24) and Rs1.25bn was received as dividend income transferred from its subsidiary Royal Challengers Sports Private Limited (RCSPL), since RCSPL has wiped out all their accumulated losses and have positive reserves now. This dividend income should continue in coming years at the same range as well as the management expects the subsidiary to remain profitable.
- RCB men's team is amongst the top 5 sports team in the world in terms of social media interactions.
- UNSP currently does not have any official sales in Andhra Pradesh.
- White spirits are just 5% of the market currently but are growing fast.

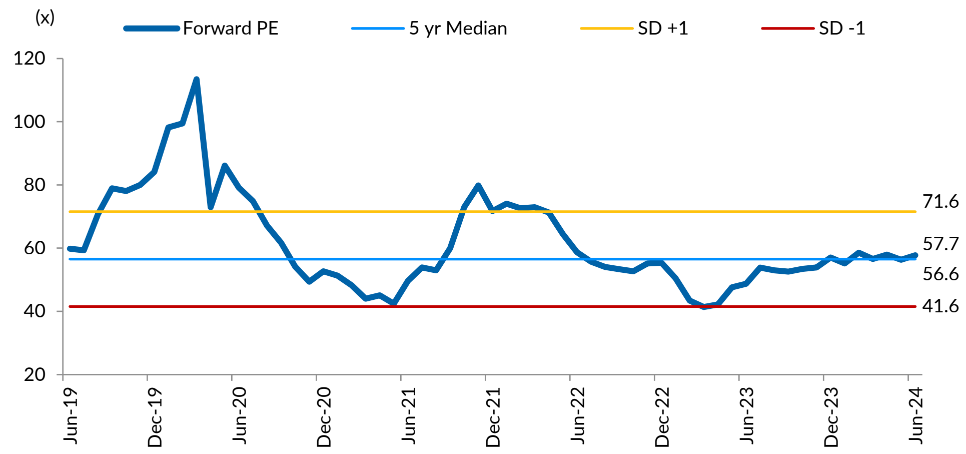
United Spirits Ltd

Initiate coverage on UNSP with an ADD rating and a target price of Rs1,320

- United Spirits (UNSP) has witnessed a remarkable turnaround in its portfolio mix and margin profile since its control was taken by Diageo, a global leader in alcohol beverage. The company's strong focus on premium segments has yielded considerable results, with the Prestige & Above (P&A) segment now contributing around 87% to its overall sales in FY24, up from around 45%-50% around the time of its acquisition (July 2014).
- Growth has moderated since 2 years along with continued pressure in lower end of the consumer spectrum, even though last couple of quarters have been slightly better. However, premiumization remains intact.
- In the near term, since commodity inflation has moderated, we do expect headline pricing to moderate as well. This should be offset by better volume growth in the near term. We thus expect topline to grow at a CAGR of 10.8% over FY24-26E led by ~11% revenue CAGR in the Prestige & Above (P&A) segment.
- UNSP has delivered an healthy EBITDA margin improvement post the change in control. Even after seeing strong expansion in FY24, company's intent remains to expand gross margin from current levels through the combination of some headline pricing (sitting on high price growth of last two years), revenue growth management, sustained productivity and premiumization offsetting inflation leading to gross margin enhancement. Management believes, in FY24 UNSP has covered two years of margin expansion in just 1 year. Hence, it has given guidance of moderate margin expansion. We build EBITDA margin expansion of 120bps (driven by 120bps gross margin expansion) over FY24-26E.
- **Dividend income from subsidiary**: Royal Challengers Sports Private Limited (RCSPL) has wiped out all their accumulated losses and now are sitting on positive reserves. In 4QFY24, it paid out Rs1.25bn to its parent UNSP (Diageo India) as dividend income (sits in other income of UNSP standalone business). This is expected to continue in coming years at the same range as well as the management expects the subsidiary to remain profitable. This means earnings estimate for consensus would have seen a upgrade but earnings CAGR would be lower than EBITDA CAGR over FY24-26E due to high base of other income (includes dividend income from subsidiary and income tax refund).
- We thus build EBITDA/Earnings CAGR of ~15%/12.9% over FY24-26E for the standalone business.
- **Resumes dividend distribution in FY24**: Exactly after a decade, UNSP resumes dividend distribution as it wiped out all its accumulated losses in 1QFY24. A formal dividend dsitribution policy is in place. In 2QFY24 the Board of Directors had approved its first-ever interim dividend of Rs4.0 per share after a long hiatus enabled by the successful turnaround of the company to sustained profitability. In 4QFY24, the company announced a final dividend of Rs5 for FY24.
- Return ratios are low compared to consumer staples but better than the listed beer player, stands at >25% (RoCE pre-tax in FY24) and should improve over the medium-term. Cash flows are also wintessing robust improvement.
- The stock is currently trading at ~60x/52x FY25E/FY26E EPS. We initiate coverage on UNSP with a ADD rating and target price of Rs1,320 (targetig ~50x on March'2026E EPS of standalone business + RCSPL).
- **Event to watch out for in near-term:** India and UK have been discussing the Free Trade Agreement (FTA) since January 2021. Industry particpant believe it will be a big milestone for market access in the alcobev industry in decades if the 150% duty levied on imported Scotch whisky is reduced. The talks seems to be in the final stages. Scotch Whisky accounted for 8.1mn cases in India, which is <3% of the total whisky market. Only 24% of exports to India are bottled in Scotland. Most Scotch Whisky sold in India is bottled locally coming in as bulk Scotch Whisky and being added to Indian products.
- **Risks**: (1) Regulatory changes continue to be the biggest risk for the industry and the sector. (2) Competitive intensity also remains a key risk.

