June 29, 2020

ADS Spirits Private Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term: Fund Based/Cash Credit	21.00	21.00	[ICRA]BBB+ (Stable); reaffirmed
Long-term: Fund Based/Term Loan	4.03	4.03	[ICRA]BBB+ (Stable); reaffirmed
Long-term: Unallocated	34.97	34.97	[ICRA]BBB+ (Stable); reaffirmed
Total	**60.00**	**60.00**	

**Instrument details are provided in Annexure-1*

Rationale

For arriving at the ratings, ICRA has taken a consolidated view of ADS Spirits Private Limited (ADS Spirits) and its Group company, ADS Distilleries Private Limited (ADS Distilleries), together referred to as the ADS Group, given the strong operational and management linkages.

ICRA's rating action takes into account the Group's increasing geographic presence through the establishment of a new entity – ADS Distilleries – by the promoters in Uttar Pradesh (UP). In December 2019, ADS Distilleries commenced bottling operations for five IMFL[1] brands owned by ADS Spirits under a contractual agreement with the latter to cater to the UP market. The ratings continue to factor in the Group's increasing scale of operations over the past few years (which continued in the first two months of the current fiscal as well) aided by increased sales volumes on the back of diversification into new markets of the IMFL segment and gradual brand recognition. ICRA's ratings also centrally factor in the continued infusion of unsecured loans by the promoters to support business growth, which has kept the dependence on external borrowings relatively low. ICRA believes that the Group will continue to benefit from the extensive experience of the promoters and favourable long-term volume outlook for the spirits industry, driven by the favourable demographic profile. The rating, however, is constrained by the fact that the Group has undertaken significant capacity expansion plans, and is in midst of undertaking further expansion, which might impact its return indicators in the near to medium term. Moreover, the Group's ability to establish its brand and increase its market share in states where it has recently entered, is yet to be seen. Further, the Group's working capital intensity of operations remains high owing to its high receivable cycle and high inventory holding period exerting pressure on its liquidity; this has resulted in near-complete utilisation of working capital facilities as well in the past. The receivable build-up beyond six months also remains a concern. Moreover, the working capital cycle in the newly entered geographies is yet to be established. However, the significant unsecured loans from promoters invested in the Group along with the proposed limit enhancement, offers comfort. The rating also factors in the concentration risks arising out of high dependence on a single brand – Royal Green – for most of its sales, and limited presence of the Group in other product categories. Additionally, the margins remain exposed to any fluctuation in raw material prices, given the increased reliance on

[1] Indian-made foreign liquor

purchase of spirits from outside. The rating is also constrained by the high business risk inherent in the liquor industry owing to high taxes and stringent Government controls and regulations, and limited pricing power.

The Stable outlook on the [ICRA]BBB+ rating reflects ICRA's opinion that the Group company will continue to benefit from the extensive experience of its promoters and its established track record in the liquor industry. Although the order inflows have remained healthy, the Group's ability to recover pending receivables from its customers and improve its liquidity position remains critical. ADS's ability to grow its OI and profitability in a regulated market would remain the key rating sensitivity. Any significant withdrawal of unsecured loans and advances from its other Group companies resulting in an increase in debt levels will be a key monitorable. Any unforeseen regulatory change will also be a key rating sensitivity.

Key rating drivers and their description

Credit strengths

Over two decades of experience of promoters in industry – The promoters have been involved in the alcohol business for more than two decades. They have an established presence in liquor retailing in Haryana, which provides access to retail outlets for selling the products under ADS' own brands, especially IMFL.

Expansion in scale of operations with improvement in product mix – With an increase in sales volumes following geographic diversification, ADS' OI and profitability have consistently improved. Further, over the last two years, the Group has increased its geographical footprint by entering into various distribution arrangements, thereby expanding its footprints to Jharkhand, Andhra Pradesh, Punjab, Telangana, Odisha, UP, etc. Healthy scale up of operations along with continued focus on the more margin-accretive IMFL segment supported margins in the recent years.

High entry barriers – Liquor policies governing its production and sales are entirely controlled by the respective state governments. With all the alcohol consuming states/Union Territories having their own regulations and entry-exit restrictions, it is very difficult for new entrants to get licenses, thus providing a competitive advantage to the existing players. However, the states have been reasonably flexible in granting expansion of the existing capacity to meet demands. This acts in favour of incumbents as new players find it difficult to start.

Strong financial support from promoters as visible by regular infusion of unsecured loans – The promoters have been supporting the Group financially by way of unsecured loans when the need arises. The unsecured loans stood at ~Rs. 117 crore as on March 2020. Given the elongated receivable cycle, ICRA expects this support to continue over the medium term.

Credit challenges

Increase in working capital intensity of operations – In line with the increase in scale of business, the working capital requirements of the Group have increased. As most debtors outstanding are from state corporations, the risk of debtors turning bad remains low; however, the delays in recoveries continue to constrain ADS's financial flexibility. The receivable build-up beyond six months also remains a concern. In the past, this has necessitated regular long-term fund infusion in the form of unsecured loans (from promoters) along with near-full utilisation of sanctioned limits (barring March 2020).

Substantial capacity expansion plans and foray into relatively newer geographies – ICRA notes the sizeable capital expenditure undertaken by the Group in the recent past. In addition, the Group is, at present, in the midst of a capacity expansion programme, wherein the ENA producing capacities would increase to 115 kilo litre per day (KLPD) by FY2022 (at a total capex outlay of ~Rs. 60 crore). Even though a predominant share of the capex is likely to be funded through internal accruals and unsecured loans, timely completion of the capex programme, and ADS's ability to achieve commensurate and timely returns from the enhanced as well as proposed capacities would remain a key rating sensitivity.

