5 March 2021

Alcoholic Beverages

Sensex: 50405

Nifty: 14938

Industry context turning favourable, recovery to follow

After the challenging operating environment of the last 3-4 years, the industry context for the alcoholic beverage (alcobev) sector is turning favourable, aided by supply-chain normalisation, stable to soft input costs and likely less irrational taxation. We expect normal operations in FY22-23 and factor in a steep volume recovery. This, and easier input costs, leverage benefits and debt reduction would drive healthy, 12-22%, earnings growth over FY20-23. With the greater revenue assurance, we expect valuations to be buoyant. We initiate coverage on United Spirits (with a Buy), United Breweries (Hold) and Radico Khaitan (Buy).

Sector parameters turning favourable. On the normalised supply chain, alcobev volumes have progressively recovered especially in key markets (Karnataka, UP, Maharashtra, Kerala, Tamil Nadu). Regulatory risks have been receding with the partial or full rollbacks of the Covid-19 cess and favourable excise-policy recommendations in select states. This, and the likely further relaxations in the on-premises channel, we believe, would drive overall volume growth. We expect volume CAGRs of 12-13% over FY21-23 (3-5% over FY20-23) for alcobev players.

Volume recovery, easier input costs to boost margins. We expect operating margins to improve and return to mid-teen levels for alcobevs aided by softer costs (stable ENA prices, moderate barley prices), recovery in premium products, and operating leverage.

Competition unlikely to be less intense. Competition in the P&A spirits category is intensifying with Pernod Ricard, India, firming up brand spends and mid-size manufacturers expanding their range. In beer, with softer input costs, competition could hot up. United Breweries, however, in terms of scale and balance-sheet strength, is better set to tackle the competition.

Valuation: United Spirits, United Breweries and Radico Khaitan are trading at 22x/23x/15x FY23e EBITDA. **Risks:** Adverse regulatory change in key markets.

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Valuation matrix

Company	CMP (Rs)	Reco	TP (Rs)	Upside (%)	EPS (Rs) FY21e	EPS (Rs) FY22e	EPS (Rs) FY23e	PE (x) FY21e	PE (x) FY22e	PE (x) FY23e	EV / EBITDA (x) FY21e	EV / EBITDA (x) FY22e	EV / EBITDA (x) FY23e	EPS CAGR (FY20-23e)
UB	1,229	Hold	1,388	13%	3.9	22.6	29.6	318.0	54.5	41.6	87.8	29.0	23.4	22.3%
UNSP	561	Buy	653	16%	6.1	12.6	15.9	92.4	44.5	35.2	45.2	27.3	22.3	18.1%
Radico*	617	Buy	721	17%	18.9	23.7	27.3	32.7	26.0	22.6	20.9	17.2	15.0	17.0%

*Source: Bloomberg, Anand Rathi Research   * PBT CAGR is 17.9% over FY20-23, All prices as on 4 March 2021*

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Alcoholic Beverages

Industry context turning favourable, recovery to follow

Industry rationale

Macro-economic tailwinds point to growth potential

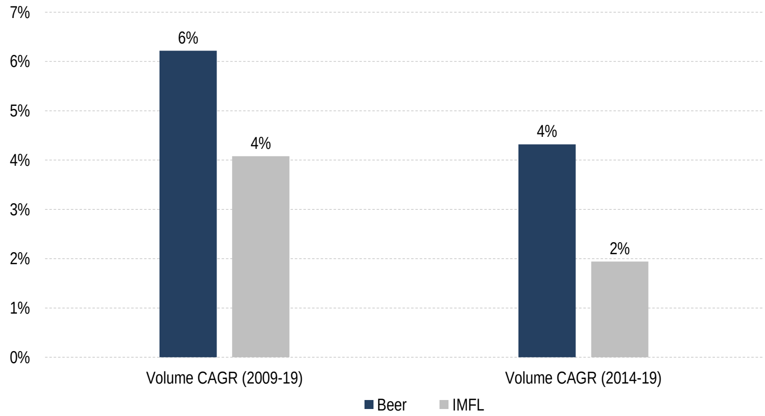
In terms of macro-economic drivers, opportunities for growth appear healthy for the alcobev segment in India. The market here has sufficient drivers: a young demographic (median age: 28 years), increasing number of people entering legal drinking age (15m/year), low per-capita consumption and premiumisation potential on the shift from illicit liquor to branded alcobevs. Further, per-capita consumption of beer/IMFL in India is lower than in emerging and developed markets.

Growth curtailed by regulatory complexities, disruptions

Despite favourable macro-economic drivers, IMFL and beer volume CAGRs in India have not markedly outdone other consumption categories. Over 2008-09 to 2018-19, beer volumes in India have clocked a ~5-6% CAGR. IMFL volumes have registered a slower ~4-5% CAGR.

Challenging regulatory environment and supply-chain disruptions have curtailed industry growth over 2014-19

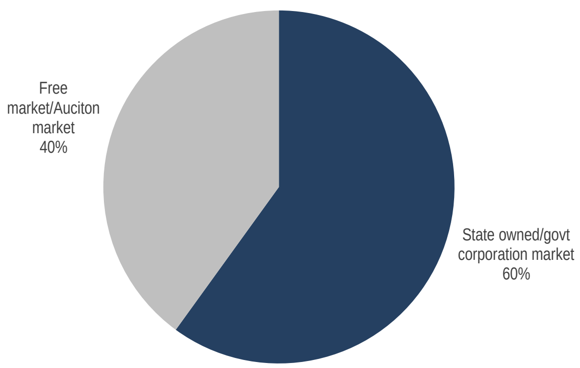
Fig 1 – Segment growth – Moderation in growth in the last five years



Source: Company, Anand Rathi research

This is chiefly due to complex regulations covering this segment, where product, pricing, promotion and distribution (accessibility to consumers) are regulated by state governments in most markets. (In more than 60% of markets, pricing is dictated directly by state governments.)

Fig 2 – Highly regulated markets



Source: Company, Anand Rathi Research

Fig 3 – Market structure in key states

Market Structure	Key markets
Government-controlled markets	Andhra Pradesh, Chhattisgarh, Delhi, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Rajasthan, Tamil Nadu, Telangana, West Bengal
Free markets	UP, Maharashtra, Goa

Source: Company, Anand Rathi Research

A decade prior to 2014-15, the IMFL and beer segment enjoyed high single-digit to low double-digit volume CAGRs. In the last 5-6 years, however, many unforeseen issues (de-monetisation/GST/highway ban/ national elections/Covid-19) kept growth at low single-digits. After the disruptions of de-monetization/GST and the highway ban, the industry recovered healthily in FY18/19. The national elections and the Covid-19 pandemic outbreak, however, severely disrupted volumes of the key manufacturers in FY20 and H1 FY21.

United Breweries saw sharper declines than other spirits manufacturers as the key summer quarter was hit by the complete lockdown during the pandemic period

Fig 4 – Disruptions: FY17 (highway ban); FY20, H1 FY21 (elections / pandemic)

Company	FY17	FY18	FY19	FY20	Q1FY21	Q2FY21
United Breweries	-2.5	10.0	13.0	-4.0	-77	-48
United Spirits	-3.2	-12.8	3.9	-2.3	-49	-3
Radico Khaitan	0.4	6.8	10.8	12.5	-44	4

Source: Company

Sector context turning favourable; volume recovery to follow

With the severity of the pandemic easing, production is largely back on track. Also, with the distribution network normalising (off-premises largely open while the on-premises channel allowed at 50% capacity), we expect growth to revive. Besides, receding regulatory risks (likelihood of a relatively rational taxation regime), we believe, should result in a healthy recovery in volume growth in FY22 and FY23.

Volume assurance improving

Encouraging recovery trends visible

The Covid-19 outbreak severely struck at and completely halted supply chains. Moreover, as alcobev is non-essential, the opening up of its distribution channels was slower than those of staples and other discretionary products. However, with the phased unlocking of the economy, restrictions on manufacturing and distribution eased for this segment, and by end-Q2 FY21, most off-premises channels were open and the on-premises channel was allowed to function with certain restrictions.

This resulted in progressive recovery in volumes of alcobev players sequentially, though less than volumes of other staples and discretionaries. Besides its discretionary nature, the key reason for the slower recovery was restrictions on operations off premises (fewer operating hours and night curfew).

Fig 5 – Volume growth improving on normalising supply chain

Company	Q1 FY20	Q FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
UBL	5.0	6.5	-7.0	-21.0	-77.0	-48.0	-15.0
UNSP	6.0	1.0	-1.8	-13.3	-49.2	-3.4	-0.9
RDCK	20.1	10.9	13.9	13.0	-43.6	4.5	0.8

Source: Company, Anand Rathi Research

Fig 6 – Though slower than other consumption peers

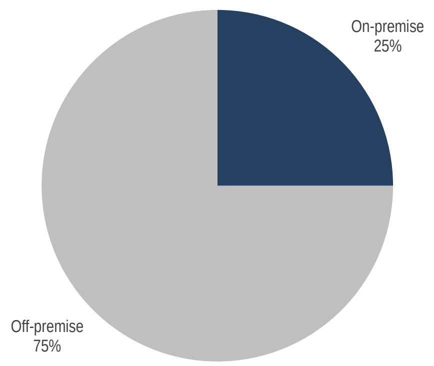
Company	Q1 FY20	Q FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
HUL	7	7	4	-9	-7	3	4
APNT	16	14	10	0	-38	11	33
Dabur	10	5	6	-15	-10	17	18

Source: Company, Anand Rathi Research

Out-of-home consumption gradually recovering with opening of the on-premises channel

Out-of-home (OOH) consumption was considerably affected in H1 FY21 as the on-premises channel (~20-25% of industry volumes) was mostly shut. Also, restrictions on number of guests at weddings and lack of corporate conferences further hurt overall outdoor consumption of alcobevs. However, bars and restaurants were allowed to re-open gradually from the start of H2 FY21, though at 50% capacity and with other social-distancing norms. Our interactions with the industry players suggest that ~85-90% of the on-premises channel is now operational. As a result we have started to see a gradual recovery in OOH consumption too, which, along with the continued recovery in the off-premises channel would drive further volume growth in coming quarters.

Fig 7 – Distribution channel sales-mix



Source: Company, Anand Rathi Research

Regulatory environment likely to be more stable than irrational

One of the key revenue generators for states is alcobevs (~15-20% of state revenues), with taxes comprising ~60-65% of consumer prices.

Fig 8 – Share (%) of state excise duty in state's own tax revenue

	2016	2017	2018	2019	2020	2021
All States	11.9	11.3	11.2	12.3	12.7	12.8
Andhra Pradesh	11.0	10.5	10.4	10.6	12.0	11.2
Karnataka	20.3	19.9	19.9	20.4	20.6	20.3
Kerala	5.0	4.8	4.7	4.9	5.2	6.2
Maharashtra	9.8	9.0	7.8	8.1	9.0	8.5
Punjab	18.0	15.9	16.3	15.9	16.8	17.4
Tamil Nadu	7.3	7.3	6.0	6.5	6.0	6.1
Telangana	9.5	11.5	16.2	16.4	17.7	18.8
Uttar Pradesh	17.4	16.6	15.8	19.5	23.9	31.6
West Bengal	9.4	11.5	16.2	17.2	17.7	18.0

Source: RBI

On the Covid-19 outbreak, taxation on the alcobev segment across states increased through the imposition of a Covid cess or rise in excise duty. States like Andhra Pradesh, Delhi and J&K raised taxes by 50-70% by imposing a Covid cess. West Bengal and Odisha increased excise duty by 30%. In other major markets, tax hikes ranged from 10% to 20%.

Fig 9 – Post-Covid excise hikes by state governments

State	Rate %	Comments
Delhi	70	Special Corona fee on MRP
Andhra Pradesh	75	Retail tax on beer / IMFL
J&K	50	Additional excise duty
Odisha	30	Special Covid fee
West Bengal	30	Sales tax
Goa	20	Increase in excise
Telengana	15	Increase in MRP
Karnataka	11	Increase in AED on liquor
Rajasthan	45-55	1000bp increase in AED on beer / IMFL
Tamil Nadu	15	Increase in excise duty on liquor

Source: Anand Rathi Research

Such steep hikes, however, resulted in curtailed revenue as consumption was hit, resulting in volumes shrinking. Also, cases of smuggled goods increased in these states, resulting in losses to state revenues. With their revenue targets not being attained, states re-examined the impact of the cess and duty on volumes and rolled back excessive hikes in order to revive consumption and generate revenues.

Fig 10 – Rollback of tax hikes

State	Earlier rate *	Change in rates#
Delhi	70%	Rolled back 70% covid cess & increased VAT by 5%
J&K	50%	0
West Bengal	30%	0 (only for beer)
Andhra Pradesh	75%	~30-35% price cut
Rajasthan	45-55% (beer)	35% to 45% on Beer. Covid surcharge of Rs20/bottle removed
Odisha	50%	15%
Assam	25%	0

*Source: Anand Rathi Research * imposed during Covid outbreak in 1HFY21, #changes done in 2HFY21*

Delhi, J&K and Assam fully reversed the steep Covid cess while Andhra Pradesh and Odisha reduced it by almost half. West Bengal, too, reversed its 30% excise hike on beer to 0%.

Apart from this, news on the regulatory front has been positive in terms of a) favourable excise policies in UP and Punjab, b) positive recommendations regarding Delhi's liquor policy and c) price hikes for liquor manufacturers in Kerala and Telengana.

