20 July 2010 | 7 pages

United Spirits (UNSP.BO)

Equity

Buy: 1QFY11 Ahead of Estimates; W&M Imponderables Remain

- **Results ahead of expectations** — Recurring PAT rose 12.5% YoY to Rs1.21bn; ahead of our expectations of Rs1bn and in line with consensus estimates. EBITDA margins increased 135bps YoY and 420bps QoQ to 19.6% benefiting from the high gross margins (+320bps YoY, flat QoQ). Interest expense remained at heightened levels reflecting the refinanced W&M debt now sequestered in the parent's balance sheet and higher working capital loans.

- **AP de-stocking leads to subdued volume growth** — Revenue growth of ~18% YoY to Rs14.7bn reflects various changes in accounting bases (re-grouping of sales/A&SP expenses ex tie up units). Like to like, revenues rose ~11% YoY, comprising 6% YoY volumes and the rest due to mix/price increases. Mgmt noted that volume growth during the Q was adversely impacted by de-stocking in the state of Andhra Pradesh due to a fresh tendering process for retail licenses. Ex AP, mgmt mentioned that growth was ~15% YoY.

- **Gross contribution / case expanded QoQ** — Contribution per case increased by Rs29/case to ~Rs249/case. The results on a YoY basis are meaningless, given various changes in accounting policy. This Rs29 / case is 'pure profit' - driven by mix / pricing and generates an additional Rs1bn QoQ - which is the primary driver of the QoQ EBITDA growth.

- **Mgmt outlook positive** — Mgmt indicated in a press interview (Source: CNBC-TV18) that the AP issue should be resolved in 2Q. Cost pressures are expected to abate in 2HFY11 – in line with expectations. Costs in 2Q are expected to remain at current levels. W&M EBITDA for 1QFY11 was £5.93m (+9% YoY). No commentary (yet) on W&M (branded) strategy going forward.

- **Debt levels elevated** — Consolidated net debt levels are ~Rs52bn, up Rs4bn Q/Q. We reckon most of these funds have been raised for working capital.

Buy/Medium Risk	1M
Price (20 Jul 10)	Rs1,391.50
Target price	Rs1,452.00
Expected share price return	4.3%
Expected dividend yield	0.2%
Expected total return	**4.5%**
Market Cap	Rs174,765M US$3,709M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	1,174	13.25	-49.0	105.0	5.9	6.8	0.1
2009A	3,830	37.19	180.7	37.4	6.0	17.2	0.1
2010E	4,218	34.96	-6.0	39.8	3.7	12.1	0.2
2011E	6,571	54.46	55.8	25.6	3.2	13.5	0.3
2012E	8,552	70.87	30.1	19.6	2.8	15.3	0.3

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

1QFY11 Results Summary

EBITDA / case improved 19% YoY and 42% QoQ to ~Rs108 /case; well ahead of our estimate of Rs90/case

Figure 1. United Spirits (Parent)-Per Case Analysis

	1QFY10	4QFY10	1QFY11	% Y/Y	% QoQ
Cases sold (m)	25.2	25.7	26.7	6.0	3.9
Revenue / case	493	487	548	11.2	12.5
Material costs / case	285	267	299	5.0	11.8
Contribution /case	**208**	**220**	**249**	**19.7**	**13.3**
Other costs/case	120	149	144	19.8	-3.7
EBITDA / case	**91**	**76**	**108**	**19.4**	**42.2**

Source: Company Reports

Like-for-like revenue growth of +11% YoY was driven by underlying volume growth of +6%YoY during Q

Parent EBITDA margins expanded ~420bps QoQ and ~135bps YoY to 19.6%

Input costs were lower YoY on last year's high base –material cost per case increases 5% YoY; gross margins expanded 320bps YoY to 45.7%

Interest costs for the parent company increased 63% Y/Y – in line with the trends seen over the last few quarters

Recurring PAT increased 13% YoY to Rs1.21bn, ahead of our estimate of Rs1bn. Reported PAT in 1QFY10 included Rs700m of treasury stock sale proceeds

Figure 2. United Spirits – 1QFY11 Results (Rs Mn)

	1QFY10	4QFY10	1QFY11	% Y/Y	% QoQ
Gross Sales	23,702	23,264	29,012	22.4	24.7
Excise Duty	11,285	10,743	14,382	27.4	33.9
Net Sales	**12,417**	**12,521**	**14,630**	**17.8**	**16.8**
Other operating income	63	142	77	20.8	-46.0
Total income	**12,481**	**12,663**	**14,706**	**17.8**	**16.1**
Total Expenditure	10,198	10,708	11,818	15.9	10.4
EBITDA	**2,283**	**1,955**	**2,888**	**26.5**	**47.7**
EBITDA Margin (%)	*18.3*	*15.4*	*19.6*	*135 bps*	*420 bps*
Interest	592	1,023	965	63.0	-5.6
Depreciation	80	114.1	91	13.9	-20.1
Other Income	719	4	(8)	nm	nm
PBT	**2,329**	**822**	**1,823**	**-21.7**	**121.7**
Tax	553	254	613	10.7	141.4
Tax Rate (%)	*23.8*	*30.9*	*33.6*	*985 bps*	*274 bps*
PAT	**1,776**	**569**	**1,211**	**-31.8**	**112.9**
Exceptional Items	700	(91)	-		
Adjusted PAT	**1,076**	**660**	**1,211**	**12.5**	**83.5**
Cost Details					
Raw Material Consumed	7,177	6,873	7,983	11.2	16.1
% of Sales	*57.5*	*54.3*	*54.3*	*-323 bps*	*0 bps*
Employee Expenses	681	752	766	12.5	1.8
% of Sales	*5.5*	*5.9*	*5.2*	*-25 bps*	*-73 bps*
Selling & Administrative Expenses	883	1,498	1,390	57.5	-7.2
% of Sales	*7.1*	*11.8*	*9.5*	*238 bps*	*-238 bps*
Other Expenses	1,457	1,585	1,680	15.3	6.0
% of Sales	*11.7*	*12.5*	*11.4*	*-25 bps*	*-109 bps*