United Spirits Ltd

Exhibit 36: Currently trading in-line with its 5-year median PE



Source: Company, YES Sec

FINANCIALS

Exhibit 37: Balance Sheet

Y/E Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Share capital	1,453	1,455	1,455	1,455	1,455
Reserves	47,564	57,990	68,180	71,120	77,891
Net worth	49,017	59,445	69,635	72,575	79,346
Total debt	0	11	0	0	0
Other long-term liabilities	1,159	249	630	630	630
Total liabilities	**50,176**	**59,705**	**70,265**	**73,205**	**79,976**
Gross block	21,062	22,717	25,573	26,573	27,573
Depreciation	7,970	10,483	13,123	15,939	18,863
Net block	13,092	12,234	12,450	10,634	8,710
Capital work-in-progress	817	668	370	370	370
Investments	4,390	4,617	8,230	10,744	12,744
Inventories	20,771	22,300	20,630	23,798	26,232
Debtors	23,021	23,828	31,280	26,080	28,028
Cash	328	8,496	12,090	15,690	18,715
Loans & advances	14,858	17,084	17,265	20,084	21,584
Other current assets	5,398	4,914	3,340	3,507	3,682
Total current assets	64,376	76,622	84,605	89,160	98,242
Creditors	15,048	17,383	18,270	20,498	22,713
Other current liabilities & provisions	17,451	17,053	17,120	17,205	17,377
Total current liabilities	32,499	34,436	35,390	37,703	40,090
Net current assets	31,877	42,186	49,215	51,457	58,152
Total assets	**50,176**	**59,705**	**70,265**	**73,205**	**79,976**