Fig 11 – Policy recommendations in Uttar Pradesh, Rajasthan, Delhi, Punjab

States	Key changes / recommendations
Uttar Pradesh	Reduction in excise on beer, resulting in ~15% lower prices
Rajasthan	10% reduction in AED on beer, to result in ~Rs30-35 lower prices
Punjab	No change in excise; increase in quotas of IMFL / beer by 6% / 4% for FY22
Delhi	Recommendations: lower legal drinking age, fewer dry days, licenses to department stores

Source: State excise policy, media reports, Anand Rathi Research

With the economy returning to normal, state revenues have improved in the last two quarters. Hence, we believe states are likely to refrain from irrational excise hikes on alcobevs. A stable regulatory regime, especially in key markets would provide greater assurance of volume growth.

Strong rebound post-clarification regarding highway ban

The previous instance when distribution was severely hit was the highway ban in FY17. However, post-clarification by the Supreme Court, volume growth of most alcobev manufacturers steeply rebounded.

Fig 12 – Sharp volume recovery (from Q2 FY18), post-clarification regarding the highway ban

Volume growth (%)	Q1 FY17	Q2 FY17	Q3 FY17	Q4 FY17	Q1 FY18	Q2 FY18	Q3 FY18	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19
United Breweries	6.0	0.0	-8.0	-9.0	0.0	11.0	12.0	24.0	12.0	17.0	16.0
United Spirits - P&A	10.7	11.3	4.1	4.9	-9.7	2.2	-2.0	15.3	13.1	15.4	12.1
Radico Khaitan	3.6	4.5	-6.7	0.5	-5.8	4.3	17.7	12.5	19.1	11.5	7.2

Source: Company

Expect sharp recovery in FY22 as economy normalises

During the highway ban disruption, there was no issue on the demand side while the Covid'19-triggered disruption curtailed supply and consumer demand. However, we believe that, as the intensity of the pandemic eases, overall mobility would further improve, thereby increasing consumption of alcobevs. This is also seen from volume recovery in key markets such as Maharashtra, Karnataka, UP, West Bengal in the second half of Q3 FY21. Restrictions on travel and malls have been eased, and further relaxations are expected for the on-premises channel in the months ahead. This and a favourable base should result in volume growth in alcobevs bouncing back strongly in FY22.

Within the segment, the pace of recovery of IMFL manufacturers has been better than that of beer manufacturers (beer is bulkier) and the lowered preference for cold beverages during the pandemic. Sales volumes of alcoholic-spirit manufacturers are back to pre-Covid levels, and we expect United Breweries' sales volumes to hit pre-Covid levels in Q4 FY21. We expect normal operations for alcobev producers in FY22 and FY23, and factor in 12% volume CAGRs over FY21-23 for United Spirits (~4% volume CAGR over FY20-23) and Radico Khaitan (~5% volume CAGR for IMFL over FY20-23), and ~33% for United Breweries over FY21-23 (~3% CAGR over FY20-23). Growth for the latter appears higher over FY21-23, due to lower base in FY21, as disruption for it was more severe due to a tight lockdown in the key summer quarter.

Fig 13 – Volume growth assumptions

Volume growth	FY18	FY19	FY20	FY21e	FY22e	FY23e
United Breweries	10	13	-4	-38	56	13
United Spirits	-13	4	-2	-10	17	8
Radico Khaitan	7	11	13	-9	18	9

Source: Company, Anand Rathi Research

Favourable input cost milieu

Moderate input cost environment and a better mix to aid gross margins

Over FY17-19, gross margins of IMFL producers expanded considerably, while those of beer producers were steady, largely due to the stable to moderate input-cost environment. In FY20, however, the gross margins steeply deteriorated, hit by higher input costs (ENA and glass; and for beer producers high prices of barley and glass). On the steep drop in volumes, weaker mixes and lower utilisations, H1 FY21 margins were constrained. Now, however, the worst of the input cost increases in IMFL and beer is behind.

Fig 14 – Gross margin trend

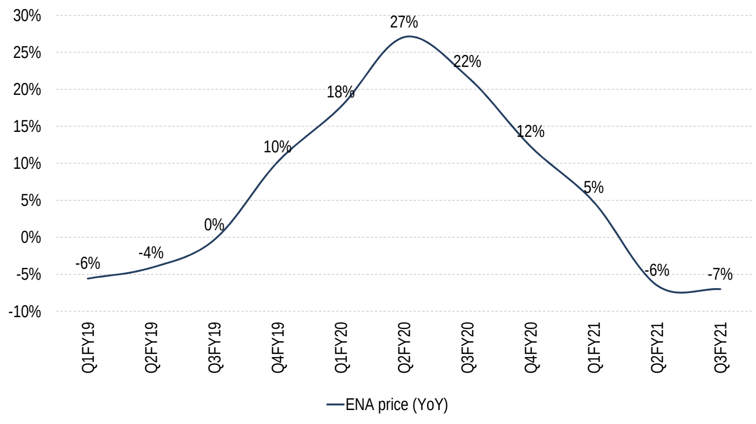
Gross margins (%)	FY17	FY18	FY19	FY20	9M FY21
United Breweries	53.7	52.9	53.4	51.4	52.0
United Spirits	42.9	48.6	48.8	44.8	43.7
Radico Khaitan	45.2	47.8	51.6	48.3	51.0

Source: Company, Anand Rathi Research

Stable input costs and& recovery in the premium category would boost gross margins

For IMFL manufacturers, prices of ENA (~40% of the cost of goods sold) have been ~6-8% down, y/y. Ahead, grain and molasses available (on greater sugarcane output) are expected to be good. However, the increase in the government-administered price of ethanol for 2021 and the 10% blending target for OMCs by 2022 are likely to arrest further declines, and the price of ENA could slightly rise in coming quarters.

Fig 15 – ENA price trend (Y/Y)



Source: Anand Rathi Research

Further, inflation in glass (steep in FY20) is likely to be only modest in the medium term.

For beer manufacturers similarly, barley prices are down 10% y/y. This, and normalisation in the use of recycled bottles and recovery in higher-realisation states should continue to help gross margins expand.

Moreover, with recovery in the on-premises channel and in metros/tier-1 markets, the product mix is expected to be better (the P&A category for IMFL manufacturers and the super-premium category in beer). This is positive for gross margins. Some of the above recovery has begun, evident in the good recovery in P&A and in the gross margin trend in the last three quarters.

Fig 16 – Gross margin trend: steady recovery over Q1 FY21 to Q3 FY21

Gross margins (%)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
United Breweries	50.3	52.1	52.7	50.9	46.7	52.3	53.9
United Spirits	47.3	45.0	44.4	42.2	41.7	42.1	44.6
Radico Khaitan	48.0	48.4	48.5	49.8	54.6	48.9	50.8

Source: Company, Anand Rathi Research

Fig 17 – P&A mix improving y/y for Radico Khaitan and United Spirits

(%)	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21
United Spirits	53.4	52.4	53.0	45.9	51.0	54.3	53.5
Radico Khaitan	31.8	28.2	29.5	26.3	29.7	28.0	30.8

Source: Company, Anand Rathi Research

Over FY21-23 we factor in a 70bp gross-margin expansion (340bps over FY20-23) for Radico Khaitan, 200bps for United Spirits (~120bps over FY20-23) and ~100bps (200bps over FY20-23) for United Breweries. This, the operating leverage (over FY18 and FY19 have led to healthy EBITDA-margin expansion helped by good volume growth for alcobev manufacturers) and cost savings should steeply improve United Breweries and United Spirits' operating margins over FY21-23, though on a low base. We expect FY22 and FY23 EBITDA margins to climb back up to mid-teen levels for both the companies. Radico Khaitan's EBITDA-margin expansion in FY21, on the other hand, stemmed from its strong execution. We expect these margins to largely persist over FY22-23.

Fig 18 – Margin assumption table

	FY18	FY19	FY20	FY21e	FY22e	FY23e
Gross margins (%)						
United Spirits	48.6	48.8	44.8	43.4	44.8	46.0
Radico Khaitan	47.8	51.6	48.3	51.0	51.4	51.7
United Breweries	52.9	53.4	51.4	52.5	53.0	53.5
EBITDA margins (%)						
United Spirits	12.6	14.3	16.6	11.7	15.5	16.7
Radico Khaitan	14.8	16.7	15.3	17.1	17.2	17.4
United Breweries	16.0	17.6	13.4	8.2	15.7	16.5

Source: Company, Anand Rathi Research

Premiumisation opportunity

Premiumisation opportunity, but yet to see material gains

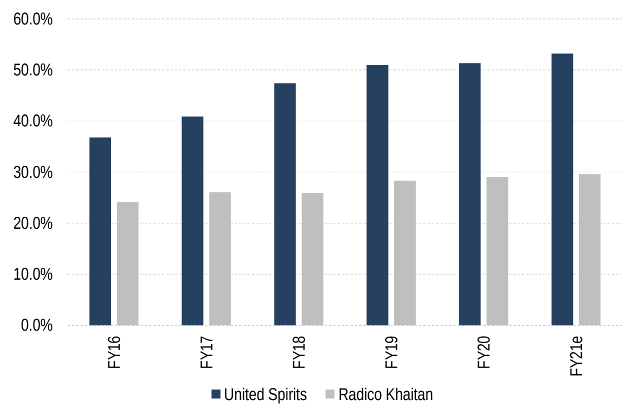
Opportunities for premiumisation exist in the alcobev segment in both beer and IMFL. In the spirits segment, a large portion of consumption is still of country liquor, the "regular" and lower prestige categories than the premium one. Similarly for beer, the share of the super-premium segment in the overall industry is still a low ~6-8%.

For United Spirits, the proportion of P&A volumes to its overall volumes has risen from 37% in FY16 to ~51% in FY20, boosted by the strategy to reduce the focus on the "regular" category and drive growth in the P&A one. Similarly, Radico Khaitan has shown strong execution, with the proportion of P&A improving from 24% in FY16 to 29% in FY20. We expect growth of the P&A category of both companies to outpace the "regular" category, resulting in a continuing improvement in the mix over FY20-23. We expect the P&A contribution to overall volumes to reach 54.7% for United Spirits and 31.7% for Radico Khaitan by FY23

Similarly, the super-premium category makes up only ~6-8% of the Indian beer segment, much lower than the 15-25% in emerging and developed markets. With double-digit growth over FY16-FY20, the super-premium category outdid the overall beer sector. The share of the category in the overall segment has increased from ~1–1.5% in FY16 to mid-high single digits in FY20.

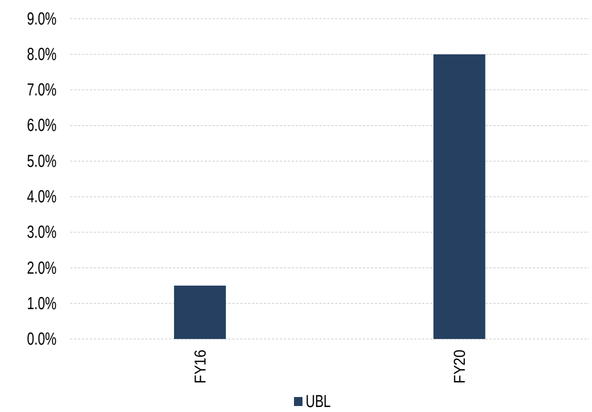
For United Breweries, the category has seen double-digit growth, and its share in overall sales rose from ~1.5–2% in FY16 to ~7-8% in FY20. We believe enough headroom exists to raise the share further and, most launches being in this segment, highlight the company's focus on increasing operations in this segment. Management is confident about this segment and expects to increase the share of this segment by ~1-2% a year in its overall portfolio.

Fig 19 – P&A mix trend



Source: Company, Anand Rathi Research

Fig 20 – UBL super-premium segment (percent of sales)

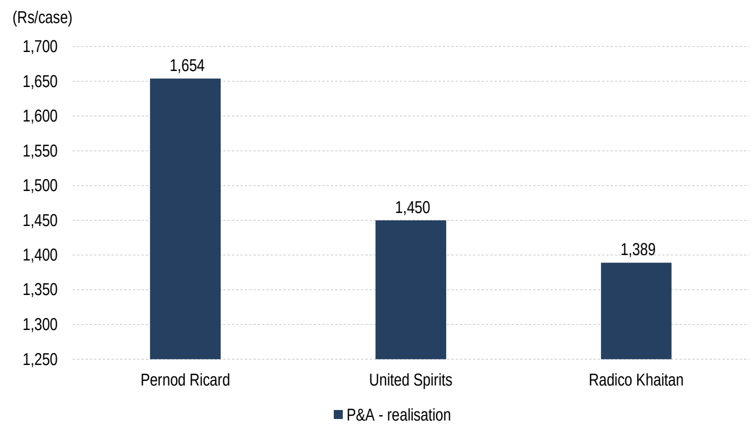


Source: Anand Rathi Research

Potential for margin expansion, evident from profitability of the premium category manufacturers

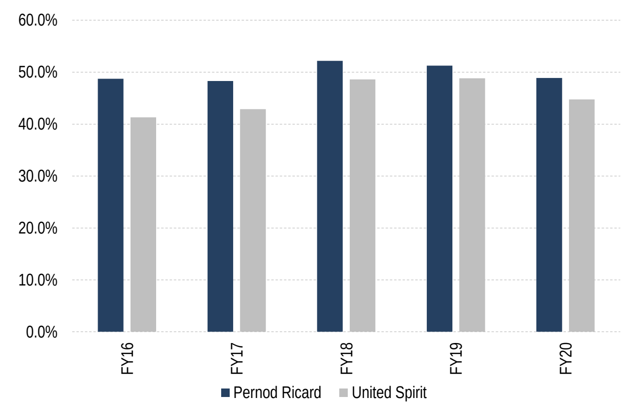
Pernod Ricard (India) enjoys the higher gross margins, of ~50% (United Spirits: ~45%), as it operates only in the Prestige & Above IMFL category. In the super-premium beer category, realisations are 50-60% higher than in the base category. B9 Beverages (Bira) enjoy much better gross margins of ~65%+ (compared to United Breweries' ~50-55%), largely on account of its greater tilt toward premium products.

