United Spirits Ltd.

Price Objective Change NEUTRAL

Equity | India | Distillers
26 February 2009

Bank of America Merrill Lynch

RESEARCH

Vandana Luthra >> +91 22 6632 8670
Research Analyst
DSP Merrill Lynch (India)
vandana_luthra@ml.com

Anuj Bansal >> +91 22 6632 8690
Research Analyst
DSP Merrill Lynch (India)
anuj_bansal@ml.com

Scenario analysis: assessing risks and opportunities

Cut FY10 EPS by 16% & PO to Rs600(745); reiterate Neutral

Molasses prices continue to rise ahead of our and market expectations. We build in another 10% increase and hence cut our FY10EPS by 16% to Rs38. Secondly, we undertake a scenario analysis for three situations – no sale of treasury stock, sale at mkt price of Rs600 & sale at premium i.e. price of Rs1000. We conclude; assuming FY11 P/E of 15x, the worse & best case stock price is Rs557 & Rs740. Our PO of Rs600 is based on 15xFY11 EPS assuming sale of treasury stock at market price. Treasury stocks accounts for 16% of fully diluted share capital.

Why then a Neutral? Primarily for two reasons

Market has not yet fully factored the continuing pain from rising molasses price – our 4Q FY09 and FY10 profit is 25% and 16% below consensus. State Budget news so far is neutral but Budgets of two key States (24% of vol.) are still awaited.

Scenario #1 (base & worse case): No sale of treasury stock

We get FY10 & FY11 EPS of Rs38 and Rs37.1. In FY10: Higher molasses prices will restrict EBITDA growth to mere 6% but lower interest costs (Libor reset) leads to EPS growth of 23%. In FY11: Lower molasses prices leads to EBITDA growing 18% but higher interest cost (debt refinancing) leads to EPS decline of 2%.

Scenario #2: Treasury stock sale at Rs600

We get FY10 and FY11 EPS of Rs35.8 and Rs39.9. Total cash inflow is $204m vs. repayment of $330m, hence interest cost still rise slightly in FY11. This is 6% dilutive in FY10 but 8% accretive in FY11 versus the base case.

Scenario #3 (best case): Treasury stock sale at Rs1000

We get FY10 and FY11 EPS of Rs38.2 and Rs49.4. Price of Rs1000 is based on fully diluted EV/EBITDA of 13.4x vs. global beverage deals at 14-20x. Cash inflow of $340m will meet FY11 repayment but will still leave a funding gap for FY12.

Estimates (Mar)

(Rs)	2007A	2008A	2009E	2010E	2011E
Net Income (Adjusted - mn)	2,560	2,540	2,739	3,362	3,287
EPS	30.89	28.66	30.92	37.95	37.10
EPS Change (YoY)	47.2%	-7.2%	7.9%	22.8%	-2.2%
Dividend / Share	2.25	1.50	0.500	0.500	0.500
Free Cash Flow / Share	31.61	(688.01)	(29.33)	9.27	9.42

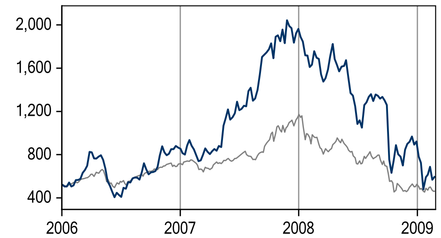
Valuation (Mar)

	2007A	2008A	2009E	2010E	2011E
P/E	19.43x	20.94x	19.41x	15.81x	16.18x
Dividend Yield	0.375%	0.249%	0.083%	0.083%	0.083%
EV / EBITDA*	27.01x	11.15x	10.84x	10.21x	8.69x
Free Cash Flow Yield*	4.93%	-114.65%	-4.89%	1.54%	1.57%

* For full definitions of *iQmethod* SM measures, see page 11.

Stock Data

Price	Rs600.10
Price Objective	Rs745.00 to Rs600.00
Date Established	26-Feb-2009
Investment Opinion	C-2-7
Volatility Risk	HIGH
52-Week Range	Rs425.65-Rs1,874
Mrkt Val / Shares Out (mn)	US$1,065 / 88.6
Average Daily Volume	6,340,987
ML Symbol / Exchange	UDSRF / BSE
Bloomberg / Reuters	UNSP IN / UNSP.BO
ROE (2009E)	12.4%
Net Dbt to Eqty (Mar-2008A)	273.5%
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	47.2%



Refer to important disclosures on page 12 to 14. Analyst Certification on Page 10. Price Objective Basis/Risk on page 10.

iQprofile SM United Spirits Ltd.

