

MONTHLY MAG

August 2019

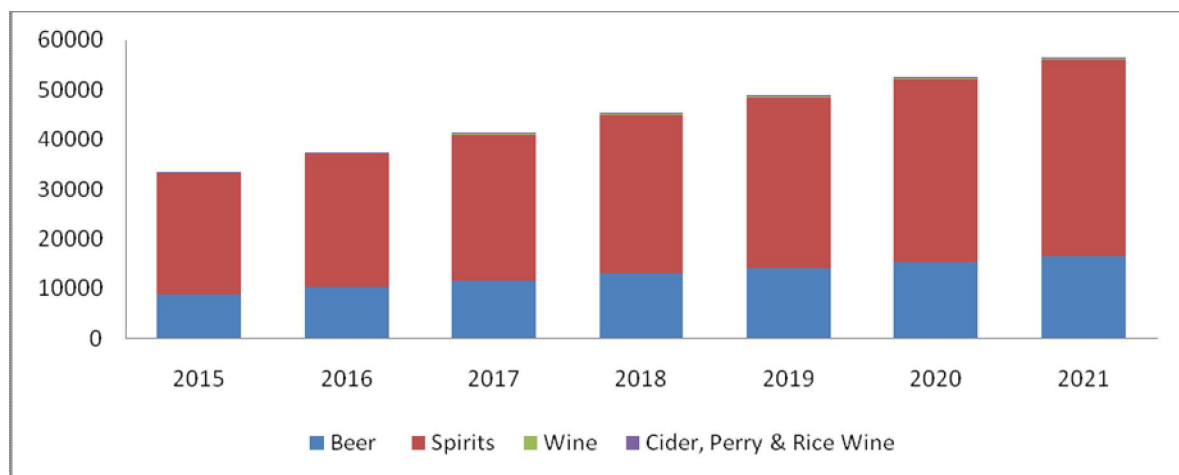
- ✓ Sector of the month
- ✓ Picks of the month

Sector of the Month (Alcohol):

- The Indian economy is likely to expand from ~US\$2.7 trillion in 2018 to \$5 trillion in the next five years and \$10 trillion in eight years after that. Domestic consumption, which powers 60% of the Gross Domestic Product (GDP) now, is expected to grow close to \$6 trillion.
- The macro environment plays a significant role in shaping the emerging opportunities in the alcohol beverage industry.
- India’s alcohol industry is the third largest in the world with a value of \$35 billion. The industry is divided into three categories: Indian Manufactured Foreign Liquor (IMFL), beer, and homemade liquor.
- FAVOURABLE DEMOGRAPHICS: With a median age of 31 in 2030, India will remain one of the world’s youngest nations. The country will add more working-age citizens to the world than any other country, possessing one of the largest working-age populations.
- The Indian liquor Industry is one of the most vibrant in the world. The array of liquor sold in India is dazzling and demand for the same is growing among affluent Indians. India is one of the top markets for higher consumption and growing at a healthy rate.
- Indians are drinking more than ever before, with the annual per capita alcohol consumption going up by 38% in seven years to 5.9 litres (ltr) in 2017, up from 4.3 ltr in 2010, according to a new study on harmful alcohol use in 189 countries.
- Consumption is projected to reach 7.6 ltr per adult by 2030, the highest rise being forecast in middle-income countries such as China, India, Vietnam and Myanmar, the medical journal said. People who had never had alcohol fell from 46% in 1990 to 43% in 2017, while current drinkers went up from 45% in 1990 to 47% in 2017.

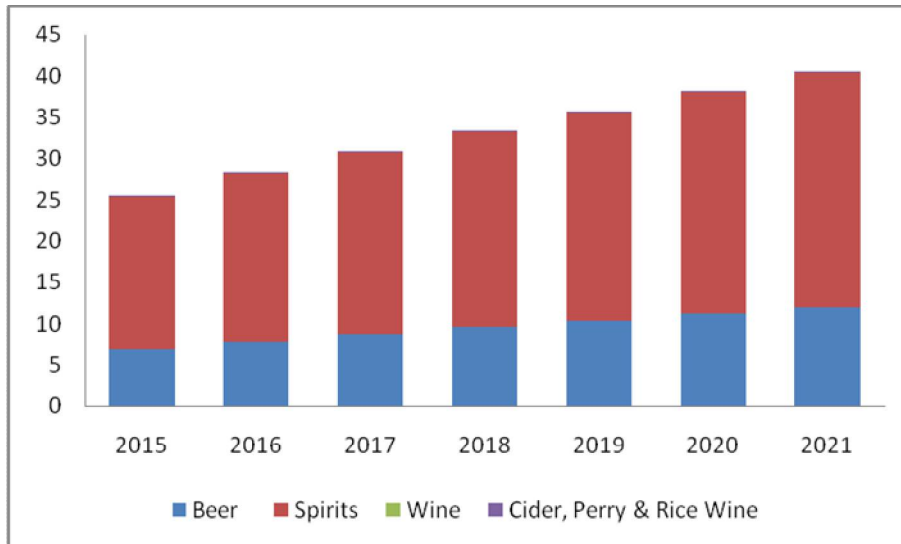
Revenue in the Alcoholic Drinks market amounts to US\$48,855m in 2019.

