

## Company In-Depth

15 May 2007 | 14 pages

# United Spirits (UNSP.BO)

## Buy: Whyte & Mackay Seems Positive Despite Potential High Valuations

 Rating change   
 Target price change   
 Estimate change 

- India an emerging scotch destination** — Rising incomes and preference for high-end brands are driving 30% growth in scotch whisky demand in India, against overall liquor market growth of 12%. India is among the top-20 scotch importing nations, and rationalization of import duties could fuel further growth.
- Acquisition seems a good fit** — UNSP's bid for Whyte & Mackay (W&M) fits its aspirations to cater to the fast-growing high-end Indian whisky segment and expand into China and Russia. W&M would secure UNSP's long-term bulk scotch supply, enhance its brand portfolio and provide access to EU markets.
- Whyte & Mackay unlikely to come cheap** — Based on US\$1.4bn EV for W&M we estimate the acquisition could be valued at 18.8xEV/EBITDA, a 25% premium to global peer-group average. The valuation reflects scarcity premium for sizeable scotch assets, but we believe is justified given potential benefits to UNSP.
- Whyte & Mackay has strong margin profile** — W&M's annual report filing (Sep'05) shows EBITDA margin of 18%, though high interest burden led to reported net loss. We estimate that W&M would have turned profitable in FY06 through a restructuring exercise started in FY05. UNSP can drive further margin expansion by driving a higher proportion of W&M's sales from bottled scotch.
- Raising estimates** — We raise our FY08E-FY09E EPS estimates 1.5%-3.1% and our target price to Rs1114 based on 25x FY08E P/E. We are not yet incorporating W&M into our estimates pending a formal announcement, but expect the stock to increasingly start reflecting the potential acquisition. Buy (1L).

<b>Buy/Low Risk</b>	<b>1L</b>
Price (14 May 07)	Rs860.30
Target price	Rs1,114.00
	<i>from Rs1,080.00</i>
Expected share price return	29.5%
Expected dividend yield	0.0%
<b>Expected total return</b>	<b>29.5%</b>
Market Cap	Rs81,283M
	US\$1,995M

### Price Performance (RIC: UNSP.BO, BB: UNSP IN)



See Appendix A-1 for Analyst Certification and important disclosures.

### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	446	7.38	3.5	116.6	6.2	7.9	0.0
2007A	2,418	25.59	246.9	33.6	6.1	22.4	0.0
2008E	3,452	36.52	42.7	23.6	5.0	23.5	0.0
2009E	4,160	44.02	20.5	19.5	4.2	23.4	0.0
2010E	4,911	51.97	18.1	16.6	3.5	22.9	0.1

Source: Powered by dataCentral

### Princy Singh<sup>1</sup>

 +91-22-6631-9871  
 princy.singh@citigroup.com

### Pragati Khadse<sup>1</sup>

pragati.khadse@citigroup.com

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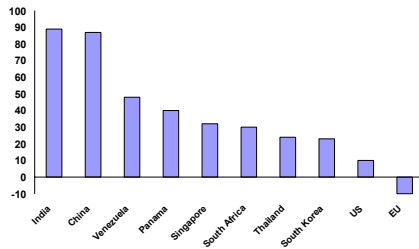
<sup>1</sup>Citigroup Global Market India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	116.6	33.6	23.6	19.5	16.6
EV/EBITDA adjusted (x)	45.8	17.9	14.3	12.0	10.1
P/BV (x)	6.2	6.1	5.0	4.2	3.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.1
<b>Per Share Data (Rs)</b>					
EPS adjusted	7.38	25.59	36.52	44.02	51.97
EPS reported	21.00	53.53	36.23	43.61	51.43
BVPS	139.20	139.92	170.43	206.20	247.33
DPS	0.29	0.31	0.37	0.42	0.46
<b>Profit &amp; Loss (RsM)</b>					
Net sales	21,485	28,674	32,469	36,651	41,286
Operating expenses	-19,988	-24,073	-26,872	-30,177	-33,780
<b>EBIT</b>	<b>1,497</b>	<b>4,601</b>	<b>5,597</b>	<b>6,474</b>	<b>7,506</b>
Net interest expense	-1,524	-1,418	-945	-765	-675
Non-operating/exceptionals	596	426	500	500	500
<b>Pre-tax profit</b>	<b>569</b>	<b>3,609</b>	<b>5,152</b>	<b>6,209</b>	<b>7,331</b>
Tax	-123	-1,191	-1,700	-2,049	-2,419
Extraord./Min.Int./Pref.div.	824	2,641	-27	-39	-52
<b>Reported net income</b>	<b>1,270</b>	<b>5,059</b>	<b>3,424</b>	<b>4,121</b>	<b>4,860</b>
Adjusted earnings	446	2,418	3,452	4,160	4,911
Adjusted EBITDA	1,923	5,064	6,083	6,986	8,041
<b>Growth Rates (%)</b>					
Sales	85.9	33.5	13.2	12.9	12.6
EBIT adjusted	215.7	207.4	21.6	15.7	15.9
EBITDA adjusted	204.9	163.4	20.1	14.8	15.1
EPS adjusted	3.5	246.9	42.7	20.5	18.1
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>-349</b>	<b>5,417</b>	<b>3,742</b>	<b>4,420</b>	<b>4,891</b>
Depreciation/amortization	426	462	487	511	536
Net working capital	-1,221	-120	-196	-252	-556
<b>Investing cash flow</b>	<b>-1,776</b>	<b>-1,050</b>	<b>-350</b>	<b>-350</b>	<b>-350</b>
Capital expenditure	-3,095	-534	-350	-350	-350
Acquisitions/disposals	1,319	-515	0	0	0
<b>Financing cash flow</b>	<b>14,565</b>	<b>69</b>	<b>-2,957</b>	<b>-2,780</b>	<b>-2,025</b>
Borrowings	9,692	-2,542	-2,390	-2,000	-1,000
Dividends paid	-224	-387	-568	-780	-1,025
<b>Change in cash</b>	<b>12,440</b>	<b>4,436</b>	<b>435</b>	<b>1,289</b>	<b>2,516</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>32,596</b>	<b>37,060</b>	<b>38,784</b>	<b>41,519</b>	<b>45,906</b>
Cash & cash equivalent	3,611	5,167	5,602	6,891	9,407
Accounts receivable	3,220	4,161	4,702	5,313	6,003
Net fixed assets	4,864	4,936	4,799	4,637	4,451
<b>Total liabilities</b>	<b>22,893</b>	<b>22,553</b>	<b>21,393</b>	<b>20,748</b>	<b>21,248</b>
Accounts payable	6,311	8,406	9,518	10,744	12,103
Total Debt	15,431	12,890	10,500	8,500	7,500
<b>Shareholders' funds</b>	<b>9,703</b>	<b>14,507</b>	<b>17,391</b>	<b>20,771</b>	<b>24,658</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	8.9	17.7	18.7	19.1	19.5
ROE adjusted	7.9	22.4	23.5	23.4	22.9
ROIC adjusted	11.1	16.8	18.9	21.3	24.1
Net debt to equity	121.8	53.2	28.2	7.7	-7.7
Total debt to capital	61.4	47.0	37.6	29.0	23.3

