

## Sula Vineyards Ltd.

13<sup>th</sup> May 2024

To overcome competition, attempting to diversify business

Sula Vineyards Ltd. (SVL) reported a ~10% growth in total gross revenue on a YoY basis, with own brands and wine tourism up by ~9% and ~31%, respectively. Elite and premium brand categories saw volume and value increases of about 8.2% and 9.1%, respectively, on a YoY basis, leading to a contribution to gross operating revenue of ~64% YoY. SVL conducted around ~172,237 tastings, a 38% increase from the previous quarter. Its operating profit fell by ~4% on a YoY basis, and EBITDA margin reduced by ~315 bps to ~24%.

## Competition on the street to continue in FY25

The Company has been witnessing headwinds in its key markets like Mumbai and Goa since H2FY24. The Selling and Distribution expense increased by ~12% on a YoY basis and ~22% in FY24. While the Company had seen a slowdown in Goa due to changes in licensing and distribution, the Company experienced a slowdown due to a decline in tourism in Q4FY24. The result is that the volume for the Elite and Premium segments grew by ~18%, and its value grew by ~15% on a YoY basis. While the Company affirms the decline in realization due to faster growth in the Premium segment, we believe there could have been heavy discounting and competition in the Elite and Premium wines, resulting in lower realizations. The management expects softness in demand in FY25, underlining more than typical subdued demand due to heat waves and elections in Q1FY25.

## Vague vision amidst the emerging challenges

The Company's strategy to expand into non-incentive states, facing capped WIPS in Maharashtra and increased competition, is set to erode margins. A concerning 56% hike in borrowings and a 26% rise in interest costs in FY24, alongside planned capex and potential acquisitions, suggest a potential heavy reliance on debt. Despite this, the Company paid out ~77% of its earnings as dividends in FY24, leaving a modest cash balance of ~Rs. 1 Bn.

## The new leg of growth optionality

The management is planning to expand or establish resorts, restaurants and tasting rooms in York Winery (Nashik), ND Wines (Nashik), and Domaine by Sula (Bangalore). Furthermore, SVL is open to diversifying into a non-winery business.

## View &amp; Valuation

SVL's management had previously indicated a strong performance for FY24, but the Company has faced increased competition in the second half of the year, which is expected to continue. This, along with the Company's expansion into markets outside of those with incentive programs, could lead to a decline in margins. However, SVL is also planning to grow its wine tourism business, which could help offset these challenges by diversifying the Company's revenue streams. Additionally, the Company is open to acquiring non-winery businesses, which could provide further opportunities for growth. Amidst the positive and apprehensive prospects, we revise our estimates for SVL, lower our valuation multiple by 10% to 22.5x EV/EBITDA on FY25E EBITDA, and maintain our REDUCE rating, resulting in a target price of Rs. 455 and a downside of ~4%.

## REDUCE

CMP: 475

TARGET Rs. 455 (-4%)

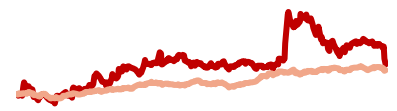
## Company Data

Bloomberg Code	SULA IN
MCAP (Rs. Mn)	40,090
O/S Shares (Mn)	84
52w High/Low	507/473
Face Value (in Rs.)	2
Liquidity (3M) (Rs. Mn)	636

## Shareholding Pattern %

	Mar-24	Sep-23	Jun-23
Promoters	26.18	26.27	27.27
FIIIs	13.85	20.61	6.78
DIIIs	22.61	17.52	10.23
Non-Institutional	37.36	35.59	55.72

## SVL vs Nifty



Feb, 23	Jul, 23	Dec, 23	May, 24
— SVL			
— NIFTY			

Source: Keynote Capitals Ltd.

## Key Financial Data

(Rs Bn)	FY23	FY24	FY25E
Revenue	5	6	6
EBITDA	2	2	2
Net Profit	1	1	1
Total Assets	9	10	11
ROCE (%)	17%	16%	14%
ROE (%)	18%	17%	15%

Source: Company, Keynote Capitals Ltd.