Fig 21 – Pernod Ricard enjoys better net realisations per case in P&A



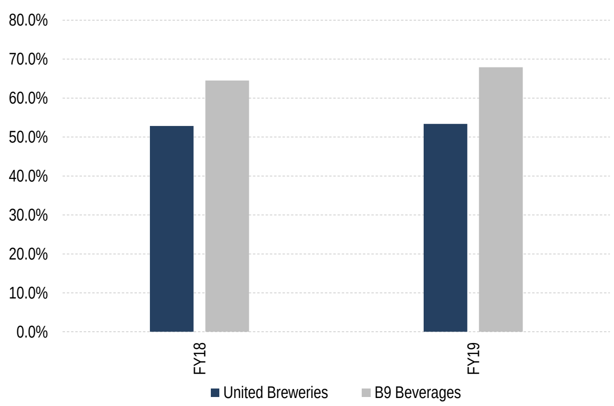
Source: Company, Anand Rathi Research

Fig 22 – Pernod Ricard's better gross margins vs UNSP



Source: Company, Anand Rathi Research

Fig 23 – High gross margins for B9 Beverages vs UBL



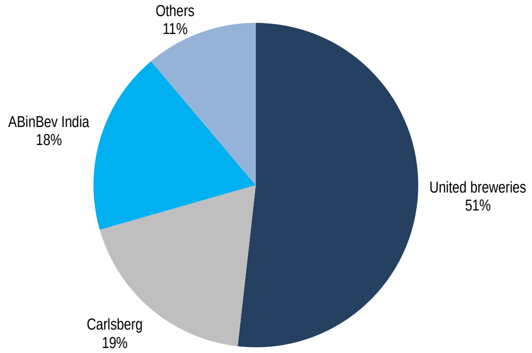
Source: Company, Anand Rathi Research

Competitive milieu

United Breweries to benefit from higher scale and size than key competitors

The Indian beer category is tightly consolidated. The top-three enjoy a commanding 90% of the domestic beer market. United Breweries dominates with a ~51% market share, while Carlsberg and ABinBev (including SAB Miller) take ~18-20% each of the market.

Fig 24 – Beer - market share



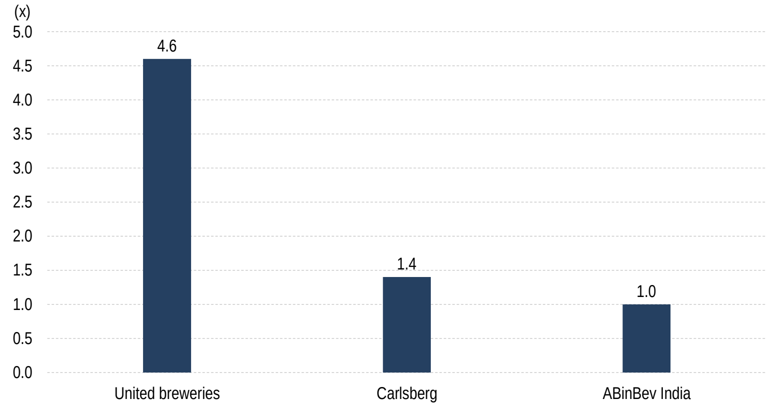
Source: Anand Rathi Research

UB and Carlsberg have gained share due to integration challenges faced by ABinBev and SAB Miller

In the past 2-3 years, during the consolidation phase of SAB Miller & ABinBev, incumbents United Breweries and Carlsberg India gained ~150-200bps market share due to integration challenges Abinbev and SAB Miller were faced with. This indicates the considerable underperformance in sales and profitability of ABinBev compared to United Breweries and Carlsberg over FY17-19.

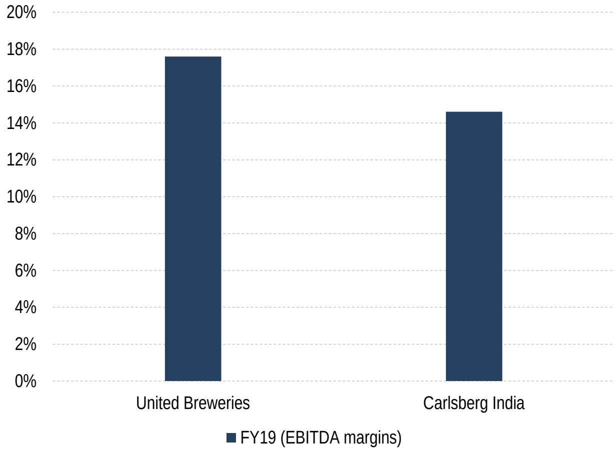
Further, United Breweries is much larger in scale and profitability. And. given the challenging environment for the alcobev segment, the focus of other two manufacturers been driving profitable growth. This is suggested by the moderation in A&P spends of Carlsberg India while ABinBev has suffered losses at the operating level, which curtails its ability to aggressively invest in brands.

Fig 25 – Revenue scale (FY19) - UBL much larger than peers



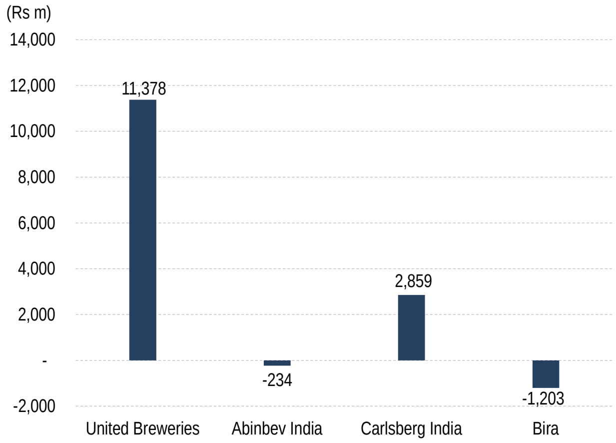
Source: Company, Anand Rathi Research

Fig 26 (a) – UBL enjoys better margins



Source: Company, Anand Rathi Research

Fig 26 (b) – Much larger in EBITDA* than peers



*Source: Company, Anand Rathi Research *FY19 EBITDA (Rs m)*

Fig 27 (a) – Carlsberg India – A&P (percent of sales)

% to sales	FY17	FY18	FY19
Advertising spend	3.4	2.7	2.8
Sales promotion expenses	0.9	0.8	0.5

Source: Company, Anand Rathi Research

Fig 27 (b) – Carlsberg has not materially outperformed UBL

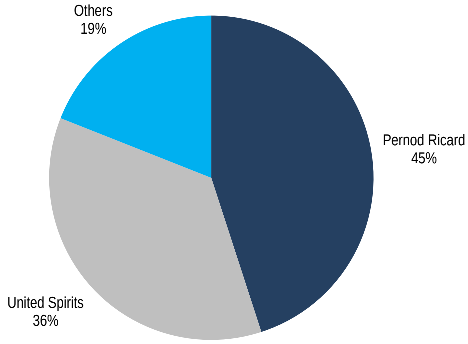
Volume growth (%)	CY17	CY18	CY19	CY20
Carlsberg India	-2	19	1	-40
United breweries	3	16	3	-45

Source: Company, Anand Rathi Research

United Spirits' P&A market-share gains would be challenging with Pernod Ricard (India)

In the last 4-5 years, United Spirits' P&A market share has been largely steady. However, over CY18-19, some stagnation/moderation has been seen in the shares of its key whiskey brands (McDowells No 1, Royal Challenge and Signature). On the other hand, Pernod Ricard's competing brands in the same categories (Imperial Blue, Royal Stag and Blender's Pride) have gained market shares.

Fig 28 – P&A market share

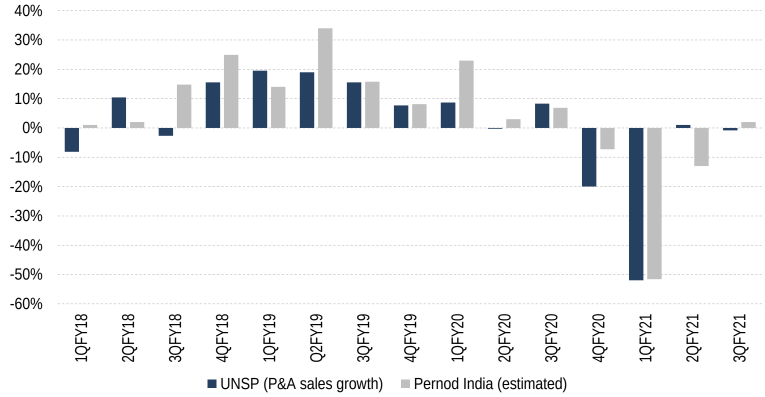


Source: Anand Rathi Research

United Spirits leads the market in the lower-prestige sub-segment, while in the mid- and upper-prestige sub-segments Pernod Ricard is the market leader. In order to gain traction in these sub-segments, the former recently renovated/relaunched its core whiskey brands, McDowell's No1 and Royal Challenge.

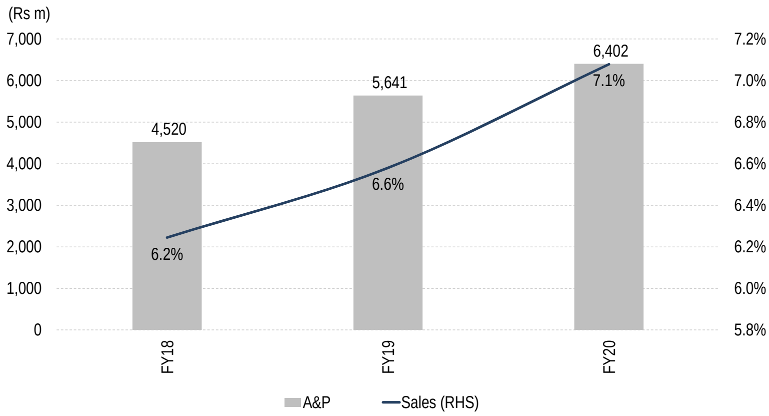
Pernod Ricard, too, is vigorously investing in its brands, indicated by its greater A&P spends in its Indian business in the last three years. We believe increasing market shares in these sub-segment for United Spirits would be challenging and entail greater investments. We believe strategic review of popular brands (expected to be completed in CY21) is a step in the right direction and would result in freeing up management bandwidth and helping to a sharper focus on P&A category. We are factoring in 14%/18% volume/sales CAGRs for P&A over FY21-23 (6%/9% volume/sales CAGR for P&A over FY20-23) for United Spirits.

Fig 29 – P&A sales growth - United Spirits vs Pernod Ricard (India)



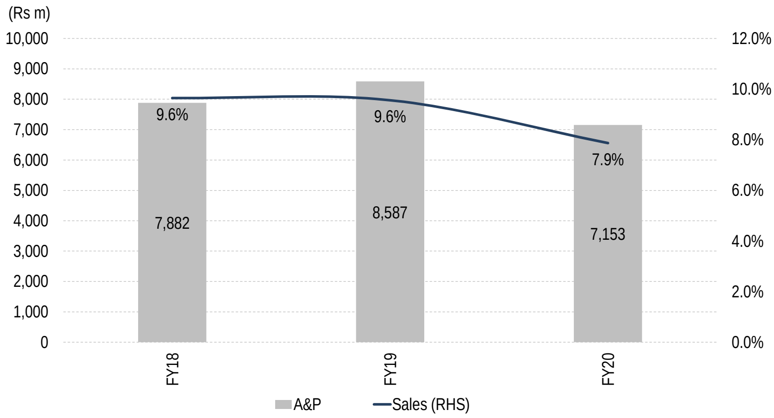
Source: Company, Anand Rathi Research

Fig 30 – Pernod Ricard A&P, as percent of sales, has been increasing



Source: Company, Anand Rathi Research

Fig 31 – United Spirits' A&P expenditure, and percent of sales



Source: Company, Anand Rathi Research

Financials

Greater earnings assurance over FY21-23

United Breweries

Volume recovery, soft input costs and leverage to drive earnings growth

We expect normal operations over FY22-23, especially in the key summer quarter. We are factoring in a ~33% volume CAGR over FY21-23 (~3% over FY20-23), helped by a favourable base, recovery in key markets and normalisation in the on-premises channel. We expect the gross margin to improve due to softer input costs and greater utilisation, and factor in a 100bp expansion over FY21-23 (~200bps over FY20-23).

This, and the operating leverage and cost savings, should drive a healthy 830bp EBITDA margin expansion over FY21-23 (310bps over FY20-23). We expect the EBITDA margin to return to ~16.5% in FY23, similar to FY18-19. Overall, we expect 6%, 16% and 22% CAGRs over FY20-23 in United Breweries' sales, EBITDA and PAT, respectively.

United Spirits

Favourable base, a better mix and less debt to drive earnings growth

We expect a 12% CAGR in overall volumes, with a 14% CAGR in volumes of the Prestige & Above category, resulting in 18% (standalone) sales CAGR over FY21-23 (a 6% sales CAGR expected over FY20-23). The gross margin sharply contracted over FY18-21 owing to higher input costs. With ENA prices likely to be stable and with recovery in the P&A category, we expect an overall ~260bp gross-margin expansion over FY21-23 (~120bps over FY20-23). On this and the continuing execution with overhead costs in check, we expect the EBITDA margin to improve 500bps over FY21-23 (flattish over FY20-23). PAT growth (an 18% CAGR anticipated over FY20-23) is expected to be much higher due to lower interest expense because of the continued reduction in debt and due to a lower effective tax rate.