Source: Company Reports

United Spirits

Company description

United Spirits is the largest player in India's branded spirits market with more than a 55% market share. It pursues an inorganic growth strategy, acquiring second-largest Indian liquor manufacturer Shaw Wallace and scotch manufacturer Whyte & Mackay. While the Shaw Wallace acquisition enhanced its competitive position, raising its market share in branded spirits market, Whyte & Mackay gave it access to scotch inventory to drive the next leg of its

India growth strategy. UNSP also acquired French winemaker Bouvet Ladubay - the wine arm of champagne major Taittinger and plans to introduce its products to the Indian market. UNSP also owns the Bangalore IPL cricket team ‘Royal Challengers' in a 100%-owned subsidiary.

Investment strategy

We rate United Spirits shares Buy/Medium Risk (1M) with a target price of Rs1452. The company is well positioned to benefit from India's organized liquor market that is growing at a rate of ~10-15% (driven by rising disposable incomes, favorable demographics and a shift in consumption patterns). Over the last year, the stock had underperformed due to concerns on high input costs; which we believe are now baked into expectations as well as estimates and the probability of input costs further surprising negatively is limited. UNSP has demonstrated the ability to pare discretionary cost items that buffer EBITDA growth. UNSP will focus on de-leveraging its balance sheet, which should help allay concerns on the high gearing and interest cost burden. Whyte & Mackay acquisition remains a long-term strategic fit and should significantly enhance UNSP's plans to expand its presence in the Indian premium whisky segments and provide UNSP access to the European 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.

Valuation

Our target price of Rs1452 is based on a two-part EV/EBITDA methodology. We value the domestic operations at 15x FY11E EV/EBITDA. The multiple is at a 25% premium to international peers. We think this is merited, given that: a) volume growth in India continues at mid teen levels vs. nominal growth in developed markets, b) With >55% market share, UNSP's market positioning in a high growth market is attractive, and c) India's demographic story is also attractive from a longer term alcohol consumption story. We value the W&M EBITDA stream at 9x (which is a ~25% discount to the global majors). We think this discount is merited, because of W&M's status as a bulk scotch manufacturer (primary revenue streams are of bulk scotch, though it does have a burgeoning branded scotch whisky business). Over the longer term, we think that W&M could re-rate, especially as management focuses on building the branded business. The bulk scotch inventory also provides the company with a real option of selling down part of the stock and reducing overall debt levels.

Risks

We rate United Spirits shares Medium Risk, instead of High Risk as suggested by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. We believe that this is warranted given that UNSP benefits from favourable demographic trends and consumption patterns in India, which offer better growth prospects. Further, strong domestic volume growth continuing in a challenging environment is an encouraging trend. The key downside risks to our rating and target price include: 1) the liquor industry is highly regulated and thus 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) a significant uptrend or delay in correction of molasses/ENA and packaging costs could adversely impact operating margins; 3) high interest expenses may impact earnings growth, if United Spirits is unable to deleverage its balance sheet over the medium term.

Appendix A-1

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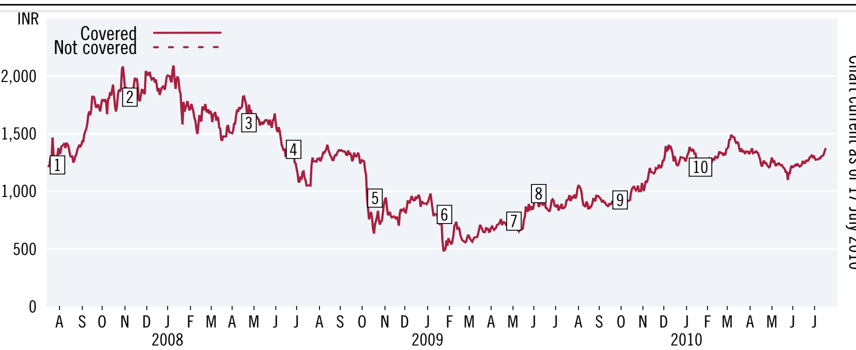
United Spirits (UNSP.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy
Covered since May 6 2008



	Date	Rating	Target Price	Closing Price
1	29-Jul-07	1L	*1,463.00	1,246.45
2	8-Nov-07	1L	*2,164.00	1,856.20
3	24-Apr-08	1L	*2,037.00	1,752.00
4	26-Jun-08	1L	*1,574.00	1,327.30
5	20-Oct-08	*1M	*930.00	712.80
6	24-Jan-09	*3H	*454.00	478.25
7	4-May-09	3H	*628.00	731.60
8	7-Jun-09	*3M	*901.00	931.20
9	30-Sep-09	*1M	*1,142.00	914.60
10	21-Jan-10	1M	*1,452.00	1,222.70

* Indicates change

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