

United Spirits (UNSP.NS - INR 865.10) Buy

Company Update

Shaken but not stirred...

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Investment Conclusion

□ We acknowledge the timing of the disclosures leaves a lot to be desired and believe these issues should have been highlighted earlier by management. However, given the notional nature of the losses and the possibility of a partial/full recovery in the years ahead, we are not too concerned about these developments and believe the long-term value of the franchise remains unaffected. Also, we do not believe the stock deserves a de-rating owing to these developments in the medium term. We expect the Street reaction to die down in a day or two and believe investors should use every fall as an opportunity to build a position in the stock. We reiterate our BUY with an unchanged target price of INR1,096.

Summary

- United Spirits reported a loss of INR4bn in its recently announced audited and consolidated FY09 results.
- However, the core business profitability is in line with our estimates and the losses are on account of: a) notional Fx loss, and b) mark-to-market actuarial loss on pension liabilities in W&M business.

FY Mar	2008A		2009E		2010E		2011E	
Currency INR	Actual	Old	New	Old	New	Old	New	
Total revenues (m)	42717.0	51276.0	51276.0	59539.0	59539.0	69043.0	69043.0	
Adj revenues (m)	54958.0	70135.0	70135.0	81196.0	81196.0	79296.0	79296.0	
EBITDA % margin	24.90	21.40	21.40	20.30	20.30	20.30	20.30	
Adj EBITDA margin	19.30	15.60	15.60	14.90	14.90	14.60	14.60	
EPS	28.7	32.7	32.7	44.9	44.9	56.2	56.2	
P/E (adj)	29.9	26.3	26.3	19.1	19.1	15.3	15.3	

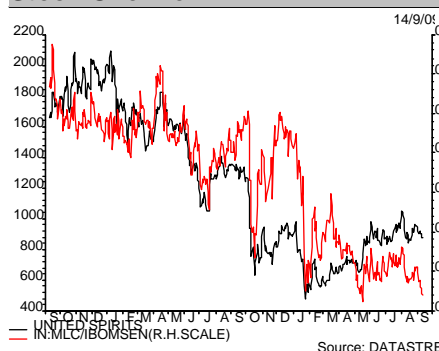
Market Data

Market Cap (mn)	93355
Market Cap (US\$ mn)	1926
Shares Outstanding (mn)	107.9
6mth Daily T/O (US\$ mn)	6.30
Free float (%)	63.40
Share per ADR	N/A

Financial Summary

Proj 3-Yr EPS Grth(%)	25.4
ROE (%)	13.6
Debt / Capital (%)	86.0
Dividend Yield (%)	0.22
P/E (x)	19.1

Stock Overview



Reuters	UNSP.NS
Bloomberg	UNSP IN
ADR	
Performance	1M 3M 12M
Absolute %	-3.4 -1.8 -34.4
Rel. Market %	-7.9 -8.0 -43.1
Rel. Sector %	N/A N/A N/A
52 Week Range	1334.50 - 478.30

Stock Rating

Target Price

New: Buy	New: INR 1096.00
Old: Buy	Old: INR 1096.00

Sector View: Bullish

Consolidated FY09 results: United Spirits reports a loss of INR4.1bn

United spirits (USL) announced its consolidated results recently. A few quick points are mentioned below:

- The company reported revenues of INR55.7bn, which represents growth of 18% for the consolidated entity. This is significantly ahead of our revenue expectations of INR51.3bn.
- **At the consolidated entity level, the company reported an EBITDA of INR10.9bn, which is largely in line with our expectation of INR11bn.**
- However, the surprise is in the below-line items (three one-time exceptional items that have been discussed in detail later in the note). Post all the exceptional items, the company reported a loss of INR4.0bn. This is against our profit expectation of INR2.8bn.