Source: Company, YES Sec

Exhibit 38: Income statement

Y/E Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
Net revenue	93,817	103,740	106,920	118,991	131,158
% Growth	**18.9**	**10.6**	**3.1**	**11.3**	**10.2**
COGS	52,696	60,720	60,480	66,635	72,662
Staff costs	6,335	6,070	5,430	5,950	6,427
A&P	6,892	9,200	10,410	11,661	13,116
Other expenses	13,029	13,560	13,520	15,029	16,369
Total expenses	78,952	89,550	89,840	99,274	108,573
EBITDA	14,865	14,190	17,080	19,717	22,585
% growth	**50.5**	**(4.5)**	**20.4**	**15.4**	**14.5**
EBITDA margin (%)	**15.8**	**13.7**	**16.0**	**16.6**	**17.2**
Other income	415	740	3,350	2,521	2,773
Interest costs	698	1,040	760	600	450
Depreciation	2,542	2,710	2,640	2,816	2,924
Exceptional items	(1,335)	1,710	(170)	0	0
Profit before tax (before exceptional items)	12,040	11,180	17,030	18,822	21,984
Tax	3,007	2,370	3,740	4,235	5,056
Rate of Tax (%)	25.0	21.2	22.0	22.5	23.0
PAT	7,698	10,520	13,120	14,587	16,928
Adj PAT	9,033	8,810	13,290	14,587	16,928
Adj PAT margin (%)	**9.6**	**8.5**	**12.4**	**12.3**	**12.9**
% Growth	**114.3**	**(2.5)**	**50.9**	**9.8**	**16.0**

Source: Company, YES Sec

Exhibit 39: Cash flow statement

Y/E Mar (Rs mn)	FY22	FY23	FY24	FY25E	FY26E
PAT	5,777	9,928	13,290	14,587	16,928
Depreciation	2,542	2,706	2,640	2,816	2,924
Interest	377	697	760	600	450
(Inc.)/dec. in working capital	(2,059)	(5,755)	(3,435)	1,359	(3,670)
Other items	2,248	(1,810)	(3,350)	(2,521)	(2,773)
Cash flow from operations	**8,885**	**5,766**	**9,905**	**16,840**	**16,632**
Capital expenditure (-)	(1,152)	(1,132)	(2,558)	(1,000)	(1,000)
Net cash after capex	**7,903**	**4,838**	**10,697**	**18,362**	**15,632**
Inc./(dec.) in investments and other assets	(1,123)	8,543	3,566	(3,618)	773
Cash flow from investments	**(2,275)**	**7,411**	**1,008**	**(4,618)**	**(227)**
Inc./(dec.) in total borrowings	(5,556)	(4,646)	(11)	0	0
Other items	(1,279)	(363)	(760)	(600)	(450)
Cash from investing and financial activities	**(6,835)**	**(5,009)**	**(7,319)**	**(8,623)**	**(10,607)**
Change in Cash Balance	(225)	8,168	3,594	3,600	3,025
Opening cash balance	553	328	8,496	12,090	15,690
Closing cash balance	328	8,496	12,090	15,690	18,715

Source: Company, YES Sec

Exhibit 40: Growth and Ratio matrix

Y/E Mar	FY22	FY23	FY24	FY25E	FY26E
Per share (Rs)					
EPS	12.4	12.1	18.3	20.1	23.3
Book value	67.4	81.7	95.7	99.8	109.1
Valuation (x)					
EV/sales	9.3	8.3	8.0	7.1	6.4
EV/EBITDA	58.5	60.8	50.1	43.1	37.4
P/E	97.0	99.4	65.9	60.0	51.7
P/BV	17.9	14.7	12.6	12.1	11.0
Return ratios (%)					
RoCE *	26.3	22.2	27.4	27.1	29.3
RoE	18.4	14.8	19.1	20.1	21.3
ROIC *	28.0	25.4	30.2	35.2	41.6
Profitability ratios (%)					
Gross margin	43.8	41.5	43.4	44.0	44.6
EBITDA margin	15.8	13.7	16.0	16.6	17.2
Adj PAT margin	9.6	8.5	12.4	12.3	12.9
Liquidity ratios (%)					
Current ratio	2.0	2.2	2.4	2.4	2.5
Quick ratio	1.3	1.6	1.8	1.7	1.8
Solvency ratio (%)					
Debt to Equity ratio	0.0	0.0	0.0	0.0	0.0
Turnover ratios					
Total asset turnover ratio (x)	1.9	1.7	1.5	1.6	1.6
Fixed asset turnover ratio (x)	7.2	8.5	8.6	11.2	15.1
Debtor days	87	82	94	88	75
Inventory days	141	129	130	122	126
Creditor days	100	97	108	106	109

Source: Company, YES Sec

United Spirits Ltd

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