United Spirits (UNSP.BO)

Target price change ☑
Estimate change ☑

Buy: High but Expect More Kick; Raising TP to Rs2164

- **Raising target price** – Revisiting estimates and raising TP to Rs2164 based on 18xFY09E EV/EBITDA. We no longer factor in treasury stock sale, given uncertainty over timing, and maintain status quo on debt level. Therefore, we shift our valuation basis to EV/EBITDA from P/E, which also better captures the operating strength and de-leveraging capability of the business.
- **De-leveraging to drive up equity value** — While UNSP stock is up 119% over the last 12 months, we believe that likely aggressive debt pay down will drive further stock price momentum. Management is looking to pay down debt over the next 2 years and has the levers to do so – stake sale in W&M and treasury stock sale. Current annual interest (tax adjusted) burden is Rs40 per share.
- **Whyte & Mackay at inflexion point** — W&M's FY06 annual report indicates a revival in branded volumes and healthy 25%+ EBITDA margins. We expect more upside, given that scotch prices continue to remain strong.
- **Domestic business strong** — Growth in the domestic business continues to be strong, aided by 13% volume growth and up-trading driving improving product mix. Sharp declines in raw material costs are aiding margins and introduction of Whyte & Mackay brands will provide a further leg up to margins.
- **Revising estimates** — Our new EBITDA estimates for FY08E-FY10E are higher by 19%-32%. However, incorporating higher debt and interest leads to 16.4% lower FY08E EPS, though FY09E-FY10E estimates are higher by 0.8%-4.6%.

Buy/Low Risk	1L
Price (08 Nov 07)	Rs1,856.20
Target price	Rs2,164.00
from Rs1,463.00	
Expected share price return	16.6%
Expected dividend yield	0.0%
Expected total return	**16.6%**
Market Cap	Rs183,864M
	US$4,694M

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 (%)
2006A	446	7.38	3.5	nm	13.3	7.9	0.0
2007A	2,418	24.18	227.8	76.8	14.0	22.3	0.0
2008E	3,469	34.69	43.5	53.5	12.5	24.7	0.0
2009E	5,893	58.93	69.9	31.5	9.4	34.0	0.0
2010E	7,446	74.46	26.4	24.9	7.1	32.4	0.0

Source: Powered by dataCentral

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

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	nm	76.8	53.5	31.5	24.9
EV/EBITDA adjusted (x)	99.1	38.2	21.1	17.8	15.4
P/BV (x)	13.3	14.0	12.5	9.4	7.1
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rs)					
EPS adjusted	7.38	24.18	34.69	58.93	74.46
EPS reported	21.00	50.59	20.92	58.53	73.94
BVPS	139.20	132.77	147.94	198.26	261.14
DPS	0.29	0.31	0.38	0.43	0.47
Profit & Loss (RsM)					
Net sales	21,485	28,674	48,179	57,847	64,997
Operating expenses	-19,988	-24,073	-38,925	-45,513	-50,895
EBIT	**1,497**	**4,601**	**9,255**	**12,334**	**14,102**
Net interest expense	-1,524	-1,418	-4,500	-4,140	-3,690
Non-operating/exceptionals	596	426	201	224	224
Pre-tax profit	**569**	**3,609**	**4,956**	**8,418**	**10,637**
Tax	-123	-1,191	-1,487	-2,525	-3,191
Extraord./Min.Int./Pref.div.	824	2,641	-1,377	-39	-52
Reported net income	**1,270**	**5,059**	**2,092**	**5,853**	**7,394**
Adjusted earnings	446	2,418	3,469	5,893	7,446
Adjusted EBITDA	1,923	5,064	10,267	13,495	15,308
Growth Rates (%)					
Sales	85.9	33.5	68.0	20.1	12.4
EBIT adjusted	215.7	207.4	101.1	33.3	14.3
EBITDA adjusted	204.9	163.4	102.8	31.4	13.4
EPS adjusted	3.5	227.8	43.5	69.9	26.4
Cash Flow (RsM)					
Operating cash flow	**2,842**	**-1,830**	**4,148**	**7,826**	**9,337**
Depreciation/amortization	426	462	1,013	1,162	1,206
Net working capital	1,975	-7,362	1,024	781	697
Investing cash flow	**320**	**-746**	**-2,688**	**-377**	**-383**
Capital expenditure	-999	-230	-2,679	-377	-383
Acquisitions/disposals	1,319	-515	-10	0	0
Financing cash flow	**14,788**	**4,201**	**46,478**	**-611**	**-927**
Borrowings	9,692	-2,542	46,110	-4,000	-5,000
Dividends paid	-224	-387	-575	-821	-1,107
Change in cash	**17,950**	**1,625**	**47,938**	**6,838**	**8,027**
Balance Sheet (RsM)					
Total assets	**32,596**	**37,115**	**95,175**	**98,099**	**101,370**
Cash & cash equivalent	3,611	5,222	109	468	783
Accounts receivable	3,220	4,161	8,250	9,127	10,053
Net fixed assets	4,864	4,936	12,618	12,479	12,316
Total liabilities	**22,893**	**22,553**	**79,095**	**76,987**	**73,971**
Accounts payable	6,311	8,406	18,199	19,945	21,772
Total Debt	15,431	12,890	59,000	55,000	50,000
Shareholders' funds	**9,703**	**14,562**	**16,080**	**21,112**	**27,399**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.9	17.7	21.3	23.3	23.6
ROE adjusted	7.9	22.3	24.7	34.0	32.4
ROIC adjusted	11.1	16.8	16.5	13.2	14.5
Net debt to equity	121.8	52.7	366.2	258.3	179.6
Total debt to capital	61.4	47.0	78.6	72.3	64.6

