Motilal Oswal

3 December 2012

Update | Sector: Consumer

Alcoholic Beverages

Cheers!

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Consumer | Alcoholic Beverages: Cheers!

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Alcoholic Beverages

Cheers! Improving outlook as MNCs gain control

Reiterate Buy on United Spirits and Radico Khaitan

- **The recent agreement under which Diageo has acquired ~28% in United Spirits (UNSP) will result in Diageo gaining management control of India's largest spirits company.**
- **Over 50% of the IMFL market will be controlled by MNCs, which should result in greater transparency, operational discipline and more efficient deployment of resources.**
- **IMFL stocks have run up considerably post the deal announcement. We expect the re-rating to sustain, given the potential sector-wide benefits following the deal.**
- **We recommend Buy on United Spirits and Radico Khaitan and upgrade our target prices. We introduce Tilaknagar Industries (Not Rated).**

UNSP-Diageo deal can change dynamics of IMFL industry

The UNSP-Diageo deal will result in Diageo gaining management control of UNSP. Given Diageo's focus on the premium/super-premium segments, the industry trend towards premiumization will be further boosted. Post the deal, over 50% of the IMFL market will be controlled by MNCs. This should result in greater transparency, operational discipline and more efficient deployment of resources. With the shift in competitive landscape, we expect advertising spends and brand investments to go up considerably. Also, the passage of management control of the industry leader to a foreign company could pave the way for lower import duties.

United Spirits: The party has just begun

Post the deal , United Spirits (UNSP) stock has been re-rated on the back of expected balance sheet improvements following management control by Diageo. Though the IMFL sector offers an attractive long-term opportunity, there are also challenges pertaining to regulations, duties/taxes, and ban on advertising, none of which will change immediately. The benefits will, therefore, be back-ended. Nonetheless, we expect the stock re-rating to sustain - a precedent exists in the deal between Heineken and United Breweries (UBBL). We reiterate **Buy**, with a revised target price of INR2,490.

Radico Khaitan: Premiumization strategy working

Radico Khaitan (RDCK) has demonstrated its ability to drive premiumization - the salience of premium brands has risen from 8% of total volumes in FY09 to 16% in 1HFY13. Also, the IMFL pricing environment is turning favorable, which should enable margin expansion. We expect RDCK to deliver strong 23% earnings CAGR over FY12-15, led by 230bp margin improvement. The stock has appreciated ~25% since our initiation on 31 October 2012 and subsequent announcement of the Diageo-UNSP deal. We reiterate **Buy**, with a revised price target of INR181 - 24% upside.

Tilaknagar Industries: Emerging player

Tilaknagar Industries' (TLNGR) robust financial performance in the last five years highlights its ability to capitalize on the rapidly premiumizing IMFL industry. Its strength in South India and manufacturing network makes it an attractive partner for foreign liquor companies. It has announced a strategic bottling agreement with Pernod Ricard India. The stock trades at 13.6x FY13E and 10x FY14E earnings (Bloomberg consensus). **Not Rated**.

UNSP-Diageo deal can change dynamics of IMFL industry

To hasten premiumization; brand investments to accelerate

- **The recent agreement under which Diageo has acquired ~28% in UNSP will result in Diageo gaining management control of India's largest spirits company.**
- **Given Diageo's unwavering focus on the premium/super-premium segments, the growing industry trend towards premiumization would be further boosted.**
- **With the resultant shift in competitive landscape, we expect industry advertising spends as well as brand investments to go up considerably.**
- **The passage of management control of the industry leader to a foreign company could also pave the way for easing of import duties in future, in our view.**

Diageo to gain management control of UNSP

Diageo Plc, United Breweries Holdings (UB) and United Spirits (UNSP) announced agreements under which Diageo will acquire 27.4% stake in UNSP. Post this, Diageo will launch a mandatory tender offer (open offer), at a price of INR1,440/share. However, post the announcement of the deal, UNSP shares have rallied significantly and have crossed the open offer price. If Diageo's open offer is fully subscribed, it would eventually own 53.4% of UNSP at a total consideration of INR111.7b. While its gaining majority shareholding in UNSP now appears difficult, Diageo has secured board/management rights as part of the deal conditionalities.

Details of the deal

- Diageo will acquire 19.3% interest in UNSP's current share capital at a price of INR1,440/share from the UB group, the UNSP Benefit Trust, two subsidiaries of UNSP - Palmer Investment Group and UB Sports Management, and the SWEW Benefit Trust.
- Of the 19.3%, 12.8% will come from UB, which post the stake sale will own 14.9% of UNSP's current share capital. The balance 6.5% will come from treasury shares - UNSP Benefit Trust, two subsidiaries of UNSP and SWEW Benefit Trust.
- UNSP will also make a preferential allotment of 10% of the post-issue capital base to Diageo at a price of INR1,440/share.
- The above transactions will result in Diageo acquiring 27.4% stake in UNSP at a total consideration of INR57.3b, triggering an obligation on Diageo to launch a mandatory tender offer (open offer).
- Diageo will launch a tender offer to acquire a maximum of 37,785,214 shares (26% of the enlarged share capital) at a price of INR1,440/share.
- Assuming the open offer gets fully subscribed, Diageo will own 53.4% of UNSP at a total consideration of INR111.7b.
- The deal values UNSP at an EV of 20x FY12 EBITDA.
- Dr Vijay Mallya will continue in his current role as Chairman of UNSP and UB.

Deal conditionalities

- Share acquisition from UB is subject to the release of all security interests (pledging, etc) over the UNSP shares to be acquired by Diageo.

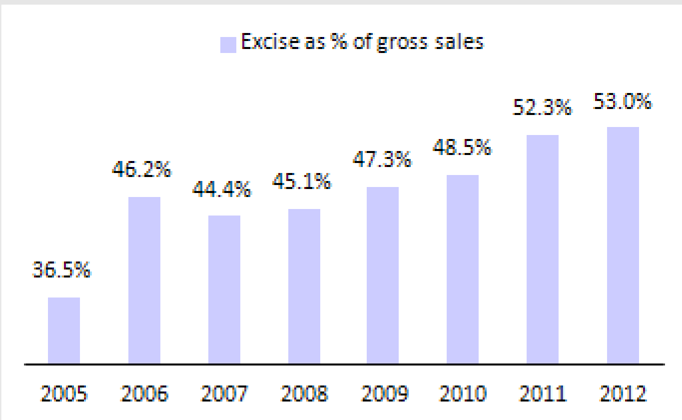
- The receipt of mandatory regulatory approvals (including competition approvals) in India and elsewhere.
- If the preferential allotment is not successful (including where it is not approved by the shareholders of UNSP), UB has agreed to sell additional shares in UNSP to Diageo at a price of INR1,440/share to ensure that Diageo has a minimum shareholding of 25.1%.
- If the share purchase agreement, the preferential allotment and the tender offer do not result in Diageo holding a majority interest in UNSP, UB has agreed to vote its remaining shareholding in UNSP as directed by Diageo for a four-year period. UB will also vote its UNSP shares to enable Diageo to ensure that its nominees are appointed to the UNSP board.
- Diageo will have the right of first offer over UB's remaining stake if a member of the UB group proposes to transfer any UNSP shares other than to a permitted transferee.
- UB will also have an option to put some or all of its remaining stake in UNSP to Diageo at a price of INR1,440/share, provided no further mandatory tender offer is triggered; this put will start once Diageo has first consolidated a full financial year's results for UNSP and terminate on the 7th anniversary of that date.

Premiumization to get further boost

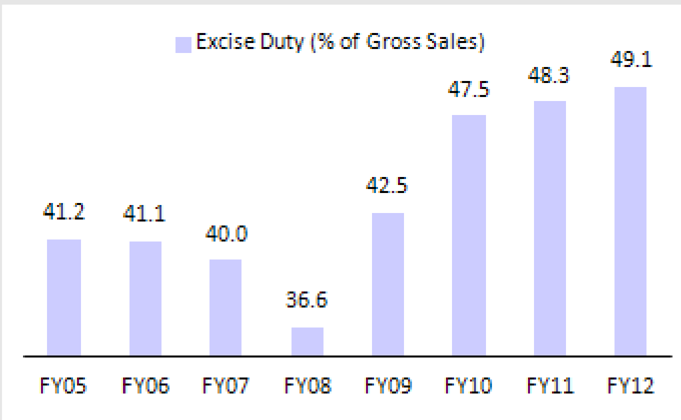
Rising state-level excise duties, sustained inflation in input costs and elevated competitive intensity have impacted operating margins of IMFL companies, driving the shift towards premiumization. Supportive macro factors - rising disposable incomes and affluence, growth in middle class households, favorable demographics and changing social attitude toward liquor consumption amongst urban upper middle class families have also aided the shift. Diageo gaining control of the market leader, UNSP, which holds 41% volume share, can help accelerate this shift, in our view.

Increasing excise duties and inflationary RM environment has impacted operating margins; driving need for premiumization

Excise duty has gone up for UNSP ...

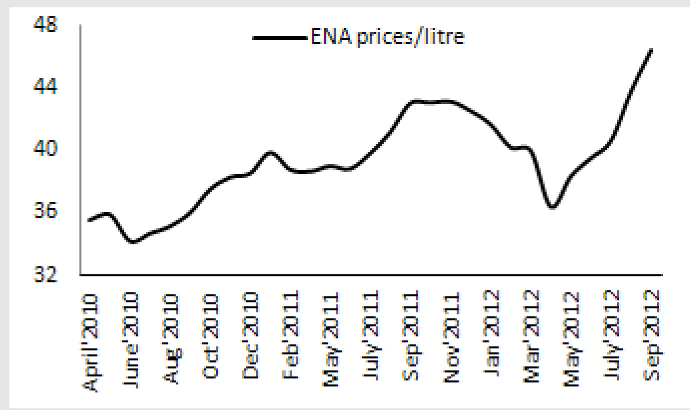


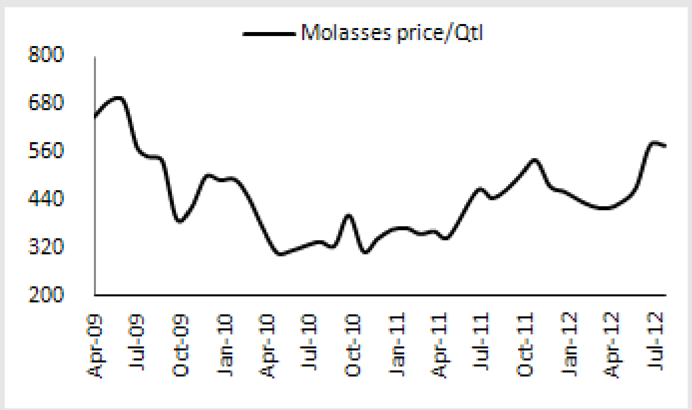
... and RDCK



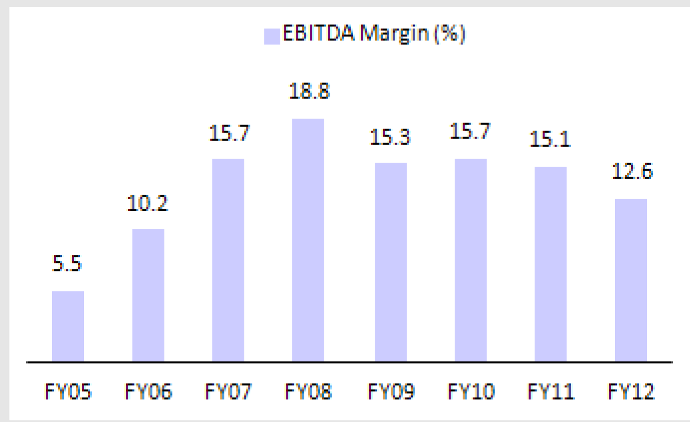
Source: Company, MOSL

Input cost also gone up

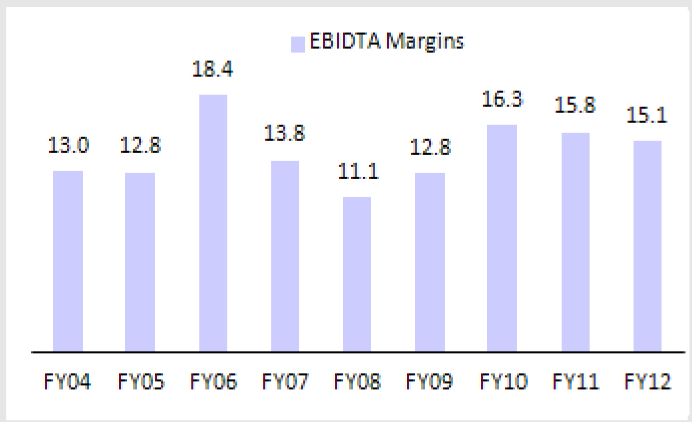




EBITDA margins have declined for UNSP....



... while it has remained stable for RDCK



Source: Bloomberg, Company, MOSL

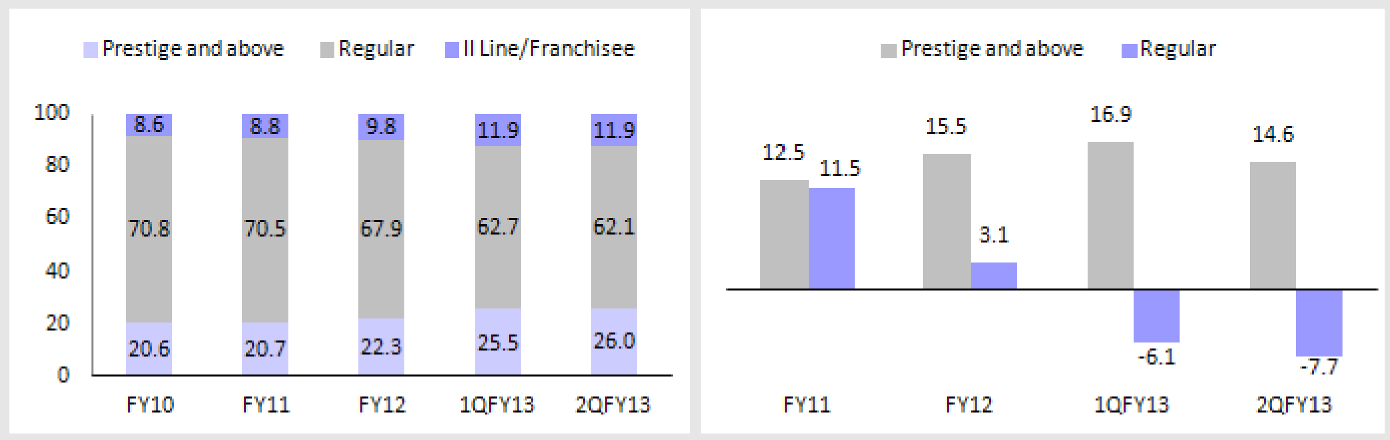
More than 50% of MRP goes towards duties and taxes

Item	2011-12	2012-13
Price of Liquor	9.5	9.5
Bottling and labelling	6.7	6.7
Packaging charges	1.1	1.1
Hologram fixation	0.3	0.3
Ex Factory price (without duty)	17.6	17.6
Excise duty	140.0	141.8
Ex Factory price (with duty)	157.6	159.4
Ex Factory price at Distillery gate	157.6	159.4
Profit @ 3% of distillery	4.7	4.8
Ex-Distiller price (with profit)	162.3	164.2
Freight	1.5	1.5
Godown expenses	1.2	1.2
Wastage @0.5% of Ex-dist cost	0.8	0.8
Wholesale cost price	165.7	167.6
Incidence of licensee fees	1.7	1.7
Profit @1% of wholesale cost price	1.7	1.7
Optimal Wholesale price	169.1	171.0
Proposed Maximum Wholesale price	169.1	171.0
Wholesaler's margin	6.8	6.8
Incidence of retailers licence fees	18.7	19.6
Retailer's profit and expenses	19.2	19.2
Optimal margin for retailers	37.9	38.8
Optimal retail price	207.0	209.7
Proposed MRP	210.0	210.0

Source: Company, MOSL

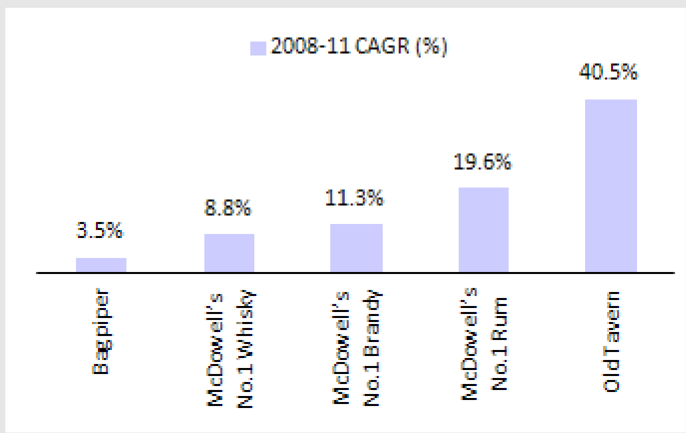
While the Premiumization theme is already underway

Growth in Prestige Plus segment higher than overall industry average

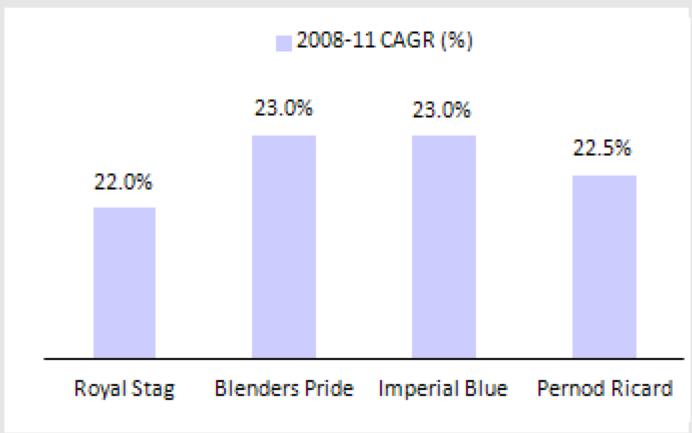


Source: Company, MOSL

UNSP brands have underperformed Pernod Ricard

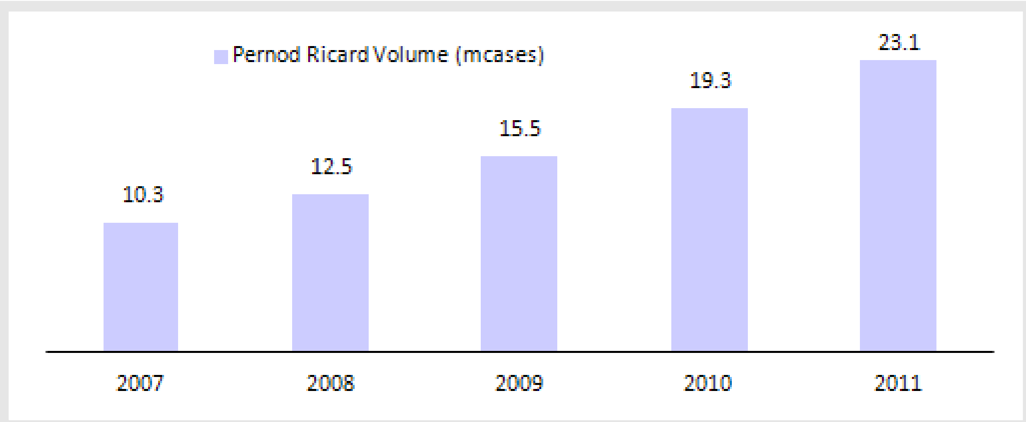


All the key brands of Pernod recorded 20% plus volume CAGR



Source: Company, Industry, MOSL

Pernod Ricard India's volumes up 2.2x since 2007



Source: Company, Industry, MOSL

Salience of prestige and above sub-segments went up recently

Segment/brand	Price point (INR)	Market Leader	Segmentwise distribution 2011-12 All India	2012-13-H1 All India
Whisky				
Scotches	>1000	100 piper	0.6	0.5
Super-premium	600-700	Antiquity	0.3	0.4
Premium-whisky	500-600	Blender Pride	2.7	2.8
Prestige-whisky	400-500	Royalstag	6.1	6.2
Delux- whisky	300-400	MCD No.1	6.9	7.7
Upper regular- whisky	250-300	Imperial Blue	7.4	7.8
Regular- whisky	Uptp 250	Bagpiper	29.2	28.2
Medium-whisky	<200	Haywards	4.7	5.7
Total-whisky			**57.8**	**59.3**
Rum				
Premium- rum	>400	Bacardi	0.2	0.2
Delux-rum	350-400		0.1	0.0
Regular-rum	<300	Celebration rum	14.6	10.9
White rum	150-500	Bacardi,Contessa	0.5	0.4
Total-rum			**15.4**	**11.5**
Brandy				
Premium- brandy	>500	Morpheus	0.4	0.6
Semi-premium- brandy	350-500	Courier Napoleon	0.9	1.3
Delux- brandy	300-350	Mansion house	9.0	8.9
Regular-brandy	<300	Old Admiral	11.5	13.1
Total-brandy			**21.8**	**23.9**
Gin				
Regular-gin	250-300	Aristrocrat	0.1	0.2
Medium-gin	<225	Blue riband	1.2	1.6
Total-gin			**1.4**	**1.7**
Vodka				
Premium- vodka	>500	Smiranoff	0.4	0.3
Semi premium- vodka	350-500	Magic Moments	1.0	1.1
Regular- vodka	<-350	White mischief	2.2	2.2
Total- vodka			**3.6**	**3.6**
All india			**100.0**	**100.0**

Source: Company, MOSL

Deal to drive premiumization

(an extract from our Inititating Coverage report dated 31 October 2012 on Radico Khaitan)

If Diageo acquires strategic stake in UNSP, we expect a further shift in focus of industry players towards premium IMFL segments. Diageo's India portfolio is geared to capitalize on the unfolding premium IMFL consumption story in India. Post the acquisition, it will be able to drive its premium/super-premium brands through a wider distribution footprint.

