

Beluga Group

'Party like it is 1999 (Actually 2021)'

The management opened a window into its medium term strategic goals and objectives highlighting, to our mind 1) product strategy – meeting the changing needs of the market 2) channel / distribution strategy focusing on the success of its owned channel WineLab (and its 'click & collect'/ e-commerce) as an anchor for own product as well as 3rd party product distribution, and 3) vertical integration to increase cost control and supply-chain management. We believe the strategy stands on solid ground. We have added 2024 estimates (and adjusted our publish estimates for 2021-2023) which implies 2020-2024 earnings CAGR of 38% vs. peer group average of 17%. In spite of stellar stock performance (140% YoY), we think a discount of 60%+ in P/E terms, 70%+ EV/EBITDA terms on current years' estimate is unwarranted.

What's new? Strategy Update. Management held its strategy day on the 13th of May to communicate with its stake-holders highlighting; 1) Revenue target of RUB 130 BN (2x he FY2020), EBITDA margin target of 16.5%+ (vs 14.6% FY2020), 2) balance sheet management with the objective of reducing leverage (net debt/ebitda) to below 1.0x (vs 1.7x in FY2020) and therefore enhancing returns (ROIC) to 25%+ (vs 15.6% in FY2020), and, 3) a clear and well-founded strategy on how to achieve these targets.

So What Does it Mean? To our mind, this communique significantly adds credence to our 'numerical expectations' for the business. We have 'tinkered' our P&L estimates for the current year (1-2%), however, lifted our numbers meaningfully for 2022-2023 primarily incorporating faster rollout of WineLab retail network (allowing for higher margin capture) resulting in EBITDA margin 0.5-1.5% higher than our previous flat estimates, and added 2024 estimates to our milieu. There is a more significant change in our balance sheet estimates, primarily due to higher credence on the management's working capital management. Our estimates indicate that revenue increasing by 1.9x, ebitda by 2.0x, and group net profit by 3.6x in 2024 vs 2020 levels.

Valuations. Beluga is trading at a discount of 75-80% on EV/EBITDA and a discount of 64-78% on P/E multiple basis relative to its Peers for 2021 and beyond. Considering the earnings growth profile, a CAGR of 38% (FY2020-FY2024), vs 17% for the peer group weighted average earnings CAGR (based on FactSet consensus estimates), we believe that Beluga deserves utmost serious consideration as a sound investment candidate.

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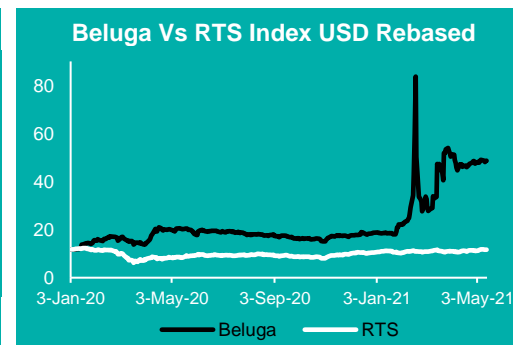
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Ticker	BELU RX / BELU RM
Last Price (Rub)	3,596
Market Cap (RUB MN)	44,332
Market Cap ((USD MN)	600
Shares Outstanding Net of Treasuries MN	12.3
Free Float	21%
Min Price RUB (Last 12 Mths)	706
Max Price RUB (Last 12 Mths)	6,671

Sources: SOVA Capital, Bloomberg



Source: Bloomberg

Key Metrics

In RUB BN	FY20	FY21	FY22	FY23	FY24
Revenue	63.3	75.4	94.7	104.1	118.7
EBITDA	9.2	11.2	14.1	15.9	18.7
Net Profit	2.5	4.1	6.0	7.1	9.0
RoAE	12.2%	19.2%	25.1%	26.8%	31.8%
EV/EBITDA	6.5	5.6	4.4	3.9	3.5
P/BV	2.2	2.0	1.8	1.6	1.3
P/E	18.0	10.8	7.4	6.2	4.9
DY	2.8%	4.6%	6.7%	8.0%	10.1%

