

January 31, 2020

United Spirits Limited: Ratings reaffirmed

Summary of rating action

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

*Instrument details are provided in Annexure-1

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 ratings continue to factor in USL's strong market position in the domestic spirits industry supported by its large distribution network, wide portfolio and presence across price points, flavours and segments. ICRA also takes in to account the company's strong operational and financial flexibility and robust corporate governance and compliance practices by virtue of being a 55.24% 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.

USL's operating margins improved to 15.1% during FY2019 and 18.9% during H1 FY2020 from 14.1% in FY2018. While the company benefited from the one-time sale of bulk scotch during H1 FY2020, the company's adjusted operating margins (17.1% for H1 FY2020) improved despite the general economic slowdown and rising raw material costs on the back of its internal cost control and efficiency improvement measures.

The company's debt metrics have improved to TD/OPBDITA of 1.5x as on September 30, 2019 and interest coverage of 8.3x during H1 FY2020 from TD/OPBDITA of 2.8x as on March 31, 2018 and interest cover of 4.5x during FY2018. Going forward, ICRA expects USL to continue to benefit from the premiumisation of products (with Prestige & Above segment contributing to 67% of the company's revenues during H1 FY2020) 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 going forward.

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 between FY2020 and FY2022. This is expected to be funded entirely through the robust internal accruals enabling further deleveraging.

¹ 100 lakh = 1 crore = 10 million

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 market. Going forward, ICRA expects that the company’s expansive distribution network along with its vast portfolio across price points, flavours and segments to support its 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 expenses is expected to support USL’s long-term revenue growth. The company has transformed its business model over the past 2-3 years, premiumising its portfolio through franchising manufacturing of Popular & Below segment for certain states. Improving revenue share from the Prestige & Above (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. has supported the overall revenues and margins of the company.
- **Improving margins, return indicators and debt metrics** – USL’s operating margins improved to 15.1% during FY2019 and 18.9% during H1 FY2020 from 14.1% in FY2018. While the company benefited from the one-time sale of bulk scotch during H1 FY2020, the company’s operating margins adjusted for this one-time income (17.1% for H1 FY2020) have witnessed an expansion. Despite the general economic slowdown and rising raw material costs, internal cost controls and efficiency improvement measures have facilitated this margin expansion.

USL repaid ~Rs. 530 crore and ~Rs. 250 crore of debt during FY2019 and H1 FY2020 respectively reducing its debt significantly to Rs. 2,630.4 crore as on September 30, 2019 from Rs. 3,421.1 crore as on March 31, 2018. Consequently, the company’s debt metrics have improved to TD/OPBDITA of 1.5x as on September 30, 2019 and interest coverage of 8.3x during H1 FY2020 as against TD/OPBDITA of 2.8x as on March 31, 2018 and interest cover of 4.5x during FY2018. 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 55.24% 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. During H1 FY2018, the company’s and industry revenues de-grew following the supreme court’s ruling banning sale of liquor within 500 meters of state and national highways across the nation from April 01, 2017. Further, the company’s revenues and volumes also remain vulnerable to change in route-to-market and excise duty rates across various states, 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 from operations given 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.1,000-1,100 crore during FY2020, undrawn working capital limits of Rs. 2,920 crore and cash and liquid investment balances of Rs. 119.7 crore as on September 30, 2019. In relation to these sources of cash, USL has a capex commitment of Rs. 250-300 crore annually for FY2021 and FY2022 and an upcoming NCD repayment of Rs. 750 crore during Q3 FY2021. ICRA expects USL to be able to meet its near-term capex commitments through its internal accruals while the NCD repayment may be partly refinanced through fresh long-term debt. In addition to unutilized working capital facilities, the company enjoys healthy financial flexibility enabling it to raise debt at short notice.

Rating sensitivities

Positive triggers – USL’s ratings could be upgraded if the company’s healthy financial performance translates to TD/OPBDITA of less than 0.5x on a sustained basis

Negative triggers – Negative pressure on USL’s ratings could arise if there is any deterioration in margins and, debt-funded capex, acquisitions or regulatory measures lead to weakening of the company’s credit profile with TD/OPBDITA>2.0x 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
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, a 55.24% 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, Captain Morgan and Four Seasons. With sales volumes of 81.6 million cases during FY2019, 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 (Consolidated)

	FY2018	FY2019
Operating Income (Rs. crore)	8,590.6	9,340.8
Adjusted PAT (Rs. crore)	651.9	685.4
OPBDIT/OI (%)	14.1%	15.1%
RoCE (%)	20.7%	21.7%
Total Outside Liabilities/Tangible Net Worth (times)	2.6	1.9
Total Debt/OPBDIT (times)	2.8	2.1
Interest Coverage (times)	4.5	5.9

Source: United Spirits Limited

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)			Chronology of Rating History for the past 3 years						
		Type	Amount Rated (Rs.crore)	Amount Outstanding as on March 31, 2019 (Rs Crore)	Date & Rating in 31-Jan 2020	Date & Rating in FY2019 24, Dec 2018	Date & Rating in FY2018		Date & Rating in FY2017		
							23 Feb, 2018	16 Oct, 2017	2 Mar, 2017	13 Jan, 2017	4 Apr, 2016
1	Long term/Short term Fund Based/Non-fund Based	Long Term / Short Term	3,925.00	1,196.5	[ICRA]AA+ (Stable)/A1+	[ICRA]AA+ (Stable)/A1+	[ICRA]AA+ (Stable)/A1+	[ICRA]AA (Positive)/A1+	-	-	-
2	Commercial Paper	Short Term	1,500.00	892.9	[ICRA]A1+	[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+ (Stable)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	-
4	Term Loans	Long Term	-	-	-	-	[ICRA]AA (Positive) / withdrawn	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]A+ (Positive)
5	Fund-based	Short Term	-	-	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
6	Non-Fund Based	Short Term	-	-	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
7	Fixed Deposits	Medium Term	-	-	-	-	-	-	-	-	MA- & / Withdrawn

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	NA	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: the 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	100.00%	Full Consolidation
McDowell & Co (Scotland) Limited	100.00%	Full Consolidation
Sovereign Distilleries Limited	100.00%	Full Consolidation
Liquidity Inc.	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: the company's FY2019 annual report

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