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Powered by: dataCentral

Raising Price Target to Rs2164

Figure 1. UNSP Stock Performance (%)

(%)	3M	6M	12M
Absolute	31.3	111.8	118.7
Rel. to .BSESN	0.8	51.1	48.0

Source: DataStream

UNSP stock has increased 119% over the last 12 months and 31% over the last 3 months, outperforming the Sensex by 51% and 1% for the respective time periods. The strong stock performance has been driven in part by its value accretive (both from earnings and strategic perspective) acquisition of Whyte & Mackay (W&M) and continued strong earnings growth driven by domestic demand.

We believe that the stock performance is not yet over. The next leg of stock performance will be driven by de-leveraging of the balance sheet, aided by value unlocking in W&M and sale of treasury stock. Management has indicated that it is looking to pay down most of the Rs60bn debt over the next 2 years. Based on our analysis, UNSP seems well positioned to be able to meet its debt pay down targets. W&M has turned around and is likely to see a sharp jump in profits in FY09E, and a minority stake sale in W&M is likely to materially aid debt pay down. In addition, sales of 18% treasury stock of UNSP (currently valued at Rs33bn based on the stock price) and the internal cash generation could further reduce debt. Currently, the total interest burden on UNSP (on a tax adjusted basis) translates to about Rs40 per share. We estimate that a 20% stake sale in Whyte & Mackay could take care of almost Rs46bn of the total debt. In addition, UNSP has a strong operating cash flow profile, (positive free cash flow even after accounting for the interest burden on current debt levels), which provides a high degree of comfort over debt repayment. The only caveat to our argument is a turn down in the equity markets, which could pare valuations for both the treasury stock and Whyte & Mackay stake sale. To partly factor for this risk, we value UNSP's treasury stock at a 20% discount to the current market price.

We are raising our target price for UNSP to Rs2164 based on 18xFY09E EV/EBITDA. We factor in the treasury stock held by UNSP into our estimates, valuing it at 20% discount to market price. Our valuation methodology is enumerated below:

Figure 2. United Spirits Price Target Calculations

FY09E Consolidated EBITDA (Rsm)	13495
Target Multiple (x)	18x
Target Enterprise Value (Rsm)	242916
Treasury Stock (20% disocunt to market price, Rsm)	28050
Target EV adjusted for treasury stock (Rsm)	270966
FY09E Net Debt (Rsm)	54542
Target Equity Value (Rsm)	216424
Fully Diluted Shares (m)	100
Price Target (Rs)	**2164**

Source: Citi Investment Research

Revising Earnings and Valuation Assumptions

We have revisited our earnings assumptions as well as our valuation methodology. The key changes to our assumption are:

