February 23, 2018

United Spirits Limited Revised

Summary of rated instruments

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term/Short term Fund Based/Non-fund Based	4,900.00	4,900.00	[ICRA]AA+(Stable) upgraded from [ICRA]AA(Positive)/[ICRA]A1+; reaffirmed
Commercial Paper	1,500.00	1,500.00	[ICRA]A1+; Reaffirmed
Non-convertible Debentures	765.00	765.00	[ICRA]AA+(Stable); Upgraded from [ICRA]AA(Positive)
Term Loans	500.00	0.00	[ICRA]AA(Positive); Withdrawn

*Instrument details are provided in Annexure-1

Rating action

ICRA has upgraded the long-term rating outstanding on the Rs.765.00 crore Non-convertible Debenture (NCD) programme of United Spirits Limited (USL / the company) [1] to [ICRA]AA+ (pronounced ICRA double A Plus) from [ICRA]AA (pronounced ICRA double A). Outlook on the long-term rating has been revised to Stable from Positive. ICRA has also reaffirmed the [ICRA]A1+ (pronounced ICRA A one plus) rating outstanding on the Rs.1,500 crore commercial paper programme of the company. ICRA has also upgraded the ratings outstanding on the Rs.4,900 crore Long term / Short Fund based / Non-fund based facilities of the company to [ICRA]AA+ (Stable)/A1+ from [ICRA]AA+ (Stable)/A1+. For the Rs.4,900 crore, rating of [ICRA]AA+ or [ICRA]A1+ will apply depending on the tenure of the facility.

ICRA has also withdrawn the [ICRA]AA (Positive) rating outstanding on the Rs.500 crore term loans of USL, as there is no amount outstanding against the rated instrument.

Rating Rationale

The upgrade in USL's long-term rating considers the company's increasing share of revenues from Prestige & Above (P&A) segments which the company has identified as its focus area. During Q2 and Q3 FY2018, the company derived 66% and 64% of its revenues respectively from the P&A segment thereby supporting its margins (OPM of 12.5% during 9M FY2018 as against 10.6% during 9M FY2017) to a certain extent. Going forward, changing consumer preferences towards premium brands in conjunction with continued investments in selling expenses being made by the company is expected to support long-term revenue growth of the company. Further, ICRA continues to take comfort from the strengthened corporate governance and compliance practices framework of USL, post takeover of management control by Diageo Plc (Diageo; *rated A3 / Stable by Moody's*) during FY2015. By virtue of being a 54.78% subsidiary of Diageo, the company benefits from the increasing business synergies through implementation of Diageo's global best practices across business functions which have complemented the advantageous scale of USL's operations in addition to providing it with significant financial flexibility. The ratings also take into account the company's strong and experienced management team.

[1] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

The ratings continue to derive strength from USL's market share in the domestic spirits market, with 44.0% market share during FY2017 supported by the company's expansive distribution network and presence across price points, flavours and segments. ICRA also expects the company's ongoing shift to state-specific franchisee model and productivity-led efficiency initiatives to support the company's margins going forward. ICRA also expects USL's financial profile to strengthen with the divestment of non-core assets over the medium term.

The ratings also take into account the intense competition and highly regulated nature of the industry which are likely to restrict the company's growth and margins to a certain extent. During H1 FY2018, the company's revenues de-grew by 8.1% (yoy) 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 in addition to de-growth following shift to state-specific franchisee model. Further, the company's revenues were also affected on the account of change in route-to-market from wholesaler-based model to corporation model in states like West Bengal, Haryana and Punjab. While the highway ban was modified by the Supreme Court to ensure operations of all outlets within Municipality limits during August 2017, overall, USL reported a de-growth of 8.1% (yoy) in its revenues during 9M FY2018.

Significant provisioning relating to a one-time customer claim to the extent of Rs.264.5 crore had impacted the company's net margins and debt protection metrics during FY2017. As on March 31, 2017, the company's gearing stood at 2.3x (2.6x as on March 31, 2016) while the TD/OPBDITA and interest coverage stood at 4.1x and 2.7x respectively (4.3x and 2.1x as on March 31, 2016). However, during H1 FY2018, the company's working capital position had also eased leading to Rs.249 crore being released from the working capital cycle in the form of reduction in receivables and lower advances. This was primarily on account of operating model changes. The company had also used its accruals and easing working capital position to repay its short-term debt to the tune of Rs.540 crore leading to improvement in debt metrics at a standalone level during H1 FY2018. At standalone level, as on September 30, 2017, the company's gearing stood at 2.1x while the TD/OPBDITA and interest coverage stood at 3.8x and 7.0x respectively. Going forward, ICRA expects the company's operating margins to be in the range of 12-13% and its coverage indicators to strengthen with gearing of 1.5-2.0x, interest coverage of 7.0-8.0x and TD/OPBDITA of 3.5-4.0x as on March 31, 2018.

Outlook

ICRA believes USL will continue to benefit from its strong parentage, established brand equity, favourable long-term volume outlook for the spirits industry combined with changing consumer preferences towards premium brands. The outlook may be revised to 'Positive' if substantial growth in revenue and profitability strengthen the financial risk profile and debt metrics of the company. The outlook may be revised to 'Negative' if cash accruals are lower than expected, or if debt-funded capital expenditure or unforeseen regulatory changes affect the company's margins, debt metrics and liquidity position of the company.