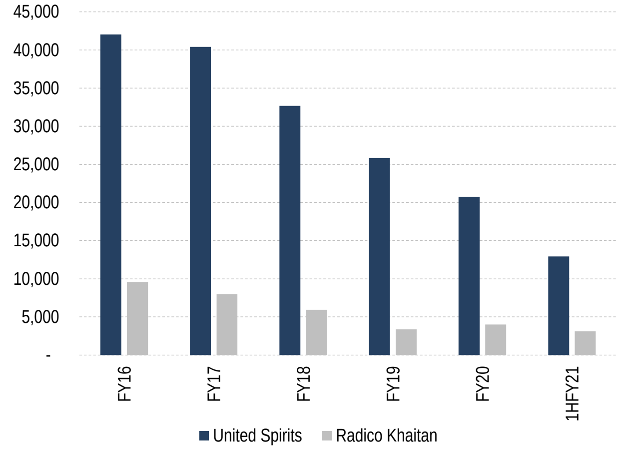
Radico Khaitan

Better execution on volumes, debt reduction to drive earnings growth

We expect a 13% volume CAGR overall, with a 17% volume CAGR in the Prestige & Above category and an 11% CAGR in the regular category, resulting in an overall 15% sales CAGR over FY21-23 (9% over FY20-23). With ENA prices likely to be stable, coupled with the better mix, we expect an overall ~80bp gross-margin expansion over FY21-23.

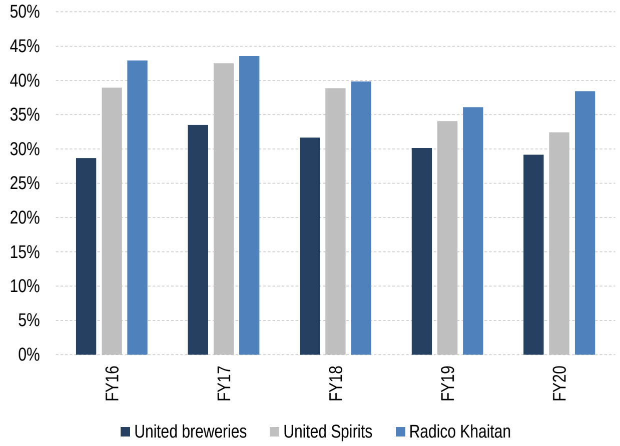
Given the thrust on launches in P&A, we have assumed higher A&P expenditure, resulting in a modest ~30bp EBITDA margin expansion over FY21-23 (~210bps over FY20-23). However, PBT growth (a 20% CAGR over FY21-23, and 18% over FY20-23) is expected to be much higher due to lower interest expenses on the continued reduction in debt. A 13% PAT CAGR is expected over FY20-23 due to a lower effective tax rate in FY20.

Fig 32 – Debt (Rs m) reduction on track



Source: Company, Anand Rathi Research

Fig 33 – Better working capital management (% of sales)



Source: Company, Anand Rathi Research

Fig 34 – Key assumptions

	FY18	FY19	FY20	FY21e	FY22e	FY23e
Volume growth (%)						
United Spirits	-12.8	3.9	-2.3	-10.2	17.1	7.6
Radico Khaitan	6.8	10.8	12.5	-8.8	18.0	8.6
United Breweries	10.0	13.0	-4.0	-37.5	56.0	13.0
Revenue growth (%)						
United Spirits	-4.4	9.9	1.2	-12.8	23.6	11.7
Radico Khaitan	8.5	15.0	15.7	-2.9	19.9	11.0
United Breweries	18.9	15.0	0.5	-31.6	58.0	16.0
Gross margins (%)						
United Spirits	48.6	48.8	44.8	43.4	44.8	46.0
Radico Khaitan	47.8	51.6	48.3	51.0	51.5	51.7
United Breweries	52.9	53.4	51.4	52.5	53.0	53.5
EBITDA margins (%)						
United Spirits	12.6	14.3	16.6	11.7	15.5	16.7
Radico Khaitan	14.8	16.7	15.3	17.1	17.2	17.4
United Breweries	16.0	17.6	13.4	8.2	15.7	16.5

Source: Company, Anand Rathi Research

Fig 35 – Return ratios to improve over FY21-23

	FY18	FY19	FY20	FY21e	FY22e	FY23e
RoE (%)						
United Breweries	14.7	17.7	12.1	2.9	14.8	16.6
United Spirits	22.1	21.9	18.5	10.4	17.7	18.3
Radico Khaitan	10.8	14.3	15.0	14.5	15.7	15.6
RoCE (%-post tax)						
United Breweries	14.2	18.1	12.5	3.2	15.5	17.8
United Spirits	12.7	14.9	14.4	9.5	16.5	18.3
Radico Khaitan	9.0	11.8	14.8	13.1	14.9	15.5

Source: Company, Anand Rathi Research

Valuation

Greater earnings assurance to support valuations

In the last five years as highlighted earlier, many disruptions have plagued the alcobev segment, indicated by United Breweries and United Spirits' volume CAGRs over FY16-20. Consequently, alcobev manufacturers have seen less consumption and lower revenue.

With the intensity of the pandemic now receding, the economy is progressively recovering, m/m. This is also visible in the higher volume-growth trajectories of staples and discretionaries since the start of H2 FY21.

For alcobev manufacturers, the pace of recovery also improved but is still lower than those in other consumption categories. While volumes of United Spirits are largely back to pre-Covid'19 levels, we expect United Breweries' volumes to touch pre-Covid-19 levels by Q4 FY21.

We expect FY22-23 to be a period of normal operations for alcobev manufacturers. With disruptions in the distribution channel now behind, the overhang of irrational tax hikes receding and stable to soft input costs, the environment for the segment overall is likely to be more favourable. This, and leverage benefits and debt reduction, should drive overall earnings growth (factoring in a 12-22% earnings CAGR over FY20-23) and returns profiles. Given the improving earnings assurance, we expect the scrips of such companies to trade at the higher end of the valuation range. In the past (FY17-19), when volume trajectories and margin assurance of alcobev manufacturers were healthy, premium valuations persisted.

For United Spirits, we believe further improvement in execution in the P&A category would be a key monitorable. We believe that stabilisation in the on-premises channel, interventions by the company in its P&A range and its lower focus on the popular range would help improve performance in the P&A category. Valuations at 22x FY23e EBITDA and 35x FY23e earnings are below historical averages. Hence, we initiate coverage with a Buy recommendation and a target price of Rs653, valuing it at 26x FY23e EBITDA and the implied PE multiple of 41x FY23e EPS.

We expect Radico Khaitan's better execution to continue, which could reduce its discount to United Spirits. We initiate coverage on it with a Buy recommendation, at a target price of Rs721, valuing it at FY23e 17.5x EBITDA and 26.5x FY23e EPS.

We expect the strong recovery in United Breweries' volumes, easing input costs and its operating leverage to result in strong earnings growth. Because of the healthy recovery in Q3 FY21, the stock has sharply run up. Hence, we initiate coverage on it with a Hold recommendation, at a target price of Rs1,388 valuing it at 26.5x FY23e EBITDA and the implied PE multiple of FY23e 47x EPS.

Fig 36 – Valuation matrix

	Sales (Rs bn)			EBITDA (Rs bn)			PAT (Rs bn)		
Company	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e
United Breweries	44.5	70.2	81.6	3.6	11.0	13.5	1.0	6.0	7.8
United Spirits	79.3	98.0	109.5	9.3	15.2	18.2	4.4	9.2	11.6
Radico Khaitan	23.6	28.2	31.3	4.0	4.9	5.4	2.5	3.2	3.6

					EPS (Rs)			PE (x)			EV / EBITDA (x)			EPS CAGR
Company	CMP (Rs)	Reco	TP (Rs)	Upside (%)	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	FY21e	FY22e	FY23e	(FY20-23e)
United Breweries	1,229	Hold	1,388	13%	3.9	22.6	29.6	318.0	54.5	41.6	87.8	29.0	23.4	22.3%
United Spirits	561	Buy	653	16%	6.1	12.6	15.9	92.4	44.5	35.2	45.2	27.3	22.3	18.1%
Radico Khaitan*	617	Buy	721	17%	18.9	23.7	27.3	32.7	26.0	22.6	20.9	17.2	15.0	17.0%

Source: Anand Rathi Research ** PBT CAGR of 17.9% over FY20-23*

Key Risks

- Spike in Covid-19 cases could lead to restrictions on mobility again, impacting volume recovery
- Delay in further relaxations for the on-premises channel could lead to slower-than-expected volume recovery
- Irregular excise hikes/regulatory changes in key markets
- Adverse movements in input costs
- For United Breweries, a negative outcome of the CCI probe, resulting in hefty fines could cut into its earnings.
- Also, a resolution pertaining to the 16% stake held by the Enforcement Directorate could lead to large supplies in the market, and have a bearing on the stock price.

Company Section

5 March 2021

United Breweries

Greater assurance; Initiating, with a Hold

Rating: **Hold**
Target Price: Rs.1,388
Share Price: Rs.1,229

Dominant in beer, United Breweries is set to capitalise on a recovery in volumes. We expect normal operations, and factor in a strong volume recovery over FY22-23. Further, softer input costs and operating leverage should boost margins and drive overall earnings growth (at a 22% CAGR over FY20-23). With greater earnings assurance, premium valuations are likely to persist. In the near term, performance in the coming summer will be the key monitorable. We initiate coverage, with a Hold rating and a target price of Rs1,388 (valuing it at 26.5x FY23e EBITDA/the implied PE multiple of 47x FY23e EPS).

Strong moats in place, dominance to continue. UBL's wide range across price points, its good share in high-realisation markets and much larger manufacturing set up than peers give it an edge over competitors. This is also evident from it consistently maintaining a 50%+ market share and realisation growth despite several disruptions over FY16-21.

Upswing in volumes, softer input costs to drive margins. We expect profitability to improve over FY21-23, driven by a) easier input costs, b) a better mix with recovery in key markets and premium products and c) operating leverage. We are factoring in a 16% EBITDA CAGR with a 310bp margin expansion over FY20-23.

Competition might turn keener, United breweries better placed. Despite its size, UBL has over the past few years gained ~200bps market share in the Indian beer category. The other two companies we are covering have strong brands but are smaller, and their profitability poorer. While some step up cannot be ruled out given the gross margin benefit, UB is better placed to respond given its scale and sturdy balance sheet.

Valuations. The stock quotes at 29x/23x FY22e/23e EBITDA. **Key Risks:** A sharp resurgence in Covid-19 cases in summer; adverse regulatory changes; negative outcome on the CCI issue.

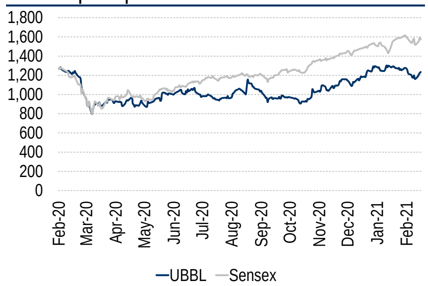
Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	64,724	65,046	44,485	70,210	81,594
Net profit (Rs m)	5,628	4,272	1,022	5,964	7,815
EPS (Rs)	21.3	16.2	3.9	22.6	29.6
P/E (x)	57.7	76.1	318.0	54.5	41.6
EV / EBITDA (x)	28.7	37.4	87.8	29.0	23.4
P/BV (x)	10.2	9.2	9.2	8.0	6.9
RoE (%)	17.7	12.1	2.9	14.8	16.6
RoCE (%)	18.1	12.5	3.2	15.5	17.8
Dividend yield (%)	0.2	0.2	0.2	0.2	0.3
Net debt / equity (x)	0.1	0.1	-0.1	-0.1	-0.2

Source: Company, Anand Rathi Research

Key data	UBBL IN / UBBW.BO
52-week high / low	Rs1330 / 750
Sensex / Nifty	50405 / 14938
3-m average volume	$11.9m
Market cap	Rs326bn / $4481m
Shares outstanding	264m

Shareholding pattern (%)	Dec'20	Sept`20	Jun`20
Promoters	57.7	57.7	57.7
- of which, Pledged	*18.2*	*18.2*	*18.2*
Free Float	42.3	42.3	42.3
- Foreign Institutions	10.0	10.7	10.7
- Domestic Institutions	9.8	8.9	8.9
- Public	22.5	22.7	22.7

Relative price performance



Source: Bloomberg

Mehul Desai
Research Analyst

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues	64,724	65,046	44,485	70,210	81,594
Growth (%)	*15*	*0*	*-32*	*58*	*16*
Direct costs	30,174	31,603	21,130	32,999	37,941
Gross profit	34,550	33,443	23,354	37,211	43,653
Gross margins %	*53.4*	*51.4*	*52.5*	*53.0*	*53.5*
Other expenses	23,172	24,699	19,709	26,192	30,163
EBITDA	11,378	8,744	3,645	11,019	13,490
EBITDA margins (%)	*17.6*	*13.4*	*8.2*	*15.7*	*16.5*
- Depreciation	2,598	2,850	2,440	3,102	3,238
Other income	317	91	410	205	246
Interest expenses	312	311	249	150	50
PBT	8,785	5,674	1,366	7,973	10,448
Effective tax rates (%)	*35.9*	*24.7*	*25.2*	*25.2*	*25.2*
+ Associates / (Minorities)	-	-	-	-	-
Net income	5,628	4,272	1,022	5,964	7,815
WANS	264	264	264	264	264
FDEPS (Rs / sh)	21.3	16.2	3.9	22.6	29.6