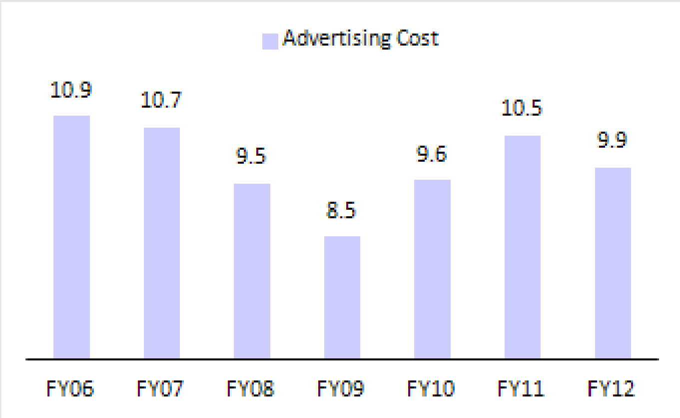
Given the lackluster growth in mature markets and its underperformance v/s Pernod in India, we expect disproportionate focus from Diageo to enhance its market footprint in India. The combination of improving pricing environment and shift in focus of the industry leader towards realizations/profitability could help drive sector profitability and margins in our view.

Brand investments to accelerate

We expect industry advertising spends as well as brand investments to go up post the Diageo transaction. In the post-deal conference call, the Diageo management indicated that it intends to focus on premium brands. We expect disproportionate spends on premium brands, as Diageo sets out to correct the underinvestment in some of UNSP's premium brands such as *Black Dog*. In our view, UNSP has under-invested in premium brands owing to its weak balance sheet position. Also, the earlier management was more focused on driving volumes.

Rising competitive intensity - as evidenced by Pernod Ricard's strong market share gains and financial performance in India - is another reason why we expect brand investments to accelerate. Pernod Ricard has almost doubled its operating profits in India in two years.

UNSP's domestic ad-spends as % of sales....



Pernod Ricard India's strong financials

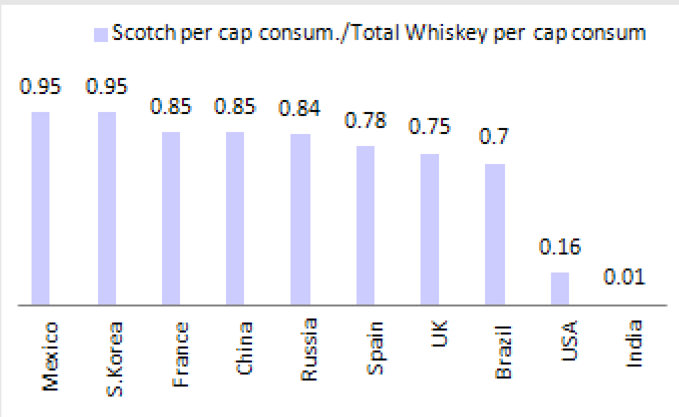
(INR m)	FY10	FY11	YoY(%)
Sales	20,740	27,720	33.7
PBT	3,847	5,078	32.0
PBT margin (%)	18.5	18.3	
Tax	1,327	1,728	30.2
Tax rate (%)	34.5	34.0	
PAT	2,520	3,350	32.9
PAT margin (%)	12.2	12.1	

Source: Company, MOSL

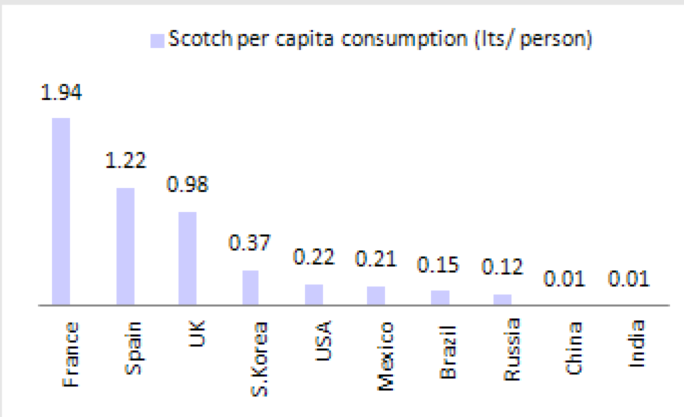
Might pave the way for easing of import duties

International spirits are subjected to 150% import duty plus several state level duties. Consequently, international spirit penetration in India is low (Scotch represents only 1% of total whisky consumption in India, compared to 85% in France, China and Russia).

Scotch forms ~1% of India's whisky demand

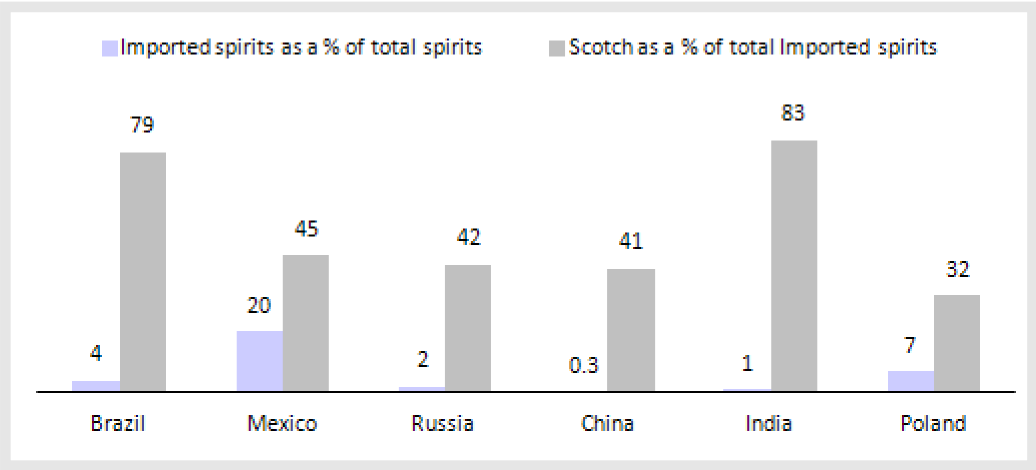


Low Per capita consumption of Scotch



Source: Industry, Company, MOSL

IImported spirits constitue just 1% of total IMFL



Source: Industry, MOSL

One of the understated benefits of the UNSP-Diageo transaction for the industry in general and Diageo in particular, is the potential relaxation in import duties on international spirits. UNSP, being the domestic market leader, was the obvious beneficiary of high import duties and would have resisted any adverse changes. With management control passing on to Diageo, the probability of import duties being lowered has increased.

For many years, talks between India and UK, EU and WTO have hovered around securing a free trade agreement and relaxing the import tariff on spirits. India and EU have been negotiating a comprehensive Free Trade Pact, officially known as Broad-based Bilateral Trade and Investment Agreement (BTIA), since June 2007. The India-EU FTA seeks to open up markets in goods, as well as services and simplify investment rules to boost bilateral trade that crossed USD90b in 2010-11. India exported goods worth USD46.8b to the EU and its imports from the region were USD44.5b.

Spirits and Wines, which enjoy high tariff protection in India, are the two sectors where the EU has been promised increased market access by India in exchange for lower duties for a host of items including textiles, garments, leather, and agriculture products. In December 2011, the media had speculated about reduction in import duty on spirits from 150% to 50%.

INDIA: Wine, spirits import duties to be cut

By just-drinks.com editorial team | 23 December 2011

India's Government is set to reduce the import duty on wine and spirits from 150% to 50%.

The reduction, announced this week by the Prime Minister's office, is expected to take effect from February, according to lobbyists in the country. No formal date has been confirmed yet for full implementation.

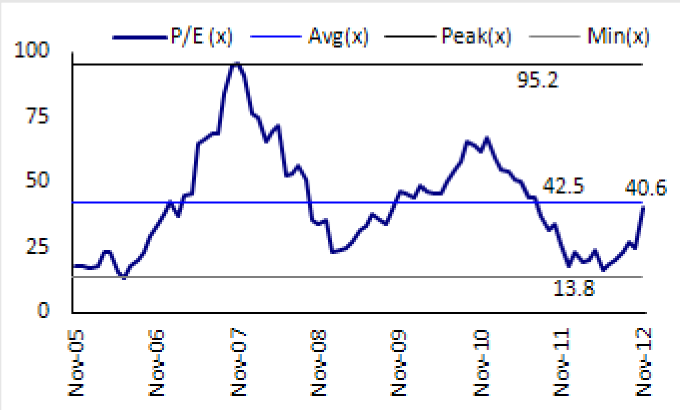
In order to protect local producers, the Government has agreed to a duty-cut on high-end wine and Scotch whisky brands that do not offer direct competition. Wines expected to benefit from the move would be Chardonnays, as India does not use the grape varietal to produce the same quality as Europe.

Negotiations on a free trade agreement between the European Union and India had been expected to complete in the first quarter of 2012. Last month, the Scotch Whisky Association (SWA) launched a lobbying mission in the country against the import tariff barriers.

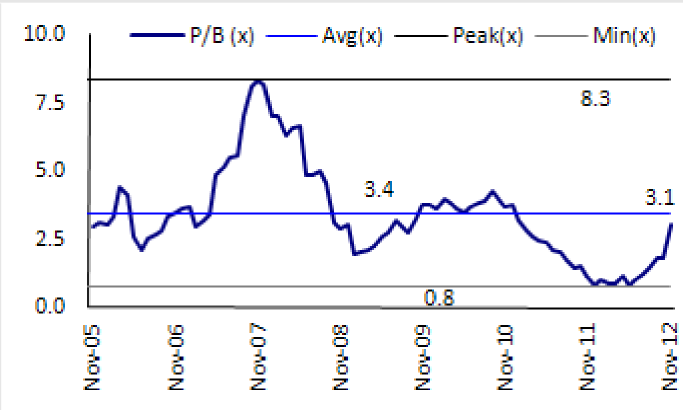
The duties will come down once the EU-India free trade agreement is in place. As and when it happens, Diageo can take advantage of UNSP's distribution strengths in India. The benefits for UNSP shareholders can be through some sort of distribution fee arrangement, assuming UNSP is not merged with Diageo's local operations. Diageo can share a certain percentage of sales/profits it earns from the imported super premium spirits brands with UNSP.

UNSP: Premium valuations can sustain

P/E (x)



P/BV (x)



Source: Bloomberg, MOSL

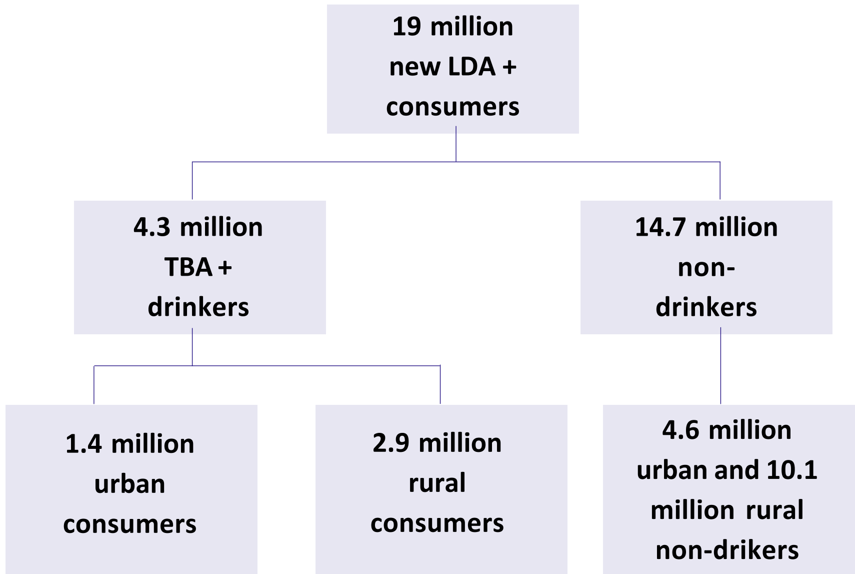
Comparative valuation

	CMP	Reco	EPS (INR)			P/E (x)			EV/EBITDA (x)			RoE (%)			EPS Gr. (%)		
	(INR)		FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E	FY12	FY13E	FY14E
Consumer																	
Asian Paints	4,328	Neutral	103.1	121.5	142.9	42.0	35.6	30.3	26.8	22.4	18.5	36.0	34.7	33.8	17.3	17.8	17.6
Britannia	496	Sell	15.6	18.4	23.7	31.7	27.0	21.0	22.7	17.4	12.6	34.9	35.1	37.9	28.5	17.7	28.7
Colgate	1,442	Neutral	32.8	40.0	46.5	43.9	36.0	31.0	33.4	26.8	22.6	109.4	114.7	108.7	10.9	21.8	16.4
Dabur	128	Neutral	3.7	4.4	5.5	34.2	29.3	23.3	26.2	21.3	17.2	37.9	34.7	35.8	14.6	16.5	25.8
Godrej Consumer	735	Neutral	15.5	22.0	27.8	47.5	33.4	26.5	30.5	23.5	18.3	18.7	23.1	24.9	5.7	42.5	26.0
GSK Consumer	3,690	Buy	84.5	105.2	122.6	43.7	35.1	30.1	27.9	23.8	19.8	31.0	32.3	31.6	18.5	24.5	16.5
Hind. Unilever	538	Neutral	11.9	15.5	18.0	45.2	34.7	29.8	34.8	27.4	23.5	74.6	72.1	63.4	19.5	30.3	16.2
ITC	298	Buy	7.9	9.5	11.3	37.8	31.5	26.3	25.1	20.5	16.9	32.8	33.2	33.4	22.3	20.0	19.8
Marico	222	Buy	5.2	6.5	8.3	42.8	34.3	26.9	30.4	22.0	17.6	28.0	20.9	21.5	34.2	25.1	27.4
Nestle	4,765	Neutral	105.7	112.3	133.9	45.1	42.4	35.6	29.9	25.6	21.0	95.7	71.6	63.5	21.7	6.3	19.3
Pidilite Inds.	214	Buy	7.2	8.5	10.2	29.9	25.3	21.0	21.0	16.0	12.9	26.9	24.7	25.0	8.7	18.3	20.7
Radico Khaitan	**146**	**Buy**	**6.0**	**6.9**	**8.9**	**24.2**	**21.1**	**16.3**	**14.1**	**11.8**	**9.9**	**11.9**	**12.5**	**14.4**	**10.9**	**14.6**	**29.2**
United Spirits	**1,992**	**Buy**	**19.5**	**30.0**	**58.6**	**102.0**	**66.4**	**34.0**	**27.7**	**26.3**	**19.4**	**4.9**	**4.3**	**7.8**	**-30.9**	**53.6**	**95.3**

India an attractive market for spirits

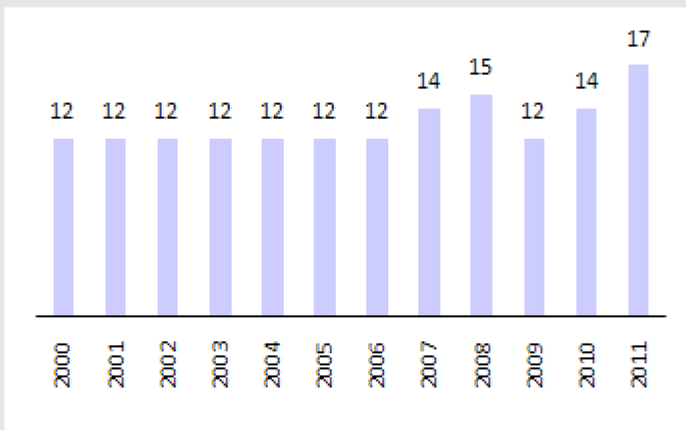
Likely to continue growing at ~10%

1.4m relevant urban consumers enter the legal drinking age every year in India

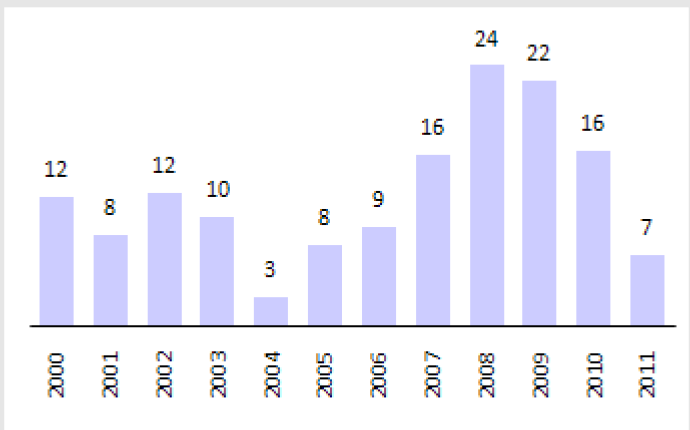


IMFL market has witnessed strong volume and value growth over the years

IMFL value growth over the years



IMFL volume growth over the years



Source: Company, Industry, MOSL

DIAGEO

Diageo in India: Strong in international spirits segment

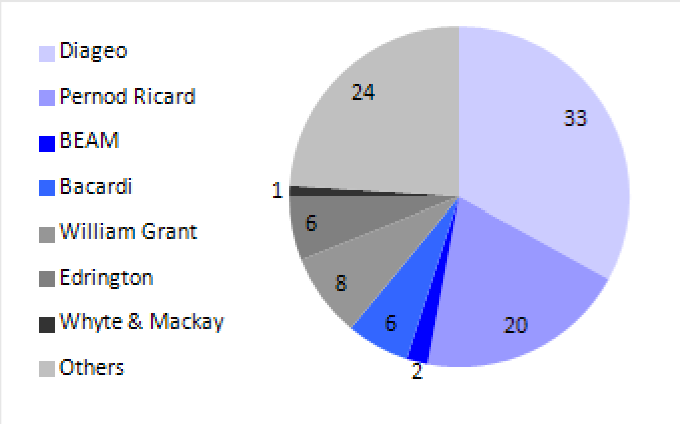
However, overall presence weak; UNSP deal a strategic coup

- **Though Diageo has a strong presence in the niche segment of international spirits, its overall presence in India is limited.**
- **It controls less than 1% of the IMFL market as against the 9% controlled by its MNC competitor, Pernod Ricard.**
- **Management control over UNSP, the market leader in India and the world's largest liquor company by volumes, would be a strategic coup for Diageo.**

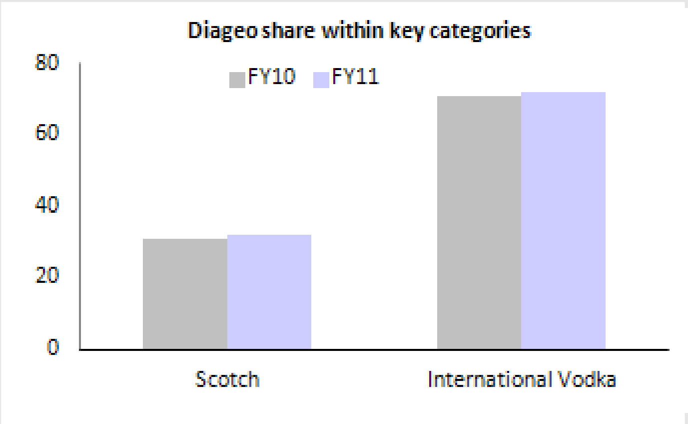
Strong in niche segment of international spirits

Diageo has strong presence in the niche segment of international spirits (scotch, ultra-premium vodka and rum), which constitutes just 6% of the industry.

