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UNITED SPIRITS LTD

MAX BUYING PRICE Rs 2500

In this overheated Indian stock market, there are a few businesses which still look attractive to own. United Spirits at the current price levels might be one. As Thomas Fuller said, "The night is always darkest before the dawn" It seems to be true for United Spirits.

Moat

A plethora of entry barriers (license, controlled distribution, manufacturing, retailing and pricing, ban on advertisement etc) is the first moat for any competitor who wants to compete with United Spirits in its business. The business enjoys a market leadership in IMFL, with 41% share by volume and 50% share by value.

The second moat is the brands it owns. It has brands like Johnnie Walker, VAT 69, Black & White, and Smirnoff in the Diageo stable and Royal Challenge, Signature, Antiquity, Bagpiper, Director's Special Whisky, McDowell No.1 Whisky, White Mischief Vodka, Romanov Vodka, McDowell's No. 1 Celebration Rum and Black Dog scotch whisky from McDowell stable. USL's restricted bulk liquid sales are now transitioning towards a branded FMCG business.

United Spirits (USL) with more than 140 brands holds the numero uno position in the Indian alcohol industry. USL boasts of nearly 21 millionaire brands (selling more than a million cases a year) across segments from whisky to gin and covering a multitude of price points, thereby catering to a vast range of customers.

Management

Till the time Vijay Mallya owned this company, it was a big No No for me. But ever since Diageo PLC launched an open offer for acquisition of up to 3,77,85,214 (26%) fully paid equity shares of Rs10 each of United Spirits (USL), I got interested in the business. The open offer has taken Diageo's stake to 54.8%. The open offer price was Rs3030 per share. Diageo's superior management ability will bring robust operational practices in USL. As also Diageo will infuse capital into USL, aiding in significant balance sheet de-leveraging. Diageo is expected to shift USL's portfolio to the premium end. The decision to sell out Whyte & Mackay brands bought by Mallya will also result in debt reduction significantly. Diageo can be a very big name in Indian Consumer Space in the next decade. Diageo's premium focus, strong execution capability and superior capital management ability will further complement the huge scale achieved by USL.

Business Prospects

USL offers a unique multi-year play on the Indian Made Foreign Liquor(IMFL) growth story. USL provides an interesting and liquid vehicle to ride the favorable demographics driven long term consumption story of India. Right now, it is a transitory phase for the business. The cleaning up is under progress. Diageo accounted for provisions to the tune of 1123.2 crore to encompass doubtful receivables and advances made to the holding company UBHL. Further, with the sale of W&M, Diageo accounted for impairment in goodwill to the extent of 3235.7 crore resulting into loss on account of discontinued operations to the tune of 3047.8 crore. The profits will eventually be visible. The margin expansion efforts and bulk of the financial improvements will happen post FY16. USL also holds 3.6% stake in United Breweries (UBL) and owns an IPL team. While Diageo intends to use the IPL asset as a marketing tool, I believe it may divest its stake in UBL. Favorable demographics, low per capita consumption, rising middle class, rising disposable income, increasing social acceptance of drinking, and rising consumption of IMFL among women are the key long-term growth drivers.

What's in it for the intelligent investor?

The intelligent investor buys a business when others shun it. Or when the business is undergoing a temporary problem. As Buffett says, "a great business at a fair price is better than a fair business at a great price." USL is a great business. The only question is, is it at a fair price? I guess so. At Rs 2300 as I write this, it matches my buying levels. I will gradually accumulate below Rs 2500/-. As I see the price jumping to 2600/-, I told my 12 yr old son Arjun, "I made a mistake, I should have bought some more shares at Rs2300/- ." And Arjun said, "Don't worry, you may get another chance. And if you don't then be happy with your 50 shares. Because if you had bought 100 shares, then you would have said, I wish I had bought 200. So don't be greedy. Have patience."

I couldn't put it better. Buy it for 2020 and beyond. And wish you all a Happy Diwali.