February 17, 2022 (Revised)

# United Spirits Limited: Ratings reaffirmed; outlook on the long-term rating revised to Positive

## 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 | 3,425.00 | 2,675.00 | [ICRA]AA+; reaffirmed and outlook revised to Positive from Stable [ICRA]A1+; reaffirmed |
| Unallocated limits | - | 125.00 | |
| Commercial Paper | 500.00 | - | [ICRA]A1+; reaffirmed and withdrawn |
| **Total** | **3,925.00** | **2,800.00** | |

**Instrument details are provided in Annexure-1*

## Rationale

ICRA has withdrawn its rating on the Rs. 500.0-crore Commercial Paper at United Spirits Limited's (USL/the company) request and in line with its policy on withdrawal of credit ratings as there was no outstanding against the facility.

The positive outlook on USL's long-term rating reflects the expected improvement in earnings (revenues and profitability) and cash flows while maintaining its debt free position over the near term. 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. The ratings also consider USL's strong market position in the domestic spirits industry supported by its large distribution network, wide product portfolio and presence across price points, flavours and segments.

The revenues witnessed de-growth of 12.8% in FY2021 due to Covid-19-led lockdown and the subsequent impact on the liquor industry in Q1 FY2021. However, revenue growth was 21.6% in 9M FY2022 on the back of low base and continued revival in both off-trade and on-trade channels. The operating profit margins declined to 12.9% in FY2021 (from 16.9% in FY2020) due to impact on revenues and inclusion of unwinding costs related to Andhra Pradesh. However, despite the second-wave impact on revenues in Q1 FY2022, the 9M FY2022 margins improved to 16.4% on the back of favourable product mix coupled with better operational leverage from Q2 FY2022. ICRA notes the significant deleveraging of the company during FY2021 and H1 FY2022 leading to sharp improvement in debt coverage metrics. Further, the standalone working capital limit utilisation reduced to nil as on December 31, 2021 (over Rs. 443.0 crore as on September 30, 2021) backed by healthy cash accruals.

Going forward, USL will continue to benefit from the premiumisation of products which will support margin expansion. Further, relatively lower per capita liquor consumption in India as compared to other south-east Asian countries is also expected to support the long-term volume growth of the company.

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 ENA and glass will continue to have a bearing on the company's margins. Even while USL commands a strong market share in the domestic market, 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 of ~Rs. 200-300 crore per annum. This is expected to be funded entirely through the robust internal accruals.

# 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 has 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 a vast portfolio and wide distribution network –** USL has a market leadership position in the domestic spirits 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, Antiquity, Signature, Royal Challenge and McDowell's No.1 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 USL's long-term revenue growth.

**Improving financial profile with significant deleveraging –** The company's debt metrics improved substantially to TD/OPBDITA of 0.8x as on September 30, 2021 and interest coverage of 20.4x in H1 FY2022 from TD/OPBDITA of 1.6x as on March 31, 2020 and interest cover of 7.4x in FY2020 on the back of healthy cash accruals. USL has also reduced its working capital utilisation to nil as on December 31, 2021. Going forward, ICRA expects the nil debt position to continue backed by robust internal accruals and no major debt-funded capex/ acquisitions over the near term.

## Credit challenges

**Exposure to regulatory changes** – USL continues to remain exposed to a plethora of stringent regulations and rapid regulatory changes, including states control on pricing. The industry has witnessed excise hikes in several states in FY2020 and FY2021, which has increased the consumer prices, in turn impacting the volumes to a certain extent. Further, the company's revenues and volumes also remain vulnerable to change in route-to-market changes (changes in Andhra Pradesh had impacted volumes of the industry severely during FY2020 and H1 FY2021), which again are governed by various state governments. However, there has been certain progressive regulatory changes like route-to-market change in Delhi, and excise duty reduction in West Bengal and Uttar Pradesh, which is expected to have a favourable impact on the company's operations.

**Volatility in input costs –** USL's margins are expected to remain sensitive to input price trends of major raw materials, such as molasses, grain, extra-neutral alcohol (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 remain healthy 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 competitive intensity in the domestic market from global players, particularly in the premium segment.

# Liquidity position: Strong

USL's liquidity is strong with expected healthy operational cash flows and undrawn working capital limits of Rs. 2,675.0 crore as on December 31, 2021. Average working capital utilisation was low at ~16% for the 12-month period ending December 31, 2021. USL has capex commitment of ~Rs. 200-300 crore annually and plans to fund the same through its internal accruals and does not have any long-term debt obligations currently. 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 –** USL's ratings could be upgraded if there is sustainable improvement in earnings and liquidity position, while maintaining a negative net debt position.

**Negative factors –** Negative pressure on USL's ratings could arise if there is any deterioration in margins and, debt-funded capex or acquisitions or regulatory measures leading to weakening of the credit profile with net debt/ OPBDITA >1.0x on a sustained basis. Deterioration in the parent's (Diageo Plc) credit profile or weakening of USL's linkages with the parent, will also lead to a review of the company's ratings.