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Figure 1: Consolidated annual results

(INR mn)	Year ended		% Chg
	FY09	FY08	
Net sales	55,719	47,338	17.7
EBIDTA	10,892	10,787	1.0
Depreciation	926	741	25.0
Interest	7,176	5,448	31.7
PBT	2,790	4,598	(39.3)
Tax	916	2,661	(65.6)
Adjusted PAT	1,874	1,937	(3.3)
Pension plan loss/(gain)	1,746	(976)	N.A
Exchange Loss	3,809	82	N.A
Onerous lease provision	404	0	N.A
Other exceptional Items	0	(181)	N.A
Reported PAT	(4,085)	3,012	N.A
Minority interest	(1)	291	N.A
Consolidated PAT	(4,084)	2,721	N.A
No. of shares (mn)	100	100	
EBIDTA margins (%)	19.5	22.8	
Adjusted EPS (INR)	74.8	77.4	(3.3)

Source: Company, Nomura research

Three exceptional Items take their toll on the company's profitability

In the consolidated results, the company announced three exceptional non-cash losses. We have tried to analyse the following in detail below:

Foreign exchange loss of INR3.8bn: USL had taken a loan of £650mn for the acquisition of the scotch whiskey manufacturer Whyte & Mackey, of which USD611mn (~£312mn) resided in a 100% subsidiary called USLUK. This resulted in an asset-liability currency mismatch, the loan was in USD but the acquisition happened in GBP.

Hence, the company had a notional loss of GBP121m or INR9.4bn on account of the currency movements, of which it booked INR3.8bn in FY09 and the residual amount, INR5.6bn, will be amortised till 2011.

However, we remain unperturbed by this for two reasons:

- 1) The losses are purely notional in nature and do not affect the cash profits of the company in any way. These notional Fx losses are booked on long-term liabilities and, hence, should not have an impact near-term core business profits in any way.
- 2) The losses have been booked as on 31 March 2009 and since the GBD-USD currency has moved significantly in favour on USL. Assuming the current exchange rate of 1.6538 (as against the exchange rate of 1.4311 on 31 March) the total notional loss would be INR5bn, which means the company needs to book only INR1.2bn additionally over a two-year period.

Figure 2: Sharp reduction in Fx losses

Total loan amount (USD mn)	619
Loan balance as on 31st March, 2008 (GBP mn)	311
Loan balance as on 31st March, 2009 (GBP mn)	432
Notional loss as on 31st March (GBP mn)	121
Loan balance as on 14th September 2009 (GBP mn)	374
Notional loss as on 14 September (GBP mn)	63
Reduction (%)	48
Total residual losses to be amortised till FY11 (INR mn)	1,234

Source: Nomura research

Actuarial loss on pension of INR1.7bn: Again, this is on the basis of expected returns on investments and is purely notional in nature and, hence, does not have us concerned. With the market conditions improving significantly, we believe a large part of these losses are likely to be recouped in FY10E.

However, what we remain concerned about is the possible additional funding requirements in W&M, pending discussions with trustees and independent advisors.

Valuations: a different way of looking at them

Though the above-mentioned developments are negative for the company's balance sheet in the near term, we would like to highlight that both of these can reverse in the following years resulting in similar notional gains.

Hence, we are not too concerned about these developments and believe the long-term value of the franchise remains unaffected. Also, we do not believe the stock deserves a de-rating owing to these developments in the medium term. We expect the Street reaction to die down in a day or two.

We have tried to reconcile our existing valuation technique with an SOTP valuation assigning different multiples to the domestic business and Whyte & Mackay owing to the difference in the business model of these entities.

We note that even after assigning a depressed EV/EBITDA multiple of 10x FY11E EBITDA to Whyte & Mackay and an EV/EBITDA multiple of 15x to the domestic business (which is in line with the multiple of the other consumer companies in our coverage universe), we arrive at a value of INR1,230 per share for United Spirits, which is a 12% premium to our target price of INR1,096.

This assures us that we have been conservative in valuing United Spirits and do not see too much risk to our positive stance on the company.