Revenue (US\$ million)

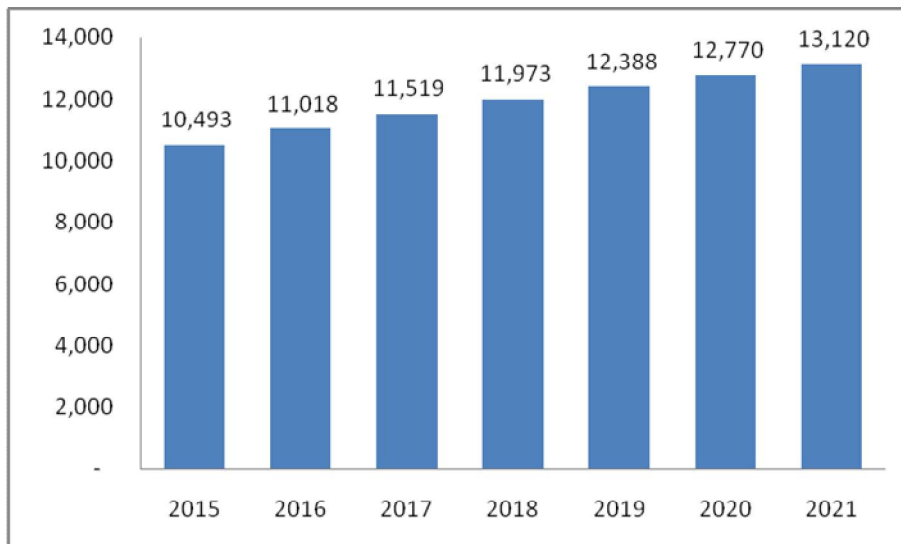


Source: Ace equity, Statista

Average Revenue per Capita in US\$



Volume in million litres



Source: Ace equity, Statista

Factors Driving Growth

- **Aggressive marketing and promotion by the alcohol industry**, lax regulation, low health literacy on alcohol-related harm in the general population, and political dependence on excise revenue drives the liquor trade in many developing countries.
- The **sociodemographic factors** that are playing a role in rising consumption in Asia are changing social norms that make it easier for both young men and women to drink, and higher life expectancy that increases the years of drinking among consuming adults, which raises gross national consumption.
- The brand name liquor carries is crucial to its success and will remain so in the year ahead as well. Demand for branded liquor is led by the most affluent segment of society and brand name led consumption includes demand for imported scotches and single malts. Many of those who consume liquor sold in this segment are liquor connoisseurs and take pride in enjoying all the trappings of an affluent lifestyle which includes knowledge of and consumption of fine liquors.
- The experience led consumer purchases whiskey that is in the premium and deluxe segment. People in this demographic are usually younger than those in the former segment many being in their 20's and are employed in prestigious jobs or are college students from relatively well-off backgrounds. They regularly experiment by consuming different brands and hence are not completely won over by a single brand. Such consumers are also open to consuming brands they have not tried before and they can be won over by new brands when brands offer better value such as attractive packaging, superior blend, a better consumer experience, and other high-value offerings.

Source: Ace equity, Statista

Risk involved

Despite the upbeat momentum of the Indian liquor industry next year, there are a few challenges the industry will have to face. One such challenge is the rising cost of doing business in India. This rising cost is in the space of dry and wet goods. Another challenge the liquor industry will face is that companies will need to make greater investments to pay excise duties.

Companies that sell to consumers who are highly conscious of price will be burdened by higher costs of raw materials next year. As the profit margins of many companies in this space are small, some players in this segment will find it difficult to remain viable. Next year it is likely that many liquor distributors will stake their claim in the liquor industry by launching their own brands. This will disrupt the distribution of liquor for many existing brands.

The entry costs to the liquor business will be higher next year which will dampen the introduction of craft and niche liquor brands thereby depriving consumers of greater variety. Finally, the scale of a liquor business will be more important than ever before to ensure the success of the business.