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**Figure 1. Scotch Export Growth YoY to various locations (05 v/s 04)**



Source: Rabobank

**Figure 2. Top Scotch Export Destinations**

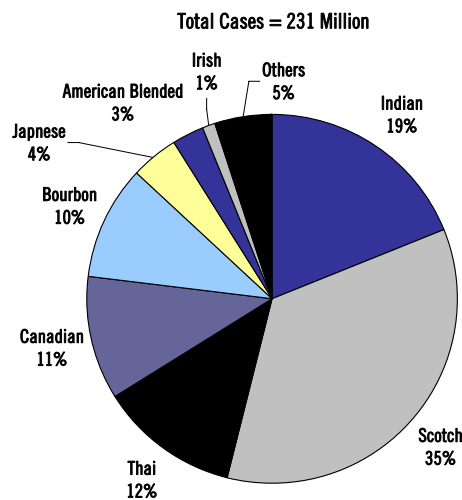
Volume Rank	Country	LPA
1	France	43,288,002
2	USA	33,608,662
3	Spain	25,955,526
4	Thailand	14,083,638
5	South Korea	11,087,751
6	Venezuela	9,483,074
7	South Africa	8,732,509
8	Germany	8,114,083
9	Australia	8,080,004
10	Brazil	6,929,581
11	Greece	6,727,310
12	Taiwan	6,330,901
13	China	5,707,919
14	Italy	5,124,443
15	Portugal	4,730,196
<b>16</b>	<b>India</b>	<b>4,388,077</b>
17	Singapore	4,282,383
18	Japan	3,860,759
19	Canada	3,210,293
20	Uruguay	2,886,422

Source: Scotch Whisky Association

## India emerging as an important scotch destination

India is emerging as an important center for scotch whiskey consumption, with demand for scotch growing at an estimated 30% per annum, albeit coming off a very low base. Indian whisky manufacturers also use scotch to blend with locally manufactured spirits, which besides imparting flavor to the locally produced whisky, also allows for pricing premium. With Indian consumers trading up from lower-end to high end whiskies, demand for bulk scotch for blending with local whisky is also increasing rapidly. In 2005, scotch imports to India increased by 90% yoy. India also ranks among the top 20 markets for scotch based on volumes. As such, in volume terms, Indian whisky accounts for almost 19% of global whisky consumption, mainly consumed domestically. India is also one of the fastest-growing markets for liquor, with demand growing at almost 12% per annum. We expect this demand growth to sustain, owing to a favorable demographic profile of the population (50% of population below 25 years), rising income (driving migration to high end brands) and changing tastes favoring higher alcohol consumption.

