United Spirits Limited

December 24, 2018

Summary of rated instruments

Instrument*	Previously Rated Amount (Rs. crore)[1]	Current Rated Amount (Rs. crore)	Rating Action
Long term/Short term Fund Based/Non-fund Based	4,900.00	3,925.00	[ICRA]AA+ (Stable) / A1+; reaffirmed
Commercial Paper	1,500.00	1,500.00	[ICRA]A1+; reaffirmed
Non-convertible Debentures	765.00	750.00	[ICRA]AA+ (Stable); reaffirmed
Total	**7,165.00**	**6,175.00**	

*Instrument details in Annexure - I

Rating action

ICRA has reaffirmed the long-term rating outstanding on the Rs.750.00 crore (revised from Rs.765.00 crore) Non-convertible Debenture (NCD) programme of United Spirits Limited (USL / the company) [2] at [ICRA]AA+ (pronounced ICRA double A Plus). Outlook on the long-term rating is Stable. 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 reaffirmed the ratings outstanding on the Rs.3,925.00 crore (revised from Rs.4,900.00 crore) Long term / Short term Fund based / Non-fund based facilities of the company at [ICRA]AA+ (Stable)/A1+. For the Rs.3,925.00 crore, rating of [ICRA]AA+ or [ICRA]A1+ will apply depending on the tenure of the facility.

Rationale

In arriving at the ratings, ICRA has taken a consolidated view of USL and all its subsidiaries given the strong strategic linkages amongst entities in the group.

The reaffirmation in ratings factors USL's strong operational and financial flexibility and improved corporate governance and compliance practices by virtue of being a 54.78% 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 have complemented its large scale of operations. The ratings also consider USL's longstanding presence and strong market position in the industry supported by the company's expansive distribution network and presence across price points, flavours and segments. ICRA also notes the improving premiumisation of products (with Prestige & Above segment contributing to 66% of the company's revenues during H1 FY2019) and productivity-led efficiency initiatives supporting the company's standalone EBITDA margin which stood at 14.7% during H1 FY2019 as against 12.7% in H1 FY2018. ICRA also expects USL's financial profile to strengthen further supported by its strong cash flows in conjunction with ongoing divestment of non-core assets. Consequent to healthy cash flows and strong accruals, during FY2018, the company reduced its debt by more than Rs.700 crore resulting in improvement of its debt metrics – gearing and TD/OPBDITA stood at 1.4x and 2.8x respectively as on March 31, 2018 as against 2.3x and 4.1x respectively as on March 31, 2017.

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[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*

During FY2018, the overall industry growth was affected by several factors like demonetization, the Supreme court's ruling banning sale of liquor within 500 meters of state and national highways across the nation from April 01, 2017 and distribution changes in states like West Bengal, Chhattisgarh and Jharkhand in addition to de-growth following implementation of GST. As a result of this, USL's revenues contracted by 2.6% to Rs.8,590 crore during FY2018 from 8,817.5 crore during FY2017. Even while changing consumer preferences towards premium brands, relatively lower per capita liquor consumption as compared to other Asia Pacific countries in conjunction with continued investments in promotion expenses being made by the company are expected to support long-term revenue growth, intense competition and the highly regulated nature of the industry are likely to cap growth and margins to a certain extent.

Outlook: Stable

ICRA believes USL will continue to benefit from its strong parentage, established brand equity, favourable long-term volume outlook for the spirits industry combined with changing consumer preferences towards premium brands. The outlook may be revised to 'Positive' if substantial growth in revenue and profitability strengthen the financial risk profile and debt metrics of the company. The outlook may be revised to 'Negative' if cash accruals are lower than expected, or if debt-funded capital expenditure or unforeseen regulatory changes affect the company's margins, debt metrics and liquidity position of the company.

Key rating drivers

Credit Strengths

- **Strong promoter group and experienced management team -** Business synergies, financial flexibility and strengthened governance structure with 54.78% stake 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 in the domestic market (market share of 44% during FY2017); expansive distribution network along with presence across price points, flavours and segments continues to support business growth prospects.

- **Premiumization to support revenue growth and margins going forward -** Changing consumer preferences towards premium brands in conjunction with continued investments in Advertising & Promotion (went up by 18% during FY2018 despite de-growth in revenues) being made by the company is expected to support long-term revenue growth. Improving revenue share from the P&A segment comprising of strong brands like Johnnie Walker, Black Dog, Black & White, VAT 69, Smirnoff, Antiquity, Signature, Royal Challenge and McDowell's No.1 etc. continues to support the overall revenues and margins of the company.

- **Improving margins and return indicators –** USL's EBITDA margin improved to 14.1% during FY2018 from 11.4% in FY2017; ROCE also improved to 20.7% during FY2018 and 21.7% during H1 FY2019 from 10.4% during FY2017; this was largely on the back of improving mix, price increases received by the company from 18 states during FY2018 and productivity-led initiatives implemented by the company resulting in cost savings of about Rs.300 crore during FY2018. Supported by improving OPM and reducing debt, the company's net margin improved by 600% during FY2018. USL's standalone EBITDA margin stood at 14.7% during H1 FY2019 supported by healthy revenue growth of 13.6% supported by improving price / mix and stable operating environment.