*Current Prices Used for Valuation metrics. Sources: Fact Set, Company Data, Sova Capital

Valuation Comparison

	FY20	FY21	FY22	FY23	FY24
Peer Average					
EV/EBITDA	24.0	22.1	20.2	18.7	17.1
P/BV	7.5	6.5	6.0	5.9	5.9
P/E	41.2	30.1	27.1	24.8	22.3
Discount to Peers					
EV/EBITDA	-72.9%	-74.7%	-78.0%	-79.2%	-79.5%
P/BV	-70.4%	-69.1%	-70.3%	-73.6%	-77.2%
P/E	-56.2%	-64.2%	-72.5%	-74.9%	-77.9%

* Peer Group Includes Stock Spirits, Diageo, Campari & Remy. Peer Group estimates from Fact Set as at May 13, 2021
Sources: Fact Set, Company Data, SOVA Capital

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What's New: Beluga Strategy Day

Beluga Group, one of Russia's largest alcohol companies, a major producer of vodka and distilled beverages and a leading independent importer of strong spirits in the country, held a strategy day on the 13th of May communicating to the investor community, its medium to long term goals and objectives (from 2020 to 2024) and a road map to achieve them. Our take on the salient features in the framework of our understanding of the business is as follows:

1. 'Management is quite agile in its product portfolio management' (page 8 Beluga Report titled 'Stoicism Redefined' dated 30 April, 2020). Acutely aware of the changes in alcohol consumption pattern (49:39:13 in 2012 to 39:49:13 in 2020 – Vodka:Wine:Spirits), management has set its goals to increase share of non-Vodka based sales in volume terms from 34% to 45%.
2. 'There is a shift in revenue mix with retail (WineLab) growing at 2x the pace of alcohol production and distribution business' (page 2 Beluga Report titled 'Makes Me Feel Like Dancing' dated 12 March 2021). Development of WineLab as its anchor distribution channel is a master-stroke and it has played a crucial role in furthering Beluga's e-commerce strategy. The management wants to capture the momentum with a target of 2,500 units of 80 sqm selling space each by 2024 (i.e. c.4x the current levels) with aim of generating about 45% of consolidated revenue from WineLab.
3. 'Higher e-commerce ticket; Average WineLab ticket in stores = RUB 491, Average ticket on Website order = RUB 2,944, and Average ticket mobile app = RUB 3,464' (slide 33, Beluga Group Strategy Presentation May 2021). With monthly website orders of 12.2k and mobile app orders of 14.7k, albeit small, the overall traffic growth in 2020 vs 2019 was 138%. Share of e-commerce sales in key markets (Moscow and St Petersburg) increased from 2.1% in 2019 to 6.1% in 2020 (overall the e-commerce sales increased to 2.7% in 2020 vs 0.8% in 2019). The management targets share of e-commerce between 10-15% of total by 2024.
4. 'Management is quite comfortable with the level of leverage and access to working capital finance at economically viable costs' (page 1 Beluga Reported titled 'Dividend Policy – Clarity of Thought & Action dated 15 September 2020). It is clear that Beluga is a brand and balance sheet driven business and one of key messages that the management has taken on board is managing working capital and the size of the balance sheet. The increase in significance of WineLab as a sales channel (i.e. reducing trade receivables), e-commerce sales (data and better inventory management) has allowed the group to reduce its working capital needs (relative to sales) significantly, resulting in significant improvement in leverage metrics – net debt to ebitda declined to 1.7x in 2020 – the management aims to reduce net debt to ebitda to sub 1x level by 2024.