Devin Joshi, Research Analyst  
Devin@keynoteindia.net

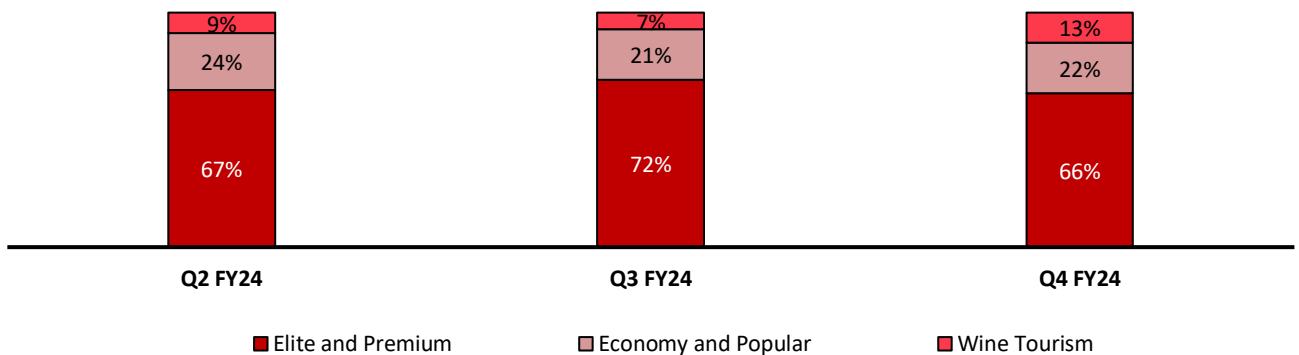
## Q4 FY24 Result Update

Result Highlights (Rs. Mn)

Particulars	Q4 FY24	Q4 FY23	Change % (Y-o-Y)	Q3 FY24	Change % (Q-o-Q)	FY24	FY23	Change % (Y-o-Y)
Net Revenue	1,225	1,134	8%	2,030	-40%	5,677	5,163	10%
COGS	245	238	3%	572	-57%	1,339	1,331	1%
Gross Profit	980	896	9%	1,458	-33%	4,339	3,832	13%
<b>Gross Profit %</b>	<b>80%</b>	<b>79%</b>	<b>97 Bps</b>	<b>72%</b>	<b>818 bps</b>	<b>76%</b>	<b>74%</b>	<b>221 Bps</b>
Employee Benefit Expense	211	205	3%	225	-6%	870	775	12%
Advertisement and promotion expense	141	126	12%	265	-47%	676	553	22%
Other Expenses	333	258	29%	249	34%	1,034	929	11%
EBITDA	295	308	-4%	719	-59%	1,759	1,575	12%
<b>EBITDA %</b>	<b>24%</b>	<b>27%</b>	<b>-314 Bps</b>	<b>35%</b>	<b>-1134 bps</b>	<b>31%</b>	<b>31%</b>	<b>47 Bps</b>
Depreciation	84	68	23%	81	3%	316	259	22%
Finance Cost	62	48	29%	81	-23%	262	211	24%
Other Income	39	9	323%	14	175%	77	35	121%
PBT	187	201	-7%	571	-67%	1,258	1,140	10%
Tax	52	58	-11%	141	-63%	325	299	8%
<b>PAT</b>	<b>136</b>	<b>142</b>	<b>-5%</b>	<b>430</b>	<b>-68%</b>	<b>933</b>	<b>841</b>	<b>11%</b>
<b>EPS</b>	<b>1.6</b>	<b>1.7</b>	<b>-</b>	<b>5.1</b>	<b>-</b>	<b>11.1</b>	<b>10.2</b>	<b>13%</b>

Source: Company, Keynote Capitals Ltd.

### Mix of Gross Operating Revenue (%)



Source: Company, Keynote Capitals Ltd.

SVL's business exhibits a seasonal pattern. Q3 is typically the strongest quarter in terms of performance, followed by Q2, Q4, and Q1. The third quarters tend to see higher contributions from the Company's Elite and Premium segment, which also translates into improved gross margins.