Diageo: Scotch leader globally…



…with strong India presence in niche segment of international spirits (%)



Source: Diageo, MOSL

Growth in scotch and vodka is a function of increasing penetration and preference for premium liquor, which in turn is driven by favorable macro factors.

The scotch category in India, currently ~ 1.5m cases, is expected to grow at 22% CAGR for the next five years and outperform the industry. This, according to Diageo's management, will be driven by continued premiumization and growing penetration.

Diageo's India revenues are also driven by the duty-free business, which continues to perform well and now contributes ~31% of Diageo's overall India business. It has outperformed competition, and has 70%+ share in the scotch segment and 80%+ share in the super-deluxe blended scotch segment.

Brand footprint

- **Johnnie Walker:** Leader in deluxe and super-deluxe scotch; growing much faster than the 25% overall scotch category growth
- **VAT 69:** Re-launched recently; growing at 52%, more than twice the 22% category growth
- **Smirnoff:** Dominates the international vodka segment

Distribution footprint

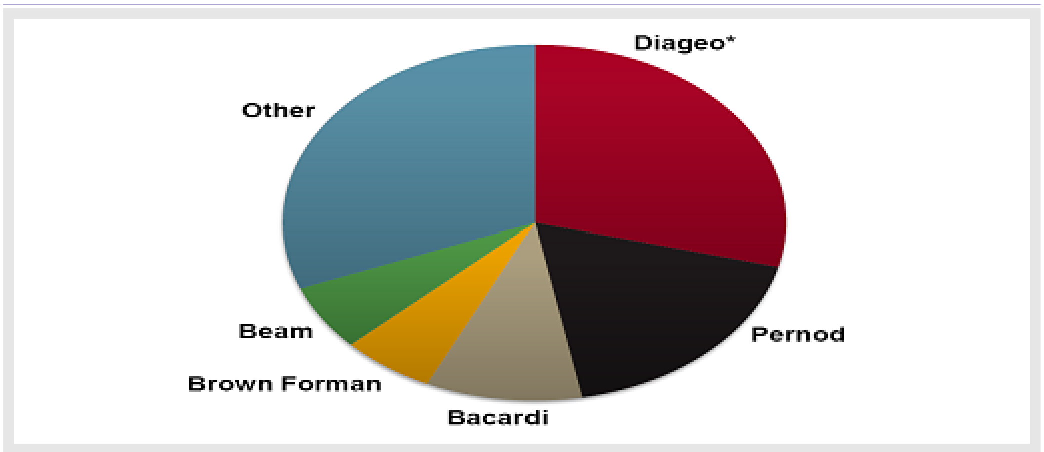
- Reaches 70% of the outlets through own Route to Market and intends to expand reach further

Market leadership in premium scotch with strong growth over the years

Blended Scotch Price Segments	Diageo Brands	F10 - F15 CAGR %	Diageo Share (%) FY11	Diageo Share (%) FY15
USD73 and Above	JW Blue Label JW Gold Label	34	67	71
USD61 - 72	JW Black Label	38	60	64
USD30 - 35	J&B JW Red Label	25	59	65
USD20 - 26	Black & White VAT 69, Haig	20	25	33

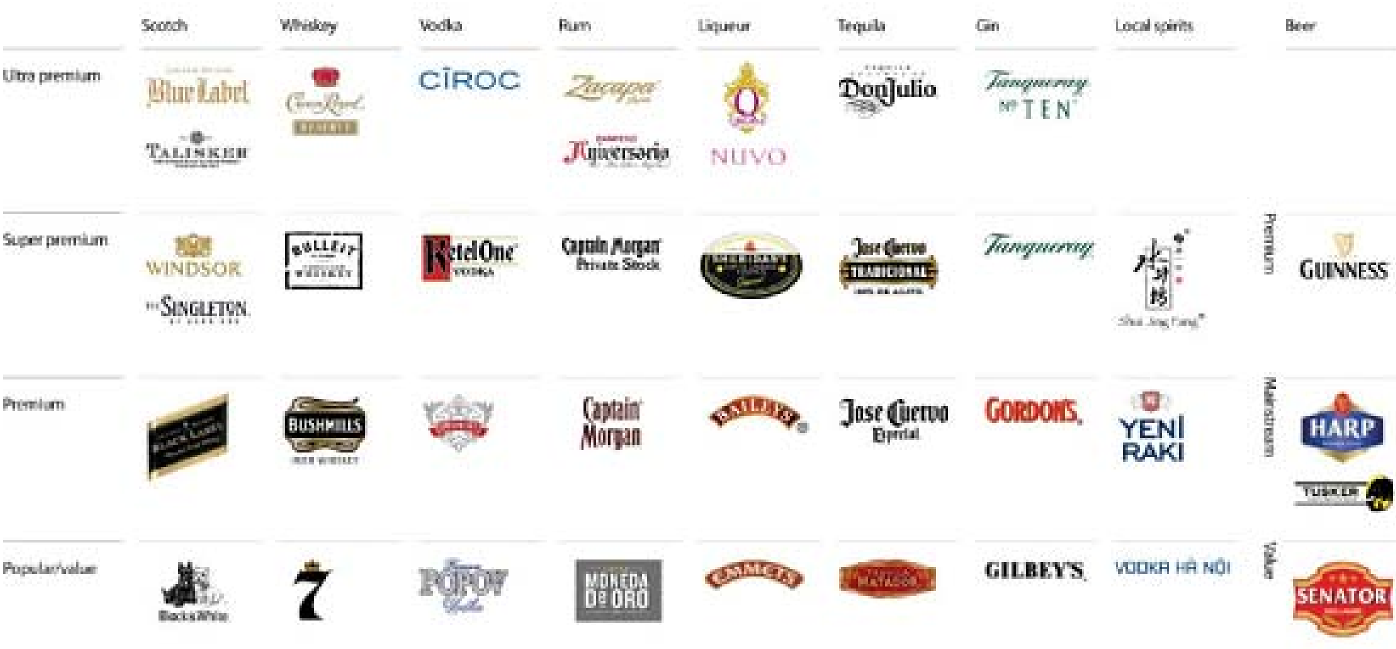
Source: Diageo, MOSL

Diageo has largest number of brands in top 100 premium spirits



Source: Diageo, MOSL

Diageo's global brand architecture: Leading global spirits player



However, overall India presence limited; some disruptions along the way

Overall, Diageo's presence in India is limited. It controls less than 1% of the IMFL market vis-à-vis 9% controlled by Pernod Ricard, its MNC competitor in India. Also, Diageo does not have a pan-India distribution reach; it is not present in all the states, which has constrained its market share.

In 2002, Diageo had sold a portfolio of Indian whisky, including Gilbey's Green Label, to its management which subsequently sold it to UNSP. This marked its exit from the Indian market for domestically produced whisky. Consequently, Diageo's expansion efforts in India relied on its international spirits brands.

Diageo's India operations were disrupted in 2009-10 due to mismanagement (inventory mismanagement, inflated promotional expenses and other losses). Diageo brought Mr Roland Abella as India Head in March 2009 and has worked at getting focus back on the business in the last 3-4 years.

Also, the US SEC had imposed a fine of USD16m on Diageo for violating the Foreign Corrupt Practices Act in India, Thailand and South Korea.

Diageo fined $16-million by SEC for Bribing officials in India, Thailand, South Korea
ET Bureau | Jul 30, 2011

BANGALORE: The US Security and Exchange Commission has slapped penalties of $16 million on Diageo Plc for bribing officials in India and some other countries to increase its sales and earn tax benefits.

The maker of Johnnie Walker Scotch Whisky and Smirnoff vodka had offered bribes of $2.7 million across India, Thailand and South Korea, which the SEC said violated the US Foreign Corrupt Practices Act. A chunk of these payments, amounting to $1.7 million, were made in India and Diageo did not accurately account for these in its books by either masking or excluding them, the SEC said.

"Diageo takes the SEC's investigation findings seriously and regrets this matter," a company statement said on Wednesday.

"Under the settlement, Diageo has agreed to pay $13,373,820 to the SEC in disgorgement of profits and pre-judgment interest, to pay $3 million (as) penalty and to cease and desist from committing any further violations of the books and records and internal controls provisions of the FCPA," the statement said.

The SEC order said Diageo paid Indian government officials during 2003 to mid-2009, yielding the company more than $11 million in profit. "Systems and controls have been enhanced to prevent occurrence of such issues and to reinforce a culture of compliance embodied in Code of Business Conduct," the statement said.

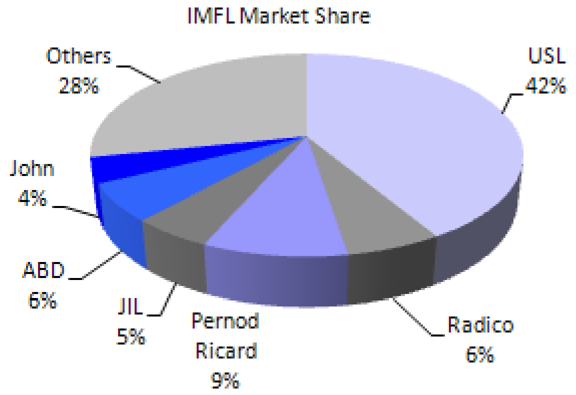
Currently, Diageo's India operations are focused on *Johnnie Walker* and *VAT 69* blended scotch and *Smirnoff vodka*. In October 2011, it launched its first Indian-made whisky, *Rowson's Reserve* in the premium segment at INR885 for a 750ml bottle in Maharashtra. Subsequently, the brand was rolled out in Haryana, Punjab and Karnataka.

UNSP deal a strategic coup; high quality distribution netowrk gained

UNSP is the leading IMFL player, with volume sales of 122m cases, 41% market share by volume and 22 millionaire brands. It services 64,000 outlets across India and 98% of the on-and-off-premises network. It has manufacturing and bottling presence in all states, with 40 owned plants and 42 contract tie-ups. Its deal with UNSP, which gives it management control over the leader in an extremely attractive sprits market, is thus, nothing less than a strategic coup. Through UNSP, Diageo becomes the market leader in India, leaving its MNC competitor, Pernod Ricard far behind in the race. Also, as and when import duties come down, Diageo will be able to use the largest distribution network in India to push its premium liquor brands in India.

UNSP: The leading IMFL player in volume terms

2011 Indian volume market share by distributor



UNSP: Category positioning in India

Category	Rank	Volume share (%)
Blended Scotch Whisky	3	19.8
Other whiskies	1	41.8
Brandy	1	41.2
Gin	1	39.5
Vodka	1	47.6
White Rum	2	14.8
Dark Rum	1	43.1
Wine	2	13.4
Total	**1**	**41.3**

Source: UNSP, MOSL

UNSP deal: What's in it for Diageo?

- **Strong market presence:** UNSP is the leading IMFL player, with volume sales of 122m cases, 41% market share by volume and 22 millionaire brands.
- **Distribution strength:** UNSP services 64,000 outlets, 98% of on-and-off-premises network.
- **Manufacturing strength:** UNSP has manufacturing and bottling presence in all states through 40 owned plants and 42 contract tie-ups.

> "The combination of United Spirits' strong business with the capabilities which Diageo brings as the world's leading premium drinks company will ensure that United Spirits continues to lead the industry in India."
> - Diageo's Chief Executive, Mr Paul Walsh

Through UNSP, Diageo becomes the market leader in India, overnight, leaving its MNC competitor, Pernod Ricard far behind in the race. It gains access to the largest distribution network in India to push its premium liquor brands in the long term.

United Spirits

BSE SENSEX	S&P CNX
19,340	5,880

UNITED SPIRITS

Bloomberg	UNSP IN
Equity Shares (m)	130.8
52-Week Range (INR)	2,149/450
1,6,12 Rel. Perf. (%)	65/221/165
M.Cap. (INR b)	260.5
M.Cap. (USD b)	4.8

Valuation summary (INR b)

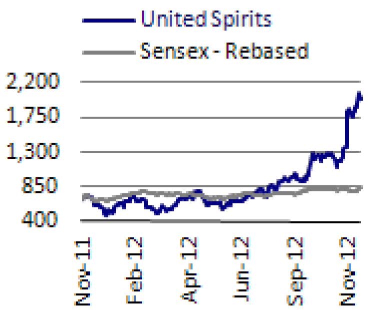
Y/E March	2012	2013E	2014E
Sales	87.8	98.4	113.2
EBITDA	11.9	12.7	16.2
NP	2.4	3.7	7.2
Adj. EPS (INR)	19.0	25.3	49.3
EPS Gr. (%)	-30.9	33.0	95.3
BV/Sh. (INR)	398	694	629
P/E (x)	104.9	78.9	40.4
P/BV (x)	5.0	2.9	3.2
EV/EBITDA (x)	28.8	24.7	19.0
EV/Sales (x)	3.9	3.2	2.7
RoE (%)	4.9	4.3	7.8
RoCE (%)	8.3	8.5	10.9

Prices as on 30 November 2012

Shareholding pattern %

As on	Sep-12	Jun-12	Sep-11
Promoter	27.8	27.8	28.0
Dom.Inst	4.9	6.1	2.6
Foreign	51.2	54.9	58.2
Others	16.1	11.2	11.2

Stock performance (1 year)



CMP: INR1,992 TP: INR2,490 Buy

The party has just begun

Re-rating to sustain notwithstanding rich valuations; Buy

- **Post the announcement of the deal, UNSP stock has been re-rated on the back of expected improvements in balance sheet (working capital, leverage, and thus, capital efficiency) post management control by Diageo.**
- **We maintain our positive stance on UNSP - the apparent expensive valuations will be dwarfed by the attractive and profitable long-term opportunity that IMFL offers.**
- **Though it might not exactly be a like-to-like comparison, a precedent exists in the deal between Heineken and United Breweries (UBBL). UBBL has continued to trade at expensive valuations after the Heineken deal in 2009.**
- **We reiterate Buy, with a revised target price of INR2,490.**

Deal with Diageo to bring plethora of structural improvements

We believe that the deal is beneficial for UNSP shareholders, as it will bring a plethora of structural improvements. It will help bring focus back on the core IMFL business, bring in greater transparency, and result in an improvement in operational as well as financial discipline. We expect Diageo's unwavering focus on premiumization to:

- Help expand margins gradually - the management mentioned 20% operating margin as an achievable target
- Improve capital efficiency, led by better working capital and judicious capital allocation decisions
- Reduce leverage cost, post the cash infusion

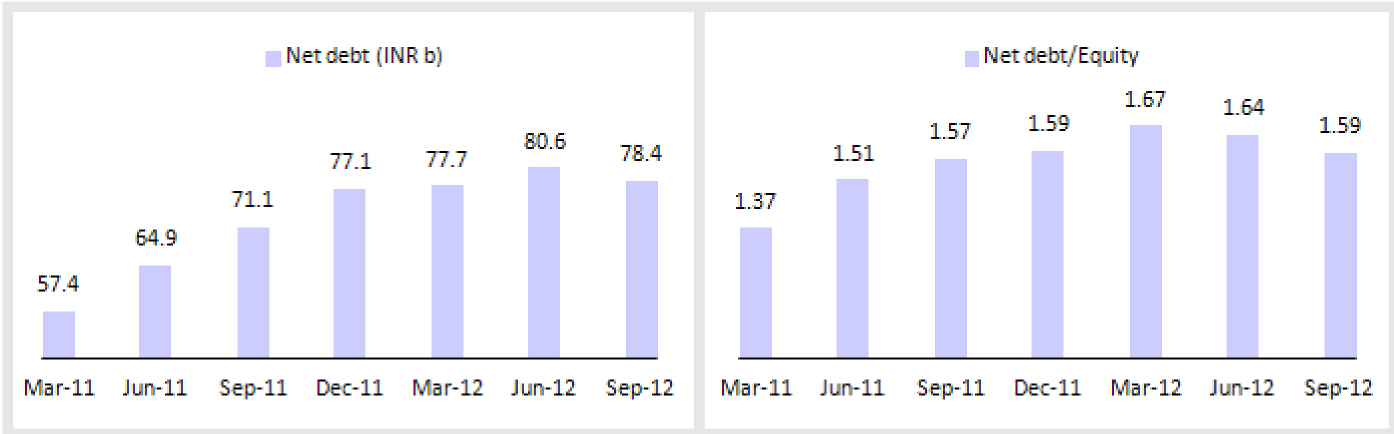
However, we expect advertising and brand building investments to accelerate, going forward, as Diageo sets out to correct under-investment in premium brands.

We model 15.3% EBITDA margin for FY15, as we expect margin improvement trajectory to be gradual. We believe our margin assumptions are conservative and reflect the complexity of the IMFL market. Though we are confident of structural margin improvement in the business, accelerated brand investments (management attested to this) will restrict margin improvement in the initial years. Given the timeframe involved in deal completion and the regulatory formalities, we expect most of the benefits to start accruing in 2HFY14.

Short-term benefits

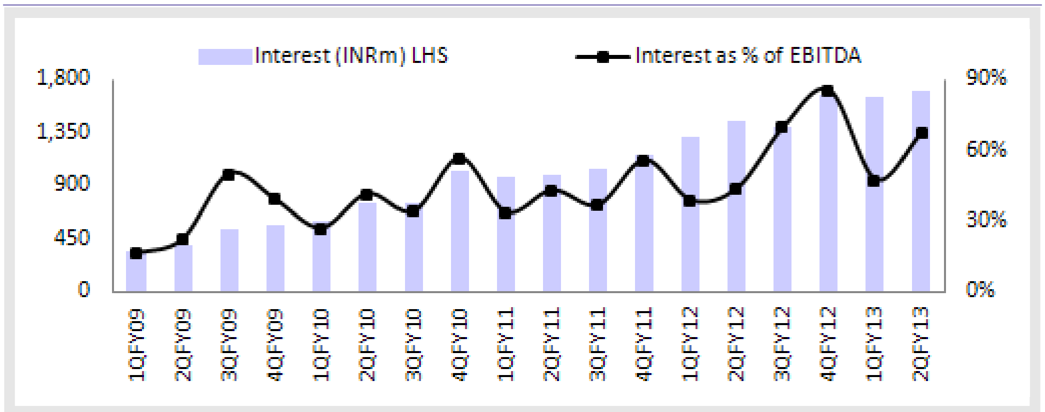
- Of the INR57.24b consideration received for the 27.4% stake sale, INR33b will go into UNSP's balance sheet.
- The fund infusion will be used to retire UNSP's debt, which currently stands at INR83b.
- This will immediately reduce interest cost by INR3.3b, assuming interest rate of 10%.
- Interest cost has consumed bulk of UNSP's EBITDA over the years.