Key Income Statement Data (Mar)	2007A	2008A	2009E	2010E	2011E
(Rs Millions)					
Sales	38,642	59,605	87,435	98,712	109,824
Gross Profit	25,550	44,883	66,327	72,847	81,280
Sell General & Admin Expense	(21,166)	(34,265)	(55,405)	(61,246)	(67,663)
Operating Profit	4,045	9,877	10,142	10,781	12,754
Net Interest & Other Income	2	(4,384)	(5,491)	(5,171)	(7,260)
Associates	NA	NA	NA	NA	NA
Pretax Income	4,047	5,492	4,651	5,610	5,494
Tax (expense) / Benefit	(1,049)	(2,661)	(1,628)	(1,964)	(1,923)
Net Income (Adjusted)	2,560	2,540	2,739	3,362	3,287
Average Fully Diluted Shares Outstanding	83	89	89	89	89
Key Cash Flow Statement Data					
Net Income	2,560	2,540	2,739	3,362	3,287
Depreciation & Amortization	338	741	780	821	864
Change in Working Capital	(2,463)	(12,605)	(5,902)	(3,146)	(3,100)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	3,547	465	284	284	284
Cash Flow from Operations	3,981	(8,859)	(2,098)	1,321	1,335
Capital Expenditure	(1,361)	(52,099)	(500)	(500)	(500)
(Acquisition) / Disposal of Investments	440	(75)	5	0	0
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(921)	(52,174)	(495)	(500)	(500)
Shares Issue / (Repurchase)	(48)	4,493	0	0	0
Cost of Dividends Paid	(237)	(159)	(51)	(51)	(51)
Cash Flow from Financing	(915)	57,222	3,561	(4,701)	(51)
Free Cash Flow	2,620	(60,958)	(2,598)	821	835
Net Debt	9,024	62,251	64,895	64,124	63,340
Change in Net Debt	(2,776)	56,698	2,644	(771)	(784)
Key Balance Sheet Data					
Property, Plant & Equipment	5,190	11,163	10,882	10,562	10,198
Other Non-Current Assets	11,478	53,413	53,413	53,413	53,413
Trade Receivables	3,991	8,370	12,241	13,820	15,375
Cash & Equivalents	5,778	5,438	6,405	2,526	3,310
Other Current Assets	11,052	23,597	30,989	34,733	38,422
Total Assets	37,489	101,981	113,930	115,053	120,718
Long-Term Debt	14,802	67,689	71,300	66,650	66,650
Other Non-Current Liabilities	19	18	18	18	18
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	7,264	11,514	16,875	19,051	21,196
Total Liabilities	22,084	79,221	88,193	85,719	87,864
Total Equity	15,405	22,765	25,738	29,334	32,854
Total Equity & Liabilities	37,489	101,986	113,931	115,053	120,718
iQmethod* SM - Bus Performance					
Return On Capital Employed	10.8%	8.4%	7.0%	7.3%	8.5%
Return On Equity	23.2%	14.7%	12.4%	13.4%	11.6%
Operating Margin	10.5%	16.6%	11.6%	10.9%	11.6%
EBITDA Margin	11.3%	17.8%	12.5%	11.8%	12.4%
iQmethod* SM - Quality of Earnings					
Cash Realization Ratio	1.6x	-3.5x	-0.8x	0.4x	0.4x
Asset Replacement Ratio	4.0x	NM	0.6x	0.6x	0.6x
Tax Rate (Reported)	25.9%	48.5%	35.0%	35.0%	35.0%
Net Debt-to-Equity Ratio	58.6%	273.5%	252.1%	218.6%	192.8%
Interest Cover	4.6x	1.8x	1.7x	2.0x	1.8x

Key Metrics

* For full definitions of *iQmethod* SM measures, see page 11.

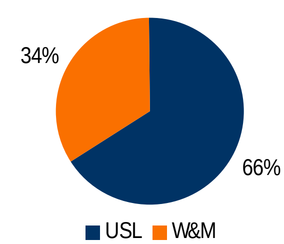
Company Description

United Spirits is India's largest spirits player. In FY08 it sold 74mn cases which gives it a volume share of 52%. Key strengths are market leading brands across all spirit categories and price segments. It recently acquired Whyte & Mackay - the fourth largest Scotch whisky player in the world. W&M is predominently a bulk spirits manufacturer. Its branded Scotch portfolio is small with 3% market share in UK.

Investment Thesis

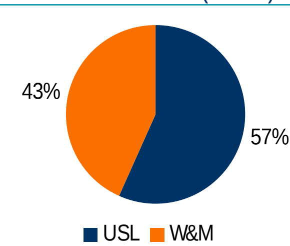
UNSP is growing faster than its peers led by a more diversified portfolio. Key positives are healthy volume growth in mid teens, some savings in packaging costs and stable outlook for W&M and scotch prices. On the other hand, mix gain benefits are beginning to run out and molasses price increase is running ahead of market expectations. Treasury stock sale is a possibility but timing and price are difficult to estimate. Overall we believe the risk reward is balanced and hence our Neutral rating.

Chart 1: Turnover breakdown (FY09E)



Source: Company, Banc of America Securities – Merrill Lynch Estimates

Chart 2: EBITDA breakdown (FY09E)



Source: Company, Banc of America Securities – Merrill Lynch Estimates

Stock Data

Price to Book Value	2.3x

Cutting through the noise

Post the Dec Q shock of profit fall of 65% and revelation of promoter stock pledges, news flow on UNSP has been dominated by potential treasury stock sale to Diageo. And it is quite likely that stock price will continue to flow and ebb in tandem with media speculation.

Key questions are when will the treasury stock be sold, to whom will it be sold and, most important of all, at what price will it be sold. We do not have answers to these questions. But in this report, we attempt to arrive at the best and worse case stock price by building three scenarios and estimating earnings in each of these scenarios.

Besides the scenario analysis, we reassess the molasses price outlook and conclude there is more pain ahead on this issue. Post the temporary relief in Dec and Jan, prices have begun to rise again led by lower sugar cane production. We estimate molasses prices will rise another 10% in FY10 and hence cut our FY10 EPS by 16%, from Rs45.3 earlier to Rs38 now.

Scenario Analysis

Key conclusion: stock price range Rs557-741

Table 1 gives our EPS outcomes for FY10 and FY11 under the three scenarios. Assuming a P/E multiple of 15x for FY11, on a worse case, we get a stock price of Rs557 and in the best case we get Rs741. This implies that at the current stock price of Rs600, UNSP is close to the scenario 2 valuation. Hence, the downside is limited and should the stake sale happen at a premium, there is a significant upside. A potential open offer, should the deal involve the strategic buyer acquiring more than the treasury stock, will further improve the risk reward outlook.

