



United Spirits

STOCK INFO.	BLOOMBERG
BSE Sensex: 8,674	UNSP IN
	REUTERS CODE
S&P CNX: 2,679	UNSP.BO
Equity Shares (m)	100.2
52-Week Range	1,873/463
1,6,12 Rel. Perf. (%)	-34/-21/-22
M.Cap. (Rs b)	47.9
M.Cap. (US\$ b)	1.0

23 January 2009

Buy

Previous Recommendation: Buy

Rs478

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	29,619	2,973	41.2	902.9	11.6	2.6	19.3	16.2	1.5	9.9
03/08A	46,275	3,012	33.7	-18.3	14.2	1.9	12.4	12.1	2.1	9.3
03/09E	54,062	3,015	33.7	0.0	14.2	1.8	12.7	11.6	1.9	9.3
03/10E	61,659	4,248	47.5	40.9	10.1	1.5	15.1	13.2	1.6	7.7

Consolidated

- Results disappoint; downgrading estimates:** We are downgrading our EPS estimates from Rs46.7 to Rs33.7 for FY09 and from Rs67 and Rs47.5 for FY10. This follows disappointing results for 3QFY09 – 65% decline in PAT and 890bp margin erosion despite 20% volume growth. 60% increase in spirit prices and Rs2,000/ton increase in glass prices impacted performance. Though the management appears confident of rebound in margins due to 30% decline in molasses/ENA prices, we believe that United Spirits will continue to face YoY margin pressure for 2-3 quarters. We are lowering our FY09 and FY10 margin estimates to 16.3% and 17.8% v/s 18.8% in FY08.
- Debt repayment to put strain on financials:** Debt repayment is likely to put a strain of the financials of United Spirits. Repayment obligations stand at Rs5.7b in FY10 and Rs14.5b in FY11. The management has indicated sale of treasury stock (17% of equity) and is open to 49% stake sale in Whyte and Mackay, which has scotch stocks of GBP456m. However, de-leveraging could be a difficult task due to sharp decline across asset classes and treasury stock value (Rs10b).
- Entry of strategic partner can re-rate the stock; maintain Buy:** Of its 34.1% stake in United Spirits, UB Holdings has pledged 33% to provide top-up comfort to Kingfisher Airlines' lenders. Kingfisher Airlines, which has debt obligation exceeding Rs65b, has suffered loss of Rs6.8b in 9MFY09 and any positive cash flows are unlikely in the near term. Its poor financial health could be a drag on United Spirits' stock price. The stock trades at 14.2x FY09E and 10.1x FY10E earnings. We believe that the stock offers value, given the long-term structural growth story in IMFL and the company's strong market position. The divestment of treasury stock to a strong strategic investor could re-rate the stock significantly. We maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

(RS MILLION)

Y/E MARCH	FY08				FY09				FY08	FY09E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Net Sales	7,657	7,526	8,890	7,590	10,134	9,020	10,293	8,897	31,663	38,344
YoY Change (%)	16.9	19.1	15.3	15.9	32.3	19.9	15.8	17.2	6.9	21.1
Total Exp	5,943	6,047	7,182	6,237	7,982	7,230	9,229	7,662	25,359	32,103
EBITDA	1,714	1,479	1,708	1,353	2,152	1,790	1,063	1,236	6,304	6,242
Margins (%)	22.4	19.6	19.2	17.8	21.2	19.8	10.3	13.9	19.9	16.3
Depreciation	70	72	90	85	82	87	87	97	317	354
Interest	292	328	328	329	341	395	529	485	1,276	1,750
PBT From operations	1,352	1,079	1,290	939	1,729	1,308	447	654	4,711	4,138
Other income	49	112	96	107	72	125	60	226	294	483
PBT	1,400	1,191	1,386	1,047	1,801	1,433	507	880	5,004	4,621
Tax	505	389	505	396	630	494	201	318	1,794	1,643
Rate (%)	36.0	32.7	36.4	37.8	35.0	34.5	39.7	36.2	35.8	35.6
PAT	896	802	882	651	1,171	939	306	561	3,211	2,978
YoY Change (%)	98.5	42.5	14.7	14.1	30.8	17.0	-65.3	-13.8	-32	-7.3
Reported PAT	896	802	882	651	1,171	939	306	561	3,211	2,978