Net debt and leverage position has worsened over the years



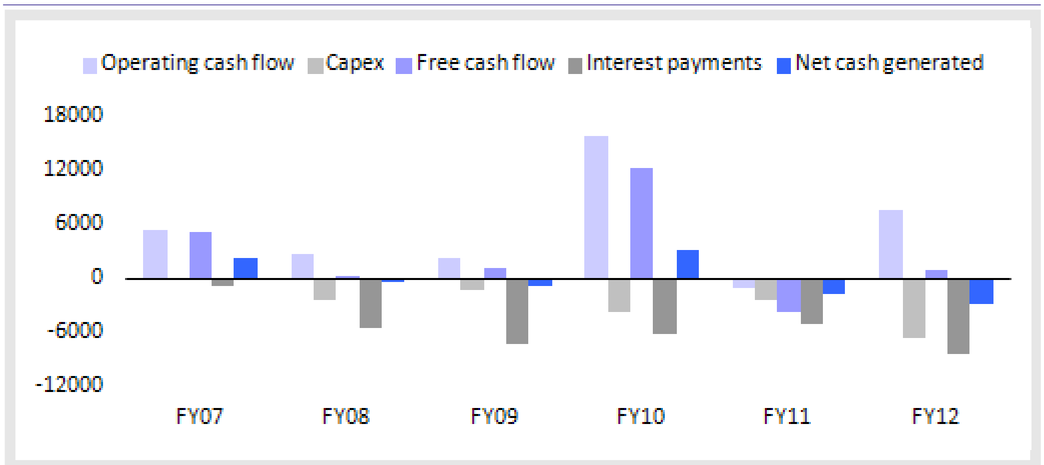
Source: Company, MOSL

Interest costs consumed~54% of EBITDA in FY12



Source: Company, MOSL

Cash flows too were impacted with inconsistent FCF generation (INR m)



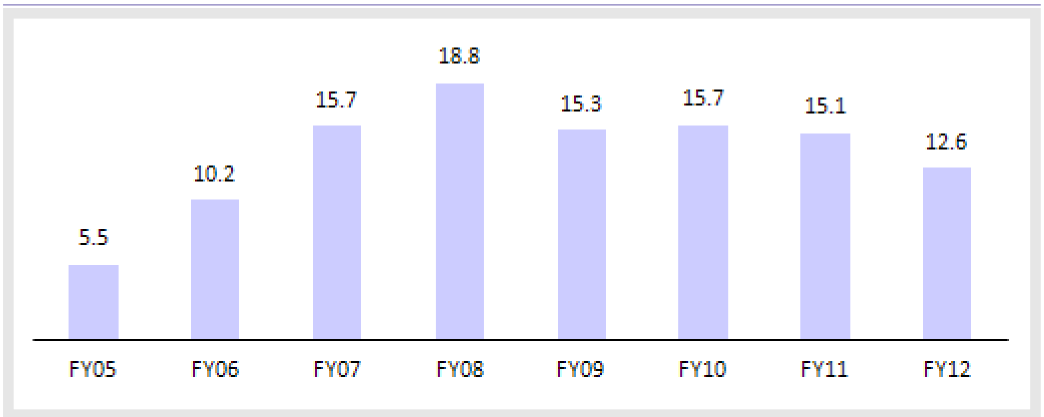
Source: Company, MOSL

Medium-term benefits

- **Better focus on core IMFL business:** Though issues surrounding group companies (Kingfisher Airlines) did not have a direct impact on UNSP's operations, they sapped top management bandwidth. This resulted in reduced focus on the core business, which was already facing trade issues in Tamil Nadu, higher excise in West Bengal, rising input costs, worsening working capital and a leveraged balance sheet.

- **Increased focus on premiumization:** While UNSP has shifted its focus from garnering volumes towards profitability in the recent past, we believe Diageo's arrival will hasten the shift. The premium segment of the industry has been outperforming mid and low-end brands, driven by favorable underlying consumption drivers - rising incomes, favorable demographics and elevated aspirations. Rising excise duties in states makes it imperative for UNSP and peers to drive premiumization to capture better value.
- **Margin improvement:** UNSP's focus on premiumization should help drive operating margin, which is currently 13-14%. In the conference call, the management sounded positive about reaching for the 20% operating margin target in the medium to long term.

EBITDA margins deteriorated ~600bp in four years



Source: Company, MOSL

- **Adequate brand investments:** We expect Diageo to accelerate brand investments in the premium segment to augment its market presence. We believe the UNSP management has under-invested in premium brands. For example, Black Dog has not seen sufficient investment support in our view.
- **Better capital allocation:** We expect improved capital allocation efficiency and judicious use of the capital, which, in our view, is a key area of improvement for UNSP.
- **Working capital improvement:** Combination of improved margin profile and judicious capital allocation decisions should provide incremental succor to the working capital position, going forward.
- **Improved operational discipline and transparency:** Possible adoption of global best practices by Diageo will provide significant improvement in transparency levels as well as operational business discipline.

Long-term benefits

- Successful achievement of aforementioned positives should help sustain and augment stock re-rating in our view.
- We believe the IMFL opportunity is attractive in the long term. Being the market leader with 55%+ market share, UNSP should be the key beneficiary.
- With improved capital position and focused management, we see strong structural improvements in UNSP's business model, going forward.
- In this context, we note the substantial re-rating of United Breweries post the Heineken deal in CY09.

W&M and IPL team stake divestments are possible upside triggers

Diageo will not hesitate to sell UNSP's 100% subsidiary, Whyte and Mackay, if the regulator requires it to. The management has said that it does not need W&M's bulk scotch inventory or its brands. Any announcement pertaining to W&M stake sale can act as a positive trigger for UNSP. Similarly, UNSP's IPL subsidiary, Royal Challengers Sports can also be sold. The management has, however, clarified that it will continue with its investments for now.

- **Whyte and Mackay (W&M)**

UNSP acquired Whyte and Mackay (W&M) in May 2007 for GBP595m. Pre-FY11, W&M was essentially a bulk scotch supplier to global players like Diageo. However, UNSP did not renew the contract with Diageo when it ended and W&M's EBITDA has since declined from GBP55m to GBP33m. UNSP's rationale for not renewing the contract was to use the strategic inventory for in-house brands. Post the UNSP-Diageo deal, Diageo will control the W&M business and this could lead to anti-trust issues in UK and EU.

W&M financials since acquisition: EBITDA has almost halved since acquisition

W&M P&L (GBP m)	May 2007 to March 2008	FY08	FY09	FY10	FY11	FY12	FY13 1Q	FY13 2Q	FY13 1H
Net Sales	157.10	179.54	176.00	177	140.88	187.01	33.77	72.02	105.79
Gross Profit	86.90	99.31	94.34	93.1	68.76	85.06	12.00	32.88	44.88
EBITDA	52.10	59.54	56.50	57.7	30.32	35.91	1.19	20.40	21.59
P B T	2.70	3.09	0.38	29	12.43	15.41	(1.83)	17.09	15.26
Contrib. Margin (%)	42.1	42.1	40.6	39.5	29.3	26.7	14.4	34.3	27.9
EBITDA Margin (%)	33.2	33.2	32.1	32.6	21.5	19.2	3.5	28.3	20.4

Source: Company, MOSL

Diageo has clarified that W&M will not change the contours of the deal and it will offload W&M stake if required. W&M's brands and scotch inventory are of limited strategic value to Diageo. Chief Executive, Mr Paul Walsh has been quoted as saying, "We are somewhat ambivalent and we will look to see how the regulators feel about this one and make our decision accordingly. W&M is not a swing issue here."

Media speculation about possibility of stake sale in W&M

Whyte & Mackay may be put on block to smoothen Diageo deal

Arijit Barman, ET Bureau | Nov 17, 2012

MUMBAI: Is Whyte & Mackay on the block? Several analysts and industry watchers believe the deal with Diageo, the world's largest drinks company, may force Vijay Mallya's flagship United Spirits to sell the Scottish distiller that it bought five years ago.

They site two reasons: one, the Glasgow-based Scotch maker may not be of strategic interest to Diageo, the largest Scotch maker; two, anti-trust regulators in the UK and Europe are expected to review their combined Scotch production capacity and market share.

Analysts say that several industry players such as Italy's Gruppo Campari that owns the Glen Grant brand, Bacardi and Japanese firm Suntory would want to gulp up Whyte & Mackay (W&M) that owns brands such as Dalmore and Isle of Jura to scale up their presence in the Scotch market.

Names of buyout PE funds such as Carlyle are also being speculated upon. "Diageo has the largest share of Scotch production in the world. So it's logical that W&M will have to be sold for the Diageo-United Spirits deal to go through," Olly Wehring, managing editor of Just-Drinks.com, an UK-based beverage industry news provider, said. "But for the moment, all eyes will be on the regulators and it will be premature to say anything with a degree of finality," he added.

W&M stake sale: EV/EBITDA of 10x can result in GBP250m of capital infusion into UNSP

EBITDA	35.9
Multiple	10.0
EV	359
Net Debt	108.2
Equity	250.8

Source: Company, MOSL

W&M's EBITDA has declined from GBP57.7m in FY10 to GBP35.9m in FY12. If W&M were to be sold, we do not expect it to fetch EV/EBITDA of more than 10x, given its weak brand positioning. Assuming a 10x multiple, W&M stake sale can result in capital infusion of GBP250m (INR22.4b at current exchange rates). This coupled with INR33b of infusion on account of treasury share sale and preferential allotment as part of the broader Diageo-UNSP deal can bring down UNSP's debt to INR23b. We are not building in any W&M transaction in our numbers yet.

- **Royal Challengers Sports (Bengaluru IPL team)**

UNSP also owns the Royal Challengers team in IPL through its wholly-owned subsidiary, Royal Challengers Sports. In the post deal conference call, Diageo's management talked about continuing its investment in IPL. "The Cricket Team clearly is one of the brand building mechanisms for Royal Challenge so we envisage it continuing. But clearly, when we get in and once we complete on this deal, we will look at all of that in terms of really understanding the most effective way to leverage it." However, the possibility of sell-out should not be ruled out, in our view.

According to the FY12 balance sheet, book investments in the IPL team stand at INR1.7b. Term liability towards the team stood at INR2.8b, and is payable over six years, with INR492.4m payable in FY13. In FY12, the team made a loss of INR70.8m.

Failure of open offer will not have any near-term impact

The failure of the open offer (open offer price way below current market price) will not have any repercussions on operations, as Diageo has secured board and management control of the business for the next four years. We do not expect Diageo to revise its open offer price upwards.

However, if preferential allotment fails, cash infusion into UNSP will be restricted

If the preferential allotment fails, it will constrain infusion of capital for debt reduction into UNSP. Due to the sharp appreciation in UNSP's stock price post the deal announcement, there are concerns about the success of the preferential allotment. If the preferential allotment does not succeed, UB Group will sell additional shares so as to take Diageo stake to 25.1%, thus triggering an open offer. However, in such an eventuality, potential cash infusion will be restricted to INR12.24b.

Will the preferential allotment succeed? Most likely, yes.

According to SEBI (DIP) guidelines, 2000, the issue of shares on a preferential basis can be made at a price not less than the higher of the following:

- The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date, or
- The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

The "relevant date" for the purpose of this clause means the date thirty days prior to the date on which the meeting of general body of shareholders is held, in terms of Section 81(1A) of the Companies Act, 1956 to consider the proposed issue.

Maintain Buy, with a revised target price of INR2,490

Target Price	FY15E
EBITDA	20,120
EV/EBITDA	20
EV	402,409
Net Debt	40,681
Equity	361,728
No of Shares	145
Value/Share	2,490
Current Price	1,992
Upside (%)	24.9

Source: Company, MOSL

As per the BSE announcement on 12 November 2012, UNSP has already sent a notice for postal ballot for the approval of preferential allotment. The document posted by UNSP on the stock exchanges says, "The "relevant date" for the preferential issue, as per the ICDR Regulations, for the determination of applicable price for the issue of the Allotment Shares shall be 14 November 2012, which is the date that is 30 (thirty) days prior to the date on which results of the postal ballot to be conducted for the purpose of seeking the approval of members to the proposed preferential issue, are to be declared, which is deemed to be the date of the General Meeting passing the resolution in accordance with Section 192A of the Companies Act, 1956 read with the relevant rules thereunder."

Thus, as per the regulatory requirements, the deal will not face any hurdles, as the relevant weekly averages prior to 14 November 2012 are below the proposed price of INR1,440/share.

Global spirits valuation

Annual	EPS Gr. (%)		P/E (x)		P/B (x)		EV/EBITDA (x)	
Performance	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Global Alocholic Beverage Cos								
Diageo PLC	32.1	11.8	18.2	16.3	6.4	5.3	14.3	13.2
Heineken NV	20.9	18.8	18.1	15.8	2.7	2.5	10.1	8.7
Carlsberg A/S	0.3	12.7	15.6	12.9	1.2	1.1	8.8	8.2
Anheuser-Busch InBev NV	18.2	28.7	18.7	17.1	3.2	2.9	11.5	9.8
SABMiller PLC	27.0	36.8	19.3	17.2	2.7	2.5	14.2	12.9
Takara Holdings Inc	12.1	15.0	26.5	22.3	1.3	1.3	0.0	0.0
Thai Beverage PCL	48.8	18.0	16.1	14.4	3.9	3.5	14.2	13.1
Luzhou Laojiao Co Ltd	5.8	11.3	10.9	8.7	4.6	3.4	7.1	5.5
Pernod-Ricard SA	19.8	14.9	17.3	15.2	2.0	1.9	13.0	12.0

Source: Company, MOSL

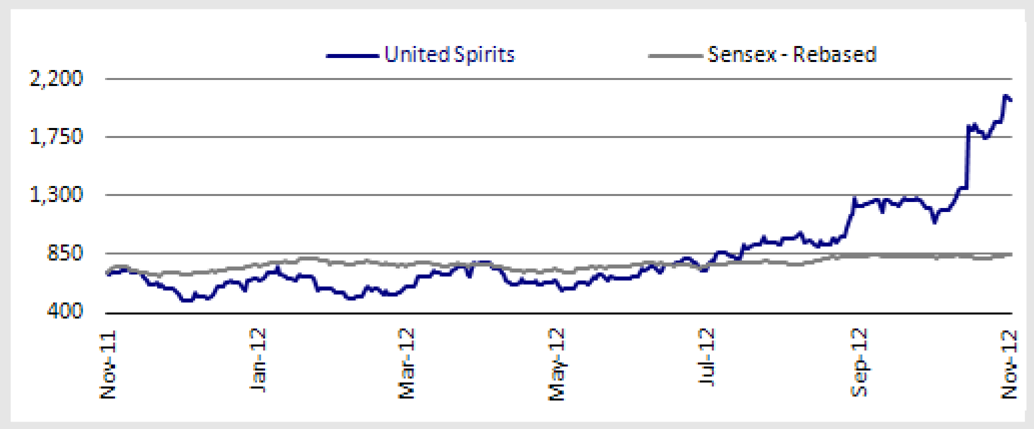
Maintain Buy, with a revised target price of INR2,490

We maintain our **Buy** rating, with a revised target price of INR2,490 (EV of 20x FY15E EBITDA). The next few quarters could be challenging on account of sustained pressure in Tamil Nadu and West Bengal markets coupled with business transition post the deal completion.

Concerns/risks: (1) Delay in expected margin improvement, (2) any regulatory uncertainty pertaining to the deal.

Re-rating to sustain notwithstanding rich valuations

Post the Diageo deal announcement, UNSP has rallied significantly



Source: Bloomberg

UBBL case study: Rich valuations sustained after Heineken deal

United Breweries' (UBBL) performance improved post the deal with Heineken. Volumes and profits increased significantly post the transaction. Market share went up, leverage came down and PAT moved up 3x over FY09-12. Consequently, UBBL got re-rated.

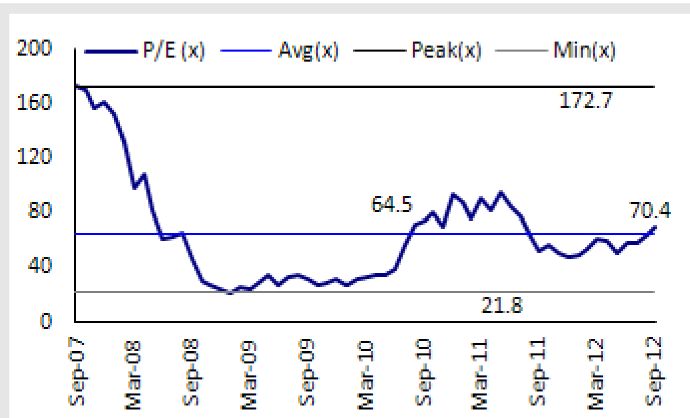
UBBL's financial performance improved after the Heineken deal...

(INR m)	FY07	FY08	FY09	FY10	FY11	FY12
Volumes (m cases)	66	75	82	101	125	133
Growth (%)		13.9	9.4	22.6	24.2	6.0
Market share (%)		NA	48.0	50+	54.0	54.5
Net Sales	**11,968**	**15,590**	**19,295**	**22,755**	**30,598**	**36,252**
Growth (%)		30.3	23.8	17.9	34.5	18.5
EBITDA	**1,737**	**2,157**	**2,807**	**3,174**	**4,353**	**4,659**
Margin (%)	14.5	13.8	14.5	13.9	14.2	12.9
Interest	412	576	1,054	665	779	989
EBIT	**1,325**	**1,581**	**1,752**	**2,509**	**3,574**	**3,670**
Profit before Tax	**851**	**850**	**856**	**1,469**	**2,266**	**2,182**
Net Profit	**550**	**542**	**456**	**896**	**1,475**	**1,398**
Margin (%)	4.6	3.5	2.4	3.9	4.8	3.9
Net Debt	**4,795**	**6,694**	**7,138**	**7,035**	**6,491**	**6,995**

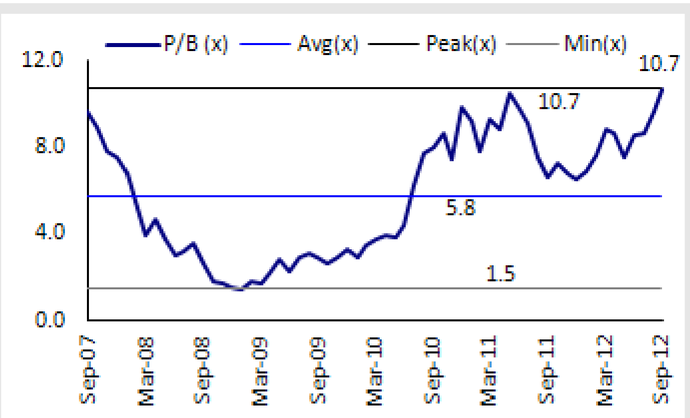
Source: Company, MOSL

...leading to significant re-rating

P/E (x)



P/BV (x)



Source: Bloomberg, MOSL

Evolution of United Breweries (UBBL)

- **Until 2003**

- **Three-way JV with S&N and Mr Ravi Jain:** United Breweries (UBBL) had a subsidiary, McDowell AlcoBev. In 2002, McDowell AlcoBey passed on to a three-way JV between UB Group company, UB Beer, Scottish and Newcastle (S&N) and Mr Ravi Jain (through Accra Investments), and was re-named as Millennium AlcoBey. The three JV partners held equity in the ratio 40:40:20 and Mr Ravi Jain headed the JV. (In 2006, Mr Jain sold his stake equally to UB Group and S&N for INR180m).
- **Strategic relationship with S&N:** Scottish and Newcastle (S&N) formed a strategic partnership with the UB Group by investing INR3.9b in the form of equity shares and preference shares in UB Beer and McDowell AlcoBev. In UB Beer, S&N invested INR10m in up to 1% equity shares and INR2b in redeemable optionally convertible preference shares with a dividend of 8.5% per annum. In AlcoBey, it invested INR540m to subscribe to 40% of the voting equity shares and INR1.35b to subscribe to preference shares.
- The agreement between UB Group and S&N envisaged marketing of S&N's international brands in India, including its flagship brands *Kronenbourg*, *Johnsmith* and *Newcastle Brown Ale*. The UB Group would utilize S&N's overseas network to market its beer brands, including the flagship brand, *Kingfisher*.

- **2004-05**

- In December 2004, the UB Group entered into an agreement with Scottish and Newcastle (S&N), allowing it to acquire 37.5% in United Breweries (UBBL).
- S&N received 17.5% of UBBL's equity through a preferential allotment for a consideration of INR2.17b at INR575/share. It then made a public offer and acquired another 20% stake at INR575/share. It then invested further INR2.47b through redeemable preference shares (non-convertible), with a coupon rate of 3%.
- After this deal, Millennium AlcoBev was merged with UBBL.