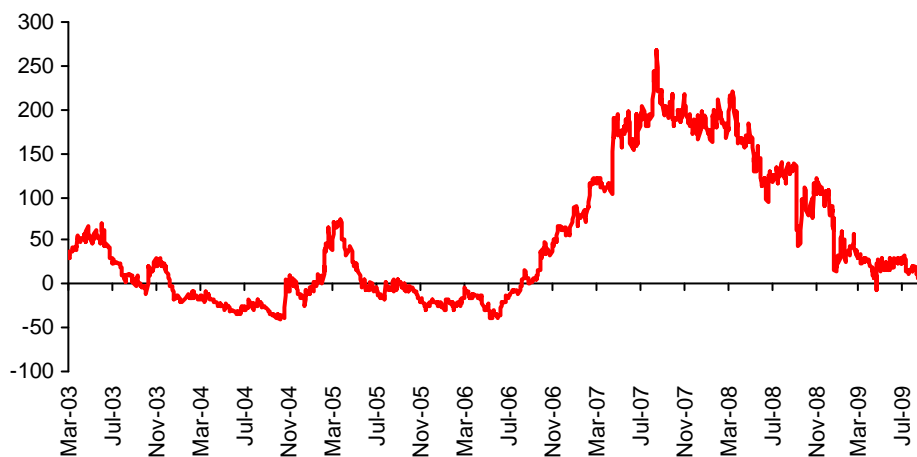
Figure 3: United Spirits – SOTP

Sum-of-the-parts valuation (INR mn)

Domestic business

	FY09	FY10	FY11
EBITDA	6,510	7,320	8,979
Cases Sold	87.8	99.2	112.1
EBITDA per case	74.1	73.8	80.1
W&M EBITDA	4,748	5,030	5,328
Total debt	70,948	55,448	55,448
of which			
Domestic debt	17,737	15,963	15,963
W&M debt	53,211	39,484	39,484
EV/EBITDA multiple for domestic business	15		
EV/EBITDA multiple for W&M	10		
EV for domestic business	134,686		
EV for W&M	53,280		
Equity value for domestic business	118,723		
Equity value for W&M	13,796		
Total equity value	132,518		
Fully diluted equity capital	107.8		
Value per share (INR)	1,229.9		

Source: Company, Nomura estimates

Figure 4: United Spirits: Premium/discount to Sensex

Source: Bloomberg, Nomura research

Conclusion

We acknowledge that the timing of the disclosures leaves a lot to be desired and believe these issues should have been highlighted earlier by management. However, given the notional nature of the losses and the possibility of a partial/full recovery in the years ahead, we are not too concerned about these developments and believe the long-term value of the franchise remains unaffected. The domestic entity remains on a very strong footing and there is no impact on the core business profitability. Also, we do not believe the stock deserves a de-rating owing to these developments in the medium term. We expect the Street reaction to die down in a day or two and believe investors should use every fall as an opportunity to build positions in the stock. We reiterate our BUY with an unchanged target price of INR1,096.

