



United Spirits

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,170	UNSP IN
	REUTERS CODE
S&P CNX: 3,065	UNSP.BO

22 October 2008

Buy

Rs778

Previous Recommendation: Buy

Equity Shares (m)	107.9
52-Week Range	2,188/612
1,6,12 Rel. Perf. (%)	-14/-16/-13
M.Cap. (Rs b)	84.0
M.Cap. (US\$ b)	2.0

YEAR	NET SALES	PAT *	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/07A	27,205	2,542	27.8	576.3	28.0	5.9	18.9	17.3	2.6	15.7
03/08A	46,593	3,547	39.7	42.8	19.6	8.4	34.9	31.5	2.3	11.5
03/09E	55,264	4,250	47.6	19.8	16.3	6.2	30.3	31.9	1.9	9.8
03/10E	61,813	6,032	67.6	42.0	11.5	4.7	29.4	34.8	1.6	7.9

*Consolidated nos; including Whyte & Mackay

- United Spirits Ltd. (USL) 2QFY09 results are below estimates. Revenues at Rs9b (est. of Rs9.2b) were up 20%. PAT at Rs939m (est. of Rs1.05b) was up 17%. Gross margin declined 610bp due to sharp increase in raw material and packaging cost. EBITDA margin improved 20bp due to sharp decline in advertising spend (down 340bp) and staff cost (down 240bp). EBITDA is Rs1.8b v/s est. of Rs1.9b, up 21% YoY.
- Sales volume increased 15% on the back of 16% growth in top five brands. Management appears confident of sustaining volume growth in the coming quarters. Management expects raw materials prices to ease off in the coming quarters. Management indicated that it will be able to neutralize the rise in cost by selective price increase in free markets and product re-engineering. It has already increased prices in Maharashtra and AP (Rs50/case).
- Whyte & Mackay reported revenue growth of 33% at GBP65m while EBITDA grew by 83% to GBP15m. Strong growth in revenue has been on account of increase in branded sales by 11% and increase in contribution from branded business. Management has guided for an EBITDA of GBP60m for FY09.
- USL has domestic borrowings of Rs14b and international borrowings of US\$619m (Citibank) and GBP325m (ICICI Bank). There is no repayment of loan in this fiscal year and loan repayment will begin from FY10. Management indicated sale of treasury stock to de-leverage USL's holdings and listing/stake in W&M, to reduce its debt.
- We believe the growth story in United Spirits is intact. Volumes are expected to grow at 12% CAGR in the long term and the outlook from the regulatory changes continues to be positive. We are downgrading FY09 and FY10 EPS (excluding treasury stock) estimates from Rs56.6 and Rs77.6 to Rs47.6 and Rs67.6. The stock is trading at 16.3x FY09 EPS of Rs47.6 and 11.5x FY10 EPS of Rs67.6. Maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Net Sales	7,657	7,526	8,890	7,590	10,134	9,020	10,850	9,177	31,663	39,182
YoY Change (%)	16.9	19.1	15.3	15.9	32.3	19.9	22.1	20.9	16.4	23.7
Total Exp	5,943	6,047	7,182	6,237	7,982	7,230	8,750	7,543	25,359	31,505
EBITDA	1,714	1,479	1,708	1,353	2,152	1,790	2,100	1,634	6,304	7,677
Margins (%)	22.4	19.6	19.2	17.8	21.2	19.8	19.4	17.8	19.9	19.6
Depreciation	70	72	90	85	82	87	90	101	317	360
Interest	292	328	328	329	341	395	350	320	1,276	1,406
PBT From operations	1,352	1,079	1,290	939	1,729	1,308	1,660	1,213	4,711	5,910
Other income	49	112	96	107	72	125	100	100	294	397
PBT	1,400	1,191	1,386	1,047	1,801	1,433	1,760	1,313	5,004	6,307
Tax	505	389	505	396	630	494	630	463	1,794	2,216
Rate (%)	36.0	32.7	36.4	37.8	35.0	34.5	35.8	35.2	35.8	35.1
PAT	896	802	882	651	1,171	939	1,130	850	3,211	4,091
YoY Change (%)	98.5	42.5	14.7	14.1	30.8	17.0	28.2	30.6	39	27.4
Extraordinary Inc/(Exp)	0	0	0	0	0	0	0	0		0
Reported PAT	896	802	882	651	1,171	939	1,130	850	3,211	4,091