**Figure 3. Major Whisky Types – Volume Share in 2005**



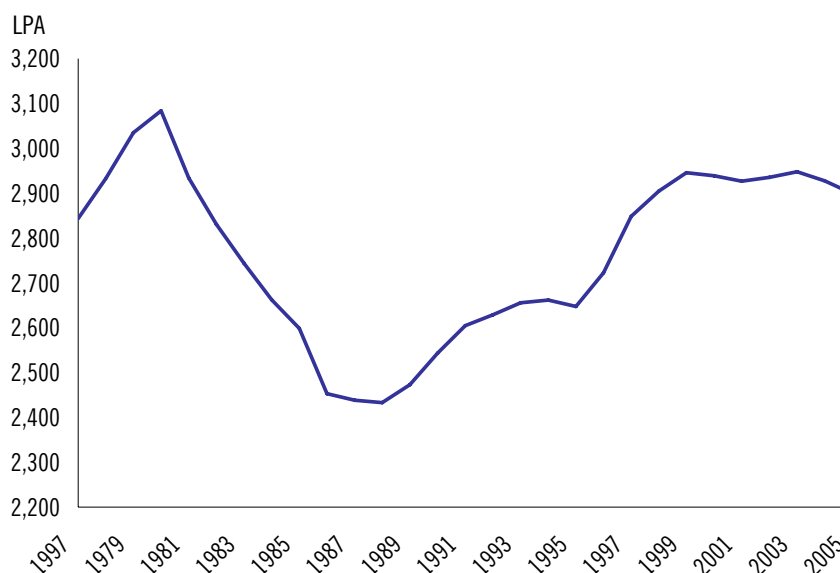
Source: Rabobank

## Whyte & Mackay seems a good strategic fit for UNSP

United Spirits seems close to announcing its acquisition of scotch major Whyte & Mackay. According to newspaper reports (*Economic Times*, May 14), the acquisition structure is already in place and the deal could be announced any time. UNSP management has at earlier occasions mentioned its keenness to acquire Whyte & Mackay. To us, Whyte & Mackay seems a good strategic fit and will significantly enhance UNSP's plans to expand its presence in the Indian premium whisky segments, as well as expand into fast-growing Chinese and Russian markets. In addition, Whyte & Mackay will provide UNSP access to the European market, though we expect UNSP's focus to remain on the Indian market. UNSP is well positioned to enhance the value of Whyte & Mackay's inventory of scotch whiskey, by providing access to a ready and fast-growing market for premium whisky.

The primary benefit to UNSP from Whyte & Mackay will be instant **access to a large inventory of scotch and secure long-term scotch supply**. This will make UNSP self-sufficient for its scotch requirement, which is likely to increase significantly, as demand for higher-end blends and scotch whisky in India increases. Globally, scotch prices have started to increase, mainly driven by strong demand from Asia and declining inventories of scotch. According to the management of the largest scotch company, Diageo (source: company presentation on website), scotch prices have moved up by 10% over the last year, and are expected to remain firm.

**Figure 4. Scotch Whisky Inventories at Bonded Warehouses (LPA)**



Source: Scotch Whisky Association

In terms of volumes, Indian whisky (manufactured and consumed predominantly in India) constitutes 19% of total global whisky volumes (although a much lower value contribution due to lower per unit selling price). Whiskey consumption in India is growing at almost 12% per annum, though consumption of scotch whiskey is likely to grow at almost 30% per annum; albeit from a very low base. As such, Indian whiskey manufacturers import bulk scotch to blend with locally manufactured spirits. Last year, UNSP imported almost 18 million litres of bulk scotch to blend with its Indian whisky brands. Overall bulk scotch imports to India grew by almost 90% yoy in 2005. We expect the scotch requirement to increase substantially, as Indian consumers migrate toward higher-end whisky, which typically has higher percentage of scotch blend.

UNSP has set up joint ventures to distribute its brands in **Russia and China**, two other important and fast-growing scotch-whisky markets, besides India. We believe that Whyte & Mackay's brands will provide a significant leg-up to the UNSP's growth strategy in these markets. Like India, China is also an important market for scotch whiskey, and its imports of scotch are also growing rapidly. (2005 scotch imports close to 90%).

We also view the potential acquisition of **Whyte & Mackay pre-emptive to the impact of likely reduction of import tariffs** on imported liquor in India. Currently, total tariffs on imported liquor in India are over 250%. The European Union has been lobbying with the Indian government for a reduction in import duties, and has also taken this up with the WTO. We believe that chances of import duty reductions are fairly high. Duty reductions would make imported liquor more competitive, and it is likely that imports of bottled scotch into India will increase significantly. UNSP would look to pre-empt a rising competition at the highly profitable top end of the market through entrenching its own scotch brands into the market and create brand loyalty before foreign imports start to increase. Whyte & Mackay has a wide array of brands that UNSP can market in India.

We believe that UNSP will be able to **enhance the profitability profile of Whyte & Mackay**. We estimate that of Whyte & Mackay's total scotch sales almost 70% is sold as bulk to bottlers/private label retailers, at relatively lower margins compared to branded sales. UNSP will be able to drive a shift in product mix favorable toward branded bottled whisky by driving sales in India AND China.