1. We are changing our valuation basis to EV/EBITDA multiple based from P/E multiple based earlier. The key reason for this shift is that we are no longer assuming sale of treasury shares into our estimates, given the uncertainly of timing and pricing. In addition, UNSP management has also indicated a potential stake sale in Whyte & Mackay for paying down debt, which we are unable to build into our estimates given uncertainty over the amount and timing of the stake sale. We therefore maintain status quo on debt levels in our balance sheet estimates, and focus the valuations on operating profits (earnings before interest payment). Also, based on our new assumptions, an EPS-based valuation is unlikely to fully capture the operating strength of the business or the potential of the business to de-leverage the balance sheet.

2. We are no longer building in sale of treasury stock into our estimates. We had earlier assumed sale of 18% treasury stock at Rs900 per share in FY08E, adjusted against debt. However, we believe that it is difficult to call the timing or value of this stake sale at this juncture (though it is very likely to occur over the next 2 years). In our opinion, a better way to capture the value of treasury stock would be to reduce the treasury shares from the fully diluted share count and base per share earnings on a lower share base. So far, we have been basing our per share estimates on 100m share count (fully diluted), which we lower to 82m adjusting for the treasury stock.

3. We understand from the UNSP management that the accounting year-end for Whyte & Mackay is being changed to March from September. Accordingly, we make adjustments to our consolidated model to account for 10 months of consolidation for W&M in FY08E against 5 months earlier. In addition, we are also revising our earnings estimates for Whyte & Mackay downwards (while revising the EBITDA growth estimates upwards) to account for interest on the debt in W&M books. We had earlier assumed a pay down of W&M debt through treasury stake sale.

4. We are also revising upward EBITDA margin estimates for UNSP's domestic business, factoring in a lower raw material costs. Prices for molasses (key raw material input for W&M) have declined sharply over the last 1 year and are expected to remain weak next year as well. We build in lower raw material costs into our estimates, resulting in about 50bps higher EBITDA margins for the domestic business over FY08E-FY09E.

Our consolidated earnings revisions summary is enumerated below. Our new EBITDA estimates for FY08E-FY10E are higher by 19.2%-32.1%. However, incorporating higher debt and interest leads to a 16.4% lower FY08E EPS, though FY09E-FY10E estimates are higher by 0.8%-4.6%. The reason for higher interest cost in our new estimates is that we are no longer assuming sale of treasury stock and the resultant debt pay down in FY08E. The reason for our higher EBITDA estimates are lower raw material costs as molasses prices have declined sharply, better than expected margins for UNSP in 1HFY08 and higher profit estimates for Whyte & Mackay in FY09E and FY10E following our discussions with the management.

Figure 3. United Spirits – Consolidated Earnings Revision Summary

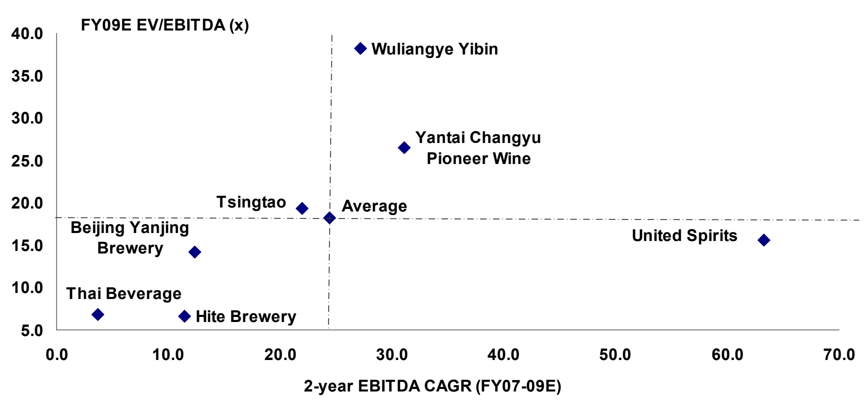
	EBITDA (Rsm)			Net Profit (Rsm)			EPS (Rs)			DPS (Rs)		
	Old	New	% Change	Old	New	% Change	Old	New	% Change	Old	New	% Change
FY08E	7,770.9	10,267.3	32.1	3,921.0	3,469.3	(11.5)	41.5	34.7	(16.4)	0.4	0.4	1.7
FY09E	11,319.6	13,495.3	19.2	5,526.0	5,892.6	6.6	58.5	58.9	0.8	0.4	0.4	1.9
FY010E	12,678.3	15,308.1	20.7	6,728.0	7,445.8	10.7	71.2	74.5	4.6	0.5	0.5	1.4