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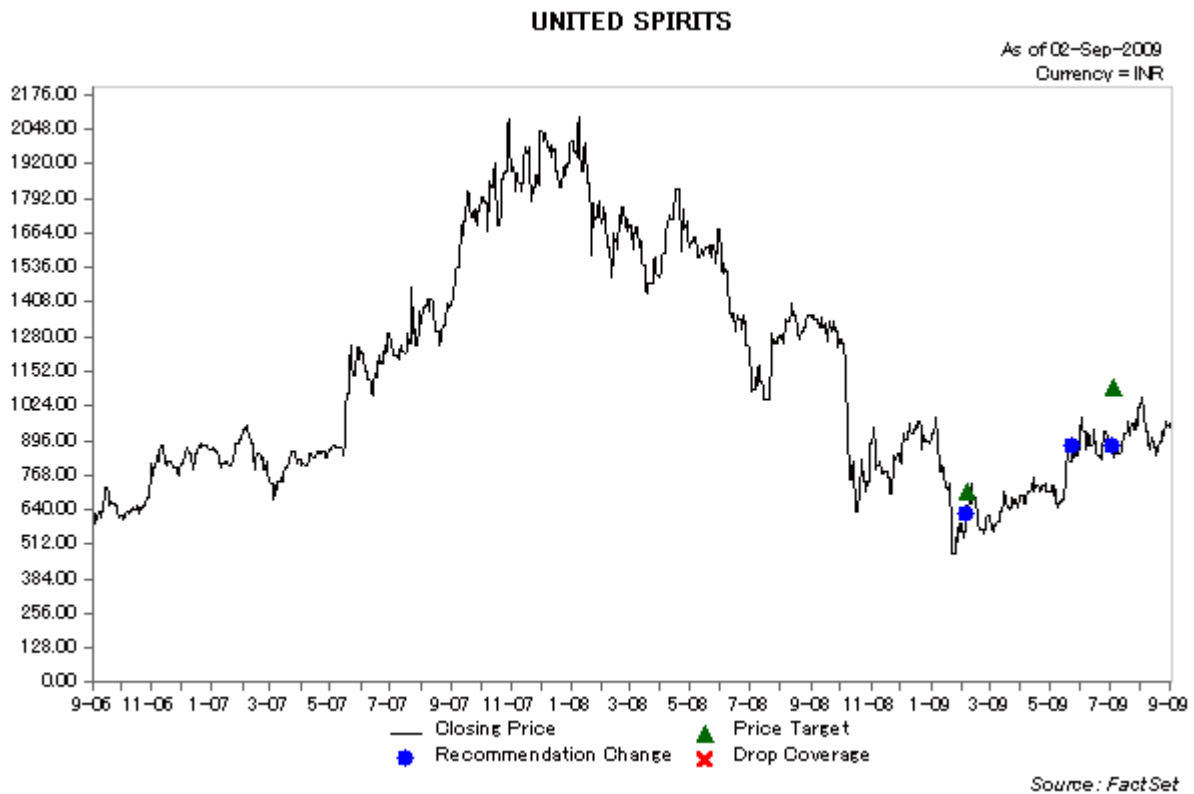
Company Description:

United Spirits dominates the Indian liquor industry with a volume share of more than 40% and is the only alcoholic beverage company in the country with a presence across all segments and all price points. It has a portfolio of nearly 145 brands, of which 17 are millionaire brands.

Important Disclosures:

United Spirits (UNSP.NS)**INR 865.10 (14-Sep-2009)****Buy / Bullish**

Rating and Price Target Chart:



Currency=INR

Date	Closing Price	Rating	Price Target
07-Jul-09	870.50		1096.00
07-Jul-09	870.50	Buy	
27-May-09	870.45	Reduce	

Date	Closing Price	Rating	Price Target
07-Feb-09	615.75		708.00
07-Feb-09	615.75	Buy	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART.

Valuation Methodology: We value UNSP at an EV/EBITDA multiple of 13x on FY10E earnings.**Risks Which May Impede the Achievement of the Price Target:** Worsening of profitability in the domestic business owing to higher raw material costs is a key downside risk to our BUY call on the stock.

Important Disclosures Continued:

Company Name	Ticker	Price	Price Date	Stock / Sector Rating
United Spirits	UNSP.NS	INR 865.10	14-Sep-2009	Buy / Bullish

All share prices mentioned are closing prices unless otherwise stated.

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As at 30 June 2009.

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- A rating of "3", or "**Reduce**", indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months.
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- A rating of "4", or "**Reduce**", indicates that the analyst expects the stock to underperform the Benchmark by 5% or more but less than 15% over the next six months.
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- A rating of "1", or "**Strong buy**" recommendation indicates that upside is more than 20%.
- A rating of "2", or "**Buy**" recommendation indicates that upside is between 10% and 20%.
- A rating of "3", or "**Neutral**" recommendation indicates that upside or downside is less than 10%.
- A rating of "4", or "**Reduce**" recommendation indicates that downside is between 10% and 20%.
- A rating of "5", or "**Sell**" recommendation indicates that downside is more than 20%.

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