Outlook

Over the coming year, it's expected that demand for whiskey will grow by 3.5 percent and will grow at this rate every year for the next 3 years while whiskey's share of the entire Indian liquor market will be 60%. Whiskey sales will comprise 73% of the value of liquor sold in India in 2019 clearly revealing that premium prices attached to whiskey don't dampen Indian consumer's appreciation of this liquor. Within the whiskey segment, it is estimated that demand for Bottled in India (BII) Scotch, Premium Whisky, and Semi-premium Whisky will grow between 16%, 10%, and 8% respectively.

Demand for scotch, Indian made foreign liquor (IMFL), deluxe whiskey, and regular whiskey will be between 12%, 3%, 15%, and -2% respectively. The drop in demand for regular whiskey is commensurate with rising standards of living in India and signals the aspirations of Indians some of whom prefer to consume more a higher quality whiskey instead of regular whiskey. A very large number of those who consume whiskey next year will consume regular whiskey signalling once again that despite an aspirational class, low prices still have an impact on the average consumer's decision to purchase whiskey in India.

Other liquors such as rum, brandy, and white spirits share by volume in India is expected to be 15%, 22%, and 3% while their share by value is expected to be 10%, 12%, and 5%. A casual examination of these numbers reveals that in India consumers still prefer relatively inexpensive rum and whiskey while those who consume white spirits are more likely to consume a premium product.

More and more Indians are saying cheers among friends every evening, a trend that is likely to continue. Excitingly more Indians are willing to pay extra for a higher quality branded liquor than did in the past; this trend is likely to increase the demand for branded liquor over the next few decades at the expense of unbranded liquor brands.

Source: Ace equity, Statista

Pick of the Month (United Spirits Ltd.): CMP: 584.6

Target: 980

United Spirits (USL), is the largest spirits company in India and a flagship entity of UB group. It manufactures wide range of whisky, vodka, rum and other spirits. United Spirits is among the top three spirits companies in the world. USL has a global footprint with exports to over 37 countries. It has a sizeable presence in India with distilleries and sales offices all across the country, and a committed team of over 7500 people dedicated to the fulfillment of the company's mission. It has established manufacturing and bottling plants in every state of India. In addition, to deliver its products to customers located anywhere in India, USL has established a robust distribution network covering the whole country

Its brands include Black Dog 12 YO Deluxe Scotch Whisky, Black Dog Centenary Scotch Whisky, Antiquity Blue Whisky, Antiquity Rare Whisky, Signature Whisky, Single Malt Whisky, DSP Black Whisky, Celebration Rum, McDowell's No.1 Brandy, White Mischief Vodka, Premium Romanov and Blue Riband Gin. United Spirits acquired leading distiller of Scotch whisky Whyte & Mackay and Bouvet Ladubay, a wine subsidiary of French champagne company Taittinger. Whyte & Mackay and Bouvet Ladubay are now 100% subsidiaries making United Spirits a manufacturer of 17 millionaire brands

Strong Q1FY20 performance: The company has reported a 143% increase in net profit at Rs 197.4 crore for the quarter ended June, mainly due to improved operating performance and lower interest cost. The company reported 10% YoY increase in its total sales for the quarter at Rs 7087.9 crore. Excluding one-time sale of bulk scotch, net sales grew 6%. EBITDA margins rose 772 basis points due to savings in operating costs and phasing effect of marketing investment. The prestige and above segment accounted for 67% of net sales, up 200 bps compared to last year.

Positive management commentary: The management is watchful of the broader economy slowdown and its overall impact in the near term. The company guided to grow topline by double digits and to improve EBITDA margin to mid-high teens.

Valuations: The stock is trading at a valuations of 59.2x P/E FY19. We recommend **buy on United Spirit Limited.** with a price target of **Rs. 650.**

NSE / BSE Code	MCDOWELL- N/532432
Sector	Alcohol
Industry	Breweries & Distilleries
Face value / Book Value (₹ per share)	10 / 45.8
Dividend yield (%)	-
52 H/L (Rs.)	680 / 439
Market Cap. (Rs. Cr)	428,717
Shares Outstanding (Cr)	726.6
NSE / BSE Code	819,027

(In Rs.Cr)	Q1FY20	Q4FY19	Q3FY19	Q2FY19
Net Sales	7,078	7,216	7,764	7,128
EBITDA	405	296	409	457
PAT	197	126	192	259
EBITDA %	5.7%	4.1%	5.3%	6.4%
PAT %	2.8%	1.7%	2.5%	3.6%