## SVL | Quarterly Update

### Q4 FY24 Conference Call Takeaways

#### Wine business

- The traditional markets, Maharashtra and Karnataka, together account for ~70% of the sales.
- The non-traditional markets, Rajasthan and Telangana, gave a strong performance. Moreover, the CSD segment grew by more than 50% on a YoY basis, presuming on a small base.
- The softness in demand observed during the year was due to intense competition in Mumbai and a slowdown in Goa.
- The management observes softness in Q1FY25 due to severe restrictions in the mobility of beverage alcohol by retail consumers. Further, the effect of heat waves has intensified the struggle.
- The season's harvest has been satisfactory in terms of quality and quantity. The quantity of wine grapes was up by 11%, and that of table grapes was down by 29% on a YoY basis; this indicates the Company's focus on elite and premium wines. Within the wine grapes, red wine grapes grew by ~7%, and white wine grapes grew by ~19, supporting the volume growth trend for sparkling white wines, which for the year was ~24%.
- Under the WIPS, the Company received ~Rs. 870 Mn in Q4FY24, with the remaining Rs. 730 Mn to be received by FY25.
- The degrowth in EBITDA margin was attributed to an increase in sales from non-incentivized states outside Maharashtra.
- The volume of Source Moscato, which was launched a few years back, was 160% higher on a YoY basis. The overall volumes for the Source were up ~44% on a YoY basis. The volumes for Rasa grew by ~18% on a YoY basis during FY24.
- Management expects volume growth of ~5-6% in the Popular and Economy segment and ~15% in the Elite and Premium segment.
- Goa's market was impacted as the frequent travellers to Goa have opted for neighboring Southeast Asian countries. To understand its significance, the UT is the 4/5<sup>th</sup> largest market for the Company with ~4% contribution in revenue.
- During the quarter, premium grew much more than Elite, which resulted in segmental volume growth of ~18% but segmental value growth of ~15% on a YoY basis.

#### Others

- In FY25, the Company expects a decline of ~3% in packaging cost per kit. This is the normalization of the costs that were inflated by ~4-5% due to geopolitical distress.
- The increase in other expenses was due to one-offs like payments to corporations and security deposit. Had this not been there, the EBITDA margin would be higher by ~190 bps.
- The increase in accounts receivables is due to a slowdown in payouts from corporations like Telengana. Also, the increase in business form CSD has led to an increase as its credit period is higher than usual.

## SVL | Quarterly Update

### New projects in wine and tourism

- **Opened the first standalone tasting room outside the winery**—Milestone Cellar by Sula—on the old Mumbai-Agra highway, 5 km from Nashik Airport. The Company selected this area considering the increasing number of flights from Nashik.
- **Expansion of ND Wines' shop to 30 times bigger space** — SVL is planning to expand ND Wine's 120 sq ft shop to a 3,500 sq ft area, which will include a wine tourism, tasting room, bottle shop, restaurant, etc. The Company aims to open this space by Dec'24.
- **Expansion at Domain Sula, Karnataka** — By FY26, The Company plans to expand the existing tasting room and restaurant at Domain Sula and build a resort on pre-owned land.
- **Expansion at York Winery, Nashik** – Planning to build a resort at York Winery, which already has a decently running wine shop and tasting room. For this, the Company has signed on with a business partner for a resort with 31 rooms, which is expected to become operational by FY26.
- **Expanding into non-traditional states** – With the brand Source growing by ~44% in FY24, the Company plans to launch it in 10 states with 30 listings. Further, they plan to launch cans in five new states. The Company plans to add ~8-10% employees to the sales team, ~80% of which will be for tier 2 and smaller towns. The contribution of sales from Maharashtra and Karnataka fell by ~3% to 60% in FY24. With a further decline in revenue, the management expects the operating margins to correct and normalize in the future.
- **Expanding 1 ML capacity for cheaper wines** – For the first time, SVL has planned to set up a dedicated capacity for low-cost cellar for cheaper wines low-cost, which will come at a cost of Rs. 80/liter against the earlier cost of Rs. 120/liter.

### New projects in beverage alcohol

- **Opened ways for acquiring companies other than wineries** – There are several small crafts producers who have production but no network to distribute. SVL has a distribution network in all states that permits sale of beverage alcohol. To establish such a network from scratch is extremely challenging in India. Therefore, the Company plans to take leverage of their deep distribution network.

### New actions from the Maharashtra Government

- **Changes in WIPS** – The Maharashtra Government has reintroduced the WIPS for a period of 8 years – 4 years in retrospect from FY24 and 4 years in hence. The new change in the scheme is that for the next 4 years, the scheme shall have a cap of ~Rs. 200 Mn per unit (bottling and dispatching). SVL has only 3 such units, which limits its potential for incentives up to Rs. 600 Mn per year. The Company has foreseen an impact in FY25. However, for the following years, the Company has planned to set up bottling and dispatching facilities from York Winery by Q1FY25 and ND Winery by Q2FY25. With these measures, the Company plans to receive at least ~83-85% of the incentive they were given in the last year.
- **Increasing solar capacity from 1 MW to 5 MW per site** – Leveraging the increase in permissible limit, the Company plans to increase its reliance on renewable energy from the present 60% to 70% by FY25 and ~80% by FY26 and 100% by FY29. The Company also opted for battery storage under the same initiative in FY24. The capex towards the same will be Rs. 60 Mn in FY25. The Company signifies the need for solar energy as ~1% savings of EBITDA margin.