Table 1: EPS estimates under various scenarios

	EPS (Rs)			
	FY10	FY11	FY11 P/E (x)	Price (Rs)
Scenario 1	38.0	37.1	15	557
Scenario 2	35.8	39.9	15	599
Scenario 3	38.2	49.4	15	741

Source: Banc of America Securities – Merrill Lynch Estimates

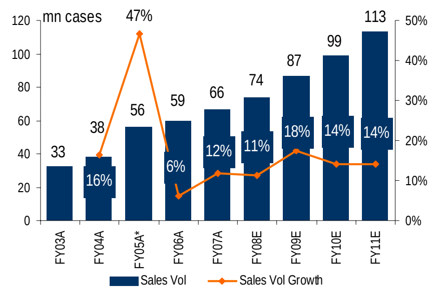
Why then a Neutral?

Despite the limited downside, our Neutral rating is influenced by primarily two factors:

- **Earnings below consensus** – We believe the market is still not yet fully building in the pain from molasses. Our profit estimates for FY09 and FY10 at Rs2.74bn and Rs3.36bn are 11% and 16% below consensus. For FY09, this implies that our 4Q profit is a huge 25% below consensus.

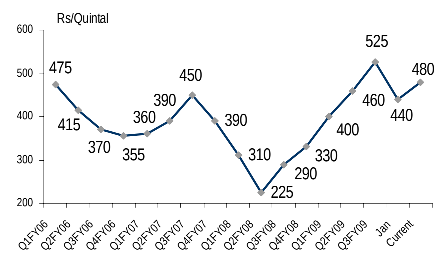
- **State Budget newsflow could likely be negative** – Among the States that have so far announced their Budgets, the overall impact is largely neutral. The only real negative so far is Rajasthan (~3% of UNSP volumes) where there is a new VAT imposition of 20%. We are still awaiting Budgets of two key States – Tamil Nadu and Maharashtra (24% of volume) to take a final view on the Budget impact.

Chart 3: Sales volume growth trends



Source: Company, Banc of America Securities – Merrill Lynch Estimates
*Shaw Wallace volumes included from FY05 onwards

Chart 4: Molasses price trends



Source: Industry

Common assumptions across the Scenarios

Amount of stake sale

We assume the total treasury stock, accounting for 17m # of shares which is 16% of the fully diluted capital, is sold to a financial / strategic investor. The proceeds are used for de-leveraging the balance sheet. .

Sales forecast

In the current year, UNSP will sell around 87m cases which is a growth of 17.5%. In FY10, we estimate volume of 99m cases, a growth of 14% and in FY11, volume of 113m cases, again a growth of 14%. In addition, we assume selling price increase of 2% in FY10 and no increase in FY11. Lastly, we assume no mix gains given tightening consumer wallets.

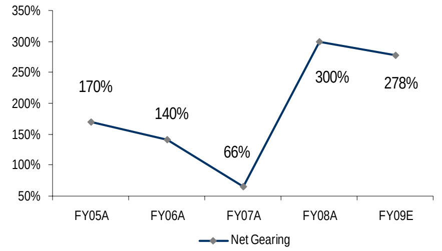
Molasses price forecast

In FY09, we estimate effective molasses price increase for UNSP to be 35%. In FY10 we build another 10% increase given the fall in sugar cane production. In FY11, we assume a price fall of 5% - since molasses is a cyclical commodity, a two year price increase is likely to be followed with a decline in the third year. We note molasses sensitivity is high – every 1% change leads to UNSP's domestic EBITDA changing by 2.5-3%. At the PAT level, the sensitivity increases further given the high interest cost.

W&M EBITDA

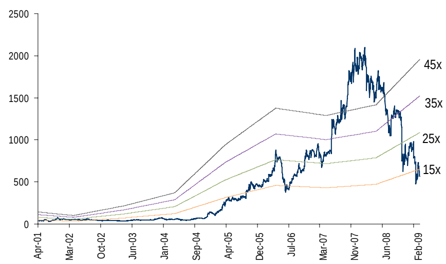
Management has guided for FY09 and FY10 EBITDA of £59m and £63m. In FY11, we assume EBITDA to grow again by 8% to £68m.

Chart 5: Net Gearing trends



Source: Company, Banc of America Securities – Merrill Lynch Estimates

Chart 6: 1-yr Forward P/E trends



Source: Bloomberg, Banc of America Securities – Merrill Lynch Estimates

Table 2: Scenario 1 Estimates

Rs m	FY10	FY11
EBITDA	11,602	13,617
Depr	821	864
EBIT	10,781	12,754
Interest	5,471	7,260
PAT	3,362	3,287
Shares O/S m #	88.6	88.6
EPS	38.0	37.1

Source: Banc of America Securities – Merrill Lynch Estimates

Interest cost

In the case of W&M acquisition debt, FY10 average interest will fall marginally by 20bp. Even though Libor is falling, we expect UNSP's Libor reset to be accompanied with higher spread, thus making the overall interest rate decline to be marginal. In domestic debt, we build interest rate fall of 60bp. These declines in interest rate coupled with repayment of US$93m will lead to FY10 interest cost declining by 11%. We note UNSP has very high leverage to interest cost. A 1% change in interest rate leads to a massive 13% change in EPS.

Refinancing costs

UNSP's FY10 repayment amounts to US$93m. This can be repaid through the current cash balance. Debt repayment in FY11 amounts to US$330m. Internal cash flows are inadequate to meet this obligation. In the absence of treasury stock sale, we assume that the refinancing cost amounts to an additional 3.5% interest rate.

Assumption for P/E multiple

Our target multiple for FY11 is 15x. This implies a 66% premium to the Sensex. This compares to consumer stocks are trading at an average ~80% premium to the Sensex for FY11. The 66% premium is also largely in line with UNSP's last 5-year average premium to the Sensex. We also note that we are being fairly charitable in our target multiple since 40% of Group EBITDA comes from W&M. W&M is a commodity business and hence should ideally trade at a lower discount versus the domestic branded spirits business.