Source: Company Reports and CIR Estimates

Valuations Benchmarked to Peer Group

We have benchmarked our 18x EV/EBITDA target multiple against the regional and global liquor companies. Our 18x EV/EBITDA target multiple is at about a 15% discount to the Asian peer group average, which we believe is conservative, given that UNSP EBITDA growth CAGR is significantly higher than the peer group average. However, we attribute a premium of about 20%-25% to UNSP to the global FY09E average valuation multiples 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 51% two-year EPS CAGR, almost 2x higher than the global peer group average.

Figure 4. Asian Liquor Stocks – EV/EBITDA (x) v/s EBITDA CAGR (%)*



Source: I/B/E/S; CIR Estimates; * UNSP adjusted for treasury stock value

Figure 5. Asian Liquor Stocks Valuation Summary

Company	Ticker	Price	Cny.	Country	Rating	Market Cap (US$m)	P/E (x) FY 08	P/E (x) FY 09	EV/EBITDA (x) FY 08	EV/EBITDA (x) FY 09	Div. Yld (%) FY 08	RoE (%) FY 08	M. Cap/ Sales (x) FY 09	EPS CAGR (%) FY07-09E	EBITDA CAGR (%) FY07-09E
Tsingtao	0168.HK	25.2	HKD	China	NR	4,981	50.5	38.6	23.1	19.3	1.3%	12.8%	2.30	35.3	22.0
Shanxi Fenjiu	600809.SS	32.2	CNY	China	NR	1,856	35.4	26.7	18.8	15.6	1.5%	32.0%	6.07	55.0	na
Wuliangye Yibin	000858.SZ	40.2	CNY	China	NR	20,752	84.6	60.7	48.2	38.2	0.3%	18.2%	15.13	42.6	27.2
Kweichow Moutai	600519.SS	181.9	CNY	China	NR	22,624	74.0	52.2	43.2	32.4	0.6%	30.3%	19.08	38.3	na
Yantai Changyu Pioneer	200869.SZ	56.5	HKD	China	NR	4,596	44.8	32.7	34.6	26.5	1.9%	30.7%	10.18	38.6	31.1
Beijing Yanjing Brewery	000729.SZ	15.5	CNY	China	NR	2,266	41.8	34.0	16.4	14.2	1.0%	6.9%	1.90	16.1	12.3
Luzhou Laojiao	000568.SZ	64.3	CNY	China	NR	7,443	75.6	53.7	53.4	39.2	0.8%	37.6%	17.22	152.2	na
Thai Beverage	TBEV.SI	0.3	SGD	Thai	3L	4,601	12.2	11.5	7.2	6.8	4.1%	20.0%	0.06	7.6	3.6
United Spirits	UNSP.BO	1,856.2	INR	India	1L	4,694	53.5	31.5	21.1	17.8	0.0%	24.7%	3.38	51.2	63.3
Hite Brewery	000140.KS	135,000.0	KRW	Korea	1M	3,152	17.6	14.5	7.8	6.6	1.2%	10.8%	2.84	47.6	11.4
Asia Ex Japan Average							**48.0**	**35.6**	**27.9**	**21.5**	**1.3%**	**21.6%**	**7.82**	**48.4**	**24.4**