## Financial Statement Analysis

### Income Statement

Y/E Mar, Rs. Mn	FY22	FY23E	FY24	FY25E	FY26E
<b>Net Sales</b>	<b>4,244</b>	<b>5,163</b>	<b>5,677</b>	<b>6,229</b>	<b>7,016</b>
Growth %	10%	22%	10%	10%	13%
Raw Material Expenses	1,171	1,331	1,339	1,588	1,789
Employee Expenses	653	775	869	965	1,087
Other Expenses	1,286	1,482	1,711	1,900	2,140
<b>EBITDA</b>	<b>1,133</b>	<b>1,575</b>	<b>1,758</b>	<b>1,775</b>	<b>1,999</b>
Growth %	86%	39%	12%	1%	13%
Margin%	27%	30%	31%	29%	29%
Depreciation	236	259	316	353	381
<b>EBIT</b>	<b>897</b>	<b>1,316</b>	<b>1,442</b>	<b>1,422</b>	<b>1,619</b>
Growth %	154%	47%	10%	-1%	14%
Margin%	21%	25%	25%	23%	23%
Interest Paid	229	211	261	306	306
Other Income & exceptional	28	35	77	77	77
<b>PBT</b>	<b>695</b>	<b>1,140</b>	<b>1,258</b>	<b>1,193</b>	<b>1,390</b>
Tax	174	299	327	310	361
<b>PAT</b>	<b>521</b>	<b>840</b>	<b>931</b>	<b>883</b>	<b>1,029</b>
Others (Minorities, Associates)	0	0	0	0	0
<b>Net Profit</b>	<b>521</b>	<b>840</b>	<b>931</b>	<b>883</b>	<b>1,029</b>
Growth %	1587%	61%	11%	-5%	16%
Shares (Mn)	15.0	84.2	84.2	84.2	84.2
<b>EPS</b>	<b>6.63</b>	<b>9.98</b>	<b>11.06</b>	<b>10.49</b>	<b>12.22</b>

### Balance Sheet

Y/E Mar, Rs. Mn	FY22	FY23E	FY24	FY25E	FY26E
<b>Cash, Cash equivalents &amp; Bank</b>	<b>196</b>	<b>338</b>	<b>1,049</b>	<b>1,451</b>	<b>1,380</b>
Current Investments	0	0	0	0	0
Debtors	1,094	1,145	1,696	1,495	1,754
Inventory	1,623	1,789	1,977	2,224	2,506
Short Term Loans & Advances	34	102	18	18	18
Other Current Assets	759	871	282	282	282
<b>Total Current Assets</b>	<b>3,705</b>	<b>4,245</b>	<b>5,023</b>	<b>5,469</b>	<b>5,937</b>
Net Block & CWIP	3,622	4,151	4,591	4,679	4,798
Long Term Investments	0	0	0	0	0
Other Non-current Assets	258	418	650	650	650
<b>Total Assets</b>	<b>7,586</b>	<b>8,814</b>	<b>10,263</b>	<b>10,797</b>	<b>11,386</b>
<b>Creditors</b>	<b>674</b>	<b>820</b>	<b>835</b>	<b>972</b>	<b>1,097</b>
Provision	42	48	18	18	18
Short Term Borrowings	1,468	897	2,478	2,478	2,478
Other Current Liabilities	717	945	521	521	521
<b>Total Current Liabilities</b>	<b>2,901</b>	<b>2,711</b>	<b>3,851</b>	<b>3,988</b>	<b>4,113</b>
Long Term Debt	481	543	518	518	518
Deferred Tax Liabilities	169	182	190	190	190
Other Long-Term Liabilities	82	58	204	204	204
<b>Total Non-Current Liabilities</b>	<b>732</b>	<b>782</b>	<b>912</b>	<b>912</b>	<b>912</b>
Paid-up Capital	157	169	169	169	169
Reserves & Surplus	3,795	5,152	5,331	5,729	6,192
Shareholders' Equity	3,953	5,320	5,500	5,897	6,360
Non-Controlling Interest	0	0	0	0	0
<b>Total Equity &amp; Liabilities</b>	<b>7,586</b>	<b>8,814</b>	<b>10,263</b>	<b>10,797</b>	<b>11,386</b>

