March 02, 2017

United Spirits Limited

Instruments	Amounts	Rating Action
	(Rs. crore[1])	
Term loans	2,900.0	[ICRA]AA (Positive) / Rating outstanding
Fund based facilities	2,400.0	[ICRA]A1+ / Rating outstanding
Non-fund based facilities	400.0	[ICRA]A1+ / Rating outstanding
Commercial Paper	1,500.0 (Revised from Rs.1,000.0 crore)	[ICRA]A1+ / Assigned/outstanding
Non-convertible Debentures / Long term debt	765.0	[ICRA]AA (Positive) / Rating Assigned

** Instrument details are provided in Annexure I; Fund based and non-fund based limits are interchangeable*

Rating Action

ICRA has assigned long term rating of [ICRA]AA (pronounced as ICRA double A)[2] to the Rs.765.00 crore Non-convertible Debenture (NCD) / Long term debt (LTD) program of United Spirits Limited (USL). The outlook on the long term rating is Positive. ICRA has also assigned the short term rating of [ICRA]A1+ (pronounced ICRA A one plus) for the Rs.1,500.00 crore (revised from Rs.1,000.00 crore) enhanced commercial paper program of the company.

ICRA has long-term rating outstanding of [ICRA]AA (pronounced as ICRA double A) on the Rs.2,900.0 crore term loan facilities of United Spirits Limited . The outlook on the long term rating is Positive. ICRA also has short-term rating of [ICRA]A1+ (pronounced as ICRA A one plus) outstanding on the Rs.2,400.0 crore fund based facilities and the Rs.400.0 crore non-fund based facilities of USL.

Rationale

USL has completed its transition from its earlier promoters - including termination of certain historical contracts with erstwhile group companies and the completion of 'Additional Inquiry' during July 2016 thereby removing uncertainties pertaining to any potential / contingent liability arising from the same. In its extraordinary general meeting held in November 2014, the company's shareholders had voted down certain historical agreements between USL and UB Group entities. The company has been able to achieve termination of all such contracts and hence no further liabilities are expected to accrue on account of those contracts. While the company has made several large provisions towards certain receivables in its financial statements during the past three fiscals, ICRA notes that, with the conclusion of 'Additional Inquiry', no further material provisioning is expected going forward. However, ICRA would continue to monitor the developments in relation to the ongoing inquiries against USL by various regulatory bodies for its impact on the company, if any.

The ratings continue to factor strong financial flexibility, strengthening corporate governance and compliance practices and framework of USL post takeover of management control by Diageo Plc (Diageo; *rated A3 / Stable by Moody's*). By virtue of being a 54.78% subsidiary of Diageo, the company benefits from the business synergies, implementation of Diageo's global best practices across functions,

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[1] 100 lakhs = 1 crore = 10 millions

[2] *For complete rating scale and definitions, please refer ICRA's website (www.icra.in) or other ICRA Rating Publications*

capital management measures and focus on value growth. The ratings also take into account the company's strong and experienced management team.

The ratings also draw strength from USL's established position as the largest spirits player in the domestic market, its wide distribution network, the company's strong product portfolio across segments, flavors and price points underlining the future growth prospects and favorable demand outlook supporting the company's long term revenue growth. USL's operating margins for 9M FY2017 dipped to 10.6% (from 12.4% in 9M FY2016) impacted by certain one-offs – though excluding the impact of the same, the company's operating margins have reported an improving trend. Further, ICRA notes that the company's ongoing cost saving and efficiency improvement initiatives, its premiumisation drive and shift to franchisee model in some states are expected to support sustainable expansion in margins going forward. The ratings also take into account increasing competitive intensity in the domestic market and highly regulated nature of the industry which are likely to restrict business growth to some extent.

Significant provisioning relating to past transactions have impacted the net worth and debt protection metrics of the company over the last two years; however, the management's efforts towards reducing debt levels as reflected by systematic divestment of non-core assets and focus on efficient working capital management is expected to aid in reducing debt levels and improving the overall credit metrics going forward. The company's ability to achieve the same in a timely manner while also enhancing its operating accruals would remain key rating sensitivities going forward.

Key Rating Drivers

Credit Strengths

- Business synergies, financial support and strengthened governance structure with 54.78% stake being held by Diageo. Strong execution capabilities and superior capital management ability of Diageo to further complement the huge scale achieved by USL.
- Established market position as largest spirits player by volumes in the domestic market; strong portfolio of brands across segments, price points and flavors supports business growth prospects
- Favorable volume outlook combined with changing consumer preferences towards premium brands to support long-term revenue growth of the company
- State-specific franchisee model likely to aid in margin expansion with USL reducing exposure on low-margin states
- Cost saving and efficiency measures being undertaken by the company to support improvement in margins; financial profile to strengthen with the divestment of non-core assets over the medium term

Credit Weakness

- Dropping market share and volume de-growth on account of increased focus on premiumisation and pruning of volumes in lower end popular segment
- USL is exposed to changes in pricing by state governments given that significant share of sales volumes are generated from regions where state governments control prices.
- Input price escalation risk with increase in prices of molasses, extra-neutral alcohol (ENA) and glass prices over the last few years in the absence of corresponding pricing flexibility with consumers
- Financial profile characterized by high gearing and relatively weak coverage indicators owing to large provisioning pertaining to doubtful advances and certain divestments over the past two years.
- Increasing competitive intensity in the domestic market from global players particularly in the premium segment
- Industry remains tightly governed with significant vulnerability to regulatory changes; however, tight regulatory requirements also favor incumbent players like USL

Description of key rating drivers highlighted above:

With an operating income of Rs.9,379.3 crore during FY2016, USL is the largest player in the domestic Indian Made Foreign Liquor (IMFL) industry. The company markets its products under various brands, including some popular brands such as: Black Dog, VAT 69, Black & White, Johnnie Walker, Royal Challenge, Signature, McDowells No.1, and Antiquity among others. In the backdrop of a highly regulated alcoholic beverages industry in India, the company enjoys a distinctive advantage of having pan-India manufacturing presence which enhances its competitive advantage. Further, while competition from other local and international players is intensifying, the company's market position is likely to remain supported by its deep distribution network and strong brand recall for its products – especially in a media-dark industry.