E: MOST Estimates

Sales volume up 15%

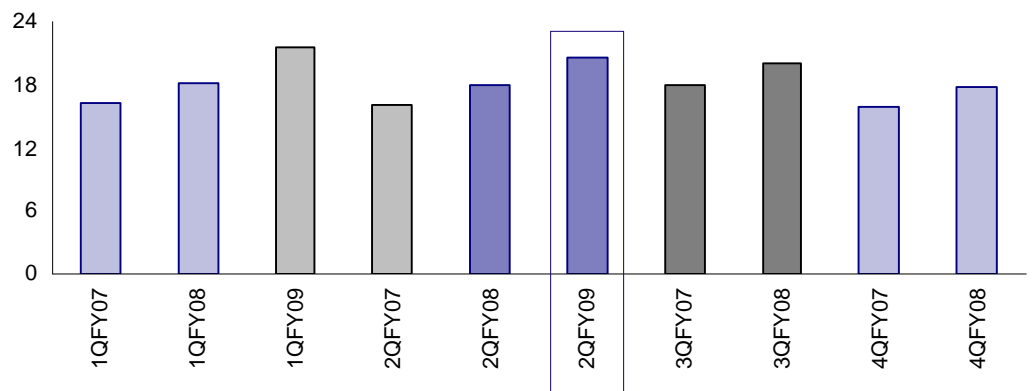
United Spirits reported strong 15% volume growth in 1QFY09. Favorable demographics and conducive regulatory changes boosted the volumes. First line brands grew by 14% and accounted for 96% of total volumes. Black Dog grew volumes by 59% while growth in other key brands such as Antiquity, Signature and Royal Challenge was up 30%, McDowell No.1 grew by 20%. The sharp increase in material cost has helped premium segment players such as USL. Raw material costs are 50-55% of the selling price for low-end brands compared with 15-30% for premium brands. Steeper increase in prices of low-end spirit brands has boosted the sales of premium segment players in which USL has a dominant share. Management appears confident of sustaining volume growth in the coming quarters.

GROWTH IN TOP BRANDS (%)

Black Dog	59	Royal Challenge	30
Antiquity	30	McDowell No 1	20
Signature	30		

Source: Company/MOSL

CONSISTENT INCREASE IN SALES VOLUMES (M CASES)