Key rating drivers

Credit strengths

- **Strong promoter group and experienced management team -** Business synergies, financial flexibility and strengthened governance structure with 54.78% stake being held by Diageo. Strong execution capabilities and Diageo's superior capital management ability complement USL's scale of operations.
- **Strong market share and healthy geographic diversification -** Established market position with 44.0% market share in the domestic market; expansive distribution network along with presence across price points, flavours and segments continues to support business growth prospects

- **Premiumization to support revenue growth going forward -** Changing consumer preferences towards premium brands in conjunction with continued investments in selling expenses being made by the company is expected to support long-term revenue growth of the company
- **State-specific franchisee model and efficiency measures to support margins –** In addition to the premiumization drive being taken up by the company, state specific franchisee model in conjunction with cost optimization measures being taken up by the company are expected to support the margins going forward.

Credit weaknesses

- **Exposure to regulatory changes -** USL remains exposed to changes in pricing by state governments. Industry also remains tightly governed with significant vulnerability to regulatory changes; During H1 FY2018, the company's revenues de-grew by 8.2% (yoy) 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 in addition to de-growth following shift to state-specific franchisee model. Further, the company's revenues de-grew by 8.1% during 9M FY2018 (yoy) primarily on the account of change in route-to-market from wholesaler-based model to corporation model in states like West Bengal, Haryana and Punjab.
- **Volatility in input costs could affect margins -** USL's margins are expected to remain dependent on input price trends of major raw materials like molasses, extra-neutral alcohol (ENA) and glass in the absence of corresponding pricing flexibility with consumers; GST is expected to have resulted in increase in packaging and molasses costs for the company. However, the same has been mitigated to a large extent on the back of productivity-led efficiency initiatives taken up by the company to improve its margins.
- **Moderate financial profile -** Financial profile continues to be characterized by high debt levels owing to large provisioning pertaining to doubtful advances and certain divestments in the past; working capital intensity also continues to remain high. However, the debt indicators have been improving over the recent past.
- **High competitive intensity** - Increasing competitive intensity in the domestic market from global players particularly in the premium segment.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below**.**

Links to applicable criteria:
Corporate Credit Rating Methodology

About the company:
USL is a subsidiary of global leader Diageo plc and manufactures, sells and distributes an outstanding 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 90.0 million cases during FY2017, the company is the largest player in the domestic spirits industry.

Headquartered in Bengaluru, the company's wide footprint is supported by 60 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)

	FY2016	FY2017
Operating Income (Rs. crore)	8,494.9	8,817.5
PAT (Rs. crore)	172.4	139.8
OPBDIT/ OI (%)	11.6%	11.4%
RoCE (%)	15.4%	10.4%
Total Debt/ TNW (times)	2.6	2.3
Total Debt/ OPBDITA (times)	4.3	4.1
Interest coverage (times)	2.1	2.7
NWC/ OI (%)	39.6%	40.5%

Source: ICRA Research; OI: Operating Income; 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); NWC: Net Working Capital

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years:
Table:

S. No.	Instrument	Current Rating (FY2018)				Chronology of Rating History for the past 3 years				
		Type	Amount Outstanding (Rs. Crore)	Amount Rated (Rs. Crore)	Date & Rating February 2018	Date & Rating in FY2018 October 2017	Date & Rating in FY2017 Mar 2017	Date & Rating in FY2017 Jan 2017	Date & Rating in FY2017 Apr 2016	Date & Rating in FY2015 Sept 2014
1	Fund Based/Non-fund Based	LT/ ST	NA	4,900.00	[ICRA]AA+ (Stable)/ A1+	[ICRA]AA (Positive)/ A1+	-	-	-	-
2	Commercial Paper	ST	NA	1,500.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
3	Non-convertible Debentures	LT	750.00	765.00	[ICRA]AA+ (Stable)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	-	-	-
4	Term Loans	LT	-	0.00 (reduced from 500.00)	[ICRA]AA (Positive) / withdrawn	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]AA (Positive)	[ICRA]A+ (Positive)	[ICRA] BBB- &
5	Fund-based	ST	-	-	-	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA] A3 &
6	Non-Fund Based	ST	-	-	-		[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA] A3 &
7	Fixed Deposits	MT	-	-	-		-	-	MA- & / Withdrawn	MA- &

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	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
	Fund Based/Non-fund Based	FY2017	-	-	4,900.00	[ICRA] AA+ (Stable)/A1+
NA	Commercial Paper	NA	NA	7-365 Days	1,500.00	[ICRA]A1+
INE854D08011	Non-convertible Debentures	FY2018	7.45%	FY2021	765.0	[ICRA] AA+ (Stable)

Source: The company

Corrigendum

Document dated February 23, 2018 has been corrected with revisions as detailed below:

- Revision on page number 5, under Rating history for last three years: The dates for the previous rating actions were mentioned as February 2017 and March 2016 respectively. However, the same have been revised to March 2017 and April 2016.

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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.

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