February 26, 2021

United Spirits Limited: Ratings reaffirmed

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	3,925.00	3,425.0	[ICRA]AA+ (Stable) /[ICRA]A1+; Reaffirmed
Commercial Paper	1,500.00	500.0	[ICRA]A1+; Reaffirmed
Non-convertible Debentures	750.00	-	[ICRA]AA+ (Stable); Reaffirmed and withdrawn
Total	**6,175.00**	**3,925.0**	

**Instrument details are provided in Annexure-1*

Rationale

ICRA has withdrawn its rating on the Rs. 750 crore NCDs at the company's request as there was no outstanding against the facility.

For arriving at the ratings, ICRA has taken a consolidated view of United Spirits Limited (USL / the company) and all its subsidiaries given the strong strategic linkages amongst entities in the group.

The ratings continue to factor in USL's strong operational and financial flexibility and robust corporate governance and compliance practices by virtue of being 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.

While revenues remained flattish in FY2020, USL's operating margins improved to 16.9% benefiting from the one-time sale of bulk scotch and its internal cost control and efficiency improvement measures despite the general economic slowdown and rising raw material costs (ENA prices grew by ~30% in FY2020). The company's debt metrics improved to TD/OPBDITA of 1.6x as on March 31, 2020 and interest coverage of 7.4x in FY2020 from TD/OPBDITA of 2.1x as on March 31, 2019 and interest cover of 5.9x in FY2019.

The company's revenues were impacted adversely in Q1 FY2021 (yoy revenue de-growth was 57.6%) following the Covid-19-led lockdown and the subsequent impact on the liquor industry. However, the company's revenues have witnessed strong revival with only 5.1% yoy revenue de-growth in Q2 FY2021 and 3.3% revenue growth in Q3 FY2021. While the company incurred net losses in Q1 FY2021, with recovery in volumes and margins in Q2 & Q3 FY2021 on the back of strong home consumption and opening up of on-trade premises, the company's operating margins in 9m FY2021 stood at 11.1% while the overall revenue de-growth was -19.6% in the same period. ICRA also notes that the company reduced its debt in H1 FY2021 supported by strong operating accruals and the company's total debt (including lease liabilities) as on September 30, 2020 stood at Rs. 1,780.8 crore as against total debt of Rs. 2,567.2 crore as on March 31, 2020.

Going forward, USL will continue to benefit from the premiumisation of products (once the situation normalizes) 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. 250-300 crore per annum. This is expected to be funded entirely through the robust internal accruals enabling further deleveraging.

Key rating drivers and their description

Credit strengths

Market leadership supported by a vast portfolio and expansive distribution network – USL has a market leadership position in the domestic spirits supported by its expansive distribution network along with vast product portfolio across price points, flavours and segments to support its growth prospects. Some of the company's famous brands are Johnnie Walker, Black Dog, Black & White, VAT 69, Smirnoff, Antiquity, Signature, Royal Challenge and McDowell's No.1 etc.

Premiumization to support revenue growth and margins going forward – Once the Covid-19 situation normalizes, USL is expected to continue benefiting from increasing revenue share from premium brands supported by its investments in advertising & promotion expenses to support USL's long-term revenue growth.

Improving debt metrics – The company's debt metrics improved to TD/OPBDITA of 1.6x as on March 31, 2020 and interest coverage of 7.4x in FY2020 from TD/OPBDITA of 2.1x as on March 31, 2019 and interest cover of 5.9x in FY2019 on the back of healthy operating accruals. USL also repaid ~Rs. 780 crore debt in H1 FY2021 reducing its total debt to Rs. 1,780.8 crore as on September 30, 2020 from Rs. 2,567.2 crore as on March 31, 2020 despite Covid-related disruptions. While the debt reduction measures are continuing, ICRA expects further deleveraging at USL over the next 1-2 years.

Strong promoter group with an experienced management team - Business synergies, financial flexibility and strengthened governance with 55.94% stake held by Diageo has yielded results over the past 3-4 years. Strong execution capabilities and Diageo's superior capital management ability complement USL's scale of operations.