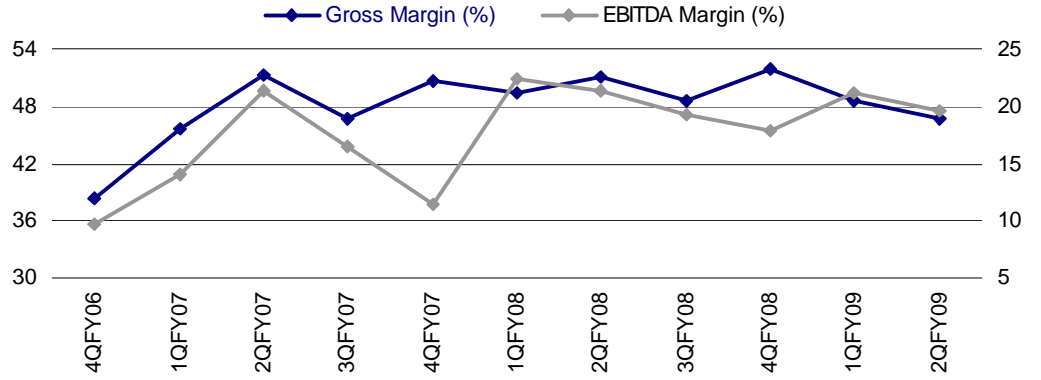


Source: Company/MOSL

Raw material prices on an upswing; 80bp margin decline in 1HFY09

Price of all the key inputs have been on an uptrend. Gross margin declined 610bp due to sharp increase in raw material and packaging cost. For 1HFY09, gross margin declined by 80bp. The sharp increase in input costs has resulted in material and packaging costs rising by 50-55%.

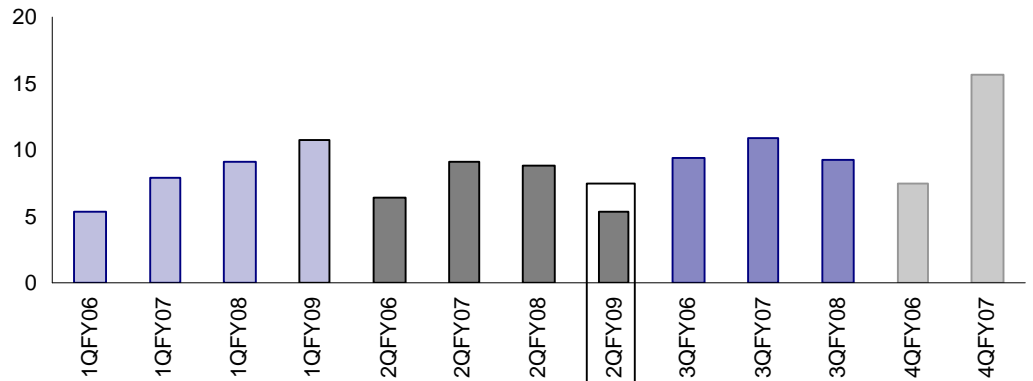
GROSS MARGINS UNDER PRESSURE



Source: Company/MOSL

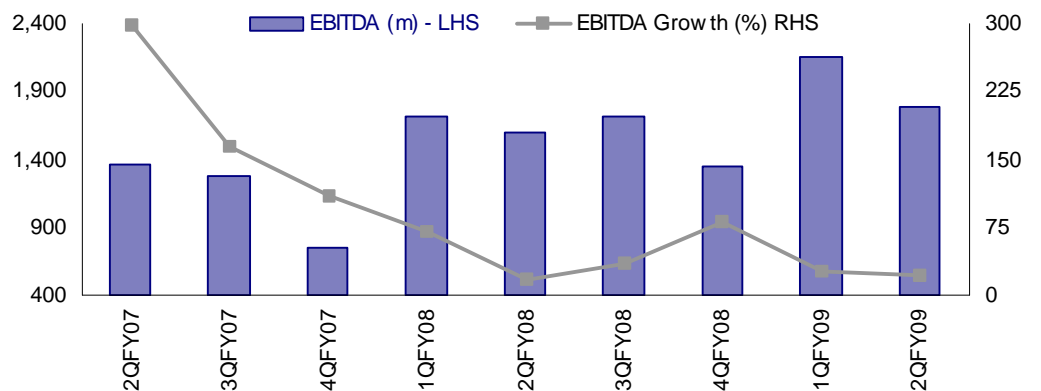
However, EBIDTA margin improved by 20bp due to sharp decline in advertising spend (down 340bp) and staff costs (down 240bp). EBIDTA is Rs1.8b v/s estimate of Rs1.9b, up 21% YoY. Advertising spend declined by 26.6% after 55.2% growth in 1QFY09 (on account of IPL).