Scenario #1: No treasury stock sale; debt refinancing in FY10

Logic:

Based on media speculation, it appears that it is a given that UNSP will be able to sell its treasury stock. However, there can be many instances which prevent the stake sale. These instances can range from non-agreement on price to structure of the deal.

Outcome: Stock price at 15xFY11= Rs557

This is our base case and it is also the worse case scenario. We get FY10 and FY11 EPS of Rs38 and 37.1. In FY10, we have group EBITDA growing a mere 6% but interest costs falls on lower rates and a small repayment. As a result, EPS grows 23%. In FY11, the EBITDA and interest cost dynamics reverse. EBITDA grows 17% as we build in molasses price fall. But interest cost rises owing to refinancing of debt because of inability to meet the repayment. Overall this leads to FY11 EPS declining a small 2%.

Scenario #2: Treasury stock sale at Rs600; debt partly refinanced in FY11

Logic:

We assume the strategic/financial investor pays virtually no premium. Despite UNSP's fundamental strengths, it is currently in a relatively weak negotiating position because of its high leverage. It has net gearing of 2.8x in FY09E which falls max to 2.4x in FY10. Its debt repayment begins in FY10 and while it can meet the FY10 repayment of $93m, it has a large funding gap for repayment of $692m over FY11 and FY12. Secondly, assuming the buyer is Diageo, the Indian market for Diageo is attractive but it does have a presence in India which appears to be growing. Hence UNSP may not be their only path to growth for India. In 1HFY09, Diageo's India volumes are up 18% and sales is up 42%. It has invested heavily in hiring new sales force, increasing distribution points and running aggressive campaigns highlighting the Johnnie Walker Select Stores. The increased marketing investments appear to be yielding results.

Table 3: Scenario 2 Estimates

Rs m	FY10	FY11
EBITDA	11,602	13,617
Depr	821	864
EBIT	10,781	12,754
Interest	4,824	5,833
PAT	3,783	4,215
Shares O/S m #	105.6	105.6
EPS	35.8	39.9

Source: Banc of America Securities – Merrill Lynch Estimates

Outcome: Stock price at 15xFY11= Rs599

We get FY10 and FY11 EPS of Rs35.8x and 39.9. Versus the base case, this is 6% dilutive in FY10 and 8% accretive in FY11. At Rs600, the total inflow will be $204m vs. repayment of $330m. Hence, some part of the debt will still need to be re-financed in FY11.

Scenario #3: Treasury stock sale at Rs1000; no debt refinancing needed in FY11

Logic:

We assume the strategic/financial investor pays a substantial premium. Globally over the last few years, alcoholic beverage deals on EV/EBITDA have ranged from 14x to 20x. A sale at Rs1000 gives us, on fully diluted basis, an EV/EBITDA of 13.4x, largely in line with the lower range of global beverage M&A deals. The bulls may argue that the India potential is greater with volumes likely to grow in low to mid teens for many years and hence a higher multiple is justified. We do not dispute that but would also add that the long term volume growth potential is offset by UNSP's lack of pricing power and hence greater cyclicality in earnings. We estimate some 60% of UNSP's volumes are sold in government control markets and hence it is has limited flexibility to pass on rising input costs. We note the premium could also be a function of % stake offered to the potential buyer – higher the stake, higher the premium.

Table 4: Scenario 3 Estimates

Rs m	FY10	FY11
EBITDA	11,602	13,617
Depr	821	864
EBIT	10,781	12,754
Interest	4,436	4,289
PAT	4,035	5,218
Shares O/S m #	105.6	105.6
EPS	38.2	49.4

Source: Banc of America Securities – Merrill Lynch Estimates

Outcome: Stock price at 15xFY11= Rs741

We get FY10 and FY11 EPS of Rs38.2 and Rs49.4. Versus the base case, this is accretive by 0.6% and 33% respectively. At Rs1000, the total inflow will be $340m, adequate to repay the debt in FY11. We note however, there will still be a funding gap in FY12, when UNSP needs to again repay debt of $360m.

Molasses – the pain continues

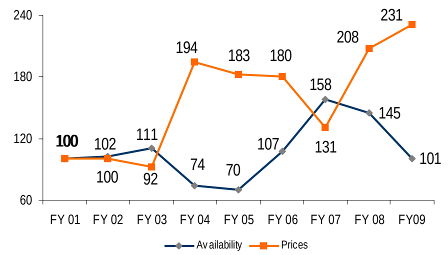
Molasses is a key raw material for making spirits. We estimate it accounts for 24% of sales followed by other flavor costs at 13% and packaging at 31.5% of sales. Molasses prices for UNSP have been rising sharply in FY09 – we estimate they are up 60% y-o-y. The rate of increase was sharpest in 2Q and 3Q with prices up ~90% y-o-y.

Molasses price to rise at least another 10% in FY10 for UNSP

Consensus view is that the worst of molasses price hike is behind us. We differ and expect molasses to rise another 10% in FY10. Our view is based on the severe shortfall of sugar cane production. Molasses is a by-product of sugar cane crushing by the sugar mills. Table 5 shows that sugar production in FY09 (Sept ending as the sugar season runs from Oct to Sept) is down 30% as a result of which molasses availability is also down 30%. If we go back into history in FY04 which was also a year of sharp molasses shortfall, prices had doubled that year. Based on this data, we believe there is upside to our 10% price increase expectation for FY09.

It is important to note that this table runs on a Sept end year basis because the sugar season runs from Oct to Sept. On the other hand, our forecasts for UNSP run on a March ending basis. This implies that in this table, molasses price for FY08 has implications for UNSP for 1HFY09 and FY09 has implications for UNSP for 2HFY09. Similarly FY09 in this table has implications for UNSP for 1HFY10.