We think that the strategy highlights what we believe are the core drivers of the business during 2021-2024 years as follows:

1. The management is completely focused on generating value by understanding the market place and changing consumer tastes and preferences by continuously innovating and managing its product suite and brands. This is one of the key strengths of the business and it is capitalizing on its strength and it adds credence to their targets.
2. WineLab foot-print expansion strategy not only allows Beluga to showcase itself as a partner of choice for 3rd party brands to launch, market and distribute its product, but also acts as an expanded collection point for the business digital strategy of sales through 'click and collect' window. Management focus on e-commerce is essential for not only expanding sales but also enhancing the efficacy of managing its balance sheet.
3. Ethanol being a key ingredient of 'hard' liquor, expanding product portfolio, especially browns (whisky etc.) require a tighter handle on cost and supply chain. Control of this key input would enable Beluga in not only cost management but also in product portfolio management as it would be less subject to ethanol price volatility. This would allow the company to expand further its ebitda margin.
4. On an overall basis, we think that the Beluga as a business is at an inflection point where we can see some parallels in Russia at the start of their big journey (e.g. M Video, Detsky Mir). This group has an added advantage of being able not only to retail but also produce a substantial part of what they sell.

The presentation is on available on the following address:

<https://belugagroup.ru/upload/documents/Beluga%20Group%20Strategy%20Day%20-%20May%202021.pdf>

Financial Estimates – Adding 2024

Our central case for Beluga is depicted as follows:

Figure 4. P&L Forecasts

In RUB MN	FY2020A	FY2021E	FY2022E	FY2023E	FY2024E
Total Volume (9 litre cases)	17,369	18,942	20,156	21,278	22,444
Premium Volume	28.9%	29.3%	29.5%	29.5%	30.4%
Mass Market Volume	57.3%	54.6%	52.4%	50.7%	48.0%
Imported Volume	13.7%	16.1%	18.1%	19.8%	21.5%
Net Revenue	63,292	75,361	94,700	104,120	118,664
Alcohol	44,420	49,701	54,528	59,250	65,088
Retail	25,294	35,662	50,339	56,980	65,857
Food	4,796	5,030	5,280	5,500	5,500
Gross Profit	22,678	25,937	32,250	35,613	40,535
EBITDA	9,209	11,173	14,088	15,929	18,678
Alcohol	6,047	7,306	8,450	9,614	10,874
Retail	2,980	3,667	5,418	6,086	7,574
Food	182	200	220	230	230
EBIT	6,500	8,404	11,298	12,889	15,637
Net Interest Expense	2,485	2,586	2,873	2,833	3,058
F/X	630	168	294	336	385
Others	152	174	191	207	228
Total Financial costs	3,267	2,928	3,357	3,377	3,671
Pretax Profit	3,233	5,476	7,941	9,512	11,966
Income taxes	774	1,369	1,985	2,378	2,991
Net Profit Group	2,459	4,107	5,956	7,134	8,974
Net Profit Parent	2,462	4,057	5,906	7,084	8,923
Minority Interest	-3	50	50	50	51
DVD	1,234	2,028	2,953	3,542	4,462

Sources: Company Data, SOVA Capital

We think that the strategy announcement gives credence to our estimate of volume growth which we see increasing by 29% cumulatively from 2020 to 2024. We are a bit cautious in our estimates on volume mix re premium category which we see inching up to 30.4% of total volume. Our estimate is indicative of continued success in growth of 3rd party products (read WineLab, E-commerce and Click & Collect strategy).

What came to us as pleasant surprise was share of retail (WineLab) in the total revenue of the firm from 34% of consolidated revenue in 2019 to 40% of consolidated revenue in 2020. Our estimates indicate that by 2024, WineLab revenue accounting for about 1/2 of total consolidated revenue, i.e. WineLab would become the most significant distribution channel, allowing the business to not only capture 'product' margin, but also, retail and distribution margin. [In house brands margin via WineLab is 1.5x, for imported brands, it is 1.3x]

Our estimates indicate EBIT of RUB 15.6BN by 2024 is 2.4x FY2020 levels. With positive impact of financial leverage, this is estimated to result in Net Profit to increase from RUB 2.5BN in 2020 to RUB 8.9BN by 2024, a cumulative growth of 265%

