

January 31, 2023

United Spirits Limited: Ratings reaffirmed and withdrawn

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/ Short-term Fund-based/Non-fund Based	2,675.0	2,675.0	[ICRA]AA+ (Positive) / [ICRA] A1+; reaffirmed and withdrawn
Unallocated Limits	125.0	125.0	
Total	2,800.0	2,800.0	

*Instrument details are provided in Annexure-1

Rationale

ICRA has reaffirmed and withdrawn the rating assigned to the bank facilities of United Spirits Limited (USL) at the request of the company and based on the No Objection Certificate (NOC) received from its bankers, and in accordance with ICRA's policy on withdrawal of credit ratings.

The rating reaffirmation factors in USL's dominant market position in the domestic spirits industry supported by its large distribution network, wide product portfolio and presence across multiple price points, flavours and segments. The ratings continue to factor in USL's strong operational and financial flexibility and robust corporate governance and compliance practices as a 55.94% subsidiary of Diageo Plc (Diageo; rated A3 / Stable by Moody's). USL continues to benefit from the business synergies through implementation of Diageo's global best practices across business functions, which has complemented its large scale of operations. On a standalone basis, with 12% YoY volume growth in H1 FY2023, the company witnessed 26% revenue growth on YoY basis supported by product mix improvement and better realisation per case. The growth was mainly led by the 'prestige and above' (P&A) segment (12% volume growth), which accounted for 75% of the sales backed by continued growth in off-trade, and renovation done in prior quarters.

Popular and below segment witnessed YoY revenue growth of 3%, largely led by volume improvement with ~6% growth in priority states. Going forward, USL will continue to benefit from the premiumisation of products, which will support margin expansion. Further, the relatively lower per capita liquor consumption in India than other South East Asian countries is also expected to support the long-term volume growth of the company. ICRA also notes the significant deleveraging of the company during FY2021 and FY2022 leading to sharp improvement in debt coverage metrics. Also, USL's liquidity is expected to remain strong with expected healthy operational cash flows and cash and liquid investment balances of Rs. 1,306.9 crore as on September 30, 2022.

On May 27, 2022, USL executed definitive agreements with Inbrew Beverages Private Limited (Inbrew) for the slump sale of USL's undertaking associated with 32 brands and a grant of a five-year exclusive franchise agreement of 11 brands, for a gross consideration of Rs. 828.5 crore. The transaction is in line with the company's stated intent of focusing on its P&A segment to support long-term profitable growth by premiumising its portfolio. The company reported exceptional gain of Rs. 381.0 crore in H1 FY2023 arising from the same. While the transaction is expected to increase the revenue and volume share of the P&A segment, the operating margins would be a key monitorable considering the current inflationary environment.

The company operates in a highly regulated industry with state-specific policies, which impact industry volumes in some markets. Further, volatility in costs of raw materials such as extra-neutral alcohol (ENA) and glass will continue to have a bearing on the company's margins in the absence of free price flexibility as prices are controlled by state corporations. USL's margins in H1 FY2023 were impacted by the ongoing scotch pricing negotiations in select states, route-to-market change in Delhi and high levels of input cost inflation. However, through savings in operating costs like staff costs and advertisement expenses, the overall H1 FY2023 OPM remained at 15.2% (15.6% in H1 FY2022).

Even while USL commands a strong market share in the domestic market, the presence of other large international and domestic players continues to impact the overall competitive scenario in the industry. Going forward, USL has outlined capital expenditure (capex) of ~Rs. 200-250 crore per annum. This is expected to be funded entirely through the robust internal accruals.

The Positive outlook on the rating reflects the expected improvement in USL's earnings (revenues and profitability) and cash flows, while maintaining its debt-free position over the near term.

Key rating drivers and their description

Credit strengths

Strong promoter group and experienced management team – Business synergies, financial flexibility and strengthened governance with 55.94% stake held by Diageo have yielded results over the past 4-5 years. Strong execution capabilities and Diageo's superior capital management ability complement USL's scale of operations.

Market leadership supported by vast portfolio and wide distribution network – USL has a market leadership position in the domestic spirits space, supported by its wide distribution network along with vast product portfolio across price points, flavours and segments to support its growth prospects. Some of the company's renowned brands are Johnnie Walker, Black Dog, Black & White, VAT 69, Smirnoff, etc.

Premiumisation to support revenue growth and margins, going forward – USL is expected to continue benefiting from increasing revenue share from premium brands supported by its investments in advertising and promotion expenses to support its long-term revenue growth.

Improving financial profile with significant deleveraging – The company's debt metrics improved substantially to TD/OPBDITA of 0.3x as on September 30, 2022, and interest coverage of 18.6x in H1 FY2023 from TD/OPBDITA of 1.0x as on March 31, 2021, and interest cover of 5.6x in FY2021 on the back of healthy cash accruals. Going forward, ICRA expects USL's nil debt position to continue, backed by robust internal accruals over the near term. The company had cash and liquid investment balances of Rs. 1,306.9 crore as on September 30, 2022.

Credit challenges

Exposure to regulatory changes – USL continues to remain exposed to a plethora of stringent regulations and rapid regulatory changes, including state control on pricing. The industry has witnessed excise hikes in several states in the past two years, which has increased consumer prices, in turn impacting volumes to a certain extent. Further, USL's revenues and volumes also remain vulnerable to change in route-to-market changes, which again are governed by various state governments.