Chart 7: Indexed molasses prod vs price trends



Source: Industry, Banc of America Securities – Merrill Lynch Estimates

UNSP has high sensitivity to molasses

We estimate every 1% increase in molasses price changes UNSP's domestic EBITDA by 2.5-3%. At the total EBITDA level, the impact is lower at ~1.5% since 40% of the EBITDA comes from W&M. Finally at net profit level the sensitivity rises further to 3.5-4% owing to very high interest costs.

Table 5: Sugarcane production and molasses price trends

Year end Sept (mn tons)	FY 01	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY09
Sugarcane production	296	297	287	234	237	281	356	344	247
Sugar cane used for non-sugar purpose	119	117	92	104	113	91	76	89	69
% of cane used by non-sugar users	40%	39%	32%	44%	48%	33%	21%	26%	28%
Sugar cane used by sugar mills	176.7	180.3	195.7	130.3	124.3	189.8	279.2	255.3	178.0
Molasses yield	5%	5%	5%	5%	5%	5%	5%	5%	5%
Molasses production	8.8	9.0	9.8	6.5	6.2	9.5	14.0	12.8	8.9
Molasses availability change	-1%	2%	9%	-33%	-5%	53%	47%	-9%	-30%
Molasses prices - Rs/100kg	221	222	204	430	404	398	289	460	510
		0%	-8%	111%	-6%	-1%	-27%	59%	11%

Source: Industry, Banc of America Securities – Merrill Lynch Estimates

Earnings Forecasts

Table 6: Summarized Earnings estimates - Consolidated

Rs mn	FY07A	FY08A	FY09E	FY10E	FY11E
Domestic volume - mn cases	66.4	73.9	86.8	99.0	113.1
Sales	38,642	59,605	87,435	98,712	109,824
- United Spirits Domestic	38,642	46,667	57,495	67,275	76,815
- W&M	-	12,939	29,940	31,437	33,009
EBIDTA - total	4,358	10,618	10,922	11,602	13,617
% chg	127%	144%	3%	6%	17%
EBITDA Margin - total	11.3%	17.8%	12.5%	11.8%	12.4%
- United Spirits Domestic	4,384	5,974	6,202	6,562	8,174
- W&M	(26)	4,644	4,720	5,040	5,443
Depreciation	338	741	780	821	864
EBIT	4,020	9,876	10,142	10,781	12,754
% chg	168%	146%	3%	6%	18%
Interest	873	5,448	6,141	5,471	7,260
Profit before OI	3,146	4,429	4,001	5,310	5,494
Other Income	876	1,063	650	300	-
Profit before tax	4,022	5,492	4,651	5,610	5,494
% chg	608%	37%	-15%	21%	-2%
Total Tax	1,049	2661	1628	1964	1923
Tax Rate	26%	48%	35%	35%	35%
Net Profit - before minority interest	2,973	2,831	3,023	3,647	3,571
Minority Interest	437	284	284	284	284
Share of associates	(0)	(7)			
Recurring Net Profit	2,535	2,539	2,739	3,362	3,287
% chg	100%	0%	8%	23%	-2%
Extro Income / (Expense)	3,135	181			
Reported Profit	5,670	2,721	2,739	3,362	3,287
Share Outstanding	82.9	88.6	88.6	88.6	88.6
EPS	30.6	28.7	30.9	38.0	37.1
% chg	46%	-6%	8%	23%	-2%

Source: Company, Banc of America Securities – Merrill Lynch Estimates

Table 7: Summarized Balance Sheet estimates - Consolidated

Rs mn	FY07A	FY08A	FY09E	FY10E	FY11E
Assets					
Gross Block (Net of Intang)	6,822	16,985	17,485	17,985	18,485
Net Fixed Assets	5,190	11,163	10,882	10,562	10,198
Goodwill on consolidations	11,324	53,260	53,260	53,260	53,260
Total Investments	2,044	2,119	2,114	2,114	2,114
Current Assets excl cash	13,152	29,272	41,269	46,592	51,837
Current Liabilities	7,264	11,514	16,875	19,051	21,196
Net Current Assets excl cash	5,888	17,758	24,394	27,541	30,641
Cash and Bank balances	5,778	5,438	6,405	2,526	3,310
Misc exp not w/o		735			
Total Assets	30,225	90,472	97,055	96,002	99,522
Liabilities					
Equity Share Capital	829	886	886	886	886
Share Premium Reserve	5,458	9894	9894	9894	9894
Reserves	7,406	9,993	12,682	15,994	19,230
Networth	13,692	20,773	23,461	26,773	30,010
Minority Interest	1,712	1,992	2,276	2,560	2,844
Deferred Tax Liability	19	18	18	18	18
Debt	14802	67689	71300	66650	66650
Total Liabilities	30,225	90,472	97,055	96,002	99,522

Source: Company, Banc of America Securities – Merrill Lynch Estimates

Table 8: Summarized Cash Flows - Consolidated

(Rs mn)	FY07	FY08	FY09E	FY10E	FY11E
Profit after tax & XO	6,107	3,005	3,023	3,647	3,571
Add depr	338	741	780	821	864
Cash bef W Cap changes	6,445	3,746	3,803	4,467	4,435
Working cap change	(2,463)	(12,605)	(5,902)	(3,146)	(3,100)
Cash from operations	3,981	(8,859)	(2,098)	1,321	1,335
(Incr) / Decr in Fixed Assets	(1,361)	(52,099)	(500)	(500)	(500)
(Incr) / Decr in Investments	440	(75)	5	-	-
Free cash flow	3,061	(61,033)	(2,593)	821	835
Incr / (decr) in Equity	(48)	4,493	-	-	-
Incr / (decr) in Debt	(630)	52,887	3,611	(4,650)	-
Dividend & Div tax payout	(237)	(159)	(51)	(51)	(51)
Total Cash from financing	(915)	57,222	3,561	(4,701)	(51)
Total cash flow	2,146	(3,811)	967	(3,879)	784
Opening cash	3,611	5,778	5,438	6,405	2,526
Closing cash	5,757	1,967	6,405	2,525	3,310