Source: I/B/E/S; CIR Estimates

Figure 6. Global Liquor Stocks Valuation Summary

Company	Ticker	Currency	Country	Rating	Mkt. Cap (US$m)	P/E (x) FY 08	P/E (x) FY 09	EV/EBITDA (x) FY 08	EV/EBITDA (x) FY 09	Div Yld (%) FY 08	ROE (%) FY 08	M Cap / Sales (x) FY 09	EPS CAGR (%) FY07-09E
C&C Group Plc	GCC.I	EUR	Ireland	2M	2,331	15.2	13.3	12.9	12.0	5.3%	66.7%	2.70	-14.8
Davide Campari-Milano	CPRI.MI	EUR	Italy	1L	3,160	16.5	15.1	11.1	10.0	1.3%	15.1%	2.14	8.9
Diageo PLC	DGE.L	GBP	UK	2L	60,316	19.0	16.9	13.4	12.6	3.1%	40.3%	3.53	10.4
Pernod-Ricard SA	PERP.PA	EUR	France	1L	24,585	18.5	16.1	14.8	13.3	1.7%	13.8%	2.38	13.0
Thai Beverage	TBEV.SI	SGD	Thailand	3L	4,601	12.2	11.5	7.2	6.8	4.1%	20.0%	0.06	7.6
United Spirits	UNSP.BO	INR	India	1L	4,694	53.5	31.5	21.1	17.8	0.0%	24.7%	3.38	51.2
Hite Brewery	000140.KS	KRW	Korea	1M	3,152	17.6	14.5	7.8	6.6	1.2%	10.8%	2.84	47.6
Asahi Breweries	2502.T	JPY	Japan	3L	8,127	22.0	21.5	7.6	7.3	1.0%	8.4%	0.65	1.7
Kirin Holdings	2503.T	JPY	Japan	3L	14,447	29.3	27.7	4.5	3.9	1.1%	5.4%	0.92	3.4
AmBev	ABV.N	USD	Brazil	1M	52,973	30.2	23.1	12.3	10.8	2.2%	17.7%	4.78	44.0
Anheuser-Busch	BUD.N	USD	US	2L	37,521	17.6	16.2	11.4	11.8	2.6%	61.4%	2.11	8.7
InBev	INTB.BR	EUR	Belgium	1M	59,650	21.2	17.8	9.4	8.5	1.4%	14.6%	2.66	28.8
Lion Nathan Ltd	LNN.AX	AUD	Australia	2L	4,611	18.0	16.9	10.7	10.3	4.6%	36.9%	2.41	2.7
SABMiller PLC	SAB.L	GBP	UK	1M	44,539	21.1	18.3	10.9	9.6	1.9%	13.4%	0.94	13.9
Scottish and Newcastle	SCTN.L	GBP	UK	2M	15,040	20.5	19.1	17.3	16.7	2.9%	9.9%	2.15	6.5
Marston's	MARS.L	GBP	UK	2H	2,047	13.5	12.9	9.0	8.9	3.6%	12.6%	1.54	6.4
Tsingtao	0168.HK	HKD	China	NR	4,981	50.5	38.6	23.1	19.3	1.3%	12.8%	2.30	35.3
Shanxi Fenjiu	600809.SS	CNY	China	NR	1,856	35.4	26.7	18.8	15.6	1.5%	32.0%	6.07	55.0
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Beijing Yanjing Brewery	000729.SZ	CNY	China	NR	2,266	41.8	34.0	16.4	14.2	1.0%	6.9%	1.90	16.1
Luzhou Laojiao	000568.SZ	CNY	China	NR	7,443	75.6	53.7	53.4	39.2	0.8%	37.6%	17.22	152.2
GLOBAL AVERAGE						32.3	25.7	18.5	15.4	2.0%	23.1%	4.66	26.9

Source: I/B/E/S; CIR estimates

Accelerated Debt Payback Imminent

Our discussions with the UNSP management indicate that the company is looking to aggressively pay down the debt raised for the Whyte & Mackay acquisition. Total debt on the consolidated books is currently Rs60bn (US$1.5bn). Management has stated that it is looking to pay down the major part of this debt over the next 2 years. We expect the company to use a combination of a minority stake sale in Whyte & Mackay and UNSP treasury stake sale to raise funds to accelerate its debt repayment. Based on our estimates, UNSP could retire about Rs50bn just through a combination of a 20% stake sale in W&M and sale of 18% treasury stock in UNSP.

Our calculations are based on valuing Whyte & Mackay at a conservative 15x FY09E P/E (post money) and assuming a 20% dilution. These assumptions put the value of the 20% W&M stake at about Rs10bn. In addition, we value the 18% treasury stock at the current market price, which returns a value of about Rs36bn. We enumerate below a scenario that demonstrates that UNSP could be debt free in FY10E. Our scenario analysis assumes a W&M stake sale in FY09E and treasury stock sale in FY10E.