DECLINE IN ADSPEND SAFEGUARDS EBIDTA MARGIN (AD- SPEND % OF SALES)



Source: Company/MOSL

TREND IN OPERATING PERFORMANCE



Source: Company/MOSL

Management expects glass prices to ease due to decline in crude prices. Molasses price is also expected to ease from the beginning of crushing season in November 2008. Management indicated that it will be able to neutralize the rise in cost by selective price increase in free markets and product re-engineering. The company has already increased prices in Maharashtra and Andhra Pradesh (Rs50/case from mid-October).

W&M reports 83% jump in EBITDA in lean season

Whyte & Mackay reported revenue growth of 33% at GBP65m while EBITDA grew by 83% to GBP15m. The strong revenue growth has been on account of an increase in branded sales by 11% and contribution from branded business, which grew by 33%. Management maintained its stance of growing branded business in the long term. Prices of scotch have increased by 30% since acquisition of W&M (recent evaluation). Management has maintained full year guidance of 15-20% growth in long-term and EBITDA of GBP60m for FY09.

W&M debt repayment to start only from FY10

USL has domestic borrowings of Rs14b and international borrowings of US\$619m (Citibank) and GBP325m (ICICI Bank). The overall cost of borrowing from Citibank is Libor + 250bp (total cost including hedge is 8.5%). Repayment of Citibank loans will start in FY10 (US\$90m in 2 installments), while repayment of ICICI Bank will start from FY11. Management indicated sale of treasury stock to de-leverage USL's holdings and listing/stake in W&M to reduce its debt. Both the transactions are likely in FY10. We believe that internal cash generation and cash in hand is adequate for repayment in FY10.

Downgrading estimates; stock trades at 10.7x FY10; Buy

We believe the growth story in United Spirits is intact. Volumes are expected to grow at 12% CAGR in the long term and outlook from the regulatory changes continues to be positive. We are downgrading EPS (excluding treasury stock) estimates for FY09 from Rs56.6 to Rs47.6 and for FY10 from Rs77.6 to Rs67.6. The lower estimates factor in: (1) higher borrowing costs of 13.5% (earlier 10.5%) for the stand-alone entity; (2) higher material costs for Malt and Glass (gross margin decline of 150bp v/s 20bp earlier); (3) lower other income of Rs397m (earlier 636m); (4) W&M to contribute Rs1.8 (Rs6.5) and Rs8.8 (Rs13) to EPS in FY09 and FY10, which is in line with management's EBITDA guidance. The stock is trading at 16.3x FY09 EPS of Rs47.6 and 11.5x FY10 EPS of Rs67.6. **Maintain Buy.**

CHANGE IN EARNINGS ESTIMATES

	FY09E		FY10E	
	EARLIER	NEW	EARLIER	NEW
United Spirits Standalone	50.1	45.8	65.8	58.8
W&M	5.9	1.8	11.9	8.8
Consolidated	56	47.6	77.6	67.6

Source: Company/MOSL

United Spirits: an investment profile

Company description

United Spirits is the market leader in the 110m cases Spirits segment of Alcoholic Beverage industry in India. It has emerged as the third largest spirits group in the world. It holds 59% market share with dominance across product segments and categories. The company has 17 millionaire brands and drives 93% of sales from mainline brands.

Key investment arguments

- ☞ We expect an EPS CAGR of 39% over FY08-10E, driven by improvement in sales mix and 11-12% volume growth.
- ☞ Favorable demographics, low penetration, high entry barriers and favorable policy changes will result in sustained volume growth for the company.

Key investment risks

- ☞ Nearly 55% of sales volumes is generated from states where the state governments control prices. Any changes in distribution controls and freeze on pricing can impact the margins of the company.
- ☞ Sharp run up in the prices of molasses and ENA can impact the profit margins. Increase in state excise and other duties also pose threat to the profit margins of the company.

Recent developments

- ☞ Nil.

Valuation and view

- ☞ We estimate FY09 EPS estimate at Rs47.6 and FY10 EPS estimate at Rs67.6.
- ☞ The stock is trading at 16.3x FY09 EPS and 11.5x FY10 EPS. Maintain **Buy**.