### **Whyte & Mackay annual report indicates strong margin potential**

We have analyzed Whyte & Mackay's latest available annual report (accounts up to Sep '05) filing. Whyte & Mackay reported revenues of Rs12bn in FY05 (GBP149 million), growth of 4.2% over FY04. It reported EBITDA margin of 18.1% (pre-restructuring costs) in FY05E, while EBITDA margins adjusted for restructuring costs were 12.3%. Whyte & Mackay had started a five-year restructuring program in FY03 to drive growth through venturing into new markets and enhancing presence outside its traditional UK market. Overall, the company reported a net loss in FY05 on account of high interest costs and amortization of intangible assets. FY05 annual report shows very high gearing levels. However, Whyte & Mackay has restructured its debt in FY05E and had infused fresh equity (GBP15m) into the company.

The annual report also states maturing whisky stocks of Rs7.2bn (GBP89m). The value has been stated at cost, while we believe that market value of these stocks could be significantly higher, based on the type and maturity of the stock. While the annual report does not provide further details on the stock, UNSP management has stated that the value of the stock could be substantially higher. According to newspaper reports (ET, May 14, 2007), the market value of the scotch inventory could be in the range of Rs29bn-Rs33bn.

Based on the reported numbers of FY04 and FY05, we have estimated financials for Whyte & Mackay. We estimate that Whyte & Mackay would have returned to net profit in FY06 post its debt restructuring in FY05. We have assumed sales growth of 3% in FY06E progressively increasing to 10% in FY08E if Whyte & Mackay is acquired by UNSP. Our underlying assumption is the UNSP will be able to drive higher volume growth for Whyte & Mackay through sales in India, China and Russia. On the margins side, we assume about 50bps EBITDA margin expansion, driven by improving product mix (higher share of branded scotch). We expect Whyte & Mackay to continue to retire debt through its free cash flows, which would likely continue to enhance net profit margins. Our P&L and Balance Sheet assumptions for Whyte & Mackay are enumerated below. Our Whyte & Mackay assumptions are pre-funding, i.e., do not take into account US\$500m that UNSP management have stated would be raised in the books of Whyte & Mackay to fund its potential acquisition.

Figure 5. Whyte & Mackay Income Statement (Rupees in Million, Percent)

Year to 30 Sep	FY04	FY05	FY06E	FY07E	FY08E	FY09E	FY10E
<b>Sales</b>	<b>11577.5</b>	<b>12069.4</b>	<b>12552.2</b>	<b>12928.7</b>	<b>13575.2</b>	<b>14932.7</b>	<b>16426.0</b>
% YoY		4.2	4.0	3.0	5.0	10.0	10.0
Cost of sales	-8496.8	-8697.5	-9163.1	-9308.7	-9502.6	-10452.9	-11498.2
<b>Gross Profit</b>	<b>3080.7</b>	<b>3371.9</b>	<b>3389.1</b>	<b>3620.0</b>	<b>4072.6</b>	<b>4479.8</b>	<b>4927.8</b>
Gross Margins (%)	26.6	27.9	27.0	28.0	30.0	30.0	30.0
Distribution Costs	-227.5	-270.1	-278.2	-286.6	-295.2	-304.0	-313.2
Administrative Expenses	-905.9	-917.9	-788.7	-941.6	-1266.0	-1338.6	-1411.6
<b>EBITDA</b>	<b>1947.2</b>	<b>2183.8</b>	<b>2322.2</b>	<b>2391.8</b>	<b>2511.4</b>	<b>2837.2</b>	<b>3203.1</b>
EBITDA Margin (%)	16.8	18.1	18.5	18.5	18.5	19.0	19.5
Restructuring Expenses	-706.2	-699.3	-688.5	-688.5	0.0	0.0	0.0
<b>EBITDA (post restructuring)</b>	<b>1241.0</b>	<b>1484.6</b>	<b>1633.7</b>	<b>1703.3</b>	<b>2511.4</b>	<b>2837.2</b>	<b>3203.1</b>
Margin (%)	10.7	12.3	13.0	13.2	18.5	19.0	19.5
Depreciation & Amortization	-537.5	-587.5	-617.7	-643.6	-669.6	-695.5	-721.4
Interest	-1331.6	-1152.1	-706.7	-696.4	-664.5	-599.4	-516.0
Non Operating Income	30.1	13.9	13.9	13.9	16.2	24.3	24.3
<b>PBT</b>	<b>-598.1</b>	<b>-241.1</b>	<b>323.1</b>	<b>377.2</b>	<b>1193.6</b>	<b>1566.6</b>	<b>1989.9</b>
Tax	168.5	-50.1	-129.2	-132.0	-417.7	-548.3	-696.5
<b>PAT</b>	<b>-429.6</b>	<b>-291.2</b>	<b>193.9</b>	<b>245.2</b>	<b>775.8</b>	<b>1018.3</b>	<b>1293.5</b>
Exceptional Items	207.8	0.0	0.0	0.0	0.0	0.0	0.0
<b>PAT (Post Exceptional)</b>	<b>-221.9</b>	<b>-291.2</b>	<b>193.9</b>	<b>245.2</b>	<b>775.8</b>	<b>1018.3</b>	<b>1293.5</b>