Figure 7. UNSP Debt Pay Down Scenario Analysis

	FY08E	FY09E	FY10E
Debt on Whyte & Mackay books (Rsm)	25600		
Debt on UNSP Holdings Books (Rsm)	24400		
Debt on UNSP Books (Rsm)	9000		
Total Debt (Rsm)	**59000**	**43000**	**360**
Interest Cost (Rsm)	-4500	-3870	-32.4
Free Cash Flow (Rsm)	1000	6000	6640
W&M 20% Stake Sale (Rsm)	0	10000	0
Treasury Stock Sale (Rsm)	0	0	36000
Debt / Equity (x)	0.8	0.7	0.0
Interest Cover (x)	2.3	3.5	472.5

Source: CIR estimates

Whyte & Mackay at Inflection Point

We expect Whyte & Mackay to start contributing significantly to consolidated earnings from FY09E. Whyte & Mackay's restructuring program seems to have revived branded product sales growth and is driving margin improvement. Whyte & Mackay's FY06 (Sep'06) annual report indicates that key branded products (Whyte & Mackay whisky and Vladivir vodka) volumes grew 3.7% in FY06, against an 18.6% decline in FY05. In addition, EBITDA margins in FY06 improved by 50bps to 25.1% as did return on stock, which improved 20bps to 26.8%. Management discussion in the FY06 annual report also points out that the full benefits of restructuring are yet to accrue in full measure, and that company performance is likely to look up in 2007. We enumerate below the key operating parameters listed out in Whyte & Mackay's 2006 annul report:

Figure 8. Whyte & Mackay Key Operating Parameters

	2005	2006	Comments
Sales growth of key brands (%)	-18.6%	3.7%	Revival of volumes of Whyte & Mackay and Vladivir brands following re-packaging and re-launch of these brands in March 2006. Growth is even better when compared from the re-launch date, and is expected to pick up further in 2007
EBITDA Margins (%)	24.6%	25.1%	Margins have improved due to restructuring and improved levels of bulk scotch maturing
Return on Stock (%)	28.4%	28.6%	Return on stock influenced by increasing bulk scotch prices

Source: Company Reports

While Whyte & Mackay's business seems to be improving post restructuring, the big upsides are yet to kick in. Bulk scotch prices have increased by almost 15% since the W&M acquisition, and we expect the Indian market to be the incremental driver for the branded business. We estimate Rsxx EBITDA profit for Whyte & Mackay in FY08E, but one-time restructuring charge and interest cost are likely to pare net profits. However, we expect a big uptick in profits to kick in from FY09E, and estimate W&M to contribute Rs1.86bn to UNSP's consolidated net profits. Our key assumptions for Whyte & Mackay are enumerated below:

Figure 9. Whyte & Mackay Income Statement (Rupees in Million, Percent)

INR Million	FY06	FY07E	FY08E	FY09E	FY10E
Sales	**13029.5**	**16200.0**	**17334.0**	**18720.7**	**20218.4**
% YoY	*8.0*	*24.3*	*7.0*	*8.0*	*8.0*
Cost of sales	-9251.8	-10368.0	-10920.4	-11419.6	-12131.0
Gross Profit	**3777.7**	**5832.0**	**6413.6**	**7301.1**	**8087.4**
Gross Margins (%)	*29.0*	*36.0*	*37.0*	*39.0*	*40.0*
Distribution Costs	-278.3	-292.2	-306.8	-322.2	-338.3
Administrative Expenses	-1018.7	-2299.8	-1651.7	-1643.5	-1885.7
EBITDA	**2480.7**	**3240.0**	**4455.0**	**5335.4**	**5863.3**
Restructuring Expenses	-644.0	-2025.0	-1620.0	0.0	0.0
EBITDA (post restructuring)	**1836.8**	**1215.0**	**2835.0**	**5335.4**	**5863.3**
EBITDA Margins (%)	*14.1*	*7.5*	*16.4*	*28.5*	*29.0*
Depreciation & Amortization	-777.5	-611.3	-630.8	-650.2	-669.6
Interest	-1239.8	-847.9	-2316.6	-2223.5	-2041.2
Non Operating Income	3.3	3.3	16.2	24.3	24.3
PBT	**-177.2**	**-240.9**	**-96.2**	**2486.1**	**3176.8**
Tax	225.2	0.0	0.0	-621.5	-794.2
PAT	**48.0**	**-240.9**	**-96.2**	**1864.5**	**2382.6**