Source: Company, Banc of America Securities – Merrill Lynch Estimates

Table 9: Key Ratios - Consolidated

	FY07A	FY08A	FY09E	FY10E	FY11E
ROE	23%	15%	12%	13%	12%
ROCE	25%	13%	0%	6%	7%
Gearing	108%	326%	304%	249%	222%
Net Gearing	66%	300%	277%	240%	211%
Net Working Cap as % of sales	15%	30%	28%	28%	28%

Source: Company, Banc of America Securities – Merrill Lynch Estimates

Price objective basis & risk

United Spirits (UDSRF)

Our preferred valuation methodology is a target P/E multiple on one year forward EPS. Our target multiple for UNSP is 15x which on FY11E EPS of Rs39.9 (assuming trreasury stock sale at price of Rs600) gives us our price objective of Rs600. We believe this multiple is justified as it implies a 66% premium to the Sensex - in line with last 5-year average premium for UNSP to the Sensex. Moreover, this is lower than consumer sector average premium of 80% and factors in UNSP's higher regulatory exposure, relative lack of pricing power and higher gearing. Upside risks: Strategic stake sale at a premium, stronger demand and lower than expected molasses price rise. Downside risks: Inability to refinance the loan in FY11, slowdown in demand and higher than expected molasses price rise.

Analyst Certification

I, Vandana Luthra, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

In accordance with the SEBI (Foreign Institutional Investors) Regulations and with guidelines issued by the Securities and Exchange Board of India (SEBI), foreign investors (individuals as well as institutional) that wish to transact the common stock of Indian companies must have applied to, and have been approved by SEBI and the Reserve Bank of India (RBI). Each investor who transacts common stock of Indian companies will be required to certify approval as a foreign institutional investor or as a sub-account of a foreign institutional investor by SEBI and RBI. Certain other entities are also entitled to transact common stock of Indian companies under the Indian laws relating to investment by foreigners. Merrill Lynch reserves the right to refuse copy of research on common stock of Indian companies to a person not resident in India.
American Depositary Receipts (ADR) representing such common stock are not subject to these Indian law restrictions and may be transacted by investors in accordance with the applicable laws of the relevant jurisdiction.
Global Depository Receipts (GDR) and the Global Depository Shares of Indian companies, Indian limited liability corporations, have not been registered under the U.S. Securities Act of 1933, as amended, and may only be transacted by persons in the United States who are Qualified Institutional Buyers (QIBs) within the meaning of Rule 144A under the Securities Act. Accordingly, no copy of any research report on Indian companies' GDRs will be made available to persons who are not QIBs.

India - Consumer Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Bombay Rayon Fashions Ltd	BORYF	BRFL IN	Manish Sarawagi
	Godrej Consumer Products Ltd.	XGOCF	GCPL IN	Manish Sarawagi
	Hindustan Unilever	HINLF	HUVR IN	Vandana Luthra
	ITC Limited	ITCTF	ITC IN	Vandana Luthra
	Mcleod Russel India Ltd.	XCVFF	MCLR IN	Manish Sarawagi

India - Consumer Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Nestle India	XNTEF	NEST IN	Vandana Luthra
NEUTRAL				
	Asian Paints	XAPNF	APNT IN	Vandana Luthra
	Colgate India	CPIYF	CLGT IN	Vandana Luthra
	Dabur India	DBUIF	DABUR IN	Vandana Luthra
	Himatsingka Seid	HMKFF	HSS IN	Manish Sarawagi
	Pantaloon	PFIAF	PF IN	Vandana Luthra
	United Spirits	UDSRF	UNSP IN	Vandana Luthra
UNDERPERFORM				
	Arvind Ltd	ARVZF	ARVND IN	Manish Sarawagi
	Gokaldas Exports	GKLDF	GEXP IN	Manish Sarawagi
	Radico Khaitan	RKHAF	RDCK IN	Vandana Luthra
	Raymond Ltd	XRAMF	RW IN	Manish Sarawagi
	Shoppers' Stop	SHPSF	SHOP IN	Manish Sarawagi
	Titan Inds Ltd	TTNIF	TTAN IN	Manish Sarawagi
	Vishal Retail Ltd	XVHLF	VISH IN	Manish Sarawagi
	Welspun India	WPNIF	WLSI IN	Manish Sarawagi

iQmethod SM Measures Definitions

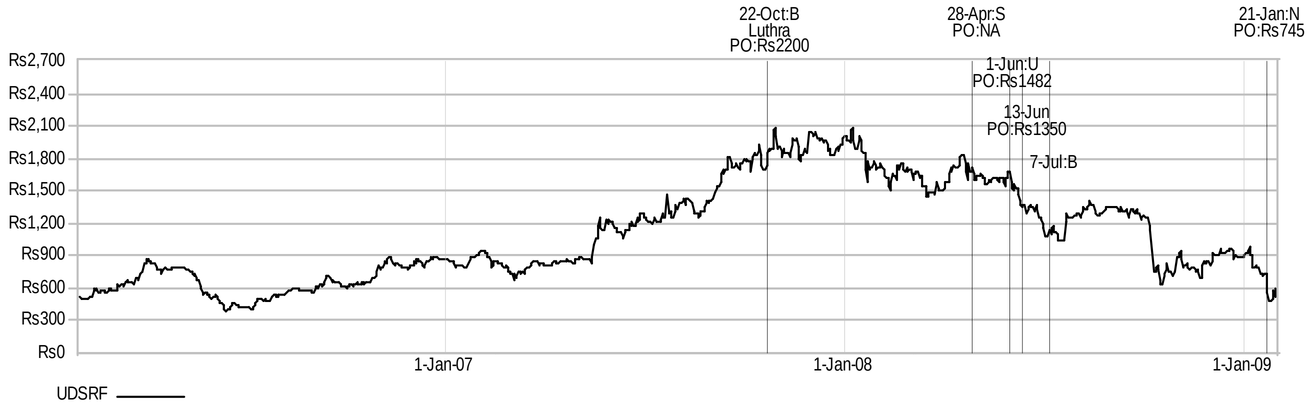
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

iQmethod SM is the set of Banc of America Securities-Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

iQdatabase ® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Banc of America Securities-Merrill Lynch.