Source: Whyte & Mackay FY05 annual report; CIR estimates; Assuming exchange rate of 1GBP = Rs81

Figure 6. Whyte & Mackay Balance Sheet (Rupees in Million, Percent)

Year end 30 Sep	FY04	FY05	FY06E	FY07E	FY08E	FY09E	FY10E
Share Capital	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Share Premium	65.8	1321.3	1321.3	1321.3	1321.3	1321.3	1321.3
P&L Account	-1153.6	-1448.1	-1254.3	-1009.1	-233.2	785.1	2078.5
<b>Total Shareholders Equity</b>	<b>-1087.6</b>	<b>-126.6</b>	<b>67.3</b>	<b>312.5</b>	<b>1088.3</b>	<b>2106.6</b>	<b>3400.0</b>
<b>Total Debt</b>	<b>15437.2</b>	<b>12478.5</b>	<b>12276.0</b>	<b>12114.0</b>	<b>11745.0</b>	<b>10935.0</b>	<b>9882.0</b>
<b>Total Liabilities</b>	<b>14349.6</b>	<b>12351.9</b>	<b>12343.2</b>	<b>12426.4</b>	<b>12833.3</b>	<b>13041.6</b>	<b>13282.0</b>
<b>Fixed Assets</b>	<b>7662.4</b>	<b>7993.3</b>	<b>8097.2</b>	<b>8201.0</b>	<b>8304.8</b>	<b>8408.7</b>	<b>8512.5</b>
Intangible Assets	3567.9	3347.7	3127.6	2907.4	2687.3	2467.1	2246.9
Tangible Assets	4094.5	4645.6	4969.6	5293.6	5617.6	5941.6	6265.6
<b>Investments</b>	<b>11.2</b>	<b>9.6</b>	<b>9.6</b>	<b>9.6</b>	<b>9.6</b>	<b>9.6</b>	<b>9.6</b>
Current Assts	10807.6	10818.6	10868.1	10992.7	11444.2	11700.5	11992.4
Stocks	7716.1	7835.5	7918.1	8000.7	8083.3	8165.9	8248.6
Debtors	3085.7	2933.7	2852.7	2828.7	2885.3	2943.0	3001.9
Cash	5.8	49.5	97.4	163.3	475.6	591.6	742.0
Current Liabilities	3095.7	5375.0	5375.0	5482.5	5592.1	5704.0	5818.1
Provisions	1035.8	1094.6	1256.6	1294.3	1333.2	1373.2	1414.4
<b>Net Current Assets</b>	<b>6676.1</b>	<b>4349.0</b>	<b>4236.5</b>	<b>4215.8</b>	<b>4518.9</b>	<b>4623.3</b>	<b>4760.0</b>
<b>Total Assets</b>	<b>14349.6</b>	<b>12351.9</b>	<b>12343.2</b>	<b>12426.4</b>	<b>12833.3</b>	<b>13041.6</b>	<b>13282.0</b>

Source: Whyte & Mackay FY05 annual report; CIR estimates; Assuming exchange rate of 1GBP = Rs81

## Acquisition premium of 25% likely

Press reports (*Economic Times*, May 7) indicate potential enterprise valuation of US\$1.38bn for Whyte & Mackay. Based on this valuation, we estimate target FY09E EV/EBITDA of 18.8x for Whyte & Mackay, which is at a premium to both UNSP's current valuations as well as global peer group valuations. The implied acquisition premium works out to 25% over average valuations. While on a near-term basis, the valuations do not seem cheap, we believe that it reflects a scarcity premium on scotch assets. There are not too many available acquisition options, especially in the context of the large size of Whyte & Mackay's scotch inventory (about 70m-80m litres according to UNSP management).

**Figure 7. Whyte & Mackay Valuation Analysis**

UNSP Market Cap (Rsm)	82025
UNSP Net Debt (Rsm)	10500
Whyte & Mackay estimated EV (Rsm)	53300
Combined EV (Rsm)	145825
Whyte & Mackay EBITDA (FY09E) (Rsm)	2837
Combined EBITDA (FY09E) (Rsm)	9823
<b>Acquisition EV/EBITDA multiple (x)</b>	<b>18.8</b>
<b>EV/EBITDA (FY09E) for Combined Entity (x)</b>	<b>14.8</b>