Credit challenges

Exposure to regulatory changes - USL continues to remain exposed to a plethora of stringent regulations and rapid regulatory changes, including state 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 have impacted volumes of the industry severely over the past 12-15 months), which again are governed by the various state governments.

Volatility in input costs - USL's margins are expected to remain sensitive to input price trends of major raw materials like molasses, 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 majority of the company's revenues. That said, despite rising raw material costs, the company has been able to maintain its margins in FY2020 on the back of one-time bulk scotch sale and the stringent cost control and efficiency improvement measures.

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 cash flow from operations of more than Rs. 600 crore in FY2021 and undrawn working capital limits of Rs. 2,400+ crore as on December 31, 2020 post repayment of its Rs. 750 crore NCD. USL has capex commitment of Rs. 250-300 crore annually and plans to fund the same through its internal accruals and does not have any long-term debt obligations on its book currently. In addition to unutilized 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 significant, sustainable improvement in the company's scale accompanied by healthy margins and debt protection metrics. Specific metrics which could lead to upgrade in ratings include TD/OPBDITA less than 0.5x on a sustained basis.

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 lead to weakening of the company's credit profile with TD/OPBDITA>1.5x on a sustained basis. Deterioration in credit profile of the company's parent, Diageo Plc will also lead to a review of the company's ratings.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Impact of Parent or Group Support on an Issuer's Credit Rating
Parent/Group Support	Diageo Plc (rated A3 / Stable by Moody's)
Consolidation/Standalone	The ratings are based on consolidated financial statements of the issuer

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 Dog, Black & White, VAT 69, Antiquity, Signature, Royal Challenge, McDowell's No.1, Smirnoff and Captain Morgan. With sales volumes of 79.7 million cases during FY2020, the company is the largest player in the domestic spirits industry. Headquartered in Bengaluru, the company's wide footprint is supported by 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	FY2019	FY2020
Operating Income (Rs. crore)	9,340.8	9,325.4
PAT (Rs. crore)	685.4	623.9
OPBDIT/OI (%)	15.1%	16.9%
RoCE (%)	21.7%	23.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.9	1.4
Total Debt/OPBDIT (times)	2.1	1.6
Interest Coverage (times)	5.9	7.4
DSCR (times)	1.7	5.6

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); DSCR: (PBIT + Mat Credit Entitlements - Fair Value Gains through P&L - Non-cash Extraordinary Gain/Loss)/(Interest + Repayments made during the Year); Source: USL, ICRA research

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of December 31, 2020 (Rs. crore)	Date & Rating	Date & Rating in FY2020	Date & Rating in FY2019	Date & Rating in FY2018	
					February 26, 2021	Jan 31, 2020	24 Dec, 2018	23 Feb, 2018	16 Oct, 2017
1	Long term/Short term Fund Based/Non-fund Based	Long Term/ Short term (interchangeable)	3,425.0	944.0	[ICRA]AA+ (Stable)/A1+	[ICRA]AA+ (Stable)/A1+	[ICRA]AA+ (Stable)/A1+	[ICRA]AA+ (Stable)/A1+	[ICRA]AA (Positive)/A1+
2	Commercial Paper	Short-term	500.0	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Non-convertible Debentures	Long-term	-	-	[ICRA]AA+ (Stable); withdrawn	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA+ (Stable)	[ICRA]AA (Positive)
4	Term Loans	Long-term	-	-	-	-	-	[ICRA]AA (Positive); withdrawn	[ICRA]AA (Positive)

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	Fund-based/non-fund based (interchangeable) facilities	-	-	-	3,425.0	[ICRA]AA+ (Stable) /A1+
NA	Commercial Paper	-	-	-	500.0	[ICRA]A1+
INE854D08011	Non-convertible Debentures	December 2017	7.45%	December 2020	750.0	[ICRA]AA+ (Stable); Reaffirmed and 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
Tern Distilleries Private Limited	100.00%	Full Consolidation
Shaw Wallace Overseas Limited	100.00%	Full Consolidation
UB Sports Management 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
Liquidity Inc.	51.00%	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: the company's FY2020 annual report

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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.

For more information, visit www.icra.in

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