Important Disclosures

UDSRF Price Chart



B : Buy, N : Neutral, S : Sell, U : Underperform, PO : Price objective, NA : No longer valid

"Prior to May 31, 2008, the investment opinion system included Buy, Neutral and Sell. As of May 31, 2008, the investment opinion system includes Buy, Neutral and Underperform. Dark Grey shading indicates that a security is restricted with the opinion suspended. Light grey shading indicates that a security is under review with the opinion withdrawn. The current investment opinion key is contained at the end of the report. Chart is current as of January 31, 2009 or such later date as indicated.

BAS-ML price charts do not reflect analysts' coverage of the stock at prior firms. Historical price charts relating to companies covered as of January 31, 2009 by former Banc of America Securities LLC (BAS) analysts are available to BAS clients on the BAS website."

Investment Rating Distribution: Beverages - Alcoholic Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	21	61.76%	Buy	1	6.25%
Neutral	6	17.65%	Neutral	4	80.00%
Sell	7	20.59%	Sell	0	0.00%

Investment Rating Distribution: Global Group (as of 01 Jan 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1297	38.46%	Buy	314	26.81%
Neutral	859	25.47%	Neutral	210	28.23%
Sell	1216	36.06%	Sell	229	20.71%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

FUNDAMENTAL EQUITY OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. *VOLATILITY RISK RATINGS*, indicators of potential price fluctuation, are: A - Low, B - Medium and C - High. *INVESTMENT RATINGS* reflect the analyst's assessment of a stock's: (i) absolute total return potential and (ii) attractiveness for investment relative to other stocks within its *Coverage Cluster* (defined below). There are three investment ratings: 1 - Buy stocks are expected to have a total return of at least 10% and are the most attractive stocks in the coverage cluster; 2 - Neutral stocks are expected to remain flat or increase in value and are less attractive than Buy rated stocks and 3 - Underperform stocks are the least attractive stocks in a coverage cluster. Analysts assign investment ratings considering, among other things, the 0-12 month total return expectation for a stock and the firm's guidelines for ratings dispersions (shown in the table below). The current price objective for a stock should be referenced to better understand the total return expectation at any given time. The price objective reflects the analyst's view of the potential price appreciation (depreciation).

Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. *Coverage Cluster* is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BAS-ML Comment referencing the stock.

In the US, retail sales and/or distribution of this report may be made only in states where these securities are exempt from registration or have been qualified for sale: United Spirits.

MLPF&S together with its affiliates beneficially owns one percent or more of the common stock of this company. If this report was issued on or after the 10th day of the month, it reflects the ownership position on the last day of the previous month. Reports issued before the 10th day of a month reflect the ownership position at the end of the second month preceding the date of the report: United Spirits.

The country in which this company is organized has certain laws or regulations that limit or restrict ownership of the company's shares by nationals of other countries: United Spirits.

The analyst(s) responsible for covering the securities in this report receive compensation based upon, among other factors, the overall profitability of Merrill Lynch, including profits derived from investment banking revenues.

Other Important Disclosures

Merrill Lynch Research policies relating to conflicts of interest are described at http://www.ml.com/media/43347.pdf.

"Merrill Lynch" includes Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S") and its affiliates, including BofA (defined below). "BofA" refers to Banc of America Securities LLC ("BAS"), Banc of America Securities Limited ("BASL"), Banc of America Investment Services, Inc ("BAI") and their affiliates. Investors should contact their Merrill Lynch or BofA representative if they have questions concerning this report.

Information relating to Non-US affiliates of Merrill Lynch and Distribution of Affiliate Research Reports:

MLPF&S, BAS, BAI, and BASL distribute, or may in the future distribute, research reports of the following non-US affiliates in the US (short name: legal name): Merrill Lynch (France): Merrill Lynch Capital Markets (France) SAS; Merrill Lynch (Frankfurt): Merrill Lynch International Bank Ltd, Frankfurt Branch; Merrill Lynch (South Africa): Merrill Lynch South Africa (Pty) Ltd; Merrill Lynch (Milan): Merrill Lynch International Bank Limited; MLPF&S (UK): Merrill Lynch, Pierce, Fenner & Smith Limited; Merrill Lynch (Australia): Merrill Lynch Equities (Australia) Limited; Merrill Lynch (Hong Kong): Merrill Lynch (Asia Pacific) Limited; Merrill Lynch (Singapore): Merrill Lynch (Singapore) Pte Ltd; Merrill Lynch (Canada): Merrill Lynch Canada Inc; Merrill Lynch (Mexico): Merrill Lynch Mexico, SA de CV, Casa de Bolsa; Merrill Lynch (Argentina): Merrill Lynch Argentina SA; Merrill Lynch (Japan): Merrill Lynch Japan Securities Co, Ltd; Merrill Lynch (Seoul): Merrill Lynch International Incorporated (Seoul Branch); Merrill Lynch (Taiwan): Merrill Lynch Securities (Taiwan) Ltd.; DSP Merrill Lynch (India): DSP Merrill Lynch Limited; PT Merrill Lynch (Indonesia): PT Merrill Lynch Indonesia; Merrill Lynch (KL) Sdn. Bhd.: Merrill Lynch (Malaysia); Merrill Lynch (Israel): Merrill Lynch Israel Limited; Merrill Lynch (Russia): Merrill Lynch CIS Limited, Moscow; Merrill Lynch (Turkey): Merrill Lynch Yatirim Bankasi A.S.; Merrill Lynch (Dubai): Merrill Lynch International Bank Ltd, Dubai Branch; MLPF&S (Zürich rep. office): MLPF&S Incorporated Zürich representative office.

