

September 08, 2022

## Sula Vineyards Limited: Long-term rating upgraded; short-term rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based Term Loan	172.0	227.0	[ICRA]A+ (Stable); Upgraded from [ICRA]A (Stable)
Short-term – Fund-based	231.2	--	--
Long-term/ Short-term – Fund-based/ Non-fund Based	--	185.0	[ICRA]A+ (Stable)/[ICRA]A1; Long-term rating upgraded from [ICRA]A (Stable); Short-term rating reaffirmed
Long-term/ Short-term – Unallocated	71.8	13.0	[ICRA]A+ (Stable)/[ICRA]A1; Long-term rating upgraded from [ICRA]A (Stable); Short-term rating reaffirmed
<b>Total</b>	<b>475.0</b>	<b>425.0</b>	

\*Instrument details are provided in Annexure-1

### Rationale

The upgrade in the long-term rating of Sula Vineyards Limited (Sula/ the company) considers the significant improvement in the company's financial profile in FY2022 and ICRA's expectation that the same will sustain, going forward. During FY2022, Sula's OPM improved to 27.9% over 16.9% in FY2021, supported by cost optimisation in terms of packaging and selling and distribution expenses, coupled with an improvement in average realisations driven by increasing consumption of premium and elite wines, and operating leverage benefits. This resulted in the company's debt coverage metrics, i.e., Total Debt/OPBITDA and interest coverage improving to 2.0x and 5.1x, respectively, in FY2022, over 4.8x and 2.0x, respectively, in FY2021. The ratings also continue to factor in the company's diversified revenue profile and dominant position in the domestic wine industry along with demonstrated financial support from the promoters and shareholders, with Sula raising Rs. 56.5 crore equity in FY2022.

The ratings, however, continue to remain constrained by the company's seasonal nature of wine and hospitality segments, where the revenues are typically higher during Q3 and Q4 of a financial year, along with the company's susceptibility to agro-climatic risk and inventory risk on account of contractual obligation with farmers in the absence of ample demand. The company procures grapes from farmers during the harvest season, which starts in January and ends in March. Due to the peak season in wine sales and the harvest of wines grapes in Q4, the company is saddled with high inventory and debtor days leading to high working capital intensity during the financial year end, which stood at 59.3% in FY2022 against 66.1% in FY2021. Further, the company operates in a highly regulated industry with state-specific policies, which could impact industry volumes. Sula derives about 60% of revenues from the wine segment from Maharashtra and Karnataka. Going forward, the risk of unfavourable policy changes in key states continues to remain one of the major risk factors for the company and the industry. Sula is also exposed to rolling back of the Wine Industry Promotion Subsidy (WIPS) by the State Government of Maharashtra, which contributes significantly to the company's OPBITDA.

ICRA notes the company's potential liability to the tune of Rs. 115.89 crore towards excise duty payment. In 2006, the Maharashtra government came out with a notification that no excise duty is to be levied on wines manufactured from grapes cultivated and thereafter sold within Maharashtra. The cause of action for issuance of Demand Notice arose from the interpretation of an ambiguous line "without blending any other wine" in the said notification. The notification has been since revised with prospective effect. Based on legal opinion, the management is confident that this matter will not result in any

cash outflow for the company. The developments in this regard will be a key rating monitorable. Any large potential obligation arising from it will need to be assessed when more information is available.

The Stable outlook reflects ICRA's expectations that Sula will maintain its healthy business and financial risk profile, going forward, and leverage its dominant position in the domestic wine industry over the near to medium term.

## Key rating drivers and their description

### Credit strengths

**Market leadership in the wine industry supported by a vast portfolio of wine brands** – Sula has a strong brand name with a dominant market share in the domestic wine industry, driven by its vast portfolio of wine brands across the price spectrum and an expansive distribution network. It produces more than 56 labels of red, white and sparkling wines and the brands are classified into 'elite', 'premium', 'economy' and 'popular' segments based on their price, composition, taste and other properties such as alcohol content. Going forward, increasing contribution from the elite and premium segments is expected to continue supporting Sula's revenues and margins over the long-term.