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	264	264	264	264	264
Net worth	31,819	35,180	35,405	40,414	46,955
Total debt	2,115	2,991	1,991	1,000	500
Minority interest	-	-	-	-	-
TL / (Assets)	115	-277	-277	-277	-277
Capital employed	34,048	37,894	37,119	41,137	47,178
Net tangible assets	17,253	18,768	17,328	15,727	14,989
Net Intangible assets					
Goodwill	269	239	239	239	239
CWIP (tang. & intang.)	1,899	1,991	1,991	1,991	1,991
Investments (strategic)					
Investments (financial)	257	257	257	257	257
Current assets (excl cash)	33,657	33,172	27,174	37,251	42,512
Cash	451	733	6,825	5,853	9,677
Current liabilities	19,738	17,267	16,694	20,181	22,487
Working capital	13,919	15,905	10,479	17,070	20,025
Capital deployed	34,048	37,894	37,119	41,137	47,178

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	8,785	5,674	1,366	7,973	10,448
+ Non-cash items	2,638	3,488	2,440	3,102	3,238
Oper. prof. before WC	11,423	9,162	3,806	11,075	13,686
- Incr. / (decr.) in WC	-1,089	-2,196	5,426	-6,591	-2,955
Others incl. taxes	3,890	1,900	344	2,009	2,633
Operating cash-flow	6,444	5,066	8,888	2,475	8,098
- Capex (tang. + intang.)	4,364	4,028	1,000	1,500	2,500
Free cash-flow	2,080	1,038	7,888	975	5,598
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	637	796	796	956	1,274
+ Equity raised	-	-	-	-	-
+ Debt raised	-1,030	115	-1,000	-991	-500
- Fin investments	54	15	-	-	-
- Misc. (CFI + CFF)	193	242	-	-	-
Net cash-flow	167	100	6,091	-971	3,824

Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

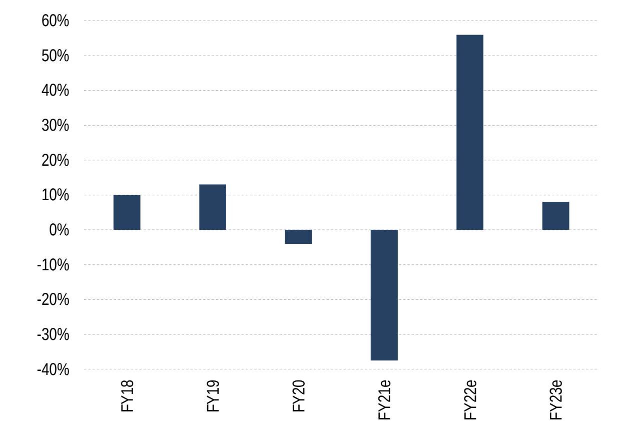
Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	57.7	76.1	318.0	54.5	41.6
EV / EBITDA (x)	28.7	37.4	87.8	29.0	23.4
EV / sales (x)	5.0	5.0	7.2	4.6	3.9
P/B (x)	10.2	9.2	9.2	8.0	6.9
RoE (%)	17.7	12.1	2.9	14.8	16.6
RoCE (%) - after tax	18.1	12.5	3.2	15.5	17.8
RoIC (%) - after tax	18.5	12.8	3.6	18.7	21.7
DPS (Rs / sh)	2.5	2.5	2.5	3.0	4.0
Dividend yield (%)	0.2	0.2	0.2	0.2	0.3
Dividend payout (%) - incl. DDT	11.3	18.6	77.9	16.0	16.3
Net debt / equity (x)	0.1	0.1	-0.1	-0.1	-0.2
Receivables (days)	85.2	75.7	85.0	80.0	80.0
Inventory (days)	58.1	61.3	60.0	60.0	60.0
Payables (days)	33.3	30.6	33.0	33.0	33.0
CFO : PAT %	114.5	118.6	869.7	41.5	103.6

Source: Company, Anand Rathi Research

Fig 5 – Price movement

Source: Bloomberg

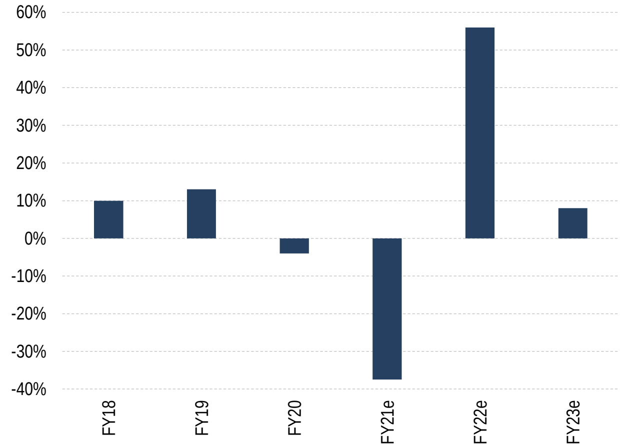
Fig 6 – Volume growth trend



Source: Company, Anand Rathi Research

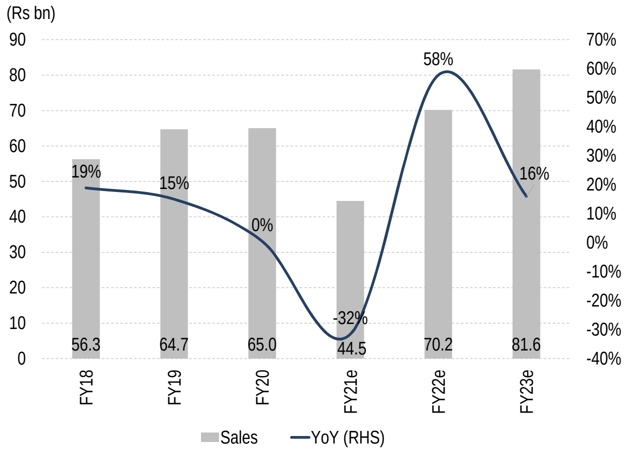
Key financial charts

Fig 7 – Strong volume recovery over FY22-23



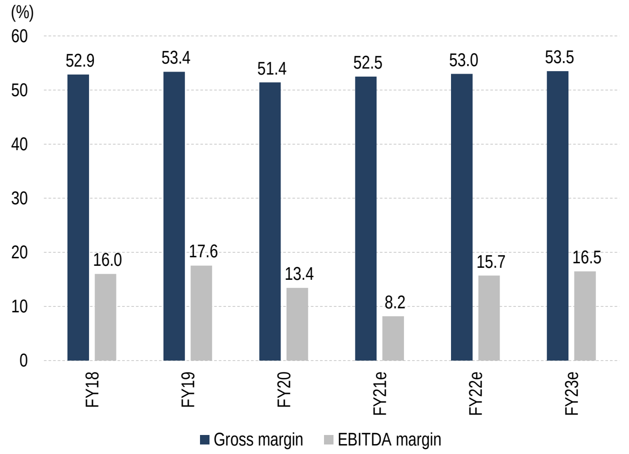
Source: Company, Anand Rathi Research

Fig 8 – 8% revenue CAGR over FY20-23



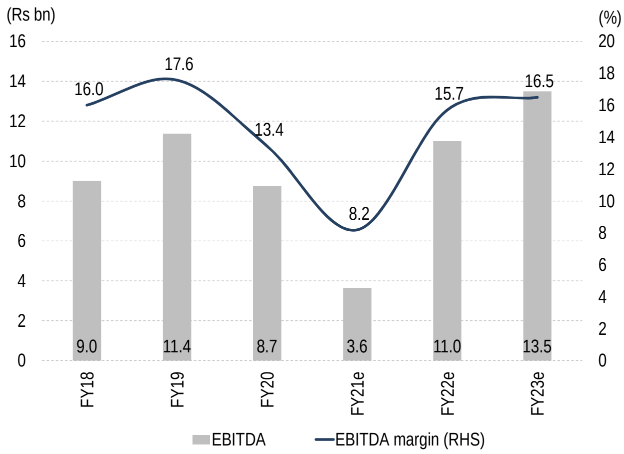
Source: Company, Anand Rathi Research

Fig 9 – Soft input costs and oper. leverage to drive margins



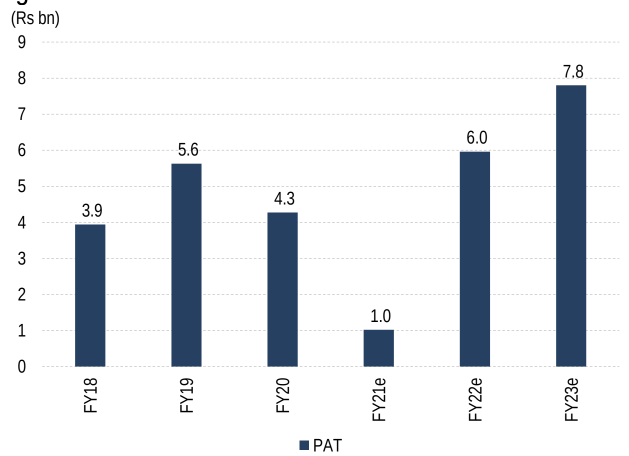
Source: Company, Anand Rathi Research

Fig 10 – 16% EBITDA CAGR over FY20-23



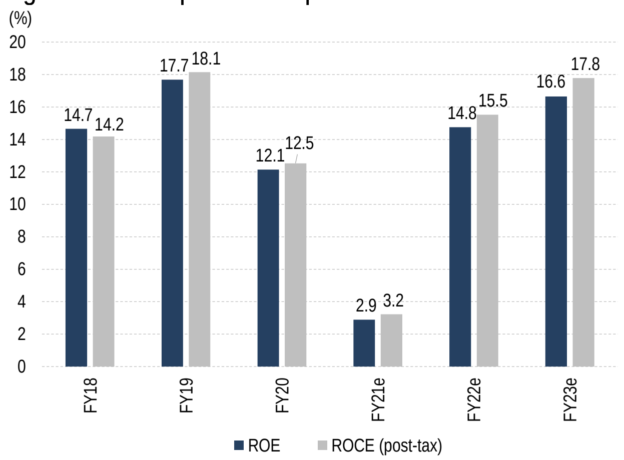
Source: Company, Anand Rathi Research

Fig 11 – 22% PAT CAGR over FY20-23



Source: Company, Anand Rathi Research

Fig 12 – Returns profile to improve FY20-23



Source: Company, Anand Rathi Research

Valuation

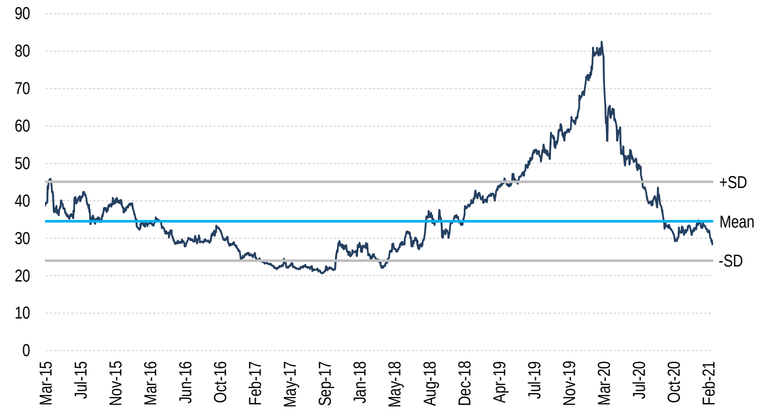
We expect normal operations over FY22-23, especially in the key summer quarter. We are factoring in a ~33% volume CAGR over FY21-23 (~3% over FY20-23), helped by a favourable base, recovery in key markets and normalisation in the on-premises channel (~20-25% of sales).

Due to softer input costs and greater utilisation, we expect the gross margin to improve, and factor in a 100bp expansion over FY21-23 (~200bp over FY20-23). This, the operating leverage and cost savings should drive a healthy 830bp EBITDA margin expansion over FY21-23 (310bp over FY20-23). We expect the EBITDA margin to return to ~16.5% in FY23, similar to FY18-19

Overall, we expect 6%, 16% and 22% CAGRs over FY20-23 in United Breweries' sales, EBITDA and PAT, respectively

We remain positive regarding United Breweries' range and supply chain strengths and expect its dominant position to persist. We believe it is poised to navigate these challenging times. However, after the healthy volume recovery in Q3 FY21, the stock has sharply run up. Hence, we initiate coverage on it with a Hold recommendation, at a target price of Rs1,388, valuing it at 26.5x FY23e EBITDA, and the implied PE multiple of 47x FY23e EPS.

Fig 13 – 1 yr fwd EV/EBITDA



Source: BSE, Anand Rathi Research

Risk

- Delay in further relaxations for the on-premises channel could lead to slower-than-expected volume recovery
- Irregular excise hikes/regulatory changes in key markets
- Adverse movements in input costs
- A negative outcome of the CCI probe, resulting in hefty fines could cut into its earnings.
- Also, a resolution pertaining to the 16% stake held by the Enforcement Directorate could lead to large supplies in the market, and have a bearing on the stock price.