Significant provisioning relating to past transactions have impacted the net worth and debt protection metrics of the company over the last two years; however, the management's efforts towards reducing debt levels as reflected by systematic divestment of non-core assets and focus on efficient working capital management is expected to aid in reducing debt levels and improving the overall credit metrics going forward. Further, business synergies, financial support and strengthened governance structure with 54.78% stake being held by Diageo also provides comfort. Strong execution capabilities and superior capital management ability of Diageo are expected to further complement the huge scale achieved by USL.

Analytical approach: For arriving at the ratings, ICRA has taken a consolidated view of United Spirits Limited and its subsidiaries. ICRA has also taken into account, inter alia, the implicit support from Diageo Plc to United Spirits Limited given the track record of sizeable investments by the former into USL in the past and high degree of operational integration of USL with its parent.

Links to applicable Criteria:
Corporate Credit Rating –A Note on Methodology
http://www.icra.in/Files/Articles/2009-October-Rating-Corp-Rating-Methodology.pdf

About the Company
United Spirits Limited ("USL" / "the Company") is 54.78% subsidiary of Diageo Plc and is engaged in the manufacture, marketing and distribution of spirits in the domestic as well as international markets. With sales volumes of 93.0 million cases during FY2016, the company is the largest player in the domestic spirits industry. USL's main products are Scotch and Indian whisky, dark and light rums, brandy, gin and vodka. The company has over 140 brands in its portfolio, 15 of which are millionaire brands (selling more than a million cases a year), and enjoys a strong brand recognition in the Indian spirits market. Major brands of USL include Antiquity, Signature, Royal Challenge, McDowell's No. 1, Bagpiper, Pinky, Romanov and White Mischief.

As on March 31, 2016, the company had 74 manufacturing units (own tie-up manufacturing facilities) that are capable of distilling molasses or grain to produce extra neutral alcohol (ENA) or bottling IMFL or both. The company also has a wide distribution network covering over 95% of the ~83,000 retail outlets across the country.

Recent Results (Standalone)

For 9M FY2017, USL reported net profit of Rs.274.1 crore on operating income of Rs.6,583.2 crore crore (net of excise duty) as against net profit of Rs.120.1 crore on operating income of Rs.6,204.7 crore (net of excise duty) during the same period previous fiscal. For FY2016, the company reported net profit of Rs.968.9 crore on operating income of Rs.9,379.3 crore (consolidated).

Status of non-cooperation with previous CRA: Not Applicable

Any other information: Not Applicable

Rating History for last three years:

Table: Rating History

S.No	Name of Instrument	Current Rating			Chronology of Rating History for the past 3 years		
		Type	**Rated amount (Rs. Crores)**	**Month-year & Rating**	**Month- year & Rating in FY2016**	**Month- year & Rating in FY2015**	**Month- year & Rating in FY2014**
				March 2017	March 2016	September 2014	November 2013
1	Term Loans	LT	2,900.00	[ICRA]AA (Positive)	[ICRA]A+ (Positive)	[ICRA]BBB- &	[ICRA]BBB- (Stable)
2	Fund-based	ST	2,400.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &	[ICRA]A3
3	Non-Fund Based	ST	400.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &	[ICRA]A3
4	Commercial Paper	ST	1,500.00	[ICRA]A1+	[ICRA]A1+	-	-
5	Non-Convertible Debentures / Long term Debt	LT	765.00	[ICRA]AA (Positive)	-	-	-
6	Fixed Deposits	MT	Nil (Earlier 400.00)	-	MA- & / Withdrawn	MA- &	MA- (Stable)

& Ratings on watch with developing implications

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

ICRA

Annexure-1

Details of Instrument

Name of the instrument	Date of issuance	Coupon rate	Maturity Date	Size of the issue (Rs. Cr)	Current Rating and Outlook
Term Loan#	-	-	Mar 2017 to June 2018	2,900.00	[ICRA]AA (Positive)
Fund-based	-	-	-	2,400.00	[ICRA]A1+
Non-Fund Based	-	-	-	400.00	[ICRA]A1+
Commercial Paper	16-11-2016 09-12-2016 20-01-2017 09-02-2017 10-02-2017 Unutilized	7.05% 7.10% 6.90% 6.70% 6.70% -	15-05-2017 07-06-2017 18-09-2017 02-11-2017 07-11-2017 -	140.00 325.00 335.00 200.00 250.00 250.00*	[ICRA]A1+
Non-convertible Debentures / Long term debt	-	-	-	765.00*	[ICRA]AA (Positive)

*Source: United Spirits Limited; * Unutilized ; #some term loans are on revolving basis*

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About ICRA Limited:

ICRA Limited was set up in 1991 by leading financial/investment institutions, commercial banks and financial services companies as an independent and professional investment Information and Credit Rating Agency.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

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