**Diversified revenue profile** – In addition to producing and selling wines, the company derives revenue from the hospitality segment through its two wine resorts, The Source at Sula and Beyond by Sula. Further, it has dealership agreement with international brands like Beluga Vodka to distribute core spirits in India. The wine segment drove ~69% of the company's revenues, while the hospitality and trading segments each accounted for ~14% and ~8% of its revenues, respectively, in FY2022 with income from WIPS bringing up the balance. In terms of profitability, the hospitality segment enjoys higher margins than the wine and trading segments. With increased capacities under the hospitality segment in FY2022 and further expansions planned in FY2023, revenue contribution from the same is expected to increase, going forward.

**Improvement in profitability in FY2022 driven by premiumisation and various cost optimisation measures** – During FY2022, Sula's OPM improved to 27.9% over 16.9% in FY2021, supported by improving share of the premium and elite category wines in its revenues. The share of premium and elite category wines stood at 46% in FY2021, which improved to 50% in FY2022 primarily on the back of increasing home consumption trends due to the pandemic, which subsequently led to an improvement in realisations and profitability. Further, cost optimisation measures undertaken by the company in terms of procuring almost its entire packaging requirement indigenously and using homogeneous outer cartons for different categories, along with reduction in selling and distribution expenses towards intermediaries, also led to an improvement in margins.

**Significant improvement in capital structure and coverage metrics in FY2022** – Supported by equity infusion to the tune of Rs. 56.5 in FY2022 and expansion in margins, the company's overall gearing improved to 0.6x in FY2022 from 1.0x in FY2021. Further, Sula's credit metrics marked by Total Debt/OPBITDA and interest coverage also improved to 2.0x and 5.1x, respectively, in FY2022, over 4.8x and 2.0x, respectively, in FY2021.

The company has filed its Draft Red Herring Prospectus (DRHP) in July 2022; however, since the entire issue is offer-for-sale, no inflow of funds is expected. However, the company has an ESOP outstanding to the tune of Rs. 49.2 crore, which may be converted to equity prior to the listing and result in a cash inflow upon exercise.

### Credit challenges

**Working capital-intensive nature of operations; exacerbated further by seasonality in sales and harvest season** – The company's operations are working capital-intensive in nature with high inventory due to the harvest of wine grapes once a year in Q4, which is converted into wines and stored in tanks to be sold in the subsequent months (Q3 is the peak sales season for the industry). Sula extends 90-120 days' credit period to state run corporations, who pay after selling the bottles to their end customers. Due to the peak season in wine sales and the harvest of wine grapes in Q4, the company is saddled with high inventory and debtor days leading to high working capital intensity during the financial year end.

**Exposure to regulatory risks** – The company operates in a highly regulated industry with state-specific policies, which continue to impact industry volumes in several markets. Sula derives about 60% of its revenue in the wine segment from sales in Maharashtra and Karnataka. Going forward, the risk of unfavourable policy changes in these key states continues to remain a major risk factor for the company and the industry. Further, extensive Government controls on advertising and taxes restrict wine industry growth to an extent. However, the same creates entry barriers for new players, thereby favouring the incumbents such as Sula.

**Susceptible to agro-climatic risks and inventory risk** – The wine manufacturing industry is seasonal in nature. The quantity of grapes harvested each year is susceptible to weather conditions. Especially during the harvest months of January and March, prolonged rainfall and lack of wind can cause moisture in the grape and reduce its quality. The company is also susceptible to inventory risk that may arise on account of contractual obligation with farmers in the absence of ample demand; this is mitigated to a certain extent by the company procuring lower proportion of grapes through the open market; however, the price at which this procurement is done will also be a key determinant of margins.

**Exposure to roll back of WIPS subsidy which contributes significantly to OPBITDA**- The company is eligible for WIPS subsidy, which is applicable for all wine that is manufactured and sold in Maharashtra, wherein 80% of the VAT paid is received back in the form of subsidy. Although there is no sunset clause with respect to the subsidy, the company’s profitability would be adversely impacted if the same is rolled back. The subsidy amount is presently built into the company’s value chain wherein it gives an incentive to the farmers.

### Liquidity position: Adequate

Sula’s liquidity position is adequate, primarily supported by expectations of healthy cash accruals for FY2023 and unutilised fund-based working capital limits (against DP) of Rs. 56.0 crore as on June 30, 2022. Against the same, the company has debt repayments to the tune of Rs. 34.0 crore in FY2023 and capex of ~Rs. 86 crore in FY2023 to be funded out of internal accruals of Rs. 46 crore and term debt of Rs. 40 crore.