Source: Citigroup Investment Research

**Figure 8. Global Liquor Valuation Summary**

Company	Ticker	Price	Country	Rating	Market Cap	P/E (x)	P/E (x)	EV/EBITDA	EV/EBITDA	Dividend Yield	RoE (%)	RoCE (%)
					(US\$m)	2007	2008	(x)	(x)	(%)	2007	2007
Luzhou Laojiao	000568.SZ	39.1	China	1M	4,429.5	62.3	36.3	37.3	24.4	0.9%	23.6%	32.6%
Wuliangye Yibin	000858.SZ	24.7	China	2M	11,875.5	59.6	41.9	32.4	26.5	0.2%	17.5%	27.8%
Kweichow Moutai	600519.SS	92.0	China	1M	11,285.5	44.0	28.3	24.6	17.8	0.8%	30.1%	118.2%
Shanxi Fenjiu	600809.SS	33.2	China	3H	1,825.9	38.8	26.9	19.2	15.6	1.4%	30.7%	52.1%
C&C Group Plc	CCR.I	12.2	Ireland	2M	5,382.6	22.5	18.9	18.7	15.4	2.2%	69.0%	27.0%
Davide Campari-Milano SpA	CPR.MI	7.7	Italy	1L	3,018.9	17.4	15.8	11.6	10.5	1.3%	15.2%	11.6%
Diageo PLC	DGE.L	10.6	UK	2L	56,134.3	19.5	17.7	13.5	12.9	3.1%	36.7%	17.4%
Pernod-Ricard SA	PERP.PA	158.3	France	1L	23,331.2	20.5	17.6	16.2	14.5	1.6%	13.2%	6.9%
Constellation Brands Inc	STZ.N	23.6	US	2H	5,542.6	14.0	17.3	7.8	9.1	0.0%	12.7%	8.5%
Thai Beverage	TBEV.SI	0.3	Thailand	3L	4,216.7	11.6	10.9	6.6	5.9	4.3%	20.5%	17.2%
United Spirits	UNSP.BO	873.3	India	1L	2,003.8	34.1	23.9	16.8	13.7	0.1%	22.4%	20.2%
<b>Average</b>						<b>31.3</b>	<b>23.2</b>	<b>18.6</b>	<b>15.1</b>	<b>1.4%</b>	<b>26.5%</b>	<b>30.9%</b>

Source: Company Reports and Citigroup Investment Research. Prices as of May 10, 2007

Our analysis suggests that at these valuations, Whyte & Mackay acquisition could dilute United Spirit's FY08E EPS by 16% mainly on account of servicing the incremental debt that would need to fund the acquisition. However, we expect the acquisition to turn accretive to EPS from FY09E onwards. We estimate that by FY10E, Whyte & Mackay could contribute incremental earnings of 13%. Our analysis is based on the following assumptions:

1. We assume cost of potential EV of acquisition to be Rs56.6bn (US\$1.38bn).
2. We assume that sale of UNSP's treasury stock, valued at Rs14.9bn, is likely to fund a part of the acquisition. We conservatively assume selling price of

treasury at Rs875 per share. We assume that the remaining cost will be funded through debt raised overseas, assuming cost of debt at 8%.

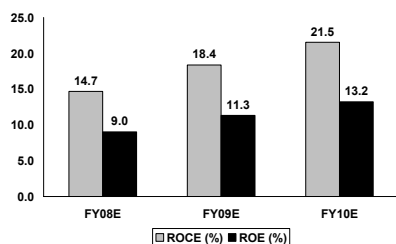
3. We estimate Whyte & Mackay's EBITDA margins to improve to 19% by FY09E, at similar levels to UNSP's estimated EBITDA margin for FY09E. Whyte & Mackay's operations have been undergoing restructuring, and according to the FY05 annual report, reported EBITDA margins post restructuring were 12.3%, while pre-restructuring EBITDA margins were 18.1%. We build in ongoing restructuring costs for Whyte & Mackay till FY07E into our estimates, as per the original 5-year restructuring plan. We believe that in the context of the FY05 reported pre-restructuring EBITDA margins of 18.1%, our assumption of 19% by FY09E is reasonable. Our assumption is also similar to other global liquor manufacturers.
4. We assume that combined free cash flows of UNSP and Whyte & Mackay will progressively be used to retire debt. We estimate the combined entity to generate cumulative free cash flows of almost Rs16bn over FY08E-FY10E, which can significantly bring down the debt burden.
5. We would like to highlight that the UNSP management has indicated that the treasury stock is unlikely to be sold near the current stock price level – management is likely to seek Rs1000 + per share for its treasury. Therefore, our funding assumptions assume sale of treasury may differ slightly on timing – UNSP may fund the acquisition through 100% debt, though we believe that it will eventually sell the treasury to retire part of the debt. However, under this scenario, our EPS estimates for the combined entity do not differ materially from our base case assumption scenario.

Figure 9. Analysis of Potential Whyte & Mackay Acquisition (Rupees in Million, Percent)