E: MOSt Estimates

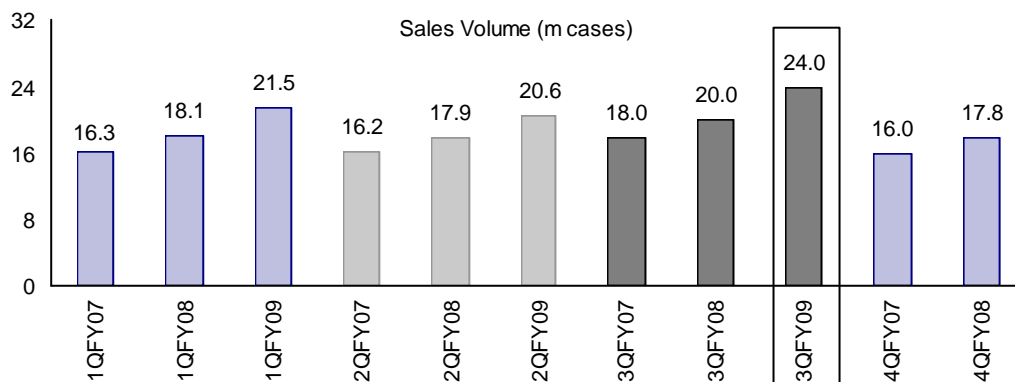
United Spirits' 3QFY09 results were below our expectations. Net sales grew 15.8% to Rs10.3b (estimate of Rs10.8b). Gross margin declined 960bp while EBITDA margin declined 890bp due to sharp increase in prices of molasses and ENA and higher packaging cost. EBITDA declined 38% YoY to Rs1.06b. Interest cost increased 61% YoY to Rs529m and PAT declined 65% YoY to Rs306m v/s our estimate of Rs1.06b.

Sales volume up 20%; first-line brands maintain strong momentum

Sales volume increased 20% on 19% growth in first-line brands. The company sold 24m cases in 3QFY09 and 60.9m cases in 9MFY09. *Royal Challenge* grew by 13%, *Antiquity* and *Signature* posted strong 33% and 28% growth, respectively. *McDowell No1* grew 17%. Favorable demographics and conducive regulatory changes boosted volumes. Management seems confident of sustaining volume growth in the coming quarters.

To increase its offering of quality international scotch, United Spirits has launched several Whyte and Mackay brands including *The DALMORE* and *ISLE of JURA*, which have gained a lot of acceptance amongst customers. The company has also launched products in the wine category (*Zinzi* and *Four Seasons*) to tap the growing wine market.

TREND IN SALES VOLUMES (M CASES)