This research report has been approved for publication in the United Kingdom by Merrill Lynch, Pierce, Fenner & Smith Limited and BASL, which are authorized and regulated by the Financial Services Authority; has been considered and distributed in Japan by Merrill Lynch Japan Securities Co, Ltd and Banc of America Securities - Japan, Inc., registered securities dealers under the Financial Instruments and Exchange Law in Japan; is distributed in Hong Kong by Merrill Lynch (Asia Pacific) Limited and Banc of America Securities Asia Limited, which are regulated by the Hong Kong SFC and the Hong Kong Monetary Authority; is issued and distributed in Taiwan by Merrill Lynch Securities (Taiwan) Ltd.; is issued and distributed in Malaysia by Merrill Lynch (KL) Sdn. Bhd., a licensed investment adviser regulated by the Malaysian Securities Commission; is issued and distributed in India by DSP Merrill Lynch Limited; and is issued and distributed in Singapore by Merrill Lynch International Bank Limited (Merchant Bank), Merrill Lynch (Singapore) Pte Ltd (Company Registration No.'s F 06872E and 198602883D respectively) and Bank of America Singapore Limited (Merchant Bank). Merrill Lynch International Bank Limited (Merchant Bank), Merrill Lynch (Singapore) Pte Ltd and Bank of America Singapore Limited (Merchant Bank) are regulated by the Monetary Authority of Singapore. Merrill Lynch Equities (Australia) Limited, (ABN 65 006 276 795), AFS License 235132 and Banc of America Securities Limited (pursuant to the Australian Securities and Investment Commission Class Order 03/1101 under paragraph 911A (2)(1) of the Corporations Act 2001) provide this report in Australia. No approval is required for publication or distribution of this report in Brazil.

Merrill Lynch (Frankfurt) distributes this report in Germany. Merrill Lynch (Frankfurt) is regulated by BaFin.

This research report has been prepared and issued by MLPF&S and/or one or more of its non-US affiliates. MLPF&S is the distributor of this research report in the US and accepts full responsibility for research reports of its non-US affiliates distributed to MLPF&S clients in the US. Any US person (other than BAS, BAI and their respective clients) receiving this research report and wishing to effect any transaction in any security discussed in the report should do so through MLPF&S and not such foreign affiliates.

BAS distributes this research report to its clients and to its affiliate BAI and accepts responsibility for the distribution of this report in the US to BAS clients, but not to the clients of BAI. BAI is a registered broker-dealer, member of FINRA and SIPC, and is a non-bank subsidiary of Bank of America, N.A. BAI accepts responsibility for the distribution of this report in the US to BAI clients. Transactions by US persons that are BAS or BAI clients in any security discussed herein must be carried out through BAS and BAI, respectively.

General Investment Related Disclosures:

This research report provides general information only. Neither the information nor any opinion expressed constitutes an offer or an invitation to make an offer, to buy or sell any securities or other financial instrument or any derivative related to such securities or instruments (e.g., options, futures, warrants, and contracts for differences). This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person. Investors should seek financial advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized. Any decision to purchase or subscribe for securities in any offering must be based solely on existing public information on such security or the information in the prospectus or other offering document issued in connection with such offering, and not on this report.

Securities and other financial instruments discussed in this report, or recommended, offered or sold by Merrill Lynch, are not insured by the Federal Deposit Insurance Corporation and are not deposits or other obligations of any insured depository institution (including, Bank of America, N.A.). Investments in general and, derivatives, in particular, involve numerous risks, including, among others, market risk, counterparty default risk and liquidity risk. No security, financial instrument or derivative is suitable for all investors. In some cases, securities and other financial instruments may be difficult to value or sell and reliable information about the value or risks related to the security or financial instrument may be difficult to obtain. Investors should note that income from such securities and other financial instruments, if any, may fluctuate and that price or value of such securities and instruments may rise or fall and, in some cases, investors may lose their entire principal investment. Past performance is not necessarily a guide to future performance. Levels and basis for taxation may change.

This report may contain a short-term trading idea or recommendation, which highlights a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Short-term trading ideas and recommendations are different from and do not affect a stock's fundamental equity rating, which reflects both a longer term total return expectation and attractiveness for investment relative to other stocks within its Coverage Cluster. Short-term trading ideas and recommendations may be more or less positive than a stock's fundamental equity rating.

Foreign currency rates of exchange may adversely affect the value, price or income of any security or financial instrument mentioned in this report. Investors in such securities and instruments, including ADRs, effectively assume currency risk.

UK Readers: The protections provided by the U.K. regulatory regime, including the Financial Services Scheme, do not apply in general to business coordinated by Merrill Lynch entities located outside of the United Kingdom. These disclosures should be read in conjunction with the BASL general policy statement on the handling of research conflicts, which is available upon request.

Officers of MLPF&S or one or more of its affiliates (other than research analysts) may have a financial interest in securities of the issuer(s) or in related investments.

Merrill Lynch is a regular issuer of traded financial instruments linked to securities that may have been recommended in this report. Merrill Lynch may, at any time, hold a trading position (long or short) in the securities and financial instruments discussed in this report.

Merrill Lynch, through business units other than BAS-ML Research, may have issued and may in the future issue trading ideas or recommendations that are inconsistent with, and reach different conclusions from, the information presented in this report. Such ideas or recommendations reflect the different time frames, assumptions, views and analytical methods of the persons who prepared them, and Merrill Lynch is under no obligation to ensure that such other trading ideas or recommendations are brought to the attention of any recipient of this report.