Sector view

- ☞ We remain positive on the stock the sector given the favorable demographics, high entry barriers and consolidation of the industry.
- ☞ Companies with wide product portfolio and presence e across segments will lead the growth rates and margin expansions.

COMPARATIVE VALUATIONS

		UNITED SPIRITS	ITC	NESTLE
P/E (x)	FY09E	16.3	19.0	25.8
	FY10E	11.5	16.3	20.2
EV/EBITDA (x)	FY09E	9.8	12.1	16.5
	FY10E	7.9	10.4	13.0
EV/Sales (x)	FY09E	1.9	3.6	3.4
	FY10E	1.6	2.9	2.8
P/BV (x)	FY09E	6.2	4.7	22.4
	FY10E	4.7	4.1	17.4

SHAREHOLDING PATTERN (%)

	SEP-08	JUN-08	SEP-07
Promoter	36.6	36.6	37.3
Domestic Inst	2.3	2.0	1.9
Foreign	38.4	37.4	36.8
Others	22.7	24.1	24.1

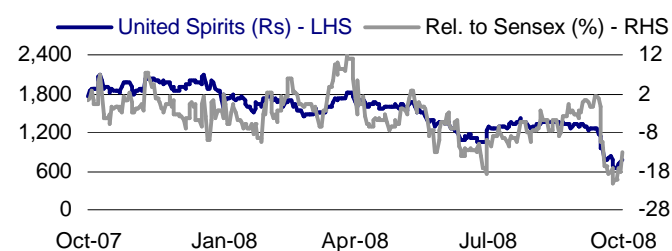
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VIATION (%)
FY09	47.6	49.0	-2.9
FY10	67.6	63.4	6.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
778	1,351	73.7	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)				
Y/E MARCH	2006	2007	2008	2009E	2010E	
Net Sales	17,966	24,367	30,144	35,528	41,570	
Other Operating Inc	2,513	2,838	3,104	3,653	4,161	
Total Revenue	20,479	27,205	33,248	39,182	45,731	
Change (%)	77.2	32.8	22.2	17.8	16.7	
Total Expenditure	-18,381	-22,736	-26,624	-31,505	-36,533	
EBITDA	2,098	4,469	6,624	7,677	9,198	
Change (%)	232.6	113.0	48.2	15.9	19.8	
Margin (%)	10.2	16.4	19.9	19.6	20.1	
Depreciation	-409	-309	-347	-360	-404	
Int. and Fin. Charges	-1,666	-1,068	-1,380	-1,406	-1,127	
Other Income - Recurring	490	704	556	397	428	
Profit before Taxes	512	3,796	5,454	6,307	8,095	
Change (%)	19.7	640.8	43.7	15.6	28.4	
Margin (%)	2.5	14.0	16.4	16.1	17.7	
Tax	156	1,188	1,952	2,097	2,683	
Deferred Tax	-64	66	-5	120	162	
Tax Rate (%)	18.0	33.0	35.7	35.1	35.1	
Adjusted PAT	420	2,542	3,507	4,091	5,250	
Change (%)	14.0	504.7	37.9	16.6	28.4	
Margin (%)	2.1	9.3	10.5	10.4	11.5	
Non-rec. (Exp)/Income	0	2,627	0	0	0	
Reported PAT	420	4,940	3,505	4,091	5,251	