Source: Whyte & Mackay Annual Reports; CIR estimates

Figure 10. Whyte & Mackay Balance Sheet (Rupees in Million, Percent)

	FY06	FY07E	FY08E	FY09E	FY10E
Share Capital	0.2	0.2	0.2	0.2	0.2
Share Premium	1321.3	1321.3	1321.3	1321.3	1321.3
P&L Account	-2836.4	-3077.2	-3173.4	-1308.9	1073.7
Total Shareholders Equity	**-1514.9**	**-1755.7**	**-1851.9**	**12.6**	**2395.2**
Total Debt	**10895.4**	**14580.0**	**26325.0**	**24705.0**	**22680.0**
Total Liabilities	**9380.5**	**12824.3**	**24473.1**	**24717.6**	**25075.2**
Fixed Assets	**7773.7**	**7796.6**	**7819.4**	**7842.3**	**7865.1**
Intangible Assets	3127.2	2907.0	2686.9	2466.7	2246.5
Tangible Assets	4646.6	4889.6	5132.6	5375.6	5618.6
Investments	**9.6**	**9.6**	**9.6**	**9.6**	**9.6**
Current Assts	11517.3	15022.8	26737.8	27052.3	27483.6
Stocks	8126.5	10530.0	22275.0	22720.5	23174.9
Debtors	3290.3	3275.1	3340.6	3407.4	3475.6
Cash	100.5	1217.7	1122.2	924.4	833.1
Current Liabilities	7986.7	8146.4	8309.3	8475.5	8645.0
Provisions	492.4	507.2	522.4	538.1	554.2
Net Current Assets	**3038.2**	**6369.2**	**17906.1**	**18038.7**	**18284.4**
Pension Deficit	-1440.2	-1351.1	-1262.0	-1172.9	-1083.8
Total Assets	**9381.3**	**12824.3**	**24473.1**	**24717.6**	**25075.2**

Source: Whyte & Mackay Annual Reports; CIR estimates

Domestic Business Momentum Strong

With a 53% market share, United Spirits is well positioned in a fast-growing Indian liquor industry that has high entry barriers. Favorable demographics, rising income levels and changing social habits are driving strong growth for branded liquor in India. We estimate that liquor consumption (branded) in India is likely to growth at a CAGR of 13% over the next 5 years, up from historical growth rate of about 10%. As such, per-capita consumption of liquor in India is low – about 2 liters per capita compared to 3.8 liters in Thailand, 5 liters in US and 9 liters in Russia.

United Spirits domestic business momentum continues to remain strong, aided by 12%-13% volume growth, improving product mix and lower raw material costs. UNSP is launching brands from the Whyte & Mackay stable in the Indian market, and this should provide a further leg up to margins. We estimate 32.7% CAGR in profits over FY07-FY10E for the domestic business. This is likely to be driven by 16.5% sales growth and 320bps EBITDA margin expansion during the same period. We believe that there could be further upsides to margins, if Whyte & Mackay brand volumes in India pick up significantly. We wish to highlight that the Scotch whisky segment contributes disproportionately to UNSP's margins, and if this segment growth outpaces growth of other segments, margins could surprise positively.

Figure 11. United Spirits – Margin Contribution and Sales Composition Across Segments

	FY06 Margin Contribution (%)	Sales Composition (%)		
		FY06	FY05	FY04
Scotch / Super	4.7	0.4	0.3	0.2
Premium	22.5	4.3	4.3	4.1
Deluxe	29.0	19.5	19.9	19.1
Regular	38.0	64.3	56.2	47.6
Economy	5.8	11.6	19.3	28.9
Whiskey - Total	**73.0**	**58.6**	**57.2**	**59.9**
Rum	**11.0**	**18.1**	**19.9**	**18.9**
Brandy	**8.0**	**18.3**	**18.1**	**16.6**
Gin	**3.0**	**2.2**	**2.5**	**2.9**
Vodka	**5.0**	**2.8**	**2.2**	**1.7**