Company & Management background

Company background

Company's foundation was laid in 1915 when all 5 breweries of South India came together. The company was bought by the late Mr. Vittal Mallya in 1947. United breweries currently is the largest player in the Indian beer market with a market share of ~52%. Scottish & Newcastle(S&N) acquired 37.5% stake in UBBL in 2005. S&N was globally taken over by Heineken, resulting in Heineken owning a 37.5% stake in UBBL in 2008. Currently it owns ~47% stake in the company.

The company has a diversified portfolio with leading brands across segments - Economy (London Pilsner), mainstream (Kingfisher Premium, Kingfisher Strong), premium (Kingfisher Ultra) and Super premium (Kingfisher Ultra max, Heineken, Amstel, imported beer portfolio)

Management profile

Mr. Rishi Pardal- MD

Mr. Rishi has completed his Masters' Program in International Business from the Indian Institute of Foreign Trade, New Delhi. He has also completed various functional, leadership and Management Development Programs from Northwestern-Kellogg's, IMD and HBS (in-progress). He has rich experience of more than 14 years with varied senior positions in top most companies like Avery Dennison Corporation, Global Apparel Solutions for Retail Brand and Information Solutions, etc.

ANANDRATHI

India I Equities

Alcoholic Beverages

Initiating Coverage

5 March 2021

United Spirits

Rating: Buy
Target Price: Rs.653
Share Price: Rs.561

P&A recovery will be key,valuations not demanding; Initiating with a Buy

Growth in United Spirits's P&A category over FY18-20 has been below peers. However, renovations of its key brands, recovery in on-premises channel as the economy returns to normal and a favourable base would aid a healthy recovery in P&A. This and steady input costs, continued cost control and debt reduction would drive a 18% earnings CAGR over FY20-23. Valuations at 35x FY23e EPS, and 22x FY23e EBITDA are not demanding. We initiate coverage of the company, with a Buy recommendation and a target price of Rs653 (valuing it at 26x EBITDA/an implied PE multiple of 41x FY23e EPS).

P&A volumes to recover, market-share gains will be key. We like the company's strategy of a sharper focus on P&A, which, along with recovery in its on-premises channel should help to greater recovery in volumes in the category. Market-share gains, however, will be challenging as competition in P&A is keen with the presence of Pernod Ricard, India (A&P expenditure increased 90bps over FY18-20) and mid-size manufacturers scaling up their P&A range.

Gross-margin pressures abating. Prices of ENA (~40% of cost of goods sold) have slid from peaks, are lower y/y and likely to be stable. This, recovery in P&A volumes and continued cost control would continue to drive margin gain. We expect EBITDA margins to return to mid-teens in FY22/23.

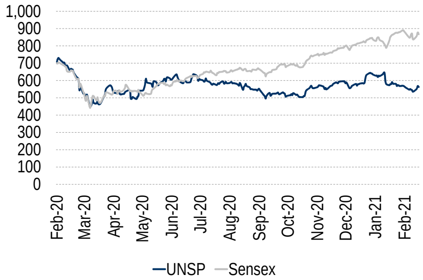
Lower debt to boost earnings growth. Despite the volatile environment, debt has been reduced ~69% over FY16-H1 FY21, driven by healthy FCF generation due to greater profitability and better working-capital management. We expect the company to turn debt free by FY23, which should aid its earnings growth and improve its returns profile.

Valuations: The stock quotes at 35x FY23e EPS and 22x FY23e EBITDA. **Risks:** Slower-than-expected recovery in the P&A category could eat into margins.

Key data	UNSP IN / UNSP.BO
52-week high / low	Rs677 / 443
Sensex / Nifty	50405 / 14938
3-m average volume	$22.5m
Market cap	Rs409bn / $5611.6m
Shares outstanding	727m

Shareholding pattern (%)	Dec'20	Sept`20	Jun`20
Promoters	56.8	56.8	56.8
- of which, Pledged	1.2	1.2	1.2
Free Float	43.2	43.2	43.2
- Foreign Institutions	19.0	18.8	19.7
- Domestic Institutions	8.1	7.5	7.7
- Public	16.2	16.9	15.9

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	89,806	90,909	79,268	98,006	109,460
Net profit (Rs m)	6,853	7,034	4,411	9,170	11,587
EPS (Rs)	9.4	9.7	6.1	12.6	15.9
P/E (x)	59.5	58.0	92.4	44.5	35.2
EV / EBITDA (x)	33.6	28.4	45.2	27.3	22.3
PBV (x)	13.0	10.7	9.6	7.9	6.4
RoE (%)	21.9	18.5	10.4	17.7	18.3
RoCE (%)	14.9	14.4	9.5	16.5	18.3
Dividend yield (%)	-	-	-	-	-
Net debt / equity (x)	0.8	0.5	0.3	0.2	-0.0

Source: Company, Anand Rathi Research

Mehul Desai
Research Analyst

Anand Rathi Share and Stock Brokers Limited (hereinafter "ARSSBL") is a full-service brokerage and equities-research firm and the views expressed therein are solely of ARSSBL and not of the companies which have been covered in the Research Report. This report is intended for the sole use of the Recipient. Disclosures and analyst certifications are present in the Appendix.

Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues (Rs m)	89,806	90,909	79,268	98,006	109,460
Growths (%)	*10*	*1*	*-13*	*24*	*12*
Direct costs	45,949	50,220	44,866	54,099	59,108
Gross profit	43,857	40,689	34,402	43,907	50,352
Gross margins %	48.8	44.8	43.4	44.8	46.0
Other expenses	30,983	25,628	25,139	28,680	32,120
EBITDA	12,874	15,061	9,263	15,226	18,231
EBITDA margins (%)	*14.3*	*16.6*	*11.7*	*15.5*	*16.7*
- Depreciation	1,445	2,275	2,409	2,554	2,748
Other income	952	455	550	605	666
Interest expenses	2,200	1,907	1,507	1,018	658
PBT	10,181	11,334	5,897	12,259	15,491
Effective tax rates (%)	*32.7*	*37.9*	*25.2*	*25.2*	*25.2*
+ Associates / (Minorities)					
Net income	6,853	7,034	4,411	9,170	11,587
WANS	727	727	727	727	727
FDEPS (Rs / sh)	9.4	9.7	6.1	12.6	15.9

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	1,453	1,453	1,453	1,453	1,453
Net worth	31,316	38,098	42,509	51,678	63,265
Total debt	25,825	20,730	14,730	10,730	5,730
Minority interest	-	-	-	-	-
TL / (Asset)	-1,878	-1,590	-1,590	-1,590	-1,590
Lease liabilities	-	1,965	1,965	1,965	1,965
Capital employed	55,263	59,203	57,614	62,783	69,370
Net tangible assets	11,151	13,044	12,035	11,481	10,733
Net Intangible assets	296	473	473	473	473
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	1,006	1,017	1,017	1,017	1,017
Investments (strategic)	-	-	-	-	-
Investments (financial)	2,984	2,526	2,984	2,984	2,984
Current assets (excl cash)	68,720	66,550	60,438	71,507	79,070
Cash	588	345	3,822	2,911	6,539
Current liabilities	29,483	24,753	23,155	27,590	31,446
Working capital	39,237	41,797	37,282	43,917	47,623
Capital deployed	55,262	59,202	57,614	62,783	69,370

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	9,914	11,347	5,897	12,259	15,491
+ Non-cash items	4,465	3,342	3,916	3,573	3,406
Oper. prof. before WC	14,379	14,689	9,813	15,831	18,897
- Incr. / (decr.) in WC	2,434	-2,361	4,515	-6,634	-3,706
Others incl. taxes	8,238	5,658	1,486	3,089	3,904
Operating cash-flow	8,575	6,670	12,841	6,108	11,286
- Capex (tang. + intang.)	656	1,978	1,400	2,000	2,000
Free cash-flow	7,919	4,692	11,441	4,108	9,286
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	-	-	-	-	-
+ Equity raised	-	-	-	-	-
+ Debt raised	-6,992	-4,927	-6,000	-4,000	-5,000
- Fin investments	1,128	-	458	-	-
- Misc. (CFI + CFF)	409	3	1,507	1,018	658
Net cash-flow	-610	-238	3,476	-911	3,628

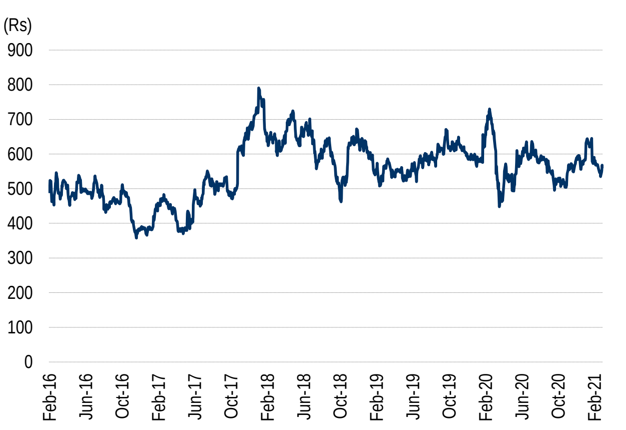
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	59.5	58.0	92.4	44.5	35.2
EV / EBITDA (x)	33.6	28.4	45.2	27.3	22.3
EV / Sales (x)	4.8	4.7	5.3	4.2	3.7
P/B (x)	13.0	10.7	9.6	7.9	6.4
RoE (%)	21.9	18.5	10.4	17.7	18.3
RoCE (%) - after tax	14.9	14.4	9.5	16.5	18.3
RoIC (%) - after tax	15.9	15.2	10.3	18.4	20.7
DPS (Rs / sh)	-	-	-	-	-
Dividend yield (%)	-	-	-	-	-
Dividend payout (%) - incl. DDT	-	-	-	-	-
Net debt / equity (x)	0.8	0.5	0.3	0.2	-0.0
Receivables (days)	102.3	91.7	98.0	92.0	92.0
Inventory (days)	76.3	73.7	74.0	74.0	74.0
Payables (days)	54.3	47.0	47.0	47.0	47.0
CFO : PAT %	125.1	94.8	291.1	66.6	97.4

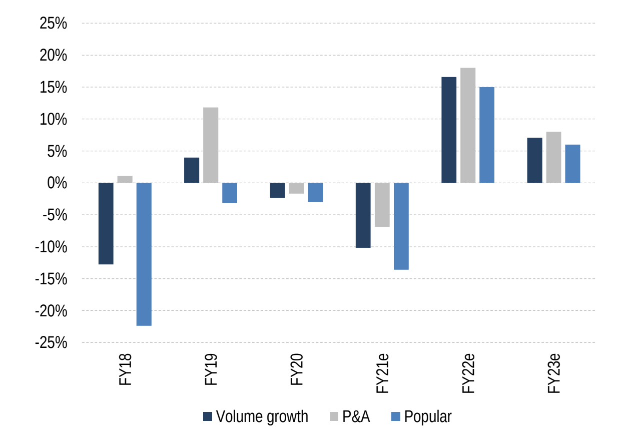
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