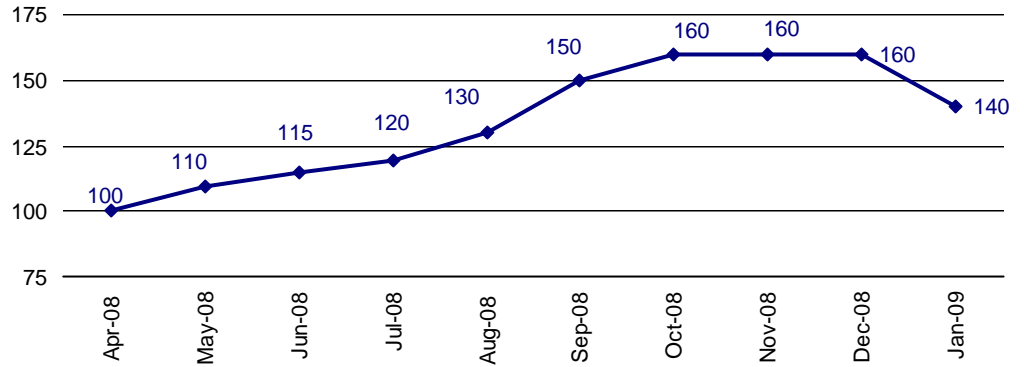


Source: Company/MOSL

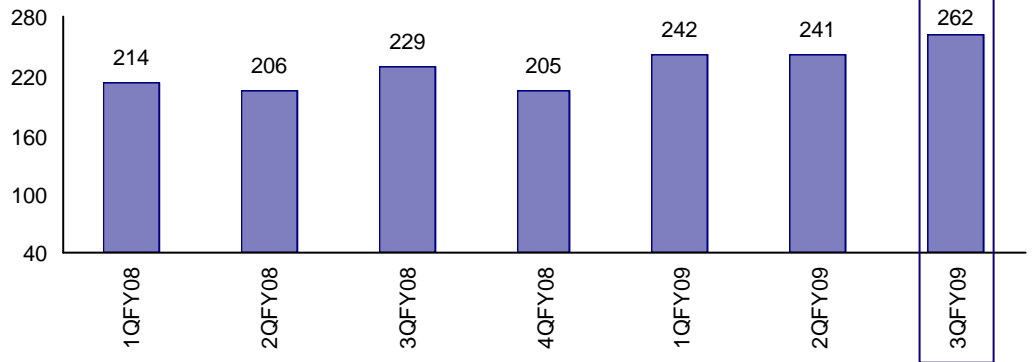
Spike in input costs leads to 960bp contraction in gross margins

Gross margins declined 960bp YoY to 38.9%, as the prices of key raw materials like molasses, ENA and glass witnessed a sharp increase. EBITDA margin declined 890bp YoY to 10.3%. Molasses and ENA prices were higher by 100% and 60% YoY, which pushed up costs by Rs1.45b during the quarter. Glass (cost increase of Rs250m) and other wet and dry goods (cost increase of Rs150m) also cost more. Sharp spike in molasses and ENA prices was due to delay in the start of sugar crushing season by 5-6 weeks, lower cane availability and restricted movement of spirit by sugar surplus states. Though the company has taken 8-9% price increase in select markets, the price increase was insufficient to ward off the rise in raw material prices.

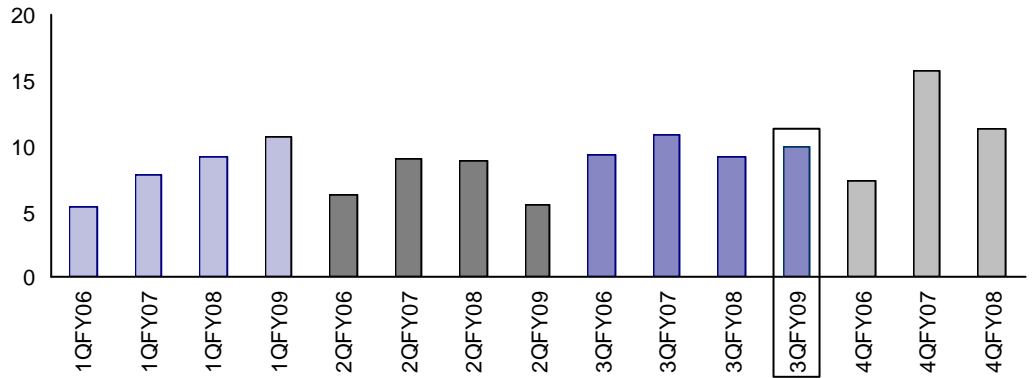
60% INCREASE IN SPIRIT PRICES SINCE APRIL 2008 (SPIRIT PRICE INDEX)



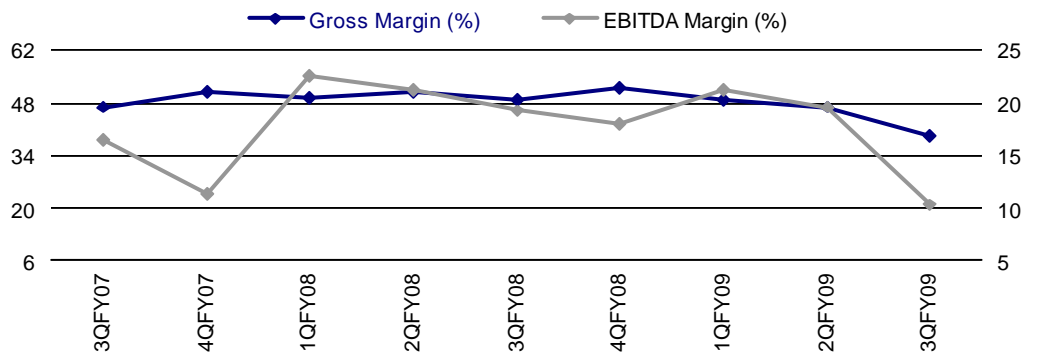
PER CASE COST OF IMFL RISES IN 3QFY09 (RS/CASE)



AD SPEND TO SALES RATIO MAINTAINED (%)