(In Rs.Cr)	FY16	FY17	FY18	FY19
Net Sales	84,949	88,175	85,906	93,408
Sales Growth	-9.0%	3.8%	-2.6%	8.7%
EBITDA	9,646	9,892	12,072	13,936
EBITDA Margin	11.4%	11.2%	14.1%	14.9%
PAT	1,434	930	6,519	6,854
NPM%	1.7%	1.1%	7.6%	7.3%
Adj. EPS (Rs.')	1.9	1.4	8.7	9.6

	FY16	FY17	FY18	FY19
P/E (x)	714.5	1,101.7	157.2	149.5
P/B (x)	59.8	57.4	42.4	33.2
EV/Sales(x)	12.4	12.0	12.3	11.3
EV/EBITDA(x)	109.5	106.8	87.5	75.8
ROCE(x)	11.6%	9.1%	20.2%	21.2%
ROE(x)	6.7%	5.4%	31.0%	24.9%

Source: Ace equity, CARE, IBEF

Pick of the Month (United Breweries Ltd.): CMP: 1409.1

Target: 1600

United Breweries (UBL) incorporated in 1999, is a flagship company of UB Group. The company is engaged in manufacturing and marketing of beer. UB Group (Parent Company) -UB Group's business interests are in area of brewing, distilling, aviation, fertilizers, life sciences, engineering, research and development and information technology. UBL started its journey in 1915, when Thomas Leishman purchased 5 breweries to form United Breweries with its registered office located at Chennai. Much later late Vittal Mallya bought the company in 1947. Today 6 bottles of Kingfisher are sold every second in India.

United Breweries Limited is synonymous with innovation and aggressive marketing that is complemented by a strong distribution network which encompasses an impressive spread of owned and contract manufacturing facilities across the country. Our flagship brand 'Kingfisher', has achieved international recognition consistently, and has won many awards at international beer festivals. Our most popular beer, Kingfisher Premium Lager beer, is currently available in 69 countries and leads the way among Indian beers in the international market.

Volume growth and cost saving measure can pull topline: 4QFY19 margins were affected on the back of higher glass bottle prices, and weak state mix due to lower volumes in Karnataka (manufacturing restrictions) and Maharashtra (trade upstocking after two months of supply discontinuation). However, better input sourcing (barley imports), use of recycled bottles and savings from increased production of premium brands can still sustain current operating margins and drive modest improvements ahead.

State policies largely stable: Ex-Andhra Pradesh policies with regards to alcohol are quite stable. Andhra Pradesh prohibition can have major impact on the revenue as nearly 20% of the state tax is from alcohol.

Valuations: Given the higher volume and market potential we hold positive outlook for the stock. The stock is trading at a valuations of 65.9x P/E FY19. We recommend **buy on United Breweries Limited**, with a price target of **Rs. 1600**.

NSE / BSE Code	UBL/532478
Sector	Alcohol
Industry	Breweries & Distilleries
Face value / Book Value (₹ per share)	1 / 120.3
Dividend yield (%)	0.2
52 H/L (Rs.)	1494 / 1083
Market Cap. (Rs. Cr)	372,811
Shares Outstanding (Cr)	264.4
NSE / BSE Code	268,522

(In Rs.Cr)	Q4FY19	Q3FY19	Q2FY19	Q1FY19
Net Sales	3,459	3,188	3,332	4,158
EBITDA	182	250	322	416
PAT	68	109	164	222
EBITDA %	5.3%	7.8%	9.7%	10.0%
PAT %	2.0%	3.4%	4.9%	5.3%

(In Rs.Cr)	FY16	FY17	FY18	FY19
Net Sales	48,331	47,292	56,190	64,754
Sales Growth	3.1%	-2.2%	18.8%	15.2%
EBITDA	6,930	6,419	9,020	11,384
EBITDA Margin	14.3%	13.6%	16.1%	17.6%
PAT	2,987	2,299	3,946	5,633
NPM%	6.2%	4.9%	7.0%	8.7%
Adj. EPS (Rs. `)	11.3	8.7	14.9	21.3

	FY16	FY17	FY18	FY19
P/E (x)	124.8	162.1	94.5	66.2
P/B (x)	17.4	16.0	13.9	11.7
EV/Sales(x)	7.9	8.0	6.8	5.9
EV/EBITDA(x)	54.9	59.3	42.2	33.4
ROCE(x)	19.0%	13.8%	22.1%	28.5%
ROE(x)	14.9%	10.3%	15.7%	19.2%

Source: Ace equity, CARE, IBEF

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