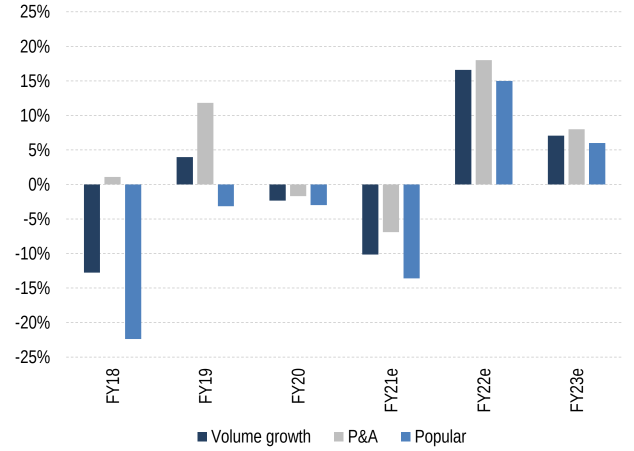
Fig 6 – Volume growth trend



Source: Company, Anand Rathi Research

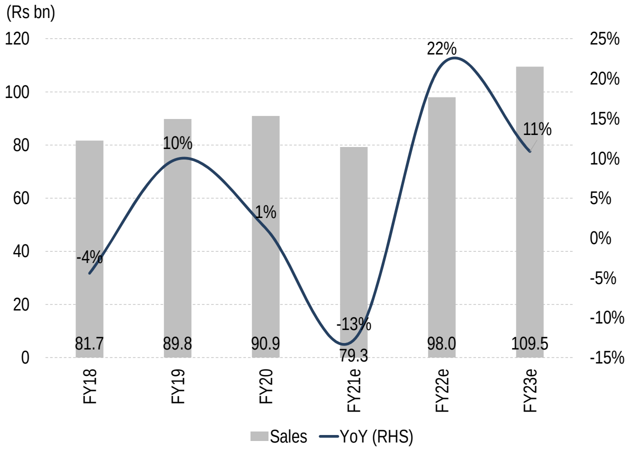
Key financial charts

Fig 7 - Volume growth trend



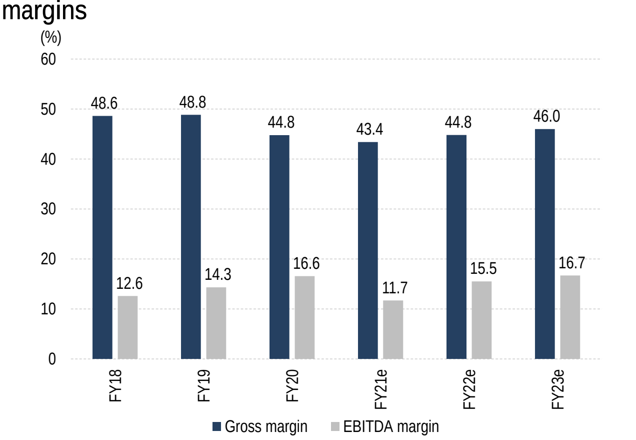
Source: Company, Anand Rathi Research

Fig 8 – 6% sales CAGR % over FY20-23



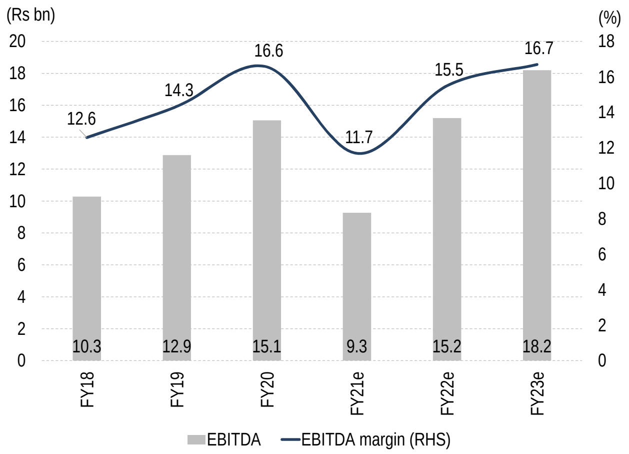
Source: Anand Rathi Research

Fig 9 – Steady input costs, better mix, cost control to aid margins



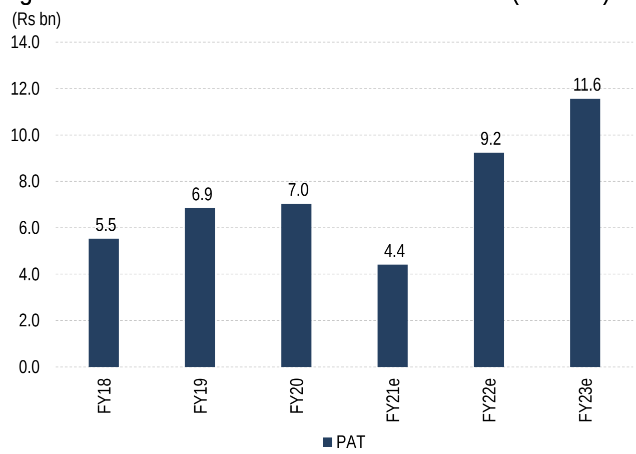
Source: Company, Anand Rathi Research

Fig 10 – 7% EBITDA CAGR over FY20-23



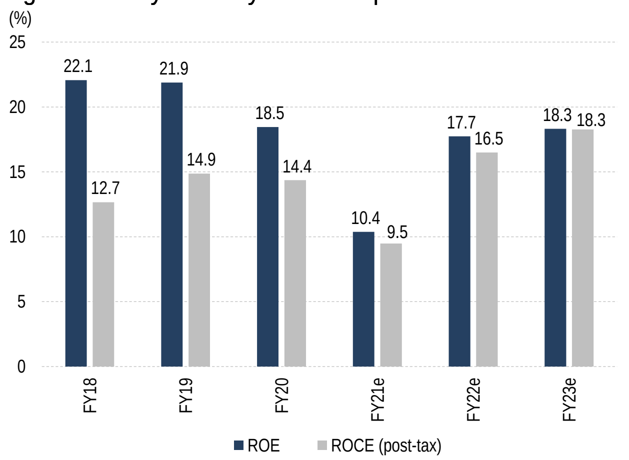
Source: Anand Rathi Research

Fig 11 – Reduced debt to lead to 18% PAT CAGR (FY20-23)



Source: Company, Anand Rathi Research

Fig 12 – Steady recovery in returns profile



Source: Anand Rathi Research

Valuation

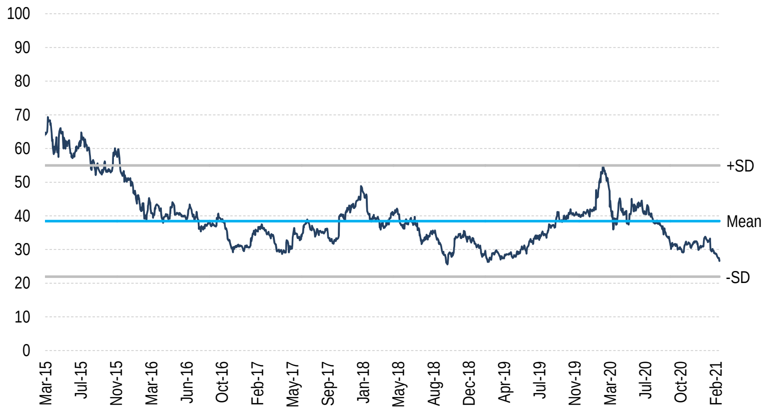
In overall volumes we expect a 12% CAGR over FY21-23, with a 14% CAGR in volumes of the Prestige & Above category, resulting in 18% (standalone) sales CAGR (a 6% sales CAGR expected over FY20-23).

The gross margin sharply contracted over FY18-21 owing to higher input costs. With ENA prices likely to be stable and with recovery in the P&A category, we expect an overall ~260bp gross-margin expansion over FY21-23 (~120bps over FY20-23).

On this and the continuing execution with overhead costs in check, we expect the EBITDA margin to improve 500bps over FY21-23 (flattish over FY20-23). PAT growth (an 18% CAGR anticipated over FY20-23) is expected to be much higher due to lower interest expense because of the continued debt reduction and a lower effective tax rate.

Further improvement in United Spirits' P&A category, we believe, would be a key monitorable. Its stabilised on-premises channel, interventions in its P&A range and its further lessening focus on the popular category would improve performance in this category. Valuations at 22x FY23 EBITDA and 35x FY23e earnings are not demanding & below historical averages. We initiate coverage with a Buy recommendation and a target price of Rs653, valuing it at 26x EBITDA, and the implied PE multiple of 41x FY23e EPS.

Fig 13 – One-year-forward EV / EBITDA



Source: BSE, Anand Rathi Research

Risk

- Delay in further relaxations for the on-premises channel could lead to slower-than-expected volume recovery in P&A
- Irregular excise hikes/regulatory changes in key markets
- Adverse movements in input costs

Company, Management background

Company background

Incorporated in 1999, United Spirits is the largest spirits company in India, manufacturing a wide range (over 80 brands) in whisky, vodka, rum and other spirits.11 of these brands sell more than a million cases annually. Diageo, the second largest spirits manufacturer globally owns a 56% stake.

In terms of sales mix, the P&A category accounts for ~51%/65% of overall volumes and sales, the balance being the popular category. In P&A, the strong brands are Johnnie Walker, Black Dog, Black & White, Vat 69, Antiquity, Signature, Royal Challenge, McDowell's No.1, Smirnoff and Captain Morgan. The company has 15 factories across India.

Management profile

Ms Hina Nagarajan - Managing Director & Chief Executive Officer Designate

Effective from April 1, 2021 Ms. Hina Nagarajan has been appointed as Chief Executive Officer - Designate, who will closely work with Mr. Anand Kripalu up to June 30, 2021. Thereafter, Mr. Anand Kripalu will step down as the Managing Director & Chief Executive Officer.

Ms Hina Nagarajan will be the new MD & CEO, effective 01st Jul'21. She is now MD, Africa Regional Markets, Diageo. Since joining Diageo in the summer of 2018, she has led its ARM operations in Ghana, Cameroon, Ethiopia, the Indian Ocean, Angola, and several other countries.

Prior to joining Diageo, she was for more than 30 years in consumer packaged goods businesses and held several senior marketing and general management positions at Reckitt Benckiser, Nestle (India) and Mary Kay (India).

She has an MBA from The Indian Institute of Management, Ahmedabad, a Commerce Honors degree from the Delhi University and a Diploma in Hotel Management from the Pusa Institute, Delhi.

ANANDRATHI

India I Equities

Alcoholic Beverages

Initiating Coverage

5 March 2021

Radico Khaitan

Rating: **Buy**
Target Price: Rs.721
Share Price: Rs.617

Robust execution in a challenging category; Initiating, with a Buy

In the highly regulated and competitive spirits sub-segment, Radico Khaitan's execution in its P&A category has been strong, aided by innovations and capitalising on opportunities in vodka. Further, its FCF generation has been healthy, thereby consistently reducing debt and strengthening its balance sheet. We expect its impressive track record to continue, and factor in 9%/13.6%/13% sales/EBITDA/PAT CAGRs over FY20-23. We expect the discount to United Spirits to narrow, and initiate coverage with a Buy rating at a target price of Rs721, valuing it at 26.5x FY23e EPS/~17.5x FY23e EBITDA).

Volume outperformance driven by strong execution. Radico Khaitan's IMFL/P&A volumes registered 8%/13% CAGRs over FY16-20, much better than its peers. We expect the outperformance to continue and factor in 5%/9% volume/revenue CAGRs over FY20-23, driven by the better execution in innovations, capitalising on opportunities in vodka and healthy recovery in its core markets (UP, Karnataka).

Good margins to continue. Over FY16-20, the gross/EBITDA margins improved 240bps/390bps. With a sound volume trajectory, its continued good execution in the P&A category and steady input costs, we expect a 13.6% EBITDA CAGR, with a 210bp margin expansion over FY20-23.

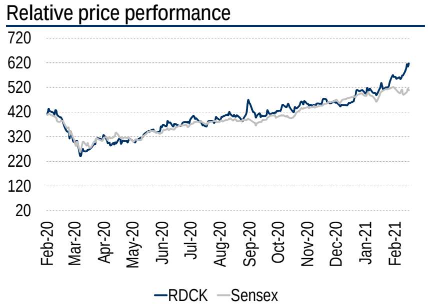
Debt reduction on track. In the last five years, the balance sheet has considerably strengthened because of greater working-capital efficiency and debt reduction. With sound profitability, continued reduction in debt/ working capital and lower capex, we expect its returns profile and FCF generation to be strong. We expect it to be debt free by FY23, which would afford it enough headroom to up its dividend payout.

Valuations: The stock trades at 17x/15x FY22e/FY23e EBITDA**. Risks:** Adverse regulatory changes in key markets, heightened competition in P&A.

Key data	RDCK IN / RADC.BO
52-week high / low	Rs628 / 220
Sensex / Nifty	50405 / 14938
3-m average volume	$3.5m
Market cap	Rs82bn / $1131.4m
Shares outstanding	134m

Shareholding pattern (%)	Dec'20	Sept`20	Jun`20
Promoters	40.3	40.3	40.3
- of which, Pledged	-	-	3.5
Free Float	56.7	56.7	53.8
- Foreign Institutions	18.3	18.0	18.6
- Domestic Institutions	17.0	16.6	15.4
- Public	21.5	22.1	19.7

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	20,969	24,270	23,560	28,239	31,334
Net profit (Rs m)	1,881	2,275	2,522	3,165	3,641
EPS (Rs)	14.1	17.0	18.9	23.7	27.3
PE (x)	43.7	32.7	32.7	26.0	22.6
EV / EBITDA (x)	24.4	23.2	20.9	17.2	15.0
PBV (x)	6.3	5.4	4.7	4.1	3.5
RoE (%)	14.3	15.0	14.5	15.7	15.6
RoCE (%)	11.8	14.8	13.1	14.9	15.5
Dividend yield (%)	0.2	0.3	0.4	0.5	0.6
Net debt / equity (x)	0.2	0.3	0.1	0.0	-0.0

Source: Company, Anand Rathi Research

Mehul Desai
Research Analyst

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Net revenues (Rs m)	20,969	24,270	23,560	28,239	31,334
Growth (%)	*15*	*16*	*-3*	*20*	*11*
Direct costs	10,143	12,557	11,542	13,707	15,129
Gross profit	10,826	11,714	12,018	14,533	16,205
Gross margins %	*51.6*	*48.3*	*51.0*	*51.5*	*51.7*
Other expenses	7,323	7,996	7,980	9,679	10,758
EBITDA	3,503	3,718	4,037	4,853	5,448
EBITDA margins (%)	*16.7*	*15.3*	*17.1*	*17.2*	*17.4*
- Depreciation	424	525	540	572	607
Other income	133	92	101	111	122
Interest expenses	355	316	227	160	95
PBT	2,857	2,968	3,371	4,232	4,867
Effective tax rates (%)	*34.2*	*15.2*	*25.2*	*25.2*	*25.2*
+ Associates / (Minorities)	-	-	-	-	-
Net income	1,881	2,275	2,522	3,165	3,641
WANS	133	134	134	134	134
FDEPS (Rs / sh)	14.1	17.0	18.9	23.7	27.3

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	267	267	267	267	267
Net worth	13,149	15,205	17,407	20,172	23,332
Total debt	3,370	4,003	2,969	1,969	969
Minority interest	-	-	-	-	-
TL / (Assets)	1,040	785	785	785	785
Capital employed	17,560	19,993	21,160	22,925	25,085
Net tangible assets	7,139	7,434	7,394	7,422	7,415
Net Intangible assets	-	-	-	-	-
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	160	181	181	181	181
Investments (strategic)	-	-	-	-	-
Investments (financial)	1,554	1,554	1,554	1,554	1,554
Current assets (excl cash)	13,276	15,253	15,556	18,182	20,088
Cash	177	182	1,064	1,030	1,896
Current liabilities	4,746	4,611	4,588	5,443	6,048
Working capital	8,530	10,642	10,968	12,738	14,040
Capital deployed	17,560	19,993	21,160	22,925	25,085