Volatility in input costs – USL's margins are expected to remain sensitive to input price trends of major raw materials, such as molasses, grain, ENA and glass, in the absence of corresponding pricing flexibility with consumers. This is primarily because pricing is controlled by state corporations for most of the company's revenues. That said, USL's margins are expected to be supported with stringent cost control and efficiency improvement measures and better product mix (with increasing premiumisation).

High competitive intensity – USL's revenues will continue to be impacted by increasing competition from global players in the domestic market, particularly in the premium segment.

Environmental and Social Risks

Environmental considerations: Environmental risks for this industry would be the risk of discharge of hazardous and pollutant waste as well as exposure to physical climate risks and water management in relation to the production process. USL has more than 47 manufacturing facilities across India. The company has been undertaking initiatives that are expected to have

environmental benefits and improve the organisation's sustainability. This includes reducing water usage by 40% in its operations through technology upgradation, wastewater treatment and recycling, coupled with 96% reduction of greenhouse gas (GHG) emissions by using biofuels, solar and steam turbine energy (base year: 2007). USL's goals are to achieve net zero carbon emissions across its direct India operations by 2025, net water positive impact in India by 2026 and ensuring 100% recycled content in plastic packaging by 2030.

Social considerations: The company is exposed to social risks, including shifts in consumer tastes that can accompany changing demographics, but also evolving regulations, including bans imposed by the Government and social attitudes towards alcoholic products, which can affect demand for its products. The company mitigates these risks through education, clear labeling, and responsible drinking messages.

Liquidity position: Strong

USL's liquidity is strong with expected healthy operational cash flows and free cash and liquid investment balances of Rs. 1,306.9 crore as on September 30, 2022. The company has a capex commitment of ~Rs. 200-250 crore annually and plans to fund the same through its internal accruals. Currently, it does not have any long-term debt obligations. In addition to unutilised working capital facilities, the company enjoys healthy financial flexibility, enabling it to raise debt at short notice.

Rating sensitivities

Positive factors – Not applicable.

Negative factors – Not applicable.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Implicit Parent or Group support Policy on Withdrawal of Credit Ratings
Parent/Group Support	Diageo Plc (rated A3 / Stable by Moody's)
Consolidation/Standalone	ICRA has considered the consolidated financials of the company for arriving at the ratings.

About the company

USL, a 55.94% subsidiary of global spirits leader, Diageo, manufactures, sells and distributes a portfolio of premium brands such as Johnnie Walker, Black & White, VAT 69, Royal Challenge, McDowell's No.1, Smirnoff and Captain Morgan. With sales volumes of 40.7 million cases during H1 FY2023, the company is the one of the largest players in the domestic, India-made foreign liquor (IMFL) industry. Headquartered in Bengaluru, the company's wide footprint is supported by more than 50 manufacturing facilities across states and Union Territories in India and a strong distribution network. The company is listed on both the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) in India.

Key financial indicators

USL	FY2021 Audited	FY2022 Audited
Operating income	8,131.3	9,712.4
PAT	363.4	810.6
OPBDIT/OI	12.9%	16.6%
PAT/OI	4.5%	8.3%
Total outside liabilities/Tangible net worth (times)	1.1	0.8
Total debt/OPBDIT (times)	1.0	0.4
Interest coverage (times)	5.6	18.3

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Current rating (FY2023)					Chronology of rating history			
Instrument	Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2022 (Rs. crore)	Date & rating in FY2023		for the past 3 years		
				Jan 31, 2023	Jun 07, 2022	Date & rating in FY2022	Date & rating in FY2021	Date & rating in FY2020
1 Long term/Short term - Fund Based/Nonfund Based	Long Term/Short Term	2,675.00	-	[ICRA]AA+ (Positive)/[ICRA]A1+; withdrawn	[ICRA]AA+ (Positive)/[ICRA]A1+	[ICRA]AA+ (Positive)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+	[ICRA]AA+ (Stable)/[ICRA]A1+
2 Unallocated limits	Long Term/Short Term	125.00	-				-	-
3 Commercial Paper	Short Term	-	-	-	-	[ICRA]A1+; withdrawn	[ICRA]A1+	[ICRA]A1+
4 Non-convertible Debentures	Long Term	-	-	-	-	-	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term/Short term - Fund Based/Non-fund Based	Simple
Unallocated	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: [Click Here](#)

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term/Short term - Fund Based/Non-fund Based	NA	NA	NA	2,675.00	[ICRA]AA+(Positive)/[ICRA]A1+; reaffirmed and withdrawn
NA	Unallocated limits	NA	NA	NA	125.00	

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	USL Ownership	Consolidation Approach
Pioneer Distilleries Limited	75%	Full Consolidation
Royal Challengers Sports Private Limited	100%	Full Consolidation
Sovereign Distilleries Limited	100%	Full Consolidation
Asian Opportunities and Investments Limited	100%	Full Consolidation
Montrose International S.A ("Montrose")	100%	Full Consolidation
McDowell & Co. (Scotland) Limited	100%	Full Consolidation
Palmer Investment Group Limited	100%	Full Consolidation
Shaw Wallace Overseas Limited	100%	Full Consolidation
United Spirits (Great Britain) Limited	100%	Full Consolidation
United Spirits (Shanghai) Trading Company Limited	100%	Full Consolidation
United Spirits (UK) Limited	100%	Full Consolidation
United Spirits Singapore Pte Ltd	100%	Full Consolidation
USL Holdings (UK) Limited	100%	Full Consolidation
USL Holdings Limited	100%	Full Consolidation
Nao Spirits and Beverages Private Limited (w.e.f. from April 29, 2022)	9.3%	Equity Method

As on September 30, 2022

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Branches



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