Source: Citi Investment Research

United Spirits

Company description

United Spirits is the largest player in India's branded spirits market. It pursues an inorganic growth strategy, acquiring the second-largest Indian liquor manufacturer, Shaw Wallace and recently acquiring scotch manufacturer Whyte & Mackay. While the Shaw Wallace acquisition has significantly enhanced its competitive position, increasing its market share in branded spirits to 53%, Whyte & Mackay has given it access to scotch inventory, which will drive the next leg of India growth strategy. UNSP has also acquired French winemaker Bouvet Ladubay — the wine arm of champagne major Taittinger — and is looking to introduce its products to the Indian market.

Investment strategy

We have a Buy (1L) rating on United Spirits and a target price of Rs2164. 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. United Spirits is exploring international acquisitions to fuel growth. It has recently acquired Whyte & Mackay, the fourth-largest scotch company in the world. The acquisition is EPS accretive and is a good strategic fit. It will significantly enhance UNSP's plans to expand its presence in the Indian premium whisky segments, as well as expand into the 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. Steady sales growth, margin expansion and lower interest costs should drive an EPS CAGR of 51% in FY07-09E. United Spirit's capital efficiency is looking up amid strong earnings growth.

Valuation

Our target price of Rs2164 is based on 18x FY09E EV/EBITDA. We have benchmarked our 18xEV/EBITDA target multiple against the regional and global liquor companies. Our 18x EV/EBITDA target multiple is at about a 15% discount to the Asian peer group average, which we believe is conservative, given that UNSP EBITDA growth CAGR is significantly higher than the peer group average. However, we attribute a premium of about 20%-25% to UNSP to the global FY09E average valuation multiples 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 51% two-year EPS CAGR, almost 2x higher than the global peer group average.

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 5) Post acquisition of Whyte & Mackay, gearing has increased significantly, increasing cash flow risks 6) UNSP will also need to successfully integrate Whyte & Mackay.

Appendix A-1

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Hite Brewery (000140.KS)

Ratings and Target Price History - Fundamental Research

Analyst: Ally Park

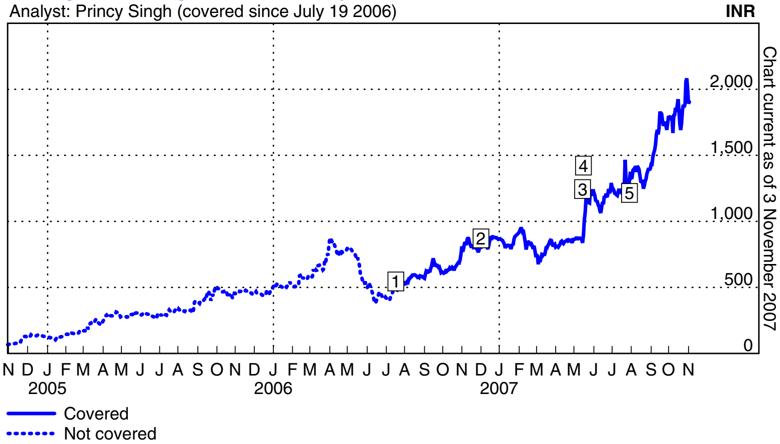
#	Date	Rating	Target Price	Closing Price
1:	22 Feb 05	*3L	*90,000.00	87,100.00
2:	27 Sep 05	*1M	*177,000.00	142,000.00
3:	31 Mar 06	1M	*167,000.00	138,500.00
4:	17 Aug 06	1M	*155,000.00	108,000.00
5:	20 Jun 07	1M	*177,000.00	126,000.00

*Indicates change.

United Spirits (UNSP.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since July 19 2006)



#	Date	Rating	Target Price	Closing Price
1:	18 Jul 06	1L	694.00	486.65
2:	1 Dec 06	1L	*1,080.00	807.65
3:	15 May 07	1L	*1,114.00	837.60
4:	16 May 07	1L	*1,250.00	895.20
5:	29 Jul 07	1L	*1,463.00	1,313.75

*Indicates change.

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