	United Spirits			Whyte & MacKay			Combined		
	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E	FY08E	FY09E	FY10E
Sales	32469	36651	41286	13575	14933	16426	46044	51584	57712
EBITDA	6083	6986	8041	2511	2837	3203	8595	9823	11245
EBITDA Margin (%)	18.7	19.1	19.5	18.5	19.0	19.5	18.7	19.0	19.5
Interest	-945	-765	-675	-664	-599	-516	-1609	-1364	-1191
Depreciation	-487	-511	-536	-670	-695	-721	-1156	-1207	-1257
Other Income	500	500	500	16	24	24	516	524	524
PBT	5152	6209	7331	1194	1567	1990	6345	7776	9320
Tax	-1700	-2049	-2419	-418	-548	-696	-2118	-2597	-3116
Net Profit	3452	4160	4911	776	1018	1293	4227	5179	6205
Estimated Enterprise Value of Whyte & Mackay (Rsm)	56580								
Estimated Equity Valuation of Whyte & Mackay (Rsm)*	44835								
Treasury Stock Sales (assuming @Rs875/share)	14884								
Free Cash Flow of Combined Entity (Rsm)							4194	5187	6264
Incremental Debt on books to Fund acquisition (Rsm)							25758	20570	14306
Incremental Interest (@ 8%)							-2061	-1646	-1145
Combined Net Profit post acquisition (Rsm)							2847	4076	5438
<b>Combined EPS (Rs)</b>							<b>30.1</b>	<b>43.1</b>	<b>57.5</b>
<b>Current United Spirits EPS (Rs)</b>							<b>36.5</b>	<b>44.0</b>	<b>51.9</b>
<i>(Dilution) / Accretion (%)</i>							<i>-17.5%</i>	<i>-2.0%</i>	<i>10.7%</i>

Source: Company Reports and CIR Estimates; Assuming US\$1bn, exchange rate 1US\$=Rs41



**Figure 10. ROE and ROCE trend post acquisition (percent)**

Source: Citigroup Investment Research

On the balance sheet side, we expect potential post acquisition gearing and capital efficiency ratios to look rather unfavorable in FY08E, but are likely to start improving from FY09E. We estimate an interest cover of 2.4x for the combined entity in FY08E, likely to improve to a comfortable 5.3x by FY10E. We also estimate gearing ratio of 1.4x in FY08E (assuming sale of treasury shares), improving to 0.97x by FY10E. We also expect near-term capital efficiency ratios to get depressed, but are likely to pick up.

## Revising estimates, target price

We are revising our EPS estimates for UNSP following better than expected FY07 results. We are not yet including Whyte & Mackay in our estimates, given that the deal has still not been announced. We are increasing our FY08E-FY09E EPS estimates by 1.5%-3%. Key drivers for the increase in our EPS estimates are higher sales and margin assumptions for UNSP, following above-expectation FY07 reported sales and profits.

**Figure 11. Earnings Revision Summary**

	Net Profit (Rsm)			EPS (Rs)			DPS (Rs)		
	Old	New	% Chg.	Old	New	% Chg.	Old	New	% Chg.
FY08E	3,348.2	3,451.5	3.1	35.4	36.5	3.1	0.8	0.4	(52.0)
FY09E	4,098.6	4,160.3	1.5	43.4	44.0	1.5	1.0	0.4	(57.1)

Source: Citigroup Investment Research

We are also revising our target price to Rs1114. We continue to maintain our earlier 25x P/E target multiple. We increase our target price to Rs1114 (from Rs1080) based on 25x FY08E adjusted P/E. We continue to use our target multiple adjusted for 18% treasury stock. While we believe that the stock price of UNSP will increasingly be viewed in the context of the impending acquisition we are not yet incorporating that to our price target, awaiting a formal announcement on the acquisition. We believe that chances of a negative surprise from the acquisition are slim – our estimates for Whyte & Mackay are based on conservative estimates, and we see higher chances for the acquisition to surprise positively.

## Background of Whyte & Mackay

Whyte & Mackay is a scotch whisky manufacturer with a 9% share of the total global scotch market. Its key brands include Whyte and Mackay Scotch Whisky, Dalmore Single Highland Malt, Isle of Jura Malt Whisky, Glayva Liqueur and Vladivar Vodka. The company is also the world's leading supplier of own-label, private label and branded Scotch Whisky. Whyte & Mackay reported a turnover of GBP149m (Rs12bn) in FY05. The company's majority shareholder is Vivan Imerman, a South African entrepreneur, who purchased a majority stake through an MBO in 2001 and subsequently took full control of the company in 2005.

Whyte & Mackay owns five distilleries across 4 different producing locations in Scotland. Its distillery profile is detailed below:

Figure 12. Key Distilleries owned by Whyte &amp; Mackay

Distillery	Location	Capacity	Key Brands Bottled
Dalmore	Highlands - North	3.2m litres	The Dalmore 12 Year Old The Dalmore Cigar Malt The Dalmore 21 Year Old The Dalmore 50 Year Old The Dalmore 20 yo cask expression The Dalmore Black Pearl and Black Isle The Dalmore Stillman's 28yr Old
Fettercairn	Highlands - East	1.6m litres	Fettercairn 12 yo single malt 1824 Fettercairn Single cask bottling 15 yo sherry wood Fettercairn Single cask bottling 15 yo American oak
Invergordon	Lowlands	NA	The Invergordon Single Grain 10 Year Old
Isle of Jura	Jura	2.5m litres	Isle of Jura 10 Year Old Isle of Jura "Superstition" Isle of Jura 16 Year Old Isle of Jura 21 Year Old Isle of Jura 27 Year Old Isle of Jura 33 Year Old Isle of Jura 36 Year Old
Tamnavulin (closed)	Speyside	NA	Tamnavulin 12 Year Old Tamnavulin 25 Year Old (distilled 1966)

Source: Scotchwhisky.net

## United Spirits

### Company description

United Spirits is the largest player in India's branded spirits market. It pursues an inorganic growth strategy, with its latest acquisition being the second-largest Indian liquor manufacturer, Shaw Wallace. The acquisition has significantly enhanced its competitive position, increasing its market share in branded spirits to 53%. It is also exploring international growth opportunities, and recently acquired French winemaker Bouvet Ladubay — the wine arm of champagne major Taittinger.