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	2,857	2,727	3,371	4,232	4,867
+ Non-cash items	744	1,060	767	733	702
Oper. prof. before WC	3,601	3,787	4,138	4,964	5,570
- Incr. / (decr.) in WC	259	-2,337	-326	-1,771	-1,302
Others incl. taxes	773	854	850	1,066	1,227
Operating cash-flow	3,087	597	2,963	2,127	3,042
- Capex (tang. + intang.)	675	718	500	600	600
Free cash-flow	2,412	-121	2,463	1,527	2,442
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	161	193	320	400	481
+ Equity raised	11	13	-	-	-
+ Debt raised	-1,739	900	-1,034	-1,000	-1,000
- Fin investments	-500	-	-	-	-
- Misc. (CFI + CFF)	261	249	227	160	95
Net cash-flow	762	349	881	-34	865

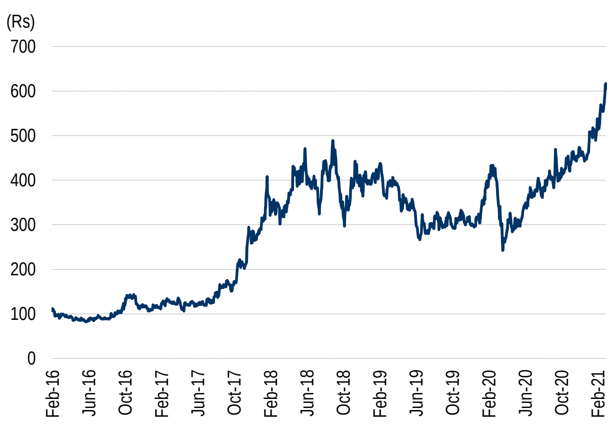
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	43.7	32.7	32.7	26.0	22.6
EV / EBITDA (x)	24.4	23.2	20.9	17.2	15.0
EV / Sales (x)	4.1	3.6	3.6	3.0	2.6
P/B (x)	6.3	5.4	4.7	4.1	3.5
RoE (%)	14.3	15.0	14.5	15.7	15.6
RoCE (%) - after tax	11.8	14.8	13.1	14.9	15.5
RoIC (%) - after tax	13.3	16.3	14.6	16.9	17.7
DPS (Rs / sh)	1.2	2.0	2.4	3.0	3.6
Dividend yield (%)	0.2	0.3	0.4	0.5	0.6
Dividend payout (%) - incl. DDT	8.5	7.7	12.7	12.7	13.2
Net debt / equity (x)	0.2	0.3	0.1	0.0	-0.0
Receivables (days)	111.7	123.8	130.0	125.0	125.0
Inventory (days)	62.6	56.3	56.0	56.0	56.0
Payables (days)	56.8	49.3	55.0	54.0	53.0
CFO : PAT %	164.1	23.7	117.5	67.2	83.5

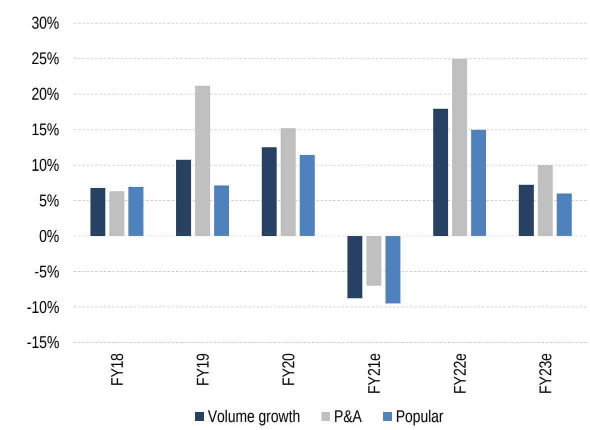
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

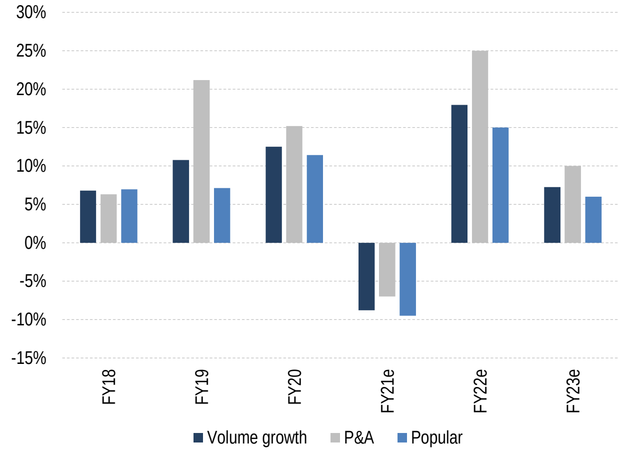
Fig 6 – Volume growth trend



Source: Company, Anand Rathi Research

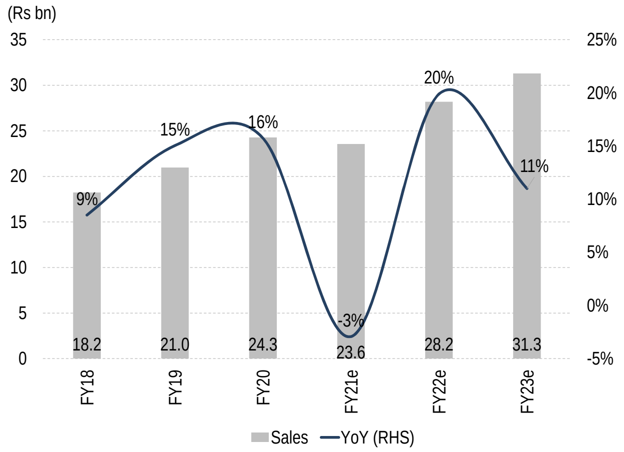
Key financial charts

Fig 7 – 5% IMFL volume CAGR over FY20-23



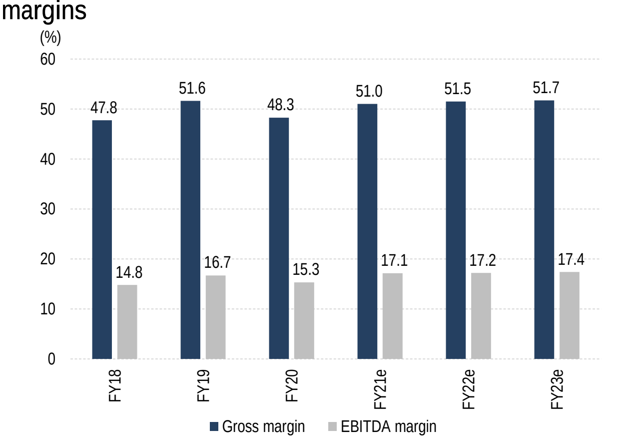
Source: Company, Anand Rathi Research

Fig 8 – 9% sales CAGR over FY20-23



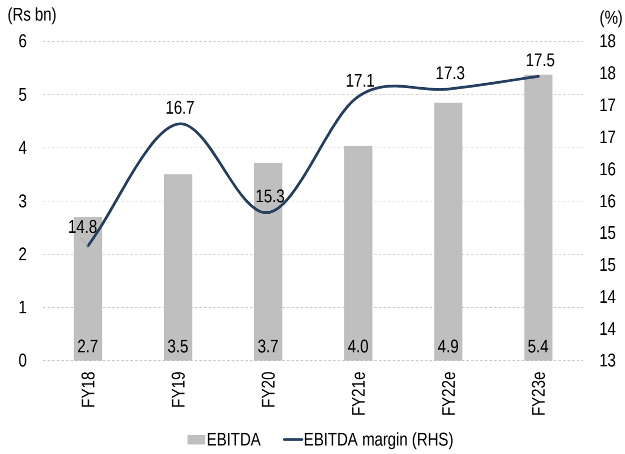
Source: Anand Rathi Research

Fig 9 – Stable RM cost, operating leverage to support margins



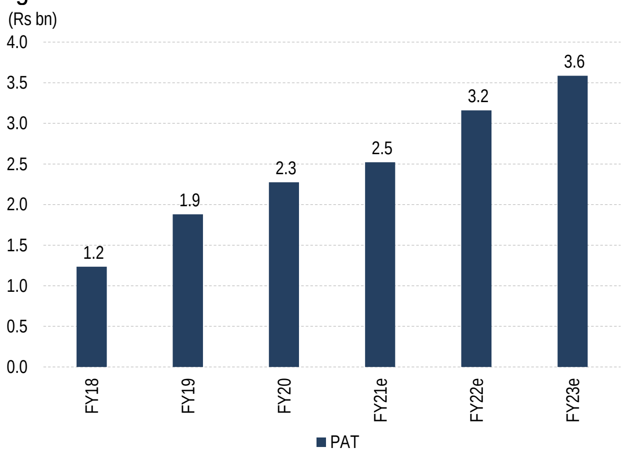
Source: Company, Anand Rathi Research

Fig 10 – 13.6% EBITDA CAGR over FY20-23



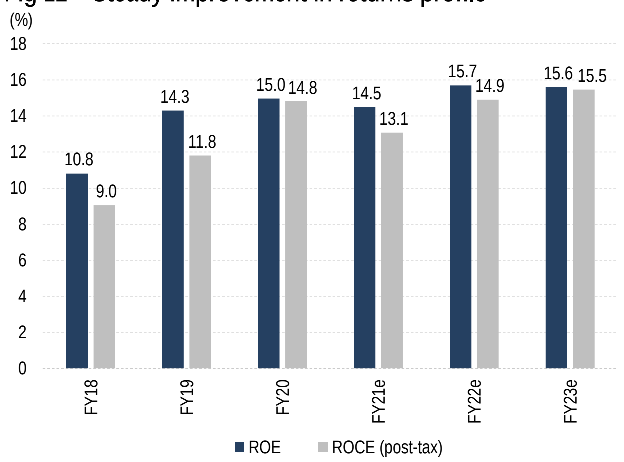
Source: Anand Rathi Research

Fig 11 – Debt reduction to further boost PAT



Source: Company, Anand Rathi Research

Fig 12 – Steady improvement in returns profile



Source: Anand Rathi Research

Valuation

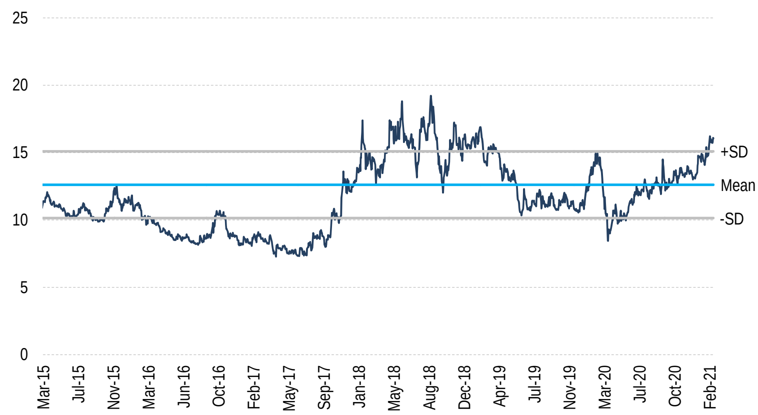
We expect a 13% volume CAGR overall, with a 17% volume CAGR in the Prestige & Above category and an 11% CAGR in the Regular one, resulting in an overall 15% sales CAGR over FY21-23 (9% sales CAGR over FY20-23).

With ENA prices likely to be stable and with the better mix, we expect an overall ~80bp gross-margin expansion over FY21-23. Given the thrust on launches in P&A, we have assumed higher A&P expenditure, resulting in a modest, ~30bp, EBITDA margin expansion over FY21-23 (~210bps over FY20-23).

However, PBT growth (a 20% CAGR over FY21-23, and 18% over FY20-23) is expected to be much higher due to lower interest expenses on the continued reduction in debt. PAT CAGR is expected to be 13% over FY20-23, due to a lower effective tax rate in FY20.

We expect Radico Khaitan's better execution to continue, which could reduce its discount to United Spirits. We initiate coverage on it with a Buy recommendation, at a target price of Rs721, (valuing it at 17.5x EBITDA and 26.5x FY23e EPS).

Fig 13 – One-year-forward EV / EBITDA



Source: BSE, Anand Rathi Research

Risk

- Spike in Covid-19 cases could lead to restrictions on mobility again, impacting volume recovery
- Irregular excise hikes/regulatory changes in key markets
- Adverse movements in input costs

Company, Management background

Company background

One of the oldest and the largest manufacturers in India of Indian-made foreign liquor (IMFL), formerly known as Rampur Distilleries, Radico Khaitan commenced operations in 1943. It now has five of its own manufacturing units, with another 28 under contract manufacturing. It has wide range of brands in the Prestige & Above category (~30%/50% of IMFL volumes/sales) and the popular category (~70%/50%). 8PM whisky, Magic Moments, Contessa rum and Morpheous brandy are its key brands.

Management profile

Chairman Dr Lalit Khaitan was educated at Mayo College, Ajmer. He acquired the company in 1972-73 with a lot of liabilities and transformed it from a bottler to a leading IMFL manufacturer in India.

Managing Director Abhishek Khaitan has a Bachelor's degree in Engineering from the BMS College of Engineering, Bengaluru, and has completed a Managerial Finance & Accounting course from Harvard, USA. He started his career in 1997 by spearheading the marketing division at Radico Khaitan. With over two decades' industry experience, he has been instrumental in launching over 15 successful brands, five of which feature in the "millionaire" category. He launched 8PM whisky and Magic Moments vodka, which were great successes. Magic Moments became the largest selling vodka in India. It is also the eleventh-largest selling vodka in the world.

Appendix

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