October 16, 2017

United Spirits Limited Revised

Summary of rated instruments

Instrument*	Rated Amount (Rs. crore)	Rating Action
Term Loans	500.00 (revised from Rs.2,900 crore)	[ICRA]AA (Positive); Reaffirmed
Long term/Short term Fund Based/Non-fund Based	4,900.00	[ICRA]AA (Positive) / A1+; Assigned
Commercial Paper	1,500.0	[ICRA]A1+; Reaffirmed
Non-convertible Debentures	765.00	[ICRA]AA (Positive); Reaffirmed
Total	**7,665.00**	

*Instrument details are provided in Annexure-1

Rating action

ICRA has reaffirmed the long-term rating of [ICRA]AA (pronounced ICRA double A) outstanding on the Rs.500.00 crore[1] (revised from Rs.2,900.00 crore) term loans and Rs.765.00 crore Non-convertible Debenture (NCD) programme of United Spirits Limited (USL / the company) [2]. Outlook on the long term rating is Positive. ICRA has also reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating outstanding on the Rs.1,500 crore commercial paper programme of the company. ICRA has also assigned the ratings of [ICRA]AA (Positive)/A1+ rating to the Rs.4,900 crore Long term / Short Fund based / Non-fund based facilities of the company. For the Rs.4,900 crore, rating of [ICRA]AA or [ICRA]A1+ will apply depending on the tenure of the facility.

Rating Rationale

The reaffirmation in ratings takes into account the strong financial flexibility and strengthened corporate governance and compliance practices framework of USL, post takeover of management control by Diageo Plc (Diageo; *rated A3 / Stable by Moody's*) during FY2015. By virtue of being a 54.78% subsidiary of Diageo, the company benefits from the increasing business synergies through implementation of Diageo's global best practices across business functions which have complemented the advantageous scale of USL's operations. The ratings also take into account the company's strong and experienced management team.

The ratings continue to derive strength from steady improvement in USL's market share in the domestic spirits market, with 44.0% market share during FY2017. This has largely been supported by the company's expansive distribution network, presence across price points, flavours and segments in addition to the continued investments in selling expenses to promote the premiumization drive being undertaken by the company. ICRA also expects the company's ongoing shift to state-specific franchisee model and productivity-led efficiency initiatives to support the company's margins going forward. Overall, the company witnessed a revenue growth of 3.8% while its operating margins stood at 11.4% during FY2017.

The ratings also take into account the intense competition and highly regulated nature of the industry which are likely to restrict the company's growth and margins to a certain extent. The company's volume growth during Q3 FY2017 was affected on account of the demonetization move by the Government of

[1] *100 lakh = 1 crore = 10 million*

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

India in November 2016. Further, the company's revenues de-grew by 13.0% yoy during Q1 FY2018 while standalone margins declined to 10.4% (Q1 FY2017 11.5%) following the supreme court's ruling banning sale of liquor within 500 metres of state and national highways across the nation from April 01, 2017 in addition to de-growth on account of moving to state-specific franchisee model. ICRA also notes that the GST which has been implemented from July 01, 2017 is likely to lead to increase in packaging costs and certain material costs for the company as alcohol has currently been kept out of the ambit of GST on account of which the company cannot claim input credit on the same. However, ICRA expects the company's increasing realizations to compensate for the same to a certain extent.

Significant provisioning relating to a one-time customer claim to the extent of Rs.264.5 crore has impacted the net worth and debt protection metrics of the company during FY2017. As on March 31, 2017, the company's gearing stood at 2.3x (2.6x as on March 31, 2016) while the TD/OPBDITA and interest coverage stood at 4.1x and 2.7x respectively (4.3x and 2.1x as on March 31, 2016). However, the management's efforts towards reducing debt levels by divestment of non-core assets to the tune of Rs.2,000 crore over the next three years in addition to the focus on efficient working capital management is expected to aid in reducing debt levels and improving the overall credit metrics going forward. Going forward, ICRA expects the company's debt levels to decline, operating margins to improve and its coverage indicators to strengthen over the next 18 months. The company's ability to achieve the same in a timely manner would remain key rating sensitivities going forward.