### Investment thesis

We rate United Spirits a Buy (1L), with a target price of Rs1114. India's organized liquor market is growing at a rate of 13%, driven by rising disposable incomes, favorable demographics and a shift in consumption patterns. Being the market leader, United Spirits looks well positioned to benefit from this growth rate. Its acquisition of Shaw Wallace has strengthened its competitive position. It has a 53% share of India's organized liquor market, which is characterized by high entry barriers. The Shaw Wallace acquisition should bring procurement, product and marketing synergies, and drive significant cost savings and a significant margin expansion over the next three years, on our estimates. United Spirits is also simplifying its shareholding structure, with all liquor companies being merged into a single entity. The non-core assets have been hived off into a separate listed company. Treasury stock of 18% could potentially be sold to strategic investors at a large premium. United Spirits is exploring international acquisitions to fuel growth. We do not rule out international joint ventures going forward. After the recent capital-raising and debt repayment, gearing has declined. Steady sales growth, margin expansion and lower interest costs should drive an EPS CAGR of 72% in FY06-09E. United Spirit's capital efficiency is looking up amid strong earnings growth.

## Valuation

Our target price of Rs1114 is based on 25x P/E for FY08E, adjusted for the 18% treasury stock that the company will hold after restructuring of the shareholding. United Spirits, in our view, could realize significant value from the treasury stock if it sold it to a strategic partner. Our target multiple is at a 10-15% premium to the global 2008E average in recognition of 1) United Spirit's dominant position in India's liquor market, 2) strong demand growth of 13%, driven by rising incomes and market-share gains at the expense of the unbranded sector, 3) high barriers to entry, and 4) a 72% three-year EPS CAGR, almost 3x higher than the global peer group average. Our target multiple is at a 10-15% discount to the average 2008E multiple for the Indian consumer universe in view of the company's much higher gearing (vs. net cash for the Indian consumer universe) and lower capital-efficiency ratios. We use adjusted EV/EBITDA as our second valuation methodology and ascribe a multiple of 15x FY08E EV/EBITDA, which equates to Rs1090. Our EV/EBITDA multiple is almost at par with the 2008E global peer group average multiple, which we believe is conservative.

## Risks

We rate United Spirits Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share-price volatility. The key downside risks to our rating and target price include: 1) the liquor industry is highly regulated. Any change in policy (like increase in taxes, further control on distribution or an outright ban on liquor sales in some states) could adversely impact growth and profitability. 2) Easing the norms for entry of foreign players could increase competition and hurt growth prospects. 3) The company is looking for international acquisitions. Any bad buyout would result in further pressure on gearing and interest costs. 4) A general slowdown in GDP / income growth could lead to slowdown in market growth and sales.

## Appendix A-1

### Analyst Certification

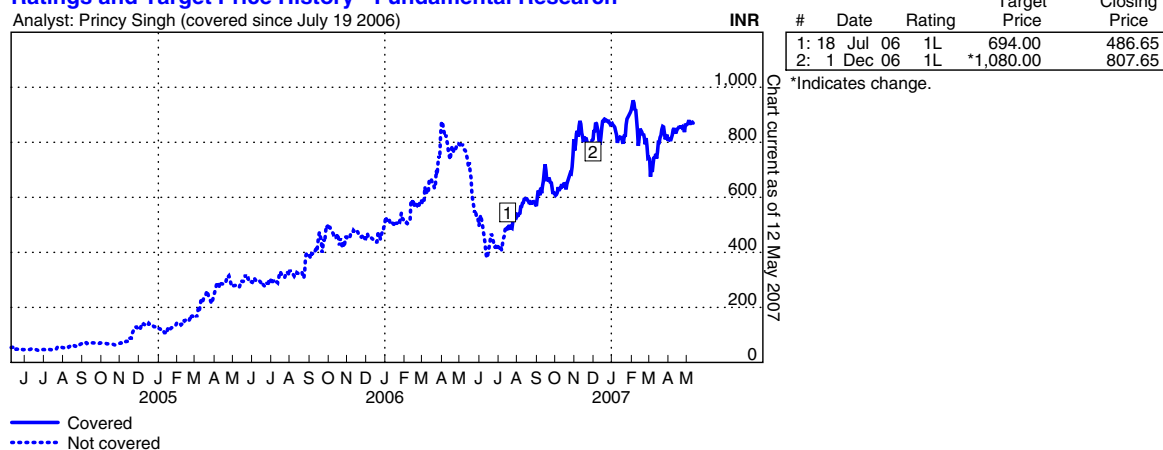
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#### United Spirits (UNSP.BO)

##### Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since July 19 2006)



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