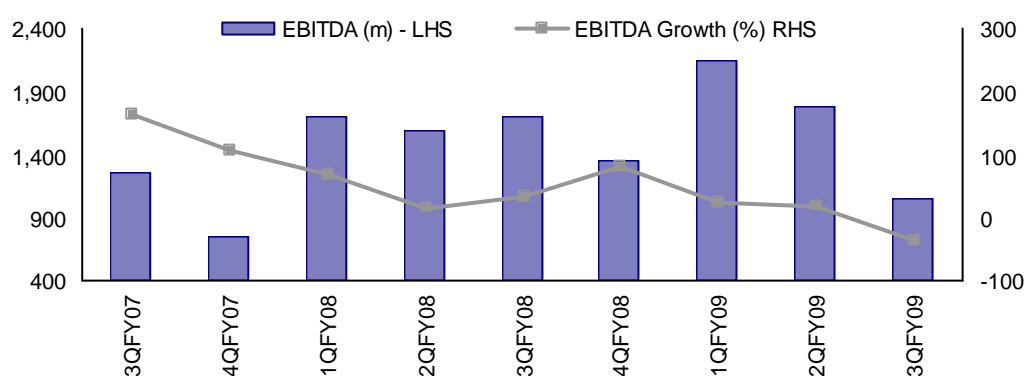
HIGHER RAW MATERIAL COST IMPACTED OPERATING MARGINS



Source: Company/MOSL

We believe that EBITDA margins would bounce back by 360bp in 4QFY09 from 10.3% in 3QFY09 but it would take the company quite some time to return to normal level of profitability, as (1) spirit prices have declined by 25% from the peak levels, but they are still 30% higher than the bottom; (2) glass prices have been rolled back by Rs500/ton against an increase of Rs2,000/ton; (3) given the declining inflation rate and impending elections, it will not be easy for United Spirits to push through price increases in the price regulated markets (55% of company's volumes).

EBITDA MARGINS UNDER PRESSURE



Source: Company/MOSL

Whyte and Mackay reports 168bp EBITDA margin decline

Whyte and Mackay (W&M) reported 8.5% revenue growth to GBP152m in 9MFY09. EBITDA grew 5% YoY to GBP53.9m; margins declined 168bp. Demand for scotch continued to grow unabated and the value of W&M stocks has increased 19% in FY09 and 45% from the time of acquisition based on the evaluation by leading industry expert provided by the company. Currently, the stock is valued at GBP457m (98.5m liters). The company has maintained EBITDA guidance of GBP60m in FY09.

W&M: SHARP INCREASE IN INVENTORY VALUE

	ON ACQUISITION	MAR-08	SEP-08	DEC-08
Inventory (m litre)	116.7	104.8	108.1	98.5
Value (m GBP)	384.2	409.5	478.2	456.9
Value/liter	3.3	3.9	4.4	4.6

Source: Company/MOSL

Sale of treasury stock and W & M stake not enough to de-leverage balance sheet

United Spirits has a total outstanding debt of Rs69b. The company has debt repayment obligations of Rs5.7b in FY10 and Rs14b in FY11. To honor the obligations, the management has indicated sale of treasury stock (17% of equity) to strategic/financial investor in addition to a 49% stake sale in W&M, which has scotch stocks of GBP456m. Assuming 20% discount to scotch stock value (GBP456m) and 40% discount to other fixed assets and brands (valued at GBP210m at the time of acquisition), 49% stake sale can fetch the company upto GBP240m, which can take care of the major part of GBP325m loan taken

in the holding company of W&M. The current value of the treasury stock (Rs10b) is inadequate to de-leverage United Spirits' balance sheet.

Kingfisher Airlines' financials might continue to be drag on stock price

Of its 34.1% stake in United Spirits, UB Holdings has pledged 33% to provide top-up comfort to Kingfisher Airlines' lenders. Kingfisher Airlines, which has debt obligation exceeding Rs65b, has suffered loss of Rs6.8b in 9MFY09 and any positive cash flows are unlikely in the near term. Its poor financial health could be a drag on USL stock price.

Downgrading estimates; maintain Buy

We are downgrading our EPS estimates from Rs46.7 to Rs33.7 for FY09 and from Rs67 and Rs47.5 for FY10. The downgrade is on account of input cost led margin erosion in standalone business and lower tax credit for holding company loans availed for W&M acquisition. We are factoring in 250bp decline in EBITDA margins in FY09 and 150bp margin expansion in FY10. We believe that margins would come to normal levels only by FY11. Assuming lower tax credit for loans in holding company, W&M acquisition will give a loss of Rs250m in FY09 and start contributing positively only by FY10.