- **Post 2008 (Heineken-UBBL)**

- In January 2008, S&N's global operations were jointly acquired by Carlsberg and Heineken for USD15.4b. Consequently, Heineken got hold of S&N's 37.5% stake in UBBL.
- This was opposed by Dr Vijay Mallya, as Heineken already owned ~44% in Asia Pacific Breweries (APB). APB used to sell beer brand, *Tiger* in India. Heineken would, therefore, have dual interest in India - one with APB and one with UBBL.
- The UB Group even moved the Bombay High Court to restrain Heineken from exercising management rights that were accorded to S&N, citing that Heineken was part of a rival firm, APB.
- This issue was resolved in December 2009. Heineken brought APB's assets in India and transferred them to UBBL. Besides, it transferred rights to brew, bottle and distribute Heineken brands in India to UBBL and paid a one-time fee of INR3b.
- The "peace" deal ensured that Heineken got the same rights - power to nominate the Chief Financial Officer and equal board representation, which S&N had enjoyed.

UNSP: Financials and Valuation

Income Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Net Sales	**68,586**	**82,141**	**92,364**	**106,470**	**123,699**
Other Operating Inc	5,175	5,652	6,036	6,754	7,509
Total Revenue	**73,762**	**87,794**	**98,400**	**113,224**	**131,207**
Change (%)	15.9	19.0	12.1	15.1	15.9
Total Expenditure	-63,115	-75,914	-85,726	-97,047	-111,087
EBITDA	**10,647**	**11,879**	**12,674**	**16,177**	**20,120**
Change (%)	-4.3	11.6	6.7	27.6	24.4
Margin (%)	14.4	13.5	12.9	14.3	15.3
Depreciation	-1,023	-1,448	-1,695	-1,846	-1,999
Int. and Fin. Charges	-4,985	-7,525	-5,925	-3,563	-2,866
Other Income - Recurring	904	857	867	886	909
Profit before Taxes	**5,543**	**3,764**	**5,921**	**11,655**	**16,165**
Change (%)	11.9	-32.1	57.3	96.9	38.7
Margin (%)	7.5	4.3	6.0	10.3	12.3
Tax	2,098	1,374	2,250	4,487	6,223
Tax Rate (%)	37.8	36.5	38.0	38.5	38.5
Minority Interest	-12	-12	-12	-12	-12
Adjusted PAT	**3,458**	**2,390**	**3,671**	**7,168**	**9,941**
Change (%)	14.3	-30.9	53.6	95.3	38.7
Margin (%)	4.7	2.7	3.7	6.3	7.6
PAT after Non-rec. (Exp)/Income	**5,695**	**3,170**	**3,671**	**7,168**	**9,941**

Balance Sheet (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Share Capital	1,259	1,259	1,453	1,453	1,453
Reserves	40,527	47,254	83,264	89,757	98,948
Minority Interest	175	200	200	200	200
Net Worth	**41,961**	**48,712**	**84,917**	**91,411**	**100,601**
Loans	67,107	88,002	54,792	48,582	41,372
Deffered Tax Liabilities	-325	-209	-17	207	518
Capital Employed	**108,743**	**136,506**	**139,692**	**140,200**	**142,491**
Gross Block	26,972	40,222	43,472	46,722	49,972
Less: Accum. Depn.	-7,573	-9,020	-10,716	-12,561	-14,560
Net Fixed Assets	**19,399**	**31,201**	**32,756**	**34,160**	**35,411**
Capital WIP	1,291	1,100	2,350	1,850	1,850
Goodwill	44,320	49,797	49,797	49,797	49,797
Investments	1,544	1,539	1,539	1,539	1,539
Curr. Assets, L&A	**61,842**	**74,487**	**78,059**	**83,490**	**91,408**
Inventory	21,168	26,218	29,385	32,261	35,947
Account Receivables	14,825	21,167	23,454	25,437	27,679
Cash and Bank Balance	4,944	5,110	2,098	315	997
Bank Deposit	1,426	104	477	40	273
Others	19,479	21,888	22,645	25,437	26,511
Curr. Liab. and Prov.	**20,102**	**24,236**	**27,427**	**33,254**	**40,132**
Account Payables	13,304	16,356	18,602	23,265	28,758
Other Liabilities	5,026	6,013	6,740	7,755	8,987
Provisions	1,771	1,867	2,086	2,234	2,387
Net Current Assets	**41,741**	**50,251**	**50,632**	**50,235**	**51,276**
Msc Expenses	448	2,618	2,618	2,618	2,618
Application of Funds	**108,742**	**136,506**	**139,692**	**140,200**	**142,491**

E: MOSL Estimates

UNSP: Financials and Valuation

Ratios

Y/E March	2011	2012	2013E	2014E	2015E
Basic (INR)					
EPS	**28.2**	**19.5**	**30.0**	**58.6**	**81.2**
Cash EPS	36.6	31.4	43.8	62.0	82.2
BV/Share	342.8	397.9	693.7	629.0	692.2
DPS	2.5	3.0	4.0	4.5	5.0
Payout %	8.9	15.4	13.3	7.7	6.2
Valuation (x)					
P/E		102.0	66.4	34.0	24.5
Cash P/E		63.5	45.4	32.1	24.2
EV/Sales		3.9	3.2	2.7	2.3
EV/EBITDA		28.8	24.6	19.0	14.9
P/BV		5.0	2.9	3.2	2.9
Dividend Yield (%)		0.2	0.2	0.2	0.3
Return Ratios (%)					
RoE	8.2	4.9	4.3	7.8	9.9
RoCE	9.7	8.3	8.5	10.9	13.4
Working Capital Ratios					
Debtor (Days)	73	88	87	82	77
Asset Turnover (x)	0.7	0.6	0.7	0.8	0.9
Leverage Ratio					
Debt/Equity (x)	1.6	1.8	0.6	0.5	0.4

Cash Flow Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
OP/(loss) before Tax	10,647	11,879	12,674	16,177	20,120
Int./Div. Received	904	857	867	886	909
Interest Paid	-4,985	-7,525	-5,925	-3,563	-2,866
Direct Taxes Paid	-2,098	-1,374	-2,250	-4,487	-6,223
Incr/Decr in WC	-11,211	-9,666	-3,021	-1,823	-126
CF from Operations	**-6,742**	**-5,828**	**2,345**	**7,190**	**11,814**
Extraordinary Items	2,238	780	0	0	0
(Incr)/Decr in FA	-5,452	-18,536	-4,500	-2,750	-3,250
(Pur)/Sale of Investments	-279	5	0	0	0
Msc Exp	0	2,170	0	0	0
CF from Invest.	**-3,493**	**-15,581**	**-4,500**	**-2,750**	**-3,250**
Issue of Shares	-1,173	4,039	33,144	12	12
(Incr)/Decr in Debt	8,603	20,895	-33,210	-6,210	-7,210
Dividend Paid	-381	-458	-610	-686	-763
Others	1,871	-4,224	191	224	311
CF from Fin. Activity	**8,919**	**20,252**	**-485**	**-6,660**	**-7,650**
Incr/Decr of Cash	**-1,316**	**-1,156**	**-2,640**	**-2,220**	**915**
Add: Opening Balance	7,686	6,370	5,214	2,575	355
Closing Balance	**6,370**	**5,214**	**2,574**	**355**	**1,270**

E: MOSL Estimates

Radico Khaitan

BSE SENSEX	S&P CNX
19,340	5,880

Radico

Bloomberg	RDCK IN
Equity Shares (m)	132.6
52-Week Range (INR)	151/92
1,6,12 Rel. Perf. (%)	17/-5/2
M.Cap. (INR b)	19.4
M.Cap. (USD b)	0.4

Valuation summary (INR b)

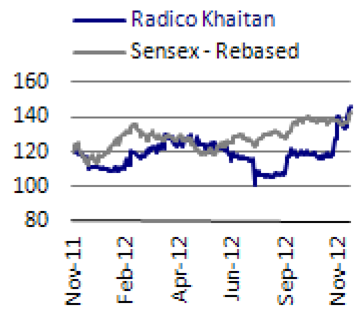
Y/E March	2012	2013E	2014E
Sales	11.4	13.0	15.0
EBITDA	1.7	2.1	2.6
NP	0.8	0.9	1.2
EPS (INR)	6.0	6.9	8.9
EPS Gr. (%)	10.9	14.6	29.2
BV/Sh. (INR)	52.4	58.3	65.7
P/E (x)	24.2	21.2	16.4
P/BV (x)	2.8	2.5	2.2
EV/Sales (x)	2.2	2.1	1.8
EV/EBITDA (x)	14.8	12.4	10.4
EV/Sales (x)	2.2	2.1	1.8
RoE (%)	11.9	12.5	14.4
RoCE (%)	10.0	11.0	12.6

Prices as on 30 November 2012

Shareholding pattern %

As on	Sep-12	Jun-12	Sep-11
Promoter	40.6	40.4	39.9
Dom. Inst	7.8	10.1	15.3
Foreign	27.5	26.4	26.3
Others	24.2	23.1	18.5

Stock performance (1 year)



CMP: INR146	TP: INR181	Buy

Premiumization strategy working

Reiterate Buy; potential upside of 24%

- **Radico Khaitan (RDCK) has demonstrated its ability to drive premiumization - the salience of premium brands has risen from 8% of total volumes in FY09 to 16% in 1HFY13.**
- **The IMFL pricing environment is turning favorable - RDCK expects price hike from Andhra Pradesh, its largest market, in November.**
- **We expect RDCK to deliver strong 23% earnings CAGR over FY12-15, led by 230bp margin improvement.**
- **The stock has appreciated ~20% since our initiation on 31 October 2012 and subsequent announcement of the Diageo-UNSP deal. We reiterate Buy, with a revised price target of INR181 - 24% upside.**

Premiumization strategy working

RDCK has demonstrated its ability to drive premiumization in its IMFL business, reflected in the consistent rise in salience of its premium brands from 8% of total volumes in FY09 to 16% in 1HFY13. *Magic Moments Vodka* has continued to outperform the segment and has been RDCK's single largest success story in the last five years. *Morpheus Brandy* is also gaining trade acceptance and has witnessed 4x jump in its volumes in the last two years, albeit on a low base.

Recent launches have been in premium/super-premium segments

RDCK's launches in the last three years have all been in the premium/super-premium segments. It launched super-premium *Verve Vodka* in 2QFY13.

IMFL pricing environment turning favorable at the margin

Our discussions with industry players suggest improvement in the pricing environment for the IMFL industry. There has been modest increase in the quantum of price hikes received by the industry, especially from South Indian states. Secondly, the time lag between demand and approval of price hike has come down. RDCK has received price hikes from (1) Kerala in 1QFY13, (2) Madhya Pradesh, Jharkhand, Bihar, Orissa, and CSD in 1HFY13.

Price hike in Andhra Pradesh can provide upside in 2H

Andhra Pradesh, one of the largest contributor for RDCK (11%) has granted price hike and Karnataka is expected to do the same. This can provide good upside to its IMFL revenue in 2HFY13. Successful premiumization strategy plus incrementally better pricing environment augurs well for RDCK's gross and operating margins in the medium term.

Suitable partner for foreign liquor companies

RDCK's reach, especially in North India and CSD markets, and its position as the third-largest liquor company in India makes it a suitable partner for any foreign liquor player trying to gain a foothold in India, the fastest growing liquor market in the world.

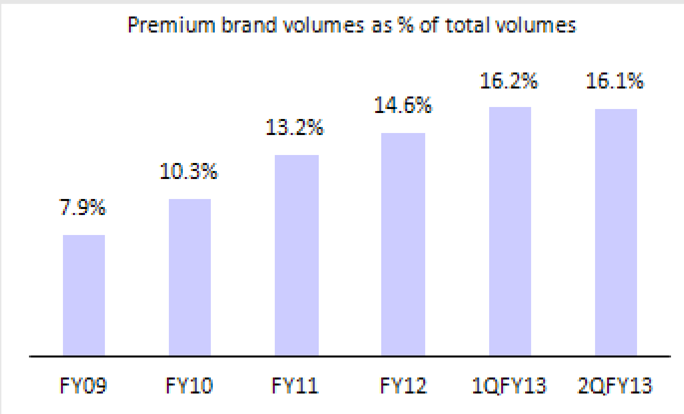
Strong earnings CAGR, supportive valuations; Buy

RDCK is an attractive play on the growing IMFL opportunity, underpinned by favorable demographic factors like rising disposable income, growing youth population, and changing social attitudes towards drinking. It has 33 bottling units spread across India, through which it covers 90% of the retail outlets. Its premiumization strategy is working and we expect the contribution of premium brands to increase from 16% of total volumes to 20% by FY15. This would be the key driver for a robust 22% CAGR in EBITDA over FY12-15.

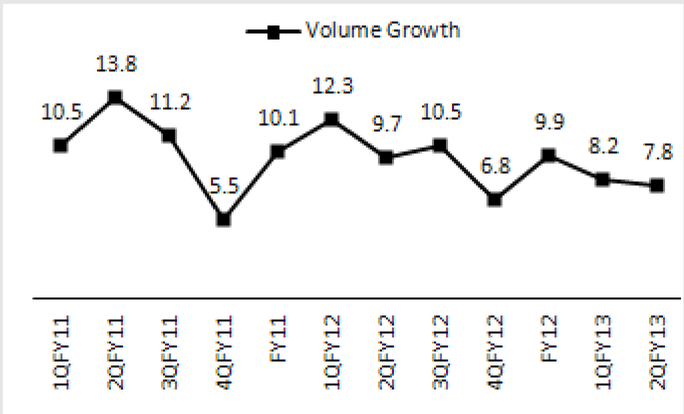
We expect RDCK to deliver strong 23% earnings CAGR over FY12-15, led by 230bp margin improvement. The stock trades at 21.1 FY13E and 16.3 FY14E earnings. We had pointed out in our Initiating Coverage report, In High Spirits, dated 31 October 2012, "Any potential deal involving the sector leader can have a positive rub-off effect on peer valuations, including RDCK's". Since our initiation and subsequent announcement of the Diageo-UNSP deal, the stock has appreciated by 25%. We now value the stock at 18x Sep'14E EPS. Our revised target price of INR181 implies 24% upside. **Buy**.

RDCK's premiumization is strategy working

Salience of premium brands rising



Volume growth trend (%)



Source: Company, MOSL

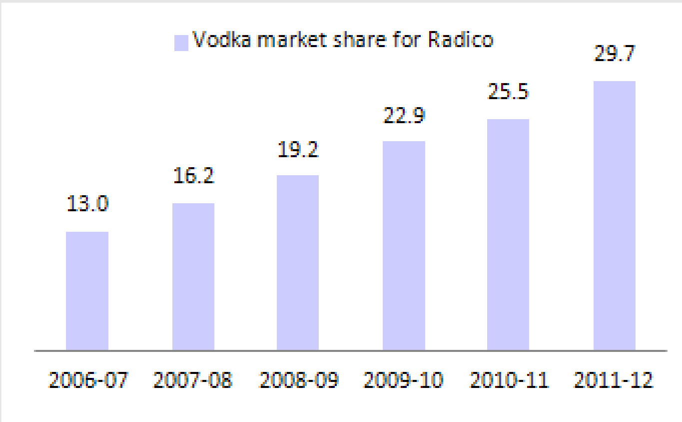
Brand-wise quarterly volumes (m cases)

Brands	1QFY11	2QFY12	3QFY13	4QFY14	1QFY12	2QFY12	3QFY12	4QFY12	1QFY13	2QFY13
Magic Moments Vodka	5.1	4.4	5.0	4.4	6.2	5.2	5.8	5.1	7.3	6.0
Morpheus Brandy	0.5	0.6	0.6	0.6	0.7	0.9	1.1	0.9	1.1	1.2
Premium Brands	5.6	5.0	5.6	5.0	6.9	6.1	6.9	6.0	8.4	7.3
Other Main Line Brands	24.7	22.5	25.7	21.3	27.7	24.5	25.7	24.5	29.9	26.2
Total main line brands	30.4	27.5	31.4	26.2	34.6	30.6	32.6	30.5	38.3	33.4
Other brands	12.0	10.4	9.6	13.5	13.0	11.1	12.6	11.9	13.3	11.5
Total	**42.4**	**38.0**	**40.9**	**39.8**	**47.6**	**41.7**	**45.2**	**42.5**	**51.5**	**44.9**

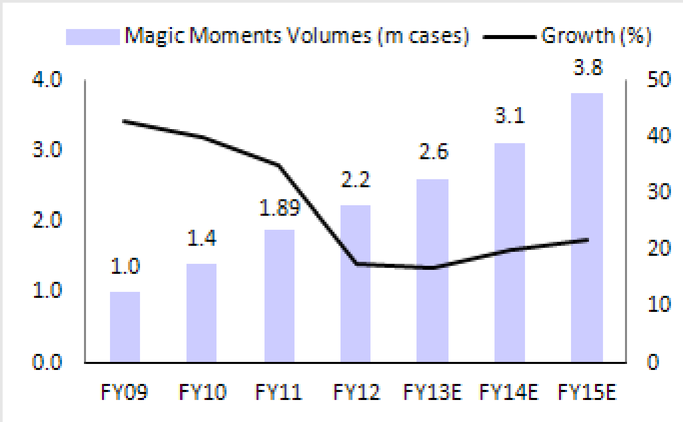
Source: Company, MOSL

Magic Moments: RDCK's key success story in the last five years

RDCK's market share in vodka has improved consistently…



…led by Magic Moments



Source: Company, MOSL

Pricing environment turning favorable

Sl. No.	State-Name	Brand-Name	% Increase	Effetive Date
RDCK has received price hikes from several states				
1	Karnataka	8PM-Whisky	6	1st-April,2012-Onwards
		Old-Admiral Brandy	6	1st-April,2012-Onwards
		Crown Whisky	7	1st-April,2012-Onwards
		Radico-Gold-Whisky	6	1st-April,2012-Onwards
		Royal-Lancer-Whisky	6	1st-April,2012-Onwards
		After-Dark-Whisky		1st-April,2012-Onwards
		Magic-Moments-Vodka	11	1st-April,2012-Onwards
		Magic-Moments-Flavours-Vodka	33	1st-April,2012-Onwards
		Morpheus-Xo-Brandy	19	1st-April,2012-Onwards
2	Bihar	8PM-Whisky	19	1st-April,2012-Onwards
		Magic-Moments-Vodka	18	1st-April,2012-Onwards
3	Jharkhand	8PM-Whisky	20	1st-April,2012-Onwards
		Magic-Moments-Vodka	13	1st-April,2012-Onwards
4	Madhya-Pradesh	8PM-Whisky	13	1st-April,2012-Onwards
		Magic-Moments-Vodka	12	1st-April,2012-Onwards
		Magic-Moments-Flavours-Vodka	9	1st-April,2012-Onwards
5	Chattisgarh	8PM-Whisky	12	1st-April,2012-Onwards
		Magic-Moments-Vodka	10	1st-April,2012-Onwards
		Magic-Moments-Flavours-Vodka	19	1st-April,2012-Onwards
6	Orissa	8PM-Whisky	14	1st-September,2012-Onwards
		Magic-Moments-Vodka	9	1st-September,2012-Onwards
		Black Cat Rum	16	1st-September,2012-Onwards
7	Kerala	8PM-Whisky	6	1st-August,2012-Onwards
		Contessa-Rum	6	1st-August,2012-Onwards
		8 Bermuda rum	6	1st-August,2012-Onwards
		m2	6	1st-August,2012-Onwards
		OAB	6	1st-August,2012-Onwards
		MXO	6	1st-August,2012-Onwards
		EXCELLENCY	6	1st-August,2012-Onwards
		CWR	6	1st-August,2012-Onwards
		BGB	6	1st-August,2012-Onwards