Exposure of profitability margins to volatilities of raw material prices – The Group's margins remain dependent on price trends of major raw materials like grains and packing materials. This apart, the product prices for a particular financial year are decided at the beginning of the year itself by the respective state governments. Hence, the Group's ability to pass on any raw material price increase during the year remains limited. Nonetheless, the Group's continued focus on premium IMFL is expected to mitigate the impact to an extent.

Intense competition and highly regulated nature of industry – ADS' revenues will continue to be impacted by increasing competition in the domestic IMFL market from global players as well as regional players. In addition, ADS remains exposed to changes in pricing by state governments. Strong government controls, ban on advertising, varying tax structures in different states pose challenges and restrict the industry's growth.

Liquidity position: Adequate

The Group's liquidity is **adequate**, aided by promoter-infused unsecured loans. The Group has an estimated capex of Rs. 60 crore over the next two years, and the same is expected to be financed partly through internal accruals, unsecured loans and bank debt. Moreover, with an increase in scale of business and distribution network, the Group's working capital funding requirements are likely to increase. This in turn which could result in some reliance on external debt. The Group's ability to avail timely limit enhancement commensurate to its scale of business remains imperative.

Rating sensitivities

Positive triggers – ICRA could upgrade the rating if the Group demonstrates a sustained improvement in revenues and profitability, which leads to an improvement in credit metrics, along with sufficient cushion available in the working capital limits.

Negative triggers – Downward pressure on the rating will emerge if the reliance on external borrowings increases to higher than-budgeted levels, resulting in deterioration in the capital structure, or lack of commensurate and timely returns from the recent expansion as well as capex in pipeline impacts the financial profile, and the overall liquidity position. Over and above, any unforeseen and unfavourable regulatory change may also warrant a rating action. Specific credit metrics that could lead to a downgrade include increase in debtor days over 100 days on sustained basis.

Analytical approach

	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Consolidation and Rating Approach
Parent/Group Support	Not applicable
Consolidation / Standalone	For arriving at the ratings, ICRA has taken a consolidated view of ADS Spirits Private Limited (ADS Spirits) and its Group company, ADS Distilleries Private Limited (ADS Distilleries), together referred to as the ADS Group, given the strong operational and management linkages.

About the company

ADS Spirits Private Limited (ADS) was incorporated in 2010. The company operates a 60-KLPD grain-based distillery in Jhajjar, Haryana for manufacturing ENA, which is the main ingredient for manufacturing country liquor (CL) and IMFL. The company commenced operations in March 2013. It also manufactures and bottles CL and IMFL (whisky and vodka), which are retailed under its own brands in Haryana. The plant has capabilities to manufacture distilled wet grain solvent (DWGS) at its facility. In addition, the company has a 2.5-MW captive coal-based power plant, which alongside meeting the entire power requirement of the manufacturing unit, supplies steam for the manufacturing process.

About the Group

ADS and ADS Distilleries Private Limited are part of the ADS Group, which has extensive experience in the liquor retail and manufacturing business. In addition to the aforementioned entities, the promoters are involved in liquor retailing and wholesaling through their Association of Persons firm ADS Associated Group[2] in Haryana.

Key financial indicators (audited)

	Standalone			Consolidated		
	FY2018	FY2019	9MFY2020	FY2018	FY2019	9MFY2020
Operating Income (Rs. crore)	315.3	391.9	351.4	315.3	391.9	351.4
PAT (Rs. crore)	17.8	32.0	29.5	17.8	32.0	29.5
OPBDITA/OI (%)	13.5%	15.3%	14.7%	13.5%	15.3%	14.7%
RoCE (%)	35.0%	41.0%	35.5%	35.0%	41.0%	35.5%
Total Outside Liabilities/Tangible Net Worth (times)	3.0	2.4	1.9	3.0	2.4	1.9
Total Debt/OPBDIT (times)	1.6	1.5	1.5	1.6	1.5	1.5
Interest Coverage (times)	6.6	7.3	7.3	6.6	7.3	7.3
DSCR (times)	2.8	5.3	4.3	2.8	5.3	4.3

Source: Financial statements of ADS Spirits; ICRA research; 9MFY2020 financials are provisional; ADS Distilleries commenced operations in December 2019

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

[2] *The promoters have liquor retail outlets in Bahadurgarh and Jhajjar area*

Rating history for last three years

SNo	Name of Instrument	Type	Current Rating (FY2021)			Chronology of Rating History for the Past 3 years		
			Rated amount	Amount outstanding	Month-year & Rating	Month- year and Rating in		
						FY2020	FY2019	FY2018
			(Rs. crore)		June 29, 2020	December 5, 2019	October 29, 2018	September 28, 2017
1	Cash Credit	Long Term	21.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
2	Term Loan	Long Term	4.03	0.00	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (Stable)
3	Unallocated	Long Term	34.97	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)	[ICRA]BBB (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	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Cash Credit	-	-	-	21.00	[ICRA]BBB+ (Stable)
-	Term Loan	FY2017	-	FY2022	4.03	[ICRA]BBB+ (Stable)
-	Unallocated	-	-	-	34.97	[ICRA]BBB+ (Stable)

Source: ADS Spirits; Sanctioned letter

Annexure-2: List of entities considered for consolidated analysis

Company name	Ownership	Consolidation Approach
ADS Spirits Private Limited	-	Full consolidation
ADS Distilleries Private Limited	-	Full consolidation

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