## Analytical approach

| Analytical Approach | Comments |
|---|---|
| **Applicable Rating Methodologies** | Corporate Credit Rating Methodology<br>Rating Approach – Implicit support from Parent or Group |
| **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, Antiquity, Signature, Royal Challenge, McDowell's No.1, Smirnoff and Captain Morgan. With sales volumes of 70.7 million cases during FY2021, 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 (audited)

| USL Consolidated | FY2020 | FY2021 | H1 FY2022* |
|---|---|---|---|
| Operating Income (Rs. crore) | 9,325.4 | 8,131.3 | 4,229.3 |
| PAT (Rs. crore) | 623.9 | 363.4 | 336.7 |
| OPBDITA/OI (%) | 16.9% | 12.9% | 15.5% |
| PAT/OI (%) | 6.7% | 4.5% | 8.0% |
| Total Outside Liabilities/Tangible Net Worth (times) | 1.4 | 1.1 | 1.0 |
| Total Debt/OPBDITA (times) | 1.6 | 1.0 | 0.8 |
| Interest Coverage (times) | 7.4 | 5.6 | 20.4 |

*Source: Company and ICRA Research *Provisional; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; All ratios are as per ICRA calculations*

### Status of non-cooperation with previous CRA: Not applicable

### Any other information: None

## Rating history for past three years

<table>
<tr><th rowspan="3"></th><th rowspan="3">Instrument</th><th colspan="4">Current Rating (FY2022)</th><th colspan="3">Chronology of Rating History for the Past 3 Years</th></tr>
<tr><th rowspan="2">Type</th><th rowspan="2">Amount Rated (Rs. crore)</th><th rowspan="2">Amount Outstanding as of Dec 30, 2021 (Rs. crore)</th><th>Date & Rating in FY2022</th><th>Date & Rating in FY2021</th><th>Date & Rating in FY2020</th><th>Date & Rating in FY2019</th></tr>
<tr><th>Feb 17, 2022</th><th>Feb 26, 2021</th><th>Jan 31, 2020</th><th>Dec 24, 2018</th></tr>
<tr><td>1</td><td>Long term/Short term - Fund Based/Non-fund Based</td><td>Long Term/Short Term</td><td>2,675.00</td><td>--</td><td rowspan="2">[ICRA]AA+ (Positive)/ [ICRA]A1+</td><td>[ICRA]AA+ (Stable)/ [ICRA]A1+</td><td>[ICRA]AA+ (Stable)/ [ICRA]A1+</td><td>[ICRA]AA+ (Stable)/ [ICRA]A1+</td></tr>
<tr><td>2</td><td>Unallocated limits</td><td>Long Term/Short Term</td><td>125.00</td><td>--</td><td>--</td><td>--</td><td>--</td></tr>
<tr><td>3</td><td>Commercial Paper</td><td>Short Term</td><td>500.0</td><td>--</td><td>[ICRA]A1+; withdrawn</td><td>[ICRA]A1+</td><td>[ICRA]A1+</td><td>[ICRA]A1+</td></tr>
<tr><td>4</td><td>Non-convertible Debentures</td><td>Long Tern</td><td>--</td><td>--</td><td>-</td><td>[ICRA]AA+ (Stable); withdrawn</td><td>[ICRA]AA+ (Stable); withdrawn</td><td>[ICRA]AA+ (Stable); withdrawn</td></tr>
</table>

## Complexity level of the rated instruments

| Instrument | Complexity Indicator |
|---|---|
| Long term/Short term - Fund Based/Non-fund Based | Not Applicable |
| Unallocated limits | 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 are available on ICRA's website: www.icra.in

## Annexure-1: Instrument details

| ISIN | Instrument Name | Date of Issuance | Coupon Rate | Maturity | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---|---|---|---|---|---|---|
| NA | Long term/Short term - Fund Based/Non-fund Based | - | - | - | 2,675.00 | [ICRA]AA+(Positive)/[ICRA]A1+ |
| | Unallocated limits | - | - | - | 125.00 | |
| INE854D14670 | Commercial Paper | - | - | - | 500.0 | [ICRA]A1+; withdrawn |

***Source:*** *Company*

### Annexure-2: List of entities considered for consolidated analysis

| Company Name | Ownership | Consolidation Approach |
|---|---|---|
| Asian Opportunities & Investments Limited | 100.00% | Full Consolidation |
| Palmer Investment Group Limited | 100.00% | Full Consolidation |
| Shaw Wallace Overseas Limited | 100.00% | Full Consolidation |
| Montrose International S.A.* | 100.00% | Full Consolidation |
| USL Holdings Limited | 100.00% | Full Consolidation |
| USL Holdings (UK) Limited | 100.00% | Full Consolidation |
| United Spirits (UK) Limited | 100.00% | Full Consolidation |
| United Spirits (Great Britain) Limited | 100.00% | Full Consolidation |
| Pioneer Distilleries Limited | 75.00% | Full Consolidation |
| McDowell & Co (Scotland) Limited | 100.00% | Full Consolidation |
| Sovereign Distilleries Limited | 100.00% | Full Consolidation |
| United Spirits (Shanghai) Trading Company Limited | 100.00% | Full Consolidation |
| Royal Challengers Sports Private Limited | 100.00% | Full Consolidation |
| United Spirits Singapore Trading Pte Ltd | 100.00% | Full Consolidation |
| Hip Bar Private Limited^ | 26.00% | Equity Method |