The stock trades at 14.2x FY09E and 10.1x FY10E earnings. We believe that the stock offers value, given the long-term structural growth story in IMFL and the company's strong market position. The divestment of treasury stock to a strong strategic investor could re-rate the stock significantly. We maintain **Buy**.

CONSOLIDATED EPS CALCULATION (RS M)

WHYTE AND MACKAY FINANCIALS	FY08	FY09E	FY10E
Revenues	12,248	14,000	15,400
EBIDTA	4,160	4,800	5,313
EBIDTA (%)	34.0	34.3	34.5
Interest	182	240	240
Depreciation	538	520	560
PBT	3,441	4,040	4,513
Tax	1,298	1,495	1,670
Effective tax rate (%)	37.7	37.0	37.0
PAT	2143	2,545	2,843
Interest on Loans	3,349	3,600	3,600
Tax Credit	846.2	810	810
Tax Credit rate (%)	25.3	23.0	23.0
PAT	-360.3	-244.8	53.2
Other Subs PAT	261.3	282.3	246.3
Total Sub PAT	-99.0	37.5	299.5
EPS Accretion	-1.1	0.4	3.4
Add: Standalone PAT	3,111	2,978	3,948
Consolidated Profit	3,012	3,015	4,248
Fully diluted equity*	895	895	895
Standalone EPS	34.8	33.3	44.1
Consol EPS	33.7	33.7	47.5

*Adjusted for treasury stock

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 Rs33.7 and FY10 EPS estimate at Rs47.5.
- ☞ The stock trades at 14.2x FY09E and 10.1x FY10E earnings. 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	14.2	19.6	26.6
	FY10E	10.1	16.8	20.9
EV/EBITDA (x)	FY09E	9.3	12.4	17.1
	FY10E	7.7	10.6	13.4
EV/Sales (x)	FY09E	1.9	3.7	3.3
	FY10E	1.6	3.2	2.7
P/BV (x)	FY09E	1.8	4.7	22.2
	FY10E	1.5	4.1	17.4

SHAREHOLDING PATTERN (%)

	DEC-08	SEP-08	DEC-07
Promoter	36.6	36.6	37.0
Domestic Inst	4.3	2.3	1.7
Foreign	35.7	38.4	37.8
Others	23.5	22.7	23.5

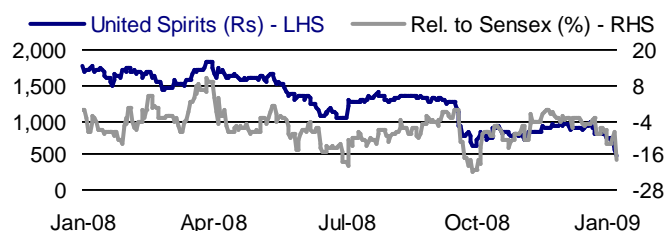
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY09	33.7	43.5	-22.5
FY10	47.5	59.5	-20.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
478	713	49.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(RS MILLION)			
Y/E MARCH	2007	2008	2009E	2010E	
Net Sales	27,148	42,717	50,616	57,727	
Other Operating Inc	2,470	3,559	3,446	3,932	
Total Revenue	29,619	46,275	54,062	61,659	
Change (%)		56.2	16.8	14.1	
Total Expenditure	-25,261	-35,657	-43,047	-48,455	
EBITDA	4,358	10,618	11,015	13,204	
Change (%)		143.6	3.7	19.9	
Margin (%)	14.7	22.9	20.4	21.4	
Depreciation	-338	-741	-874	-961	
Int. and Fin. Charges	-873	-5,448	-5,590	-5,745	
Other Income - Recurring	875	1,063	889	880	
Profit before Taxes	4,022	5,492	5,440	7,378	
Change (%)		36.6	-0.9	35.6	
Margin (%)	13.6	11.9	10.1	12.0	
Tax	1,049	2,661	2,425	3,130	
Tax Rate (%)	26.1	48.5	44.6	42.4	
Adjusted PAT	2,973	2,831	3,015	4,248	
Change (%)		-4.8	6.5	40.9	
Margin (%)	10.0	6.1	5.6	6.9	
Non-rec. (Exp)/Income	3,135	181	0	0	
Reported PAT	6,107	3,012	3,015	4,248	