Source: Company, Keynote Capitals Ltd. estimates

### KEYNOTE Rating History

Date	Rating	Market Price at Recommendation	Upside/Downside
18 <sup>th</sup> August 2023	BUY	489	+20%
15 <sup>th</sup> November 2023	BUY	488	+27%
15 <sup>th</sup> February 2024	REDUCE	595	-4%
13 <sup>th</sup> May 2024	REDUCE	475	-4%

Source: Company, Keynote Capitals Ltd. estimates

### Cash Flow

Y/E Mar, Rs. Mn	FY22	FY23E	FY24	FY25E	FY26E
Pre-tax profit	695	1,140	1,258	1,193	1,390
Adjustments	503	462	500	582	609
Change in Working Capital	-157	-441	-662	93	-415
Total Tax Paid	-167	-278	-327	-310	-361
<b>Cash flow from operating Activities</b>	<b>874</b>	<b>883</b>	<b>769</b>	<b>1,558</b>	<b>1,223</b>
Net Capital Expenditure	-459	-689	-534	-500	-500
Change in investments	30	-65	97	0	0
Other investing activities	-139	27	89	77	77
<b>Cash flow from investing activities</b>	<b>-568</b>	<b>-727</b>	<b>-348</b>	<b>-423</b>	<b>-423</b>
Equity raised / (repaid)	561.08	963.24	0	0	0
Debt raised / (repaid)	-723	-372	0	0	0
Dividend (incl. tax)	-194	-454	-780	-486	-566
Other financing activities	-256	-231	805	-306	-306
<b>Cash flow from financing activities</b>	<b>-613</b>	<b>-94</b>	<b>25</b>	<b>-792</b>	<b>-872</b>
<b>Net Change in cash</b>	<b>-306</b>	<b>62</b>	<b>446</b>	<b>343</b>	<b>-71</b>

### Valuation Ratios

	FY22	FY23E	FY24	FY25E	FY26E
<b>Per Share Data</b>					
EPS	7	10	11	10	12
Growth %	1886%	50%	11%	-5%	16%
Book Value Per Share	264	63	65	70	76
<b>Return Ratios</b>					
Return on Assets (%)	7%	10%	10%	8%	9%
Return on Equity (%)	15%	18%	17%	15%	17%
Return on Capital Employed (%)	12%	17%	16%	14%	15%
<b>Turnover Ratios</b>					
Asset Turnover (x)	0.6	0.6	0.6	0.6	0.6
Sales / Gross Block (x)	1.0	1.0	1.0	1.0	1.0
Working Capital / Sales (x)	16%	23%	24%	21%	24%
Receivable Days	100	79	91	93	85
Inventory Days	477	468	514	483	482
Payable Days	169	182	198	180	182
Working Capital Days	408	365	407	396	384
<b>Liquidity Ratios</b>					
Current Ratio (x)	1.3	1.6	1.3	1.4	1.4
Interest Coverage Ratio (x)	4.0	6.4	5.8	4.9	5.5
Total Debt to Equity	0.6	0.3	0.5	0.5	0.5
Net Debt to Equity	0.5	0.2	0.4	0.3	0.3
<b>Valuation</b>					
PE (x)		60.1	54.3	57.2	49.1
Earnings Yield (%)		2%	2%	2%	2%
Price to Sales (x)		9.8	8.9	8.2	7.2
Price to Book (x)		9.5	9.2	8.6	8.0
EV/EBITDA (x)		33.9	30.3	30.0	26.7
EV/Sales (x)		10.3	9.4	8.6	7.6

## Rating Methodology

Rating	Criteria
BUY	Expected positive return of > 10% over 1-year horizon
NEUTRAL	Expected positive return of > 0% to < 10% over 1-year horizon
REDUCE	Expected return of < 0% to -10% over 1-year horizon
SELL	Expected to fall by >10% over 1-year horizon
NOT RATED (NR)/UNDER REVIEW (UR)/COVERAGE SUSPENDED (CS)	Not covered by Keynote Capitals Ltd/Rating & Fair value under Review/Keynote Capitals Ltd has suspended coverage

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Compliance Officer: Mr. Jairaj Nair; Tel: 022-68266000; email id: jairaj@keynoteindia.net

Registered Office: 9th Floor, The Ruby, Senapati Bapat Marg, Dadar West, Mumbai – 400028, Maharashtra. Tel: 022 – 68266000.

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