BALANCE SHEET		(RS MILLION)				
Y/E MARCH	2006	2007	2008E	2009E	2010E	
Share Capital	1,022	1,022	1,079	1,079	1,079	
Reserves	7,939	12,398	8,966	12,425	16,793	
Net Worth	8,961	13,420	10,046	13,505	17,872	
Loans	15,322	14,678	11,662	10,538	8,348	
Deferred Tax Liabilities	71	8	2	122	284	
Capital Employed	24,354	28,106	21,710	24,165	26,504	
Gross Block	5,637	5,862	7,187	8,187	9,187	
Less: Accum. Deprn.	-1,038	-1,323	-1,824	-2,185	-2,589	
Net Fixed Assets	4,599	4,539	5,363	6,002	6,598	
Capital WIP	26	106	133	166	207	
Investments	7,023	6,625	3,134	3,134	3,134	
Curr. Assets, L&A	19,888	22,632	19,753	22,051	24,438	
Inventory	2,819	2,936	4,180	5,075	5,749	
Account Receivables	3,004	3,552	4,276	4,862	5,680	
Cash and Bank Balance	2,234	3,736	2,807	2,279	2,421	
Others	11,831	12,407	8,490	9,835	10,587	
Curr. Liab. and Prov.	7,182	5,795	6,672	7,188	7,874	
Account Payables	5,150	3,835	4,260	4,641	5,031	
Other Liabilities	1,646	1,496	1,338	1,236	1,140	
Provisions	385	464	1,075	1,311	1,703	
Net Current Assets	12,706	16,837	13,080	14,862	16,564	
Application of Funds	24,354	28,106	21,710	24,165	26,504	

E: MOS Estimates

RATIOS		(RS MILLION)				
Y/E MARCH	2006	2007	2008E	2009E	2010E	
Basic (Rs)						
EPS	4.1	27.8	39.3	45.8	58.8	
Cash EPS	8.7	27.7	35.7	41.2	52.4	
BV/Share	87.7	1313	93.1	125.1	165.6	
DPS	2.0	2.5	3.5	5.0	7.0	
Payout %	48.6	9.0	8.9	10.9	11.9	
Valuation (x)						
P/E		28.0	19.8	17.0	13.2	
Cash P/E		28.1	21.8	18.9	14.8	
EV/Sales		2.6	2.3	1.9	1.6	
EV/EBITDA		15.7	11.5	9.8	7.9	
P/BV		5.9	8.4	6.2	4.7	
Dividend Yield (%)		0.3	0.4	0.6	0.9	
Return Ratios (%)						
RoE	4.7	18.9	34.9	30.3	29.4	
RoCE	8.9	17.3	31.5	31.9	34.8	
Working Capital Ratios						
Debtor (Days)	54	48	47	45	45	
Asset Turnover (x)	0.8	1.0	1.5	1.6	1.7	
Leverage Ratio						
Debt/Equity (x)	1.7	1.1	1.2	0.8	0.5	

CASH FLOW STATEMENT		(RS MILLION)				
Y/E MARCH	2006	2007	2008E	2009E	2010E	
OP/(loss) before Tax	1,689	4,160	6,278	7,317	8,794	
Int./Div. Received	490	704	556	397	428	
Depreciation and Amort.	409	309	347	360	404	
Interest Paid	-1,666	-1,068	-1,380	-1,406	-1,127	
Direct Taxes Paid	156	1,188	1,952	2,097	2,683	
Incr/Decr in WC	8,591	2,838	-2,610	2,507	1,780	
CF from Operations	-7,825	79	6,458	2,063	4,037	
Extraordinary Items	0	2,627	0	0	0	
(Incr)/Decr in FA	-2,790	-305	-1,352	-1,033	-1,041	
(Pur)/Sale of Investments	-3,219	398	3,490	0	0	
CF from Invest.	-6,010	2,720	2,139	-1,033	-1,041	
Issue of Shares	6,011	-48	-1,256	0	0	
(Incr)/Decr in Debt	-9,583	644	3,016	1,124	2,190	
Dividend Paid	216	279	442	631	884	
Others	267	-328	-4,812	198	221	
CF from Fin. Activity	15,644	-1,299	-9,526	-1,557	-2,853	
Incr/Decr of Cash	1,809	1,501	-929	-527	142	
Add: Opening Balance	425	2,234	3,736	2,807	2,279	
Closing Balance	2,234	3,735	2,807	2,279	2,421	

N O T E S



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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