Credit Weaknesses

- **Exposure to regulatory changes -** USL continues to remain dependent on various state governments for price revisions. The industry also remains tightly governed with significant vulnerability to regulatory and route-to-market changes which has affected the company's revenues during FY2018. However, price increases received across 18 states supported USL's margins during FY2018. On the other hand, the regulatory intensity of the industry leads to high entry barriers favouring incumbents.
- **Volatility in input costs could affect margins -** USL's margins are expected to remain dependent on input price trends of major raw materials like molasses, extra-neutral alcohol (ENA) and glass in the absence of corresponding pricing flexibility with consumers; however, productivity-led initiatives and benign raw material pricing has supported the company's margins in the recent past. During periods of increasing raw material prices in the past, the company has been able to improve its efficiencies to support margins.
- **Moderate debt metrics –** USL's debt profile continues to be characterized by high debt levels; in line with industry requirements, the company's working capital intensity also continues to remain high. However, supported by healthy accruals, the debt indicators have been improving over the recent past (Gearing and TD/OPBDITA stood at 1.4x and 2.8x respectively as on March 31, 2018 as against 2.3 x and 4.1x respectively as on March 31, 2017 while interest coverage improved to 4.5x during FY2018 as against 2.7x during FY2017).
- **High competitive intensity –** USL's revenues will continue to be impacted by increasing competitive intensity in the domestic market from global players, particularly in the premium segment.

Liquidity Position:

During FY2018, USL's free cash flows improved primarily on the back of improvement in its operating profits as well as unlocking of working capital. As on March 31, 2018 the company had cash balances of Rs.142 crore. Further, the company's current liquidity position remains healthy as reflected in relatively low utilization (40% of drawing power during the 12-month period ending September 2018) of its sanctioned working capital limits. Given the increasing accruals supported by improvement in its margins, the company has also reduced its working capital limits.

USL plans to incur Rs.250-300 crore capex per annum over the next two-three years and plans to fund the same entirely through its internal accruals. The company's repayments include Rs.750 crore of NCD to be repaid during Q3 FY2021. ICRA expects the same to be repaid through USL's internal accruals given its healthy cash flow generation. Going forward, ICRA expects the company's working capital utilization to remain low given its healthy margins supporting the overall liquidity position of the company.

Analytical approach:

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Diageo Plc (rated A3 / Stable by Moody's)
Consolidation / Standalone	The rating is based on consolidated financial statements of the company

About the company:

USL is a subsidiary of global leader Diageo plc and manufactures, sells and distributes a portfolio of premium brands such as Johnnie Walker, Black Dog, Black & White, VAT 69, Antiquity, Signature, Royal Challenge, McDowell's No.1, Smirnoff, Captain Morgan and Four Seasons. With sales volumes of 78 million cases during FY2018, the company is the largest player in the domestic spirits industry. Headquartered in Bengaluru, the company's wide footprint is supported by 51 (as on September 2018) 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. 54.78% shareholding in the company is held by Relay BV, which is a subsidiary of Diageo Plc.

Consolidated key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	8,817.5	8,590.6
PAT (Rs. crore)	93.0	651.9
OPBDIT/ OI (%)	11.4%	14.1%
RoCE (%)	10.4%	20.7%
Total Debt/ TNW (times)	2.3	1.4
Total Debt/ OPBDIT (times)	4.1	2.8
Interest coverage (times)	2.7	4.5

Source: Company, ICRA research; OPBDITA: Operating Profit before Depreciation, Interest and Taxes; PAT: Profit After Tax; RoCE: Return on Capital Employed; TNW: Tangible Net Worth

Status of non-cooperation with previous CRA: NA

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019)				Chronology of Rating History for the past 3 years						
		Type	Amount Rated (Rs.crore)	Amount Outstanding as on March 31, 2018 (Rs Crore)	Date & Rating Dec 2018	Date & Rating in FY2018 Feb 2018	Oct 2017	Date & Rating in FY2017 Mar 2017	Jan 2017	Apr 2016	Date & Rating in FY2016 Nov 2015	Jun 2015
1	Long term/ Short term Fund Based/ Non-fund Based	Long Term / Short Term	3,925.00	966.0	[ICRA]AA+ (Stable) /A1+	[ICRA]AA+ (Stable)/ A1+	[ICRA]AA (Positive)/A1+	-	-	-	-	-
2	Commercial Paper	Short Term	1,500.00	1,337.3	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-
3	Non-convertible Debentures	Long Term	750.00	750.0	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	-	-	-
4	Term Loans	Long Term	-	352.2	-	[ICRA]AA (Positive) / withdrawn	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]A+ (Positive)	BBB- &	BBB- &
5	Fund-based	Short Term	-	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &	[ICRA]A3 &
6	Non-Fund Based	Short Term	-	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A3 &	[ICRA]A3 &
7	Fixed Deposits	Medium Term	-	-	-	-	-	-	-	MA- & / Withdrawn	MA- &	MA- &

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 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	FY2027	3,925.00	[ICRA]AA+ (Stable)/A1+
NA	Commercial Paper	NA	NA	0-365 days	1,500.00	[ICRA]A1+
INE854D08011	Non-convertible Debentures	Dec 2017	7.45%	Dec 2020	750.00	[ICRA]AA+ (Stable)

Source: United Spirits Limited

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

Pavethra Ponniah
+91 44 4596 4314
pavethrap@icraindia.com

Mythri Macherla
+91 44 43326407
mythri.macherla@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-124-2866928 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
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Hyderabad	+ (91 40) 2373 5061/7251
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