### Rating sensitivities

**Positive factors** - Sula’s rating could be upgraded if it is able to maintain its market leadership position in the domestic wine industry and exhibit sustained improvement in its revenues, profitability and liquidity position. Specific credit metrics, which could lead to a revision in rating, include interest coverage of more than 7.0 times on a sustained basis.

**Negative factors** – Negative pressure on Sula’s rating could arise if there is any material deterioration in margins and if any debt funded capex or acquisitions or regulatory measures lead to deterioration of the company’s credit profile on a sustained basis. Further, weakening liquidity position due to higher-than-expected capex could result in a downgrade. Specific credit metrics, which could lead to a revision in rating, include Net Debt/OPBITDA of more than 3.0 times on a sustained basis.

### Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a>
Parent/Group Support	Not Applicable
Consolidation/Standalone	For arriving at the rating, ICRA has considered the consolidated financials of Sula.

### About the company

Incorporated in 1999, Sula Vineyard Limited manufactures, markets and distributes wines in the domestic market. Sula is headquartered in Nashik, Maharashtra, and has six manufacturing units—four in Nashik and two in the Bangalore region. Sula

currently has a production capacity of over ~14.5 million litres per annum, of which ~12.7 million litres is housed in Nashik and ~1.8 million litres in Karnataka.

The company diversified into the hospitality business in 2010, which provides higher margins than wines. The company owns two wine resorts, The Source at Sula and Beyond by Sula, offering a wide range of room types and services.

#### Key financial indicators audited

Sula Consolidated	FY2020	FY2021	FY2022
Operating Income (Rs. crore)	485.2	385.4	422.4
PAT (Rs. crore)	-13.5	2.8	52.1
OPBDIT/OI (%)	11.4%	16.9%	27.9%
PAT/OI (%)	-2.8%	0.7%	12.3%
Total Outside Liabilities/Tangible Net Worth (times)	1.8	1.5	0.9
Total Debt/OPBDIT (times)	7.1	4.8	2.0
Interest Coverage (times)	1.7	2.0	5.1

Source: Company and ICRA Research; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Note: Total debt mentioned above includes lease liabilities

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

Any other information: None

#### Rating history for past three years

	Instrument	Type	Current Rating (FY2023)			Chronology of Rating History for the past 3 years			
			Amount Rated	Amount Outstanding as on March 31, 2022	Date & Rating in Sept 08, 2022	Date & Rating in FY2022		Date & Rating in FY2021	Date & Rating in FY2020
						Jan 06, 2022	July 09, 2021		
1	Term Loans	Long-term	227.0	82.1	[ICRA]A+ (Stable)	[ICRA]A (Stable)	--	--	--
2	Short Term - Fund Based	Short-term	--	--	--	[ICRA]A1	[ICRA]A1	--	--
3	Long Term/Short Term- Fund Based/ Non-fund Based limits	Long-term/ Short-term	185.0	--	[ICRA]A+ (Stable)/ [ICRA]A1	--	--	--	--
4	Long Term/Short Term – Unallocated limits	Long-term/ Short-term	13.0	--	[ICRA]A+ (Stable)/ [ICRA]A1	[ICRA]A (Stable) / [ICRA]A1	--	--	--

Source: Company data & ICRA Research

#### Complexity level of the rated instrument

Instrument	Complexity Indicator
Term Loans	Simple
Long Term/Short Term- Fund Based/ Non-fund Based limits	Simple
Long Term/Short Term – 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](http://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	Term Loans	FY2022	NA	FY2027	227.00	[ICRA]A+(Stable)
NA	Long Term/Short Term- Fund Based/ Non-fund Based limits	NA	NA	NA	185.00	[ICRA]A+ (Stable) / [ICRA]A1
NA	Long Term/Short Term – Unallocated limits	NA	NA	NA	13.00	[ICRA]A+ (Stable) / [ICRA]A1

Source: Company

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

Company Name	Sula Ownership	Consolidation Approach
Artisan Spirits Pvt Ltd	100%	Full Consolidation

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