*Source: Company; FY2021 annual report; *ceased to be a subsidiary with effect from April 16, 2021; ceased to be an associate with effect from August 3, 2021*

## Corrigendum

Document dated February 17, 2022 has been corrected with revisions as detailed below:

The quantum of capex range mentioned in the 5th paragraph in page 1 and the last paragraph in page 2 - liquidity section has been revised.

## ANALYST CONTACTS

**Shamsher Dewan**
+91 12 4454 5300
shamsherd@icraindia.com

**Mythri Macherla**
+91 9701191490
mythri.macherla@icraindia.com

**Seetha Pillai**
+91 7550087070
seetha.pillai@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

+91-9354738909 (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.

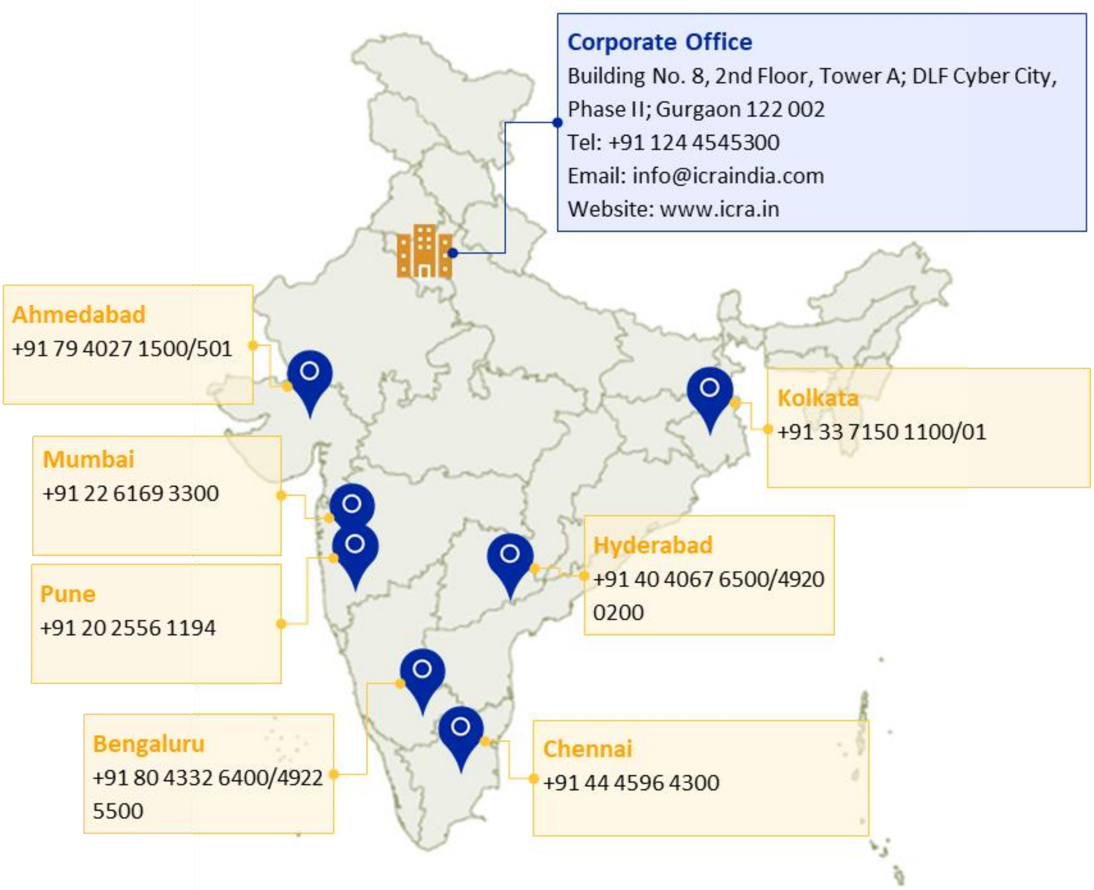
For more information, visit www.icra.in

## ICRA Limited

### Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

### Branches






ICRA ratings should not be treated as recommendation to buy, sell or hold the rated debt instruments. ICRA ratings are subject to a process of surveillance, which may lead to revision in ratings. An ICRA rating is a symbolic indicator of ICRA's current opinion on the relative capability of the issuer concerned to timely service debts and obligations, with reference to the instrument rated. Please visit our website www.icra.in or contact any ICRA office for the latest information on ICRA ratings outstanding. All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable, including the rated issuer. ICRA however has not conducted any audit of the rated issuer or of the information provided by it. While reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. Also, ICRA or any of its group companies may have provided services other than rating to the issuer rated. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.