Key rating drivers

Credit strengths

- **Strong promoter group and experienced management team -** Business synergies, financial flexibility and strengthened governance structure with 54.78% stake being held by Diageo. Strong execution capabilities and Diageo's superior capital management ability complement USL's scale of operations.
- **Strong market share and healthy geographic diversification -** Established market position with 44.0% market share in the domestic market; expansive distribution network along with presence across price points, flavours and segments continues to support business growth prospects
- **Premiumization to support revenue growth going forward -** Changing consumer preferences towards premium brands in conjunction with continued investments in selling expenses being made by the company is expected to support long-term revenue growth of the company
- **State-specific franchisee model and efficiency measures to support margins –** In addition to the premiumization drive being taken up by the company, state specific franchisee model in conjunction with cost optimization measures being taken up by the company are expected to support the margins going forward.

Credit weaknesses

- **Continuous volume de-growth –** USL has witnessed continuous volume de-growth (90.0 million cases during FY2017 as against 93.0 million cases during FY2016) on account of increased focus on premiumisation and pruning of volumes in lower end popular segment; however, strong market position of the company continues to support business prospects.
- **Exposure to regulatory changes -** USL remains exposed to changes in pricing by state governments. Industry also remains tightly governed with significant vulnerability to regulatory changes; revenues of the company de-grew by 13.0% yoy during Q1 FY2018 while standalone margins declined to 10.4% (Q1 FY2017 11.5%) following the supreme court's ruling banning sale of liquor within 500 metres of state and national highways across the nation from April 01, 2017 in addition to de-growth on account of moving to state-specific franchisee model.

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- **Continuous increase in input costs -** 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; GST is expected to result in increase in packaging and molasses costs for the company leading to a strain on the company's margins.
- **Moderate financial profile -** Financial profile continues to be characterized by high gearing and relatively stretched coverage indicators owing to large provisioning pertaining to doubtful advances and certain divestments in the recent past; working capital intensity also continues to remain high.
- **High competitive intensity** - Increasing competitive intensity in the domestic market from global players particularly in the premium segment.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company:
USL is 54.78% subsidiary of Diageo Plc and is engaged in the manufacture, marketing and distribution of potable spirits in the domestic as well as international markets. With sales volumes of 90.0 million cases during FY2017, 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, 18 of which are millionaire brands (selling more than a million cases a year), and enjoys a strong brand recognition in the Indian spirits market. USL portfolio includes brands such as McDowell's No.1, Royal Challenge, Signature and Antiquity, among others. USL also imports, manufactures and sells Diageo's iconic brands such as Johnnie Walker, VAT 69, Black and White, Smirnoff and Ciroc in India.

As on March 31, 2017, the company had 60 manufacturing units (own and 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 more than 95% of the ~81,000 retail outlets across the country.

Key Financial Indicators (Audited)

	FY2016	**FY2017**
Operating Income (Rs. crore)	8,494.9	8,817.5
PAT (Rs. crore)	172.4	139.8
OPBDIT/ OI (%)	11.6%	11.4%
RoCE (%)	15.4%	10.4%
Total Debt/ TNW (times)	2.6	2.3
Total Debt/ OPBDIT (times)	4.3	4.1
Interest coverage (times)	2.1	2.7
NWC/ OI (%)	39.6%	40.5%

Source: ICRA Research; OI: Operating Income; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation; ROCE: PBIT/Avg (Total Debt + Tangible Net-Worth + Deferred Tax Liability - Capital Work - in Progress); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:

Table:

S. No.	Instrument	Current Rating (FY2018)			Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. Crore)	Date & Rating	Date & Rating in FY2017	Date & Rating in FY2017	Date & Rating in FY2016
				October 2017	February 2017	March 2016	September 2014
1	Term Loans	LT	500.00	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]A+ (Positive)	[ICRA]BBB- &
2	Fund Based/Non-fund Based	LT/ ST	4,900.00	[ICRA]AA (Positive)/A1+	-	-	-
3	Commercial Paper	ST	1,500.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
4	Non-convertible Debentures	LT	765.00	[ICRA]AA (Positive)	[ICRA]AA (Positive)		
5	Fund-based	ST	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &
6	Non-Fund Based	ST	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &
7	Fixed Deposits	MT	-	-	MA- & / Withdrawn	MA- &	MA- (Stable)

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

Annexure-1

Instrument Details

ISIN No	Instrument	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
	Term Loans	FY2017	7.9%	FY2020	500.00	[ICRA]AA (Positive)
	Fund Based/Non-fund Based	FY2017	-	-	4,900.00	[ICRA]AA (Positive) / A1+
NA	Commercial Paper	NA	NA	7-365 Days	1,500.00	[ICRA] A1+
	Proposed Non-convertible Debentures	-	-	-	765.0	[ICRA]AA (Positive)

Source: The company

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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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