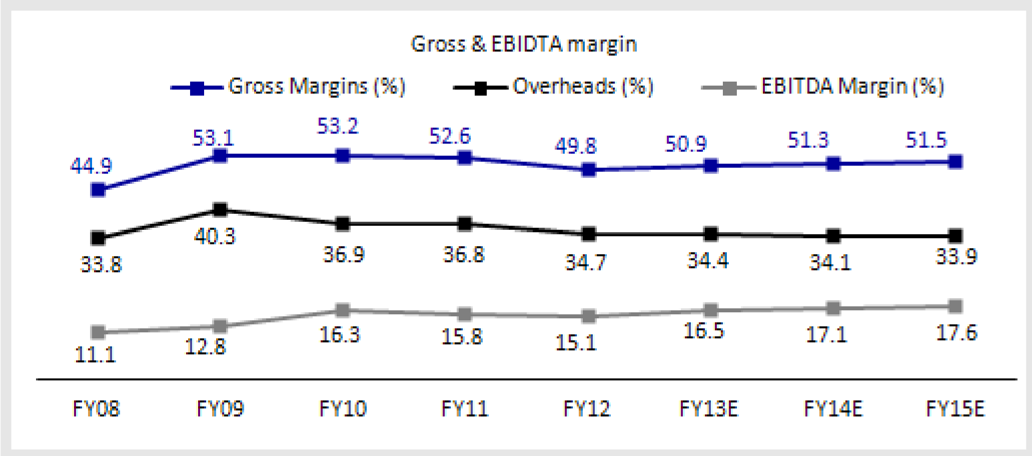
Source: Company, MOSL

RDCK's recent launches have been in premium/super-premium segments

Morpheus	After Dark	Florence	Morphues Verve -latest launch

Source: Company, MOSL

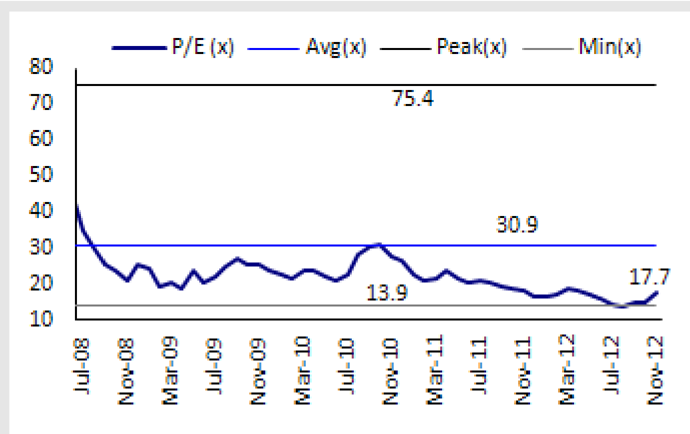
EBITDA margin to expand 230bp over FY12-15



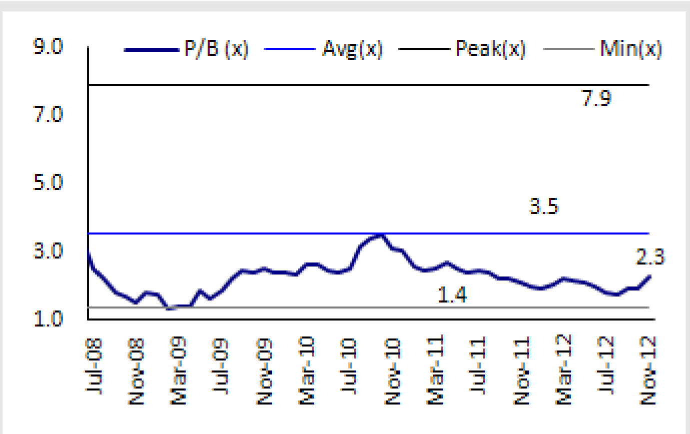
Source: Company, MOSL

RDCK: Valuations still supportive

P/E (x)



P/BV (x)



Source: Bloomberg, MOSL

RDCK: Financials and Valuation

Income Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Net Sales	**9,469**	**11,445**	**12,986**	**14,977**	**17,191**
Change (%)	12.9	20.9	13.5	15.3	14.8
Total Expenditure	7,975	9,714	10,842	12,409	14,162
EBITDA	**1,494**	**1,731**	**2,143**	**2,568**	**3,029**
Change (%)	9.3	15.9	23.8	19.8	17.9
Margin (%)	15.8	15.1	16.5	17.1	17.6
Depreciation	271	328	376	423	454
Int. and Fin. Charges	293	611	681	677	537
Financial Other Income	47	237	169	153	3
Profit before Taxes	**977**	**1,028**	**1,255**	**1,621**	**2,041**
Change (%)	94.7	5.3	22.0	29.2	25.9
Margin (%)	10.3	9.0	9.7	10.8	11.9
Tax	257	229	339	438	551
Tax Rate (%)	26.3	22.3	27.0	27.0	27.0
Profit after Taxes	**720**	**799**	**916**	**1,183**	**1,490**
Change (%)	72.4	11.0	14.6	29.2	25.9
Margin (%)	7.6	7.0	7.1	7.9	8.7
Extraordinary Income	8	-163	0	0	0
Reported PAT	**728**	**637**	**916**	**1,183**	**1,490**

Balance Sheet (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
Share Capital	265	265	265	265	265
Reserves	6,249	6,687	7,476	8,452	9,680
Net Worth	**6,514**	**6,953**	**7,742**	**8,717**	**9,946**
Loans	4,935	6,547	7,568	7,518	7,158
Deferred Tax	498	563	689	851	1,055
Capital Employed	**11,947**	**14,063**	**15,999**	**17,086**	**18,159**
Gross Block	5,728	6,870	7,670	8,470	9,270
Less: Accum. Depn.	1,539	1,847	2,223	2,647	3,101
Net Fixed Assets	**4,189**	**5,022**	**5,446**	**5,823**	**6,169**
Capital WIP	219	48	300	200	200
Investments	1,207	1,113	1,134	1,134	984
Curr. Assets, L&A	**8,059**	**10,139**	**11,620**	**12,917**	**14,312**
Inventory	1,269	1,774	1,920	2,218	2,370
Account Receivables	3,191	3,478	4,216	4,634	5,329
Cash and Bank Balance	94	218	283	282	251
Others	3,506	4,669	5,201	5,783	6,361
Curr. Liab. and Prov.	**1,728**	**2,528**	**2,770**	**3,256**	**3,774**
Account Payables	840	1,187	1,212	1,443	1,669
Other Liabilities	295	1,148	1,320	1,518	1,746
Provisions	593	193	238	295	359
Net Current Assets	**6,332**	**7,611**	**8,850**	**9,661**	**10,538**
Miscelleneous Exp./Others	0	268	268	268	268
Application of Funds	**11,947**	**14,063**	**15,999**	**17,086**	**18,159**

E: MOSL Estimates

RDCK: Financials and Valuation

Ratios

Y/E March	2011	2012	2013E	2014E	2015E
Basic (INR)					
EPS	**5.4**	**6.0**	**6.9**	**8.9**	**11.2**
Cash EPS	7.5	8.5	9.7	12.1	14.6
BV/Share	49.1	52.4	58.3	65.7	74.9
DPS	1.0	1.3	1.7	0.0	0.0
Payout %	15.0	15.4	17.6	17.6	17.6
Valuation (x)					
P/E		24.2	21.2	16.4	13.0
Cash P/E		17.2	15.0	12.1	10.0
EV/Sales		2.2	2.1	1.8	1.5
EV/EBITDA		14.8	12.4	10.4	8.7
P/BV		2.8	2.5	2.2	1.9
Dividend Yield (%)		0.9	1.2	0.0	0.0
Return Ratios (%)					
RoE	11.6	11.9	12.5	14.4	16.0
RoCE	10.2	10.0	11.0	12.6	14.2
Working Capital Ratios					
Debtor (Days)	47	42	45	43	43
Asset Turnover (x)	0.8	0.8	0.8	0.9	0.9
Leverage Ratio					
Debt/Equity (x)	0.8	0.9	1.0	0.9	0.7

Cash Flow Statement (INR Million)

Y/E March	2011	2012	2013E	2014E	2015E
OP before Tax	930	792	1,086	1,468	2,038
Int./Div. Received	47	237	169	153	3
Depreciation and Amort.	271	328	376	423	454
Interest Paid	293	611	681	677	537
Direct Taxes Paid	210	163	213	276	347
Incr in WC	1,256	1,155	1,174	812	908
CF from Operations	**75**	**650**	**925**	**1,633**	**1,777**
Extraordinary Income	8	-163	0	0	0
Incr in FA	-88	971	1,052	700	800
Other Assets	13	268	0	0	0
Pur of Investments	314	-94	20	0	-150
CF from Invest.	**-217**	**-1,040**	**-1,072**	**-700**	**-650**
Issue of Shares	-7	-70	0	0	0
Interest Paid	293	611	681	677	537
Incr in Debt	474	1,612	1,021	-50	-360
Dividend Paid	92	108	123	161	208
Others Inflows	-178	-308	-4	-47	-54
CF from Fin. Activity	**-96**	**515**	**213**	**-934**	**-1,159**
Incr/Decr of Cash	**-238**	**124**	**66**	**-1**	**-31**
Add: Opening Balance	332	94	218	283	282
Closing Balance	**94**	**218**	**283**	**282**	**251**

E: MOSL Estimates

Tilaknagar Industries

BSE SENSEX	S&P CNX
19,340	5,880

Bloomberg	TLNGR IN
Equity Shares (m)	120.4
52-Week Range (INR)	75/35
1,6,12 Rel. Perf. (%)	34/33/130
M.Cap. (INR b)	8.5
M.Cap. (USD b)	0.2

Valuation summary (INR b)

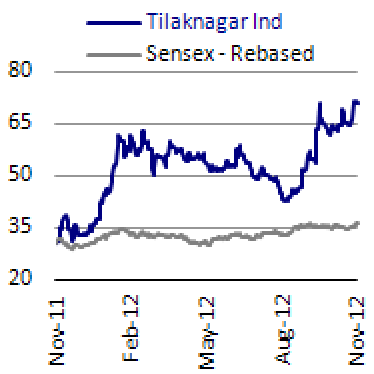
Y/E March	2010	2011	2012
Sales	5.5	6.5	8.4
EBITDA	0.8	1.2	1.5
NP	0.3	0.4	0.5
Adj. EPS (INR)	10.3	3.3	3.8
EPS Gr. (%)	77.2	12.9	19.4
BV/Sh. (INR)	39	28	34
P/E (x)	**22.6**	**13.9**	**13.6**
P/BV (x)	2.1	1.5	1.4
EV/EBITDA (x)	10.2	9.0	7.9
EV/Sales (x)	1.5	1.6	1.4
RoE (%)	39.1	28.2	33.7
RoCE (%)	20.3	15.0	14.3

Prices as on 30 November 2012

Shareholding pattern %

As on	Sep-12	Jun-12	Sep-11
Promoter	56.7	56.6	54.3
Dom. Inst	6.1	6.1	3.4
Foreign	12.4	13.2	19.6
Others	24.8	24.1	22.8

Stock performance (1 year)



CMP: INR71 — Not Rated

Emerging player

Strong presence in South India; robust manufacturing network

- **Tilaknagar Industries' (TLNGR) robust financial performance in the last five years has demonstrated its ability to capitalize on the rapidly premiumizing IMFL industry.**
- **While its geographical presence is limited, its strength in South India and good manufacturing network makes it an attractive partner for foreign liquor companies.**
- **TLNGR has recently announced a strategic bottling agreement with Pernod Ricard India.**
- **Stock trades at 13.6x FY13E and 10x FY14E EPS (Bloomberg consensus). Not Rated.**

Strong presence in South India, with diversified portfolio of 40 brands

TLNGR is a South India focused IMFL company, with Karnataka, Andhra Pradesh, Kerala, Tamil Nadu and Puducherry being its key markets. In FY12, it sold 13.2m cases. It has historically been strong in the brandy segment. It has a diversified portfolio of 40 brands, but *Madira Rum* and *Mansion House Brandy* are its flagship millionaire brands. TLNGR has expanded its distillation capacity 4x in two years. To increase its market presence in North and East India, it has recently acquired 26% equity stake in Mason and Summers Marketing Services (MSMSPL).

Robust financial performance; focusing on premiumization

TLNGR has grown volumes 10x since FY07, driven by enhanced reach, strong growth in its core brandy segment and new product launches. Over FY07-12, sales have grown at a CAGR of 43% and PAT at a CAGR of 40%, with EBITDA margin at 22-27%. It carries INR5b debt with leverage of 1x. TLNGR has been focusing on premiumization and has recently launched *Seven Islands Vintage Single Malt Scotch Whisky*, *Courrier Napoleon Blue* and *Green Brandy*. In March 2012, it had launched *White House Rum* in Kerala.

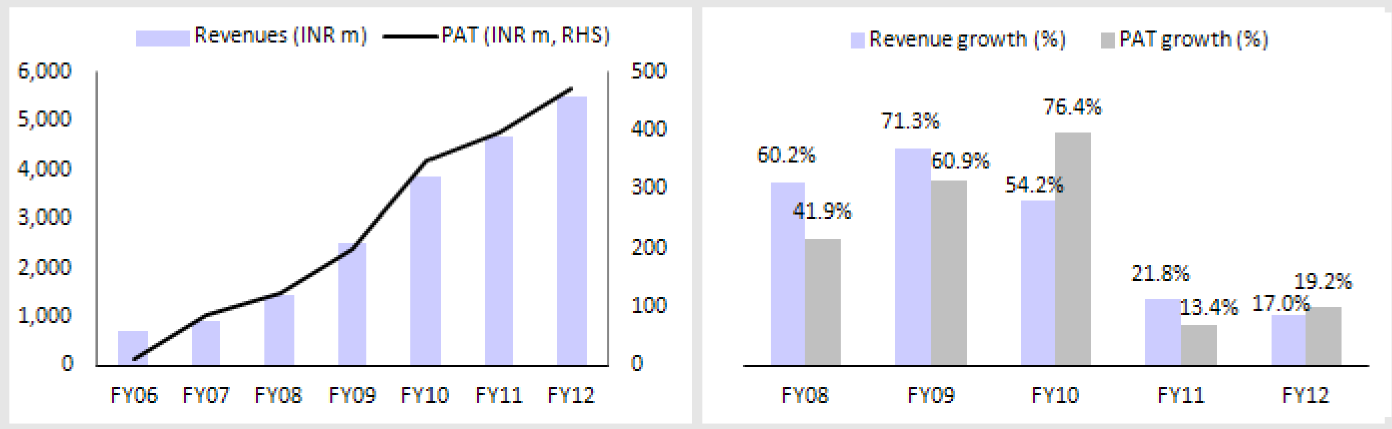
2QFY13 volumes weak; better mix, price hikes enable robust sales growth

Volumes grew just 2% in 2QFY13, owing to issues in its key Tamil Nadu market. However, better mix and price hikes resulted in 22% sales growth. TLNGR expects price hikes in Karnataka and Andhra Pradesh in 2HFY13, which will drive revenues. Rising input costs, however, pose a threat to margins, given that over 80% of its business comes from government controlled markets. The CSD segment continues to face challenges.

Strategic bottling agreement with Pernod Ricard

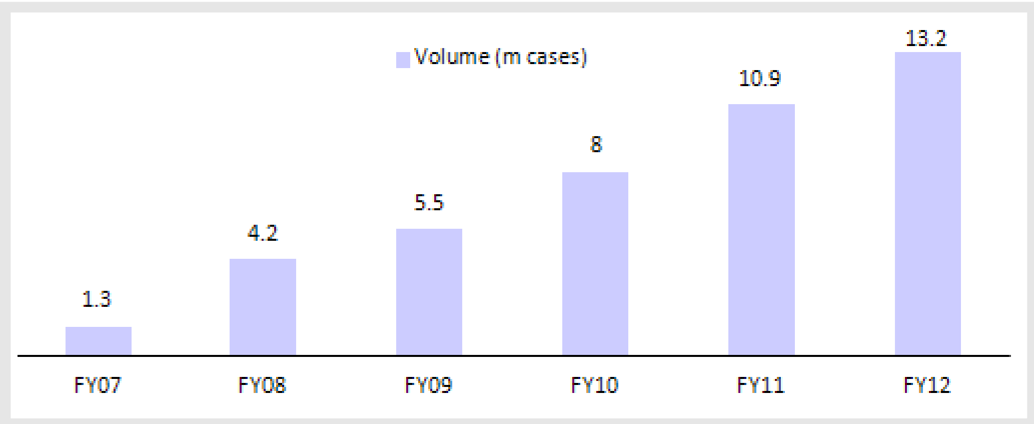
TLNGR recently announced a strategic bottling agreement with Pernod Ricard India (PRI). It will bottle PRI's brands at its facilities in Maharashtra and Andhra Pradesh, thus increasing utilization of its owned facilities. In Maharashtra, it will produce 50,000 cases per month for PRI in FY13, which it intends to increase to 200,000 cases by FY15.

TLNGR's sales and PAT have grown at 43% and 40%, respectively over FY07-12...



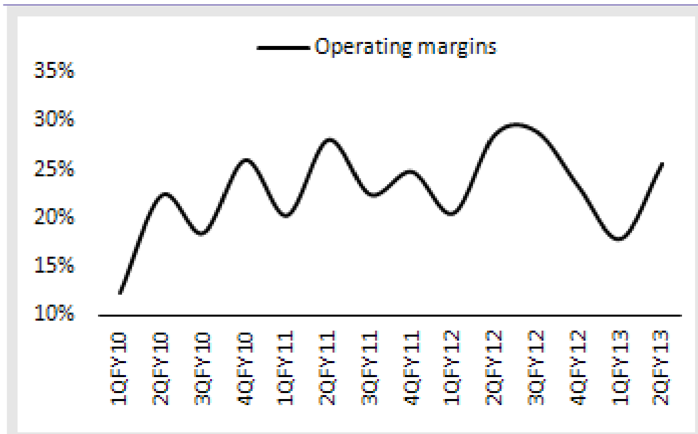
Source: Company, MOSL

...driven by 10x jump in volumes

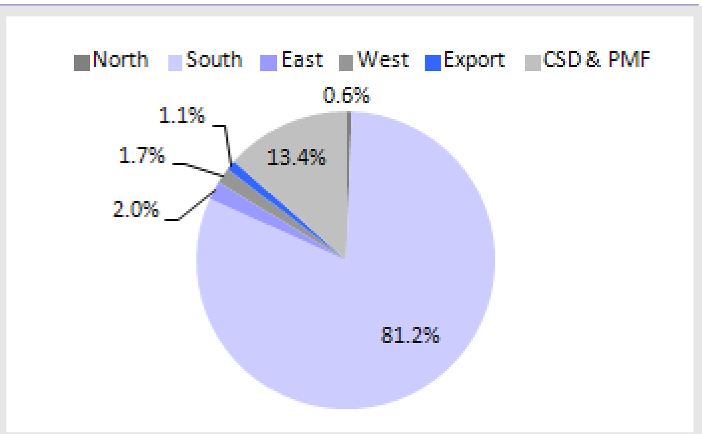


Source: Company, MOSL

Operating margins have been volatile



Revenues predominantly from South India



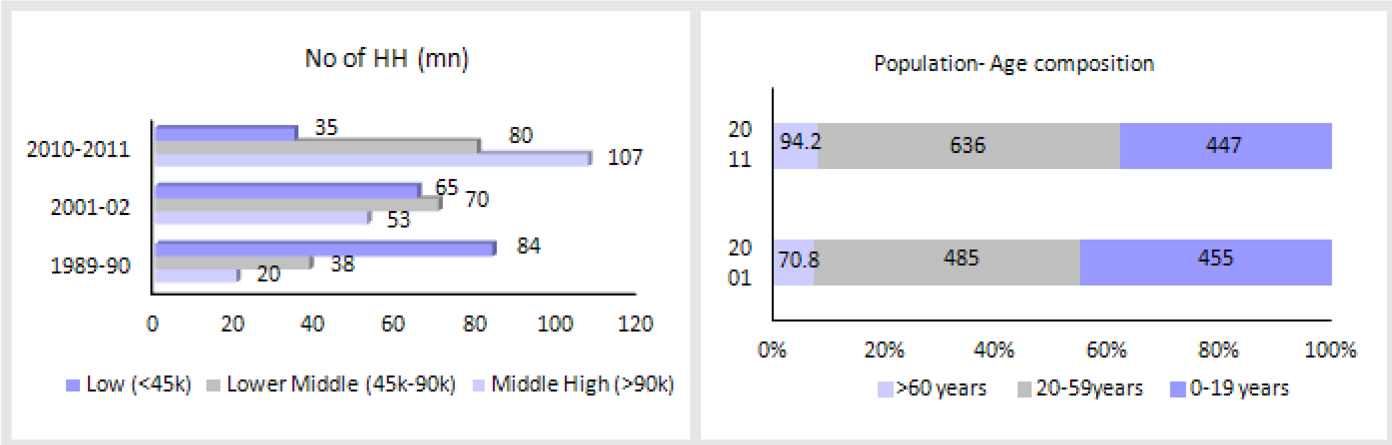
Source: Company, MOSL

Annexure 1: Key drivers of IMFL demand

Favorable demographics

The age profile of the Indian population is most conducive for sustained growth in liquor consumption. People in the age group 20-59 years are considered as primary consumers of liquor and more than half of India's population is below 30 years. Over the next 10 years, 150m potential new consumers are expected to come of drinking age.