BALANCE SHEET		(RS MILLION)			
Y/E MARCH	2007	2008	2009E	2010E	
Share Capital	829	886	895	895	
Reserves	12,863	19,887	22,902	27,150	
Minority Interest	1,712	1,992	0	0	
Net Worth	15,405	22,765	23,797	28,045	
Loans	14,802	67,689	71,394	71,360	
Deferred Tax Liabilities	19	19	19	19	
Capital Employed	30,225	90,472	95,209	99,423	
Gross Block	6,822	16,985	18,185	19,435	
Less: Accum. Deprn.	-1,764	-6,357	-7,231	-8,192	
Net Fixed Assets	5,057	10,628	10,954	11,243	
Capital WIP	133	534	250	300	
Goodwill	11,324	53,260	53,260	53,260	
Investments	2,044	2,119	2,119	2,119	
Curr. Assets, L&A	18,930	34,710	41,470	46,902	
Inventory	3,553	14,850	17,774	20,271	
Account Receivables	3,991	8,370	10,368	11,825	
Cash and Bank Balance	610	1,068	1,700	2,158	
Bank Deposit	5,168	4,370	4,370	4,370	
Others	5,608	6,052	7,258	8,277	
Curr. Liab. and Prov.	7,264	11,513	13,579	15,136	
Account Payables	4,439	8,520	10,368	11,825	
Other Liabilities	1,610	1,783	2,000	2,100	
Provisions	1,214	1,211	1,211	1,211	
Net Current Assets	11,666	23,196	27,891	31,766	
Msc Expenses	0	735	735	735	
Application of Funds	30,225	90,472	95,209	99,423	

E: MOST Estimates

RATIOS		(RS MILLION)			
Y/E MARCH	2007	2008	2009E	2010E	
Basic (Rs)					
EPS	41.2	33.7	33.7	47.5	
Cash EPS	27.7	34.3	30.9	40.3	
BV/Share	185.8	257.0	266.0	313.5	
DPS	2.5	1.5	1.5	2.5	
Payout %	6.1	4.5	4.4	5.3	
Valuation (x)					
P/E	11.6	14.2	14.2	10.1	
Cash P/E	17.3	13.9	15.5	11.9	
EV/Sales	1.5	2.1	1.9	1.6	
EV/EBITDA	9.9	9.3	9.3	7.7	
P/BV	2.6	1.9	1.8	1.5	
Dividend Yield (%)	0.5	0.3	0.3	0.5	
Return Ratios (%)					
RoE	19.3	12.4	12.7	15.1	
RoCE	16.2	12.1	11.6	13.2	
Working Capital Ratios					
Debtor (Days)	49	66	70	70	
Asset Turnover (x)	1.0	0.5	0.6	0.6	
Leverage Ratio					
Debt/Equity (x)	1.0	3.0	3.0	2.5	

CASH FLOW STATEMENT		(RS MILLION)			
Y/E MARCH	2007	2008	2009E	2010E	
OP/(loss) before Tax	4,020	9,876	10,141	12,243	
Int./Div. Received	875	1,063	889	880	
Depreciation and Amort.	338	741	874	961	
Interest Paid	-873	-5,448	-5,590	-5,745	
Direct Taxes Paid	1,049	2,661	2,425	3,130	
Incr/Decr in WC	2,838	11,530	4,695	3,875	
CF from Operations	473	-7,958	-806	1,334	
Extraordinary Items	2,627	0	0	0	
(Incr)/Decr in FA	-305	-52,099	-1,200	-1,250	
(Pur)/Sale of Investments	398	-75	0	0	
Msc Exp		-735	0	0	
CF from Invest.	2,721	-52,909	-1,200	-1,250	
Issue of Shares	-48	4,522	171	270	
(Incr)/Decr in Debt	644	-52,887	-3,705	34	
Dividend Paid	279	176	189	316	
Others	1,321	3,294	-1,048	453	
CF from Fin. Activity	350	60,527	2,638	373	
Incr/Decr of Cash	3,543	-340	633	457	
Add: Opening Balance	2,234	5,778	5,438	6,070	
Closing Balance	5,778	5,438	6,071	6,528	



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Disclosure of Interest Statement	United Spirits
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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