Figure 5. Balance Sheet Forecasts

In RUB MN	FY2020A	FY2021E	FY2022E	FY2023E	FY2024E
PPE	12,880	12,541	12,792	13,130	13,616
Intangibles	13,582	13,582	13,582	13,582	13,582
Total Non-Current Assets	28,346	28,418	29,019	29,757	30,549
Inventory	16,486	17,590	20,535	22,791	25,406
Other Current Assets (ex Cash)	13,349	16,147	18,627	20,411	22,610
Total Working Assets	29,835	33,737	39,162	43,202	48,015
A/Payable	20,262	20,028	23,323	25,426	27,671
Other Current Liab (ex Debt)	707	384	440	500	501
Total Working Liabilities	20,969	20,412	23,763	25,926	28,172
Net Working Assets	8,866	13,325	15,399	17,276	19,844
Gross Capital Deployed	37,212	41,743	44,418	47,033	50,392
Less: Other Long Term Liabilities	1,298	1,300	1,300	1,300	1,300
Net Capital Deployed	35,914	40,443	43,118	45,733	49,092
Short Term Debt	2,237	4,020	4,060	3,966	4,557
Long Term Debt	18,222	19,000	19,000	18,558	21,325
Total Debt	20,459	23,020	23,060	22,524	25,882
Less: Cash	4,890	5,000	5,000	5,000	5,000
Net Debt	15,569	18,020	18,060	17,524	20,882
Shareholders Equity	20,051	22,079	25,032	28,574	33,036
Minority Interest	294	344	394	444	495
Total Equity	20,345	22,423	25,058	28,209	28,210
Total Financing	35,914	40,443	43,118	45,733	49,092

Sources: Company Data, SOVA Capital

Working capital requirement is estimated to increase from RUB 29.8BN in 2020 to RUB 48.0BN in 2024, an increase of RUB 18.2BN. This increase is in the context of consolidated revenue increase of RUB 55.4BN. The efficiency improvement is largely driven by our view of the success of WineLab.

Aided by trade payables (i.e. funding of 3rd party sales growth by trade terms), the net capital deployed growth is estimated to be limited to RUB 13.2BN during 2020 to 2024. This is the key driver of improvement in return on capital and return on equity. On the P&L side, it is a brand and distribution channel management and from the balance sheet perspective, it is working capital management business.

We expect reported net debt to peak at RUB 20.9BN, about RUB 5.4BN higher than 2020 levels. Our estimate of shareholder equity is based on 50% dividend payout ratio which we believe that the company can comfortably afford to pay.

Figure 6. Ratios Et Al.

	FY2020A	FY2021E	FY2022E	FY2023E	FY2024E
Gross Margin	35.8%	34.4%	34.1%	34.2%	34.2%
EBITDA Margin	14.6%	14.8%	14.9%	15.3%	15.7%
Alcohol	13.6%	14.7%	15.5%	16.2%	16.7%
Retail	11.8%	10.3%	10.8%	10.7%	11.5%
Food	3.8%	4.0%	4.2%	4.2%	4.2%
EBIT Margin	10.3%	11.2%	11.9%	12.4%	13.2%
EBT Margin	5.1%	7.3%	8.4%	9.1%	10.1%
Net Margin	3.9%	5.4%	6.3%	6.9%	7.6%
RoACE (EBIT-Tax)/(Average Capital Employed)	15.6%	18.4%	22.3%	23.7%	26.7%
Average Cost of Debt (Y/E Avg Balance)	16.0%	16.4%	17.0%	17.1%	17.1%
RoAE (Net Profit/Average Total Equity)	12.2%	19.2%	25.1%	26.8%	31.8%
Gross Debt	20,459	23,020	23,060	22,524	25,882
Net Debt	15,569	18,020	18,060	17,524	20,882
Gross Debt to EBITDA	2.2	2.1	1.6	1.4	1.4
Net Debt to EBITDA	1.7	1.6	1.3	1.1	1.1
Net Debt to Equity	0.8	0.8	0.7	0.6	0.7
EBITDA to Net Interest Expense	3.7	4.3	4.9	5.6	6.1
EBITDA to Net Financing Costs	2.8	3.8	4.2	4.7	5.1
EBITDA to Net Capital Deployed	25.1%	29.3%	33.7%	35.9%	39.4%
EV/EBITDA	6.5	5.6	4.4	3.9	3.5
EV/EBIT	9.2	7.4	5.5	4.8	4.2
P/BV	2.2	2.0	1.8	1.6	1.3
P/E	18.0	10.8	7.4	6.2	4.9
DY	2.8%	4.6%	6.7%	8.0%	10.1%