4.3m relevant consumers to enter drinking age every year; youth demographics to support IMFL growth



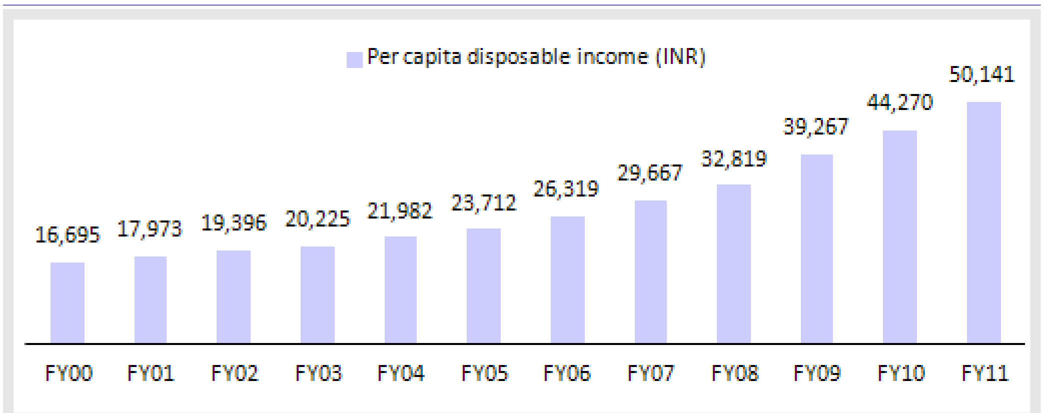
Source: GOI, Company, MOSL

There is today a sea change in social values and attitudes towards drinking. This is aided by the growing proportion of nuclear families, urbanization and changing social ethos. All these factors indicate sustained demand growth for the liquor industry in the coming years. Also, the middle class population is expected to grow from 120m to 600m (45% of total) by 2025, which augurs well for premium spirits.

Rising income levels

India is one of the fastest growing economies in the world, with more than 7.5% GDP growth in the past three years. Per capita income has increased 3.6x in the last 12 years to INR50k and the long-term outlook appears bullish. With robust economic growth, an increasing proportion of the population is coming into the consuming class. Both the affluent and the middle class income groups are expected to account

Rising per capita disposable income (INR)



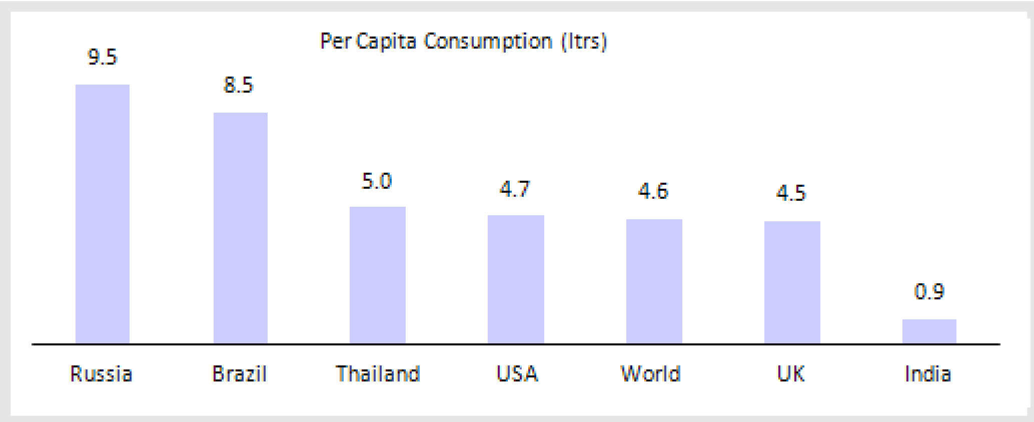
Source: GOI, MOSL

for more than 80% of national consumption by 2025. Moreover, we expect discretionary income to grow at a much faster pace than GDP growth, which will boost demand for lifestyle products including liquor.

Low per capita consumption

India has very low per capita consumption of liquor in comparison to global standards at 0.9 liters per annum. This is despite the per capita consumption growing at 22% in the past five years. The per capita consumption pattern indicates huge potential for the spirits industry. Even a small increase in per capita consumption can significantly alter the growth rates and aggregate consumption levels of liquor in the country. As factors like age composition, income levels and social attitudes are positively inclined, we expect the Indian liquor industry to report steady double-digit growth in the coming years.

Per capita consumption of liquor is very low in India



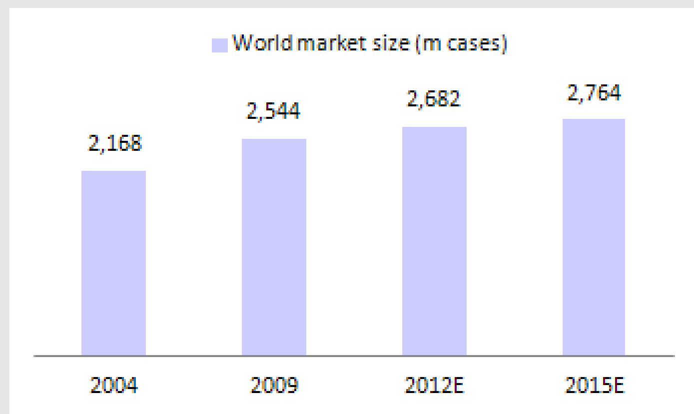
Source: Industry, MOSL

Forecast Sales of Alcoholic Drinks by Category: % Total Volume Growth

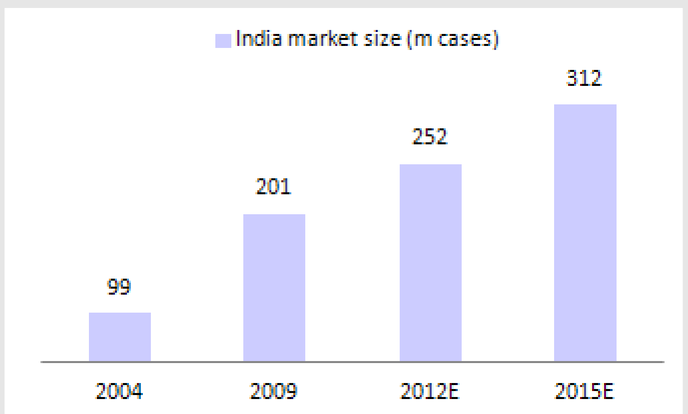
	% total volume growth	
	2015/16	**2011-16 CAGR**
Beer	9.3	10.3
RTDs/High-Strength Premixes	7.0	8.0
Spirits	8.5	9.9
Wine	6.8	6.2
Alcoholic Drinks	8.9	10.0

Source: Industry, MOSL

World market size



India market size

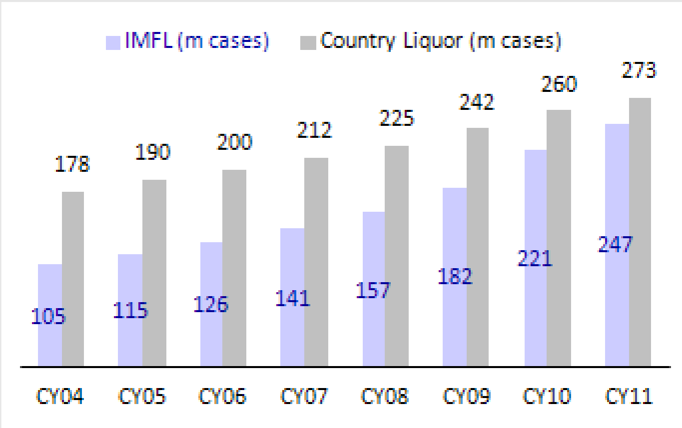


Source: Industry, MOSL

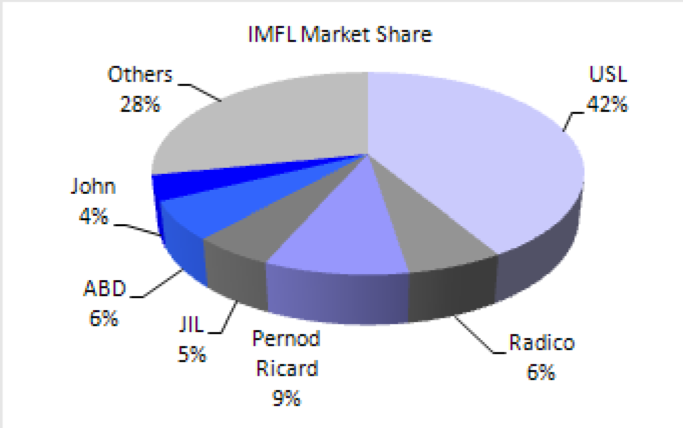
Annexure 2: Spirits - sales mix to gradually shift in favor of IMFL

The IMFL (Indian made foreign liquor) market is roughly 250m cases (12 bottles of 750ml each) and constitutes 47% of the total liquor market in India. The rest is accounted for by country liquor, which contributes 53% of the market. The IMFL segment is growing at 9-10% while country liquor has been growing at 3-4%.

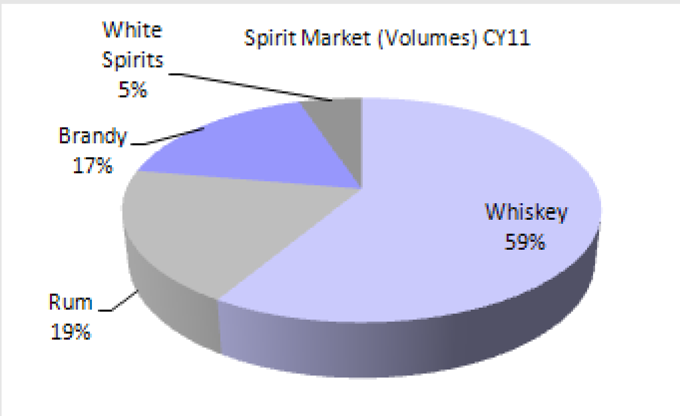
Mix shifting in favor of IMFL



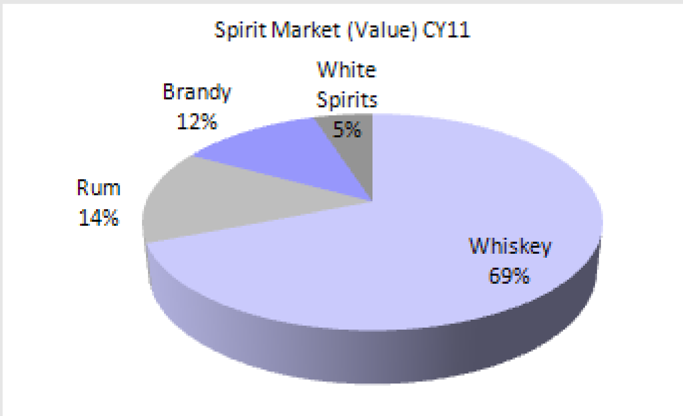
IMFL market share



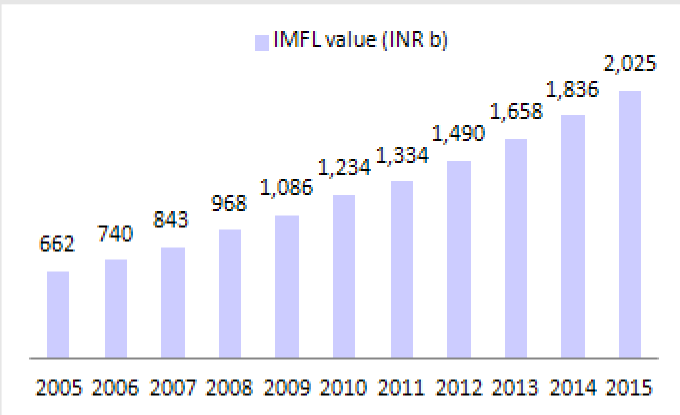
Whiskey dominates IMFL in India in volumes....

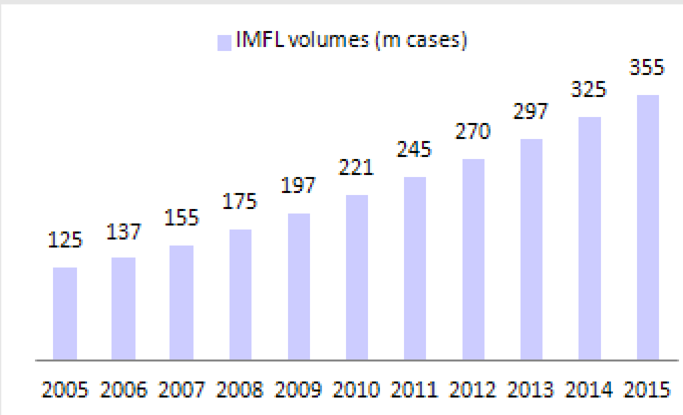


..... and value



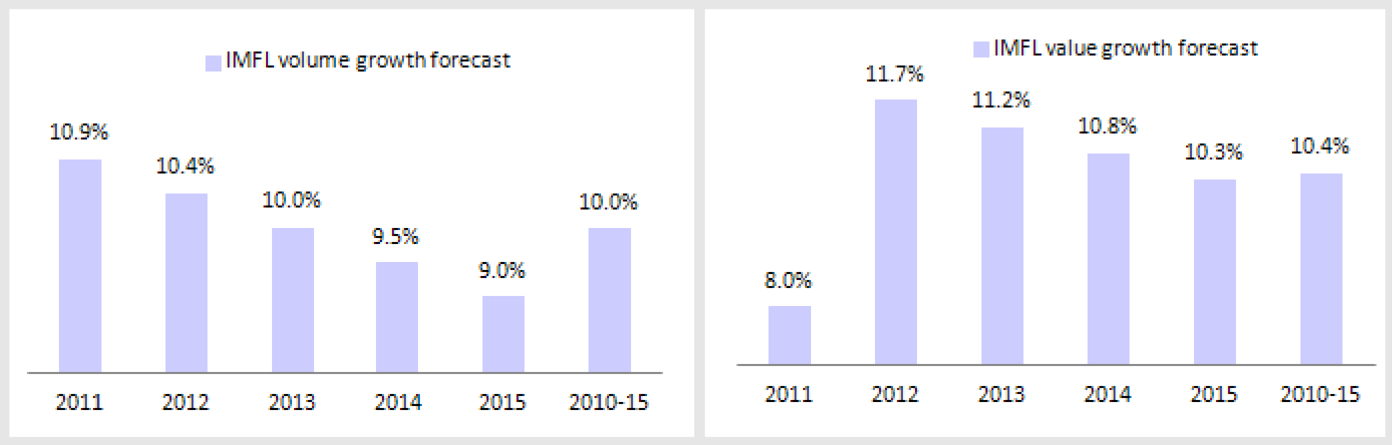
Attractive growth ahead for IMFL





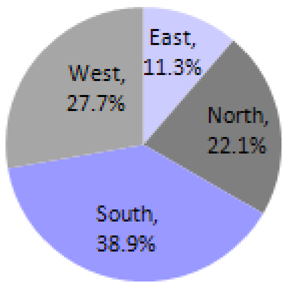
Source: Industry, Company, MOSL

IMFL expected to register 10% CAGR



Source: Company, MOSL

Geographical spread of IMFL



Source: Company, MOSL

States like Andhra Pradesh, Tamil Nadu and Kerala have banned country liquor. This stems from poor quality materials, hazardous methods of production and tax evasion by the local players. The past trend suggests that ban on country liquor leads to increased demand for IMFL, particularly at the lower end and economy segments.

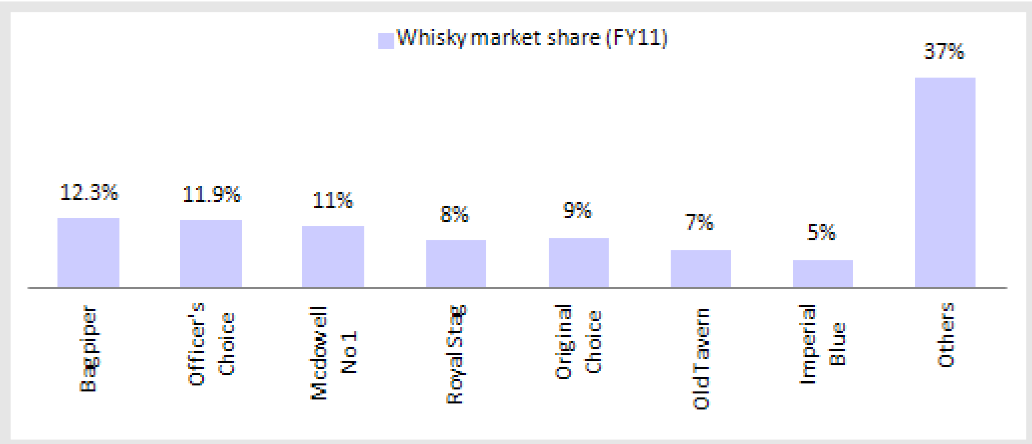
IMFL has been gaining market from country liquor in the past few years, as younger population, favorable demographics and rising consumer aspirations have resulted in higher growth for IMFL. We expect this trend to gain further momentum, with IMFL growing at 11-12% for the coming few years. This will happen as 12-13% nominal income growth will increase the discretionary income at much higher level. This will boost the growth prospects even though increase in demand for IMFL is expected to be lower than the decline in consumption of country liquor. We the expect share of IMFL in total liquor market to increase from 31% in FY06 to 37% by FY10.

Annexure 3: Key segments of IMFL industry

Whisky (~57% of IMFL volumes)

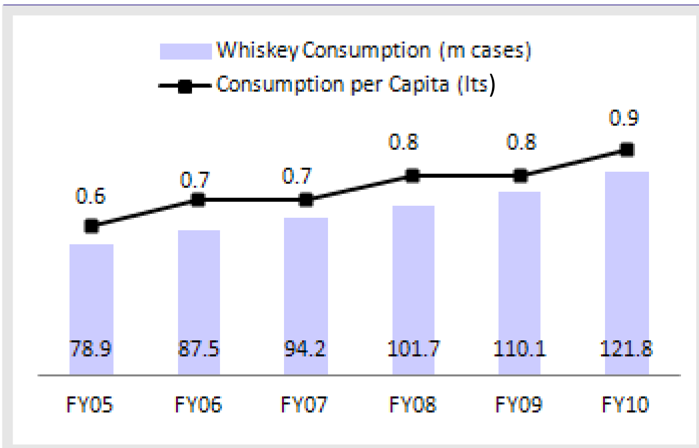
Whisky is the largest segment of the IMFL industry and contributes ~57% of the volumes. The segment has seen acceleration in growth rates from 6-6.5% to current levels of 8-8.5%. UNSP leads in almost all the Whisky segments except Scotch, which is dominated by global players. We expect Whisky growth rates to accelerate to double digits in line with rising growth rates of IMFL. Premium segments in Whisky have been growing at a faster pace due to low base and rising consumer affluence even as Regular and Economy segments continue to account for bulk of the volumes. We expect the trend to continue in the coming years as well.

Whisky market share

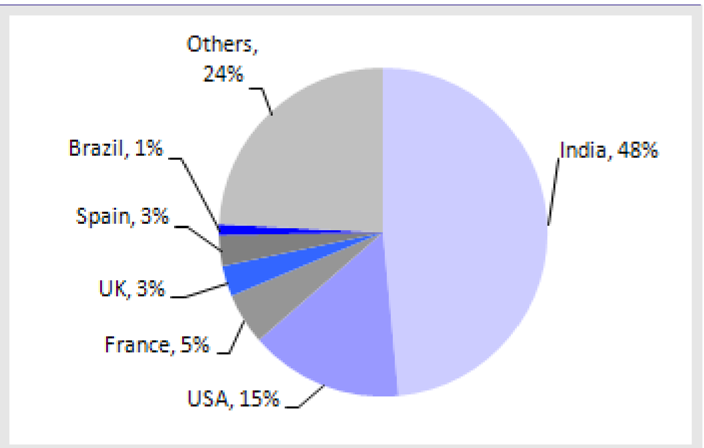


Source: Industry, Company, MOSL

Steady growth in Whisky consumption in India....



India accounts for 48% of global whisky consumption



Source: Industry, MOSL

Brandy (~20% of IMFL volumes)

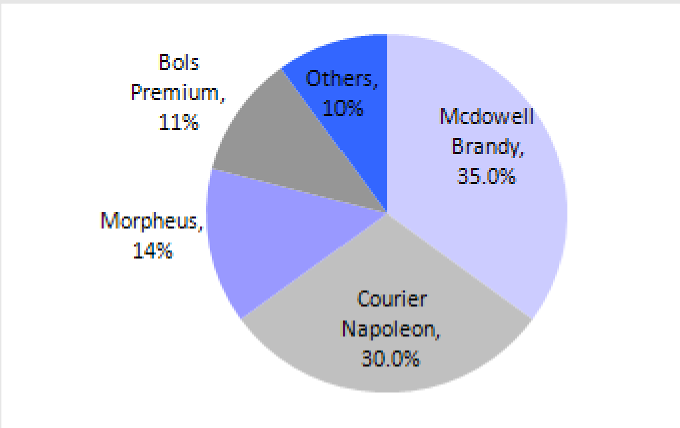
Brandy accounts for ~20% of the IMFL and 5.6% of the entire spirits market. Brandy is perceived to be older people's drink due to health benefits associated with it. Andhra Pradesh and Tamil Nadu account for more than 80% of Brandy sales, with UNSP's *McDowell No 1* dominating the Regular segment of the market.

Segmental split of Brandy category

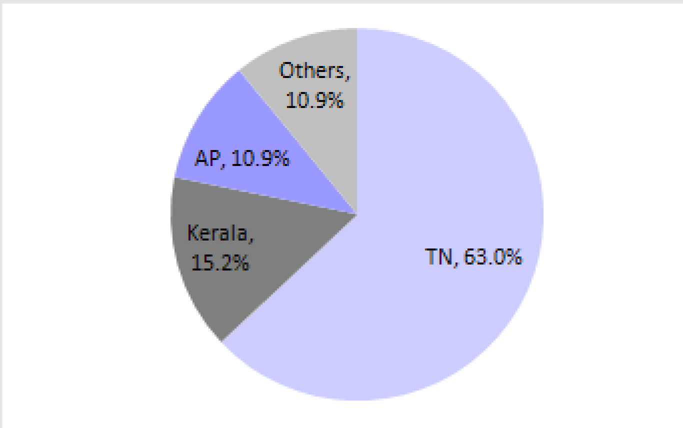
Category	Brandy Mkt share (%)	Price Range (INR)	Key Brands & segment Share (%)	Key Players Share (%)
Premium	6.1	600-800	Brihans Napoleon-23, Mansion House - 46	Tilaknagar - 46, US 30, Radico 46
Semi Premium	2.1	500-575	Bejosis - 76, Joie De Franc - 9	Amrut - 76, US - 9
Regular	36.4	400-480	Honey Bee -22, McDowell No1 - 69	US-91
Medium	25.8	300-380	John Exshaw -31, Golconda - 23, Old Admiral - 28	US- 54, Radico - 32
Economy	29.6	200-280	Monitor Brandy (47%)	Shivas - 47

Source: Industry, Company, MOSL

Brandy market share....



Tamilnadu accounts for bulk of Brandy consumption



Source: Industry, Company, MOSL

RDCK has emerged as the second largest player in the Brandy market and has consolidated its position with the acquisition of Brihans. RDCK now controls 46% market share in the Premium segment and 32% market share in the Medium segment. We expect the Brandy market to grow at 6-7% per annum in the coming few years.

Rum (~17% of IMFL volumes)

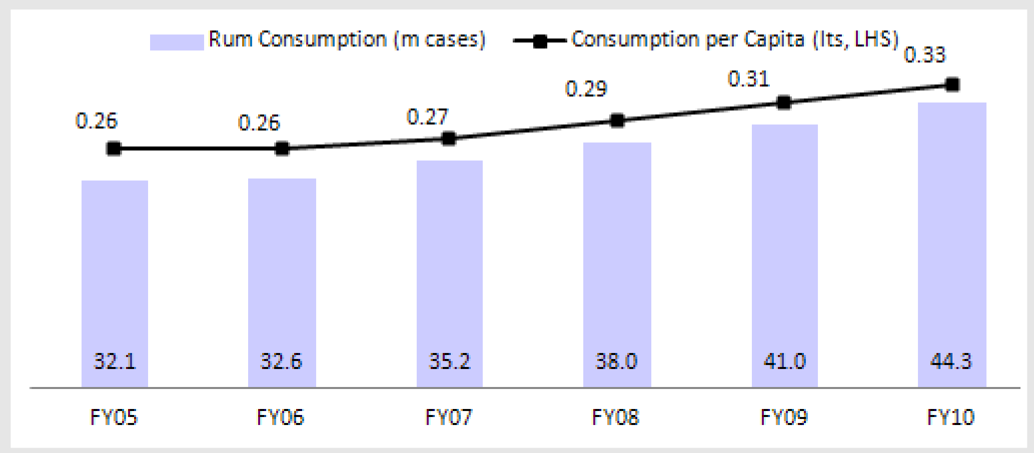
Rum is mostly consumed in South India and accounts for ~17% of the domestic IMFL market. The market for Rum has been growing in mid single digits. The Regular segment comprises 72% of the Rum market in India. Mohan Maekin leads the Rum segment, with its *Old Monk* brand. The growth rates for this product segment have been accelerating, as the younger population in other parts of the country has also started preferring rum, on the perception of it being less harsh. Aggressive marketing by foreign brands like *Bacardi* is also attracting up-market IMFL consumers to the Rum fold at the premium end. We expect the market for Rum to grow at 8-9% per annum for the coming few years. Though the Regular segment will continue to account for bulk of Rum volumes, we expect the Premium segment to grow at high double digit growth rates.

Segmental split of Rum category

Category	Rum Mkt share (%)	Price Range (INR)	Key Brands & segment Share (%)	Key Players Share (%)
Premium	0.7	Above 420	Bacardi -73, Old Smuggler -16	Bacardi - 73, Allied Dom 16
Regular	72	300-420	Contessa-14, Old Monk -43, McDowell celebration -21	Mohan Meakin-43, US -42, Radico- 15
Economy	25.7	200-250	Majestic - 21	UB-28
White	1.6		Gold Medal -23, Contessa - 16	US -23, Radico - 16

Source: Industry, Company, MOSL

Rising Rum consumption



Source: Industry, Company, MOSL

Vodka (~4% of IMFL volumes)

Vodka is the fastest growing segment of IMFL. It accounts for ~4% of the IMFL market and has been growing at ~44% in the past few years. According to industry sources, ~8.8m cases of Vodka were sold in India during FY10. UNSP is the largest player in the Vodka market, with 70% share in the Regular segment, with brands like *Romanov* and *White Mischief*. *Smirnoff* continues to be the undisputed leader in the Premium segment, which is 15% of the total Vodka market. Vodka has seen high growth rates due to consumer preference for white alcoholic drinks and rising affluence. Vodka is also emerging as a preferred drink for urban women.

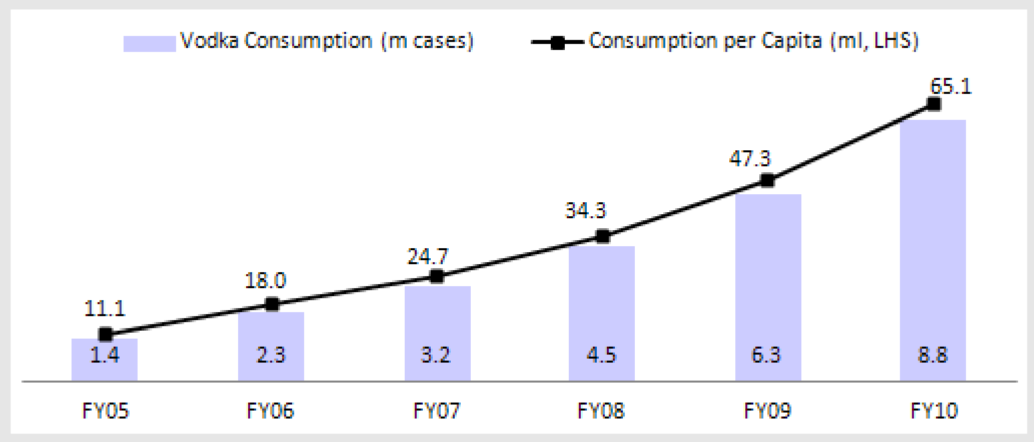
RDCK has also entered the Vodka market, with its *Magic Moments* brand positioned as the first triple distilled grain-based Vodka in the Indian market, at a premium to *Romanov*. UNSP has plans to re-launch White *Mischief Vodka* in new packaging. In addition, it is launching Mango and Chocolate Thrill flavors in Vodka. We expect the Vodka market to grow by more than 30% per annum for the coming few years. High growth in the product category would attract new players. As leading players try to get market share and mind share in the small but high potential product category, the Vodka segment will witness the launch of new variants, and various quality improvement and consumer friendly initiatives.

Segmental split of Vodka category

Category	Vodka Mkt share (%)	Price Range (INR)	Key Brands & segment Share (%)	Key Players Share (%)
Premium	15	1,400-1,800	Smirnoff-99	TDV -99
Regular	85	420-500	Romanov -39, White Mischief -31, Magic Moments	US -70

Source: Industry, Company, MOSL

Vodka has outperformed other IMFL category



Source: Industry, Company, MOSL

Gin (~2% of IMFL volumes)

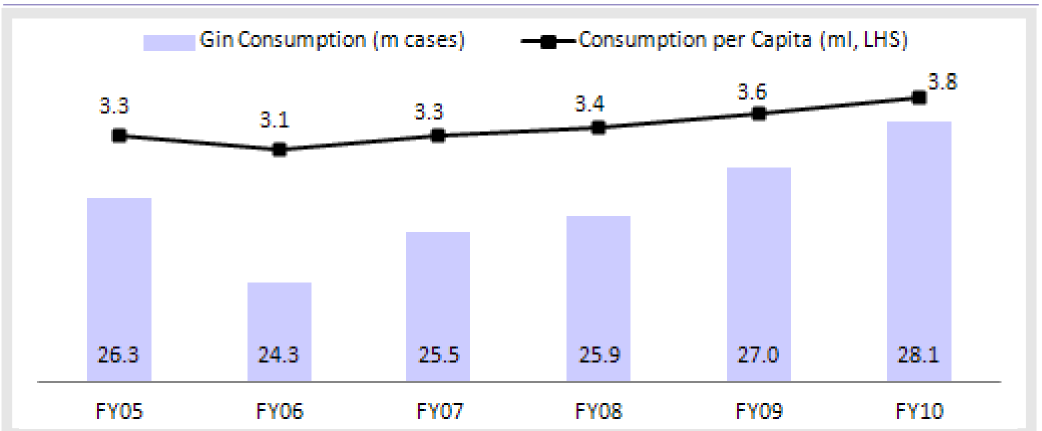
Gin accounts for 1.8% of the IMFL market and the product category has been more or less stagnating, with expected growth of 0-1% per annum. UNSP has consolidated its position in the Gin market, with 66% share in the Regular and 44% share in the Medium segment, with *Blue Riband* and *Carew* brands. The market has not seen any new players or launches for quite some time and the product category lacks excitement. We expect the trend to continue in the coming years with very little volume growth.

Segmental split of Gim category

Category	Gin Mkt share (%)	Price Range (INR)	Key Brands & segment Share (%)	Key Players Share (%)
Regular	56	360-475	Blue Riband- 66, Aristocrat - 11	US 66, JIL 11
Medium	44	250-350	Carew - 34, Marco polo - 19	US -44, Empee 19

Source: Industry, Company, MOSL

Gin category is yet to takeoff



Source: Industry, Company, MOSL

Annexure 4: High entry barriers to work in favor of existing players

Strong entry barriers characterize the Indian liquor industry. These have resulted in very few new players having successfully entered and established new brands in the market. The industry is dominated by few players like United Spirits (UNSP), Pernod Ricard, Radico Khaitan (RDCK), Jagatjit Industries (JGI) and Mohan Meakin (MOHN).

- Media advertising of liquor is banned in India. Manufacturers undertake surrogate advertising and sponsorships of various sports events to create brand awareness. Surrogate advertising is generally done for soda, bottled water and sports equipment. This makes it difficult for any player to launch a new brand and make it a success. This has thwarted the attempts of many global majors to gain a strong foothold in the Indian liquor industry.
- Though one can readily expand existing units, it is difficult to obtain a fresh license to set up a new unit. This acts as an entry barrier for any new global players.
- Taxes and duties constitute more than 50% of the final consumer price. In addition to excise, there are high taxes on inter-state movement of liquor. There are more than 100 different types of taxes on liquor in India, which raises the entry barriers for any new player.
- Liquor is subject to 150% import duty and several state level duties, which raises the price of imported liquor to very high levels. This results in very high prices for imported liquor, thus limiting their consumer reach.
- High taxes on inter-state movement of liquor results in manufacturers having small bottling units in various states, thus creating inefficiencies in manufacturing. Operating in India is akin to operating in 30 countries.

Annexure 5: Distribution system - gradually tilting in industry's favor

Liquor is a state subject in India. Consequently, the liquor industry is subjected to very strict distribution controls by the state governments. There is pricing flexibility in 32% of the market, while 57% of the market is controlled by government monopolies and 11% by government sponsored cartels. Currently, three types of distribution systems are prevalent in India - government controlled, auction market and free market. Each distribution system has its own characteristics, some of which have been impeding the growth of the liquor industry in India.

Three distribution systems in operation in India

	Government	Auction Market	Open Market
Wholesaler	State directly or through its entity	State auctions distributing rights to private parties for selected areas and time	Manufacturers sell to wholesalers/ retailers
Retailers	State operated or private	Private vends	Private parties obtain license for nominal fee
Retailer Margin	12-15%	20%+	8-10%
Sellers bargaining power	Low to average	Very low	High
Methodology	Annual tender from manufacturers	Private parties negotiate with liquor companies	Private wholesalers directly procure from manufacturers
Key States Covered	Karnataka, Kerala, Tamilnadu, Andhra Pradesh, Orissa, Andaman, Pondicherry	Himachal Pradesh, Bihar, Jharkhand	UP, Goa, Maharashtra, Delhi, West Bengal, J&K, Punjab, Haryana, Chandigarh, Rajasthan, Madhya Pradesh

Source: Company, MOSL

Government controlled: Under the government controlled system, the state government (either on its own or through an agency) purchases liquor from various entities through negotiated prices and sells at a mark-up through its own shops. This system currently exists in southern India. It indirectly imposes limits on the availability of the product.

Auction market: Under the auction market system, the state government auctions the right to sell liquor to various parties for a certain fixed fee annually. The winners of these contracts then negotiate prices with the liquor companies and sell to the consumers through their own distribution network. This creates distribution monopolies in small regions, which results in high consumer prices and fat margins for the retailers.

Free market: The open/free market system is most favorable to the trade and industry. It improves the availability of products and ensures fairness to both the consumer and retailer. Under this system, interested parties can open liquor shops by taking licenses from the state for a certain fee. Manufacturers sell the liquor directly to the retailers at negotiated prices. This ensures fair play for the manufacturer, as no one retailer can force it to reduce prices.

State-wise distribution systems

Type of market and jurisdiction	Wholesale	Retail
Government- controlled markets		
AP	Government- controlled	Free market
Bihar	Government- controlled	Free market
CSD	Government- controlled	Government- controlled
Chattisgarh	Government- controlled	Free market
Karnataka	Government- controlled	Free market
Kerala	Government- controlled	Government- controlled
Orissa	Government- controlled	Free market
Rajasthan	Government- controlled	Free market
TN	Government- controlled	Government- controlled
Uttaranchal	Government- controlled	Free market
Hybrid markets		
Delhi	Free market	Government- controlled
UP	Government- controlled	Free market
Oligopolistic markets		
Chandigarh	Private Oligopoly	Private Oligopoly
Haryana	Private Oligopoly	Private Oligopoly
HP	Private Oligopoly	Private Oligopoly
Punjab	Private Oligopoly	Private Oligopoly
UP	Private Oligopoly	Private Oligopoly
Free markets		
Assam	Free market	Free market
Bihar	Government- controlled	Free market
Daman	Free markets	Free market
Goa	Free markets	Free market
Jharkhand	Free markets	Free market
Maharashtra	Free markets	Free market
Pondicherry	Free markets	Free market
West Bengal	Free markets	Free market

Source: Company, MOSL

Key markets with changes in distribution/pricing system

State	Market in 2007	Market in 2010	Industry Pricing Power
Puduchery	Govt. controlled	Free Market	Significantly Improved
Jharkhand	Auction	Free Market	Significantly Improved
Bihar	Auction	Govt Controlled	Improved
Rajasthan	Auction	Govt Controlled	Improved
UP	Free Market	Auction	Deteriorated
Punjab	Free Market	Auction	Deteriorated
Haryana	Free Market	Auction	Deteriorated
Madhya Pradesh	Free Market	Auction	Deteriorated

Source: Company, MOSL

Annexure 6: Complex taxation/duty regime

The taxation structure for alcoholic drinks in India is complex, with legislation varying from state to state. The central government issues licenses for establishing manufacturing facilities, and imposes an import tax on imported alcoholic drinks. On top of this, state governments also impose excise and sales taxes in their own states. State governments are also responsible for making decisions on the retailing of alcoholic drinks. There are also restrictions on setting up liquor shops in the vicinity of an educational institution, as well in residential areas.

Different legislation in different states leads to anomalies in the taxation structure, and also restricts the growth of domestic manufacturers in alcoholic drinks in India. While imported products are subject to customs duty, domestically-produced alcoholic drinks are subject to different levies in various states, as well as other fees. These include license fees, vending fees, assessment fees, and sales and transport fees. The individual states have the authority to impose excise duties on domestically-manufactured liquor but their jurisdiction does not extend to imported products.

Each state imposes: (1) state excise duty on the production of alcohol in the state, (2) import duty on any alcoholic products from outside the state, and (3) export duty on all alcoholic products manufactured in the state for consumption in other states.

The high tax on alcoholic drinks means that these products constitute a major source of revenue for the central and state governments. States therefore find it difficult (or, perhaps, counter-productive) to enforce prohibition and even harder to find alternative revenue sources to replace lost alcohol taxes. Andhra Pradesh, for example, imposed prohibition in 1994, only to revoke it in 1997 in the wake of diminishing tax revenues. Gujarat, in West India, enforces total prohibition. However, the main impact of this is to remove a major income source for the Gujarat government, while encouraging the bootlegging of spirits. Most organized crime in the state has its roots in bootlegging, and alcoholic drinks continue to be widely available.

International trade forums have repeatedly raised the issue of restrictive/ prohibitively high import duties on alcoholic beverages in India. There was a significant amount of pressure on the central government to reduce tariffs on alcoholic drinks during the review period, following the entry of India to the World Trade Organization (WTO).

NOTES

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