Sources: Company Data, SOVA Capital

Gross margin estimate indicate a marginal decline from 35.8% in 2020 to 34.2% in 2024. The drivers include product mix (premium vs. mass and 3rd party), and business mix (Winelab – retail margin vs. product margin). Our estimates suggest that operating leverage (due to scale effect) to result in EBITDA margin improvement from 14.6% in 2020 to 15.7% in 2024. (Below management guidance).

Balance sheet dynamics, i.e. slower growth in the size of balance sheet, hence capital employed, in our view, allows for the business to significantly lift its Return on Average Capital Employed. We have not given any credit in terms of reduction in cost of debt. However, significant lift in RoACE allows the business to more than double its RoAE from 12.2% in 2020 to 31.8% by 2024

In spite of our estimated dividend pay-out ratio of 50% stet, improvement in RoACE allows the business to deleverage. Our dividend pay-out estimate is 2x the minimum level as per company policy (which we believe to be a conservative guidance).

Peer Comparison

Figure 10. Peer EV/EBITDA

	2020	2021	2022	2023	2024
Stock Spirits	9.0	9.2	8.4	7.5	7.2
Diageo	22.4	20.9	19.2	17.9	16.3
Campari	32.1	26.9	23.3	20.9	19.6
Remy	40.1	34.8	30.8	27.9	26.1
Weighted Average *	24.0	22.1	20.2	18.7	17.1
Beluga Discount to Weighted Average	-72.9%	-74.7%	-78.0%	-79.2%	-79.5%

Sources: Fact Set, SOVA Capital
*Weighted by market cap

Beluga's discount to its peers on an EV/EBITDA basis in the context of Beluga's EBITDA CAGR of 19% vs that of the Peers (weight average FactSet Consensus) of 6%, to our mind, is quite onerous

Figure 11. Peer P/E

	2020	2021	2022	2023	2024
Stock Spirits	14.5	15.2	14.1	13.1	12.9
Diageo	37.6	27.2	24.7	22.7	20.6
Campari	62.4	44.3	37.3	33.3	30.5
Remy	75.8	61.4	52.3	45.7	39.1
Weighted Average *	41.2	30.1	27.1	24.8	22.3
Beluga Discount to Weighted Average	-56.2%	-64.2%	-72.5%	-74.9%	-77.9%

Sources: Fact Set, SOVA Capital

EPS CAGR for Beluga for 2020 to 2024 period is 38% vs. Peers average of 17%. This significant differential in EPS growth results in expansion of discount from 56% in 2020 to 78% in 2024

Figure 12. Peer P/BV

	2020	2021	2022	2023	2024
Stock Spirits	1.5	1.5	1.5	1.7	2.1
Diageo	10.4	9.2	8.6	9.0	9.8
Campari	2.9	2.3	2.0	1.9	1.7
Remy	6.9	6.4	5.9	5.4	4.9
Weighted Average *	7.5	6.5	6.0	5.9	5.9
Beluga Discount to Weighted Average	-70.4%	-69.1%	-70.3%	-73.6%	-77.2%

Sources: Fact Set, SOVA Capital

Beluga's RoAE is estimated to reach the Peer group average by 2022. We do not think that a discount of c 70% to Peers is sustainable.

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