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United Spirits Ltd: <u>AGM</u> <u>Report:</u> 30-Sept 2014

Mallya's Reappointment and Diageo's Silence!

When it came to re-appointing Vijay Mallya, Diageo should have been bold. It should have applied the same standards to its Indian subsidiary as it would to itself.

Vijay Mallya came up for re-election to the board of United Spirits Ltd (USL) and has been re-elected. In no small measure this happened because Diageo the controlling shareholder supported his re-appointment; nearly 50% of the institutional investors voting on this resolution voted for his ouster. The question to ask is, given the recent developments relating to Vijay Mallya, would Diageo's appointment committee recommend him to be re-appointed to its board? And if the answer is no, then the shareholders have a right to ask, why here?

To recapitulate these recent developments: Vijay Mallya has been declared a willful defaulter by United Bank of India on account of defaults by Kingfisher Airlines (KFA). Vijay Mallya has obtained a temporary respite from this and has been given time till early November, by the Kolkata High Court, to file its affidavit-in-opposition, after which hearing on this, will recommence. A number of other banks, who want to declare Vijay Mallya a willful defaulter, are in a wait-and-watch mode pending the outcome of the Kolkata court. Sitting on the outside, it is not possible to say who is in the right, but re-appointing Vijay Mallya changes United Spirits risk profile, and this should not be acceptable to its shareholders.

The willful defaulter tag has a deleterious effect on a company's operations. It implies that access to bank and institutional funding is blocked, the process for recovery should be initiated expeditiously and if warranted criminal proceedings should be initiated. Reserve Bank is also in dialogue with the Securities and Exchange Board, to work out an information sharing mechanism with the objective of blocking access to the capital markets. In short, it has the ability to freeze a company from accessing the banking systems, its bloodline. Institutional shareholders can read this risk, and this explains why nearly 50% of those who voted, voted against, why can't Diageo see this?

Diageo will argue that these tough apply to Kingfisher and not United Spirits. But the company needs to take into account the direction regulations are moving. The Reserve Bank is possibly asking lenders to incorporate a covenant in its loan agreement that a borrowing company will not induct a person who is a promoter or director on the Board of a company which has been identified as a willful defaulter.



Diageo will argue that it will make funding available to United Spirits, should the banking system not be forthcoming, but is this the most efficient way for any company to operate?

Diageo will argue that under its agreement to acquire a controlling stake in United Spirits, Vijay Mallya has the right to be reappointed - interestingly, the latest newspaper articles show Diageo distancing itself from this decision. No agreement can force a company to jeopardize its future. Is there no force majeure?

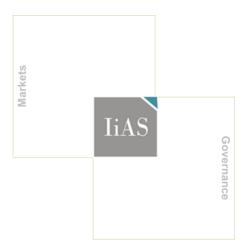
Let us move on. The FY14 financial results were delayed three times as the audit committee had sought clarifications and information on the draft financial results and related issues. The results were delayed by more than three months and were declared on 4 September 2014. USL posted record loss of Rs 44.9 bn on account of diminution in value of investment in Whyte & Mackay and write offs on loans and advances extended to UB group companies. I may be more accepting of the Whyte & Mackay writeoff – a trophy acquisition in times of loose money, but someone has to be answerable for the intra-group transactions, for which United Spirits is making provisions and has taken write-offs. Should it not be PA Murali, its executive director, who has been associated with the UB group for more than two decades? As an executive director was he not responsible for the integrity of the balance sheet? After all before being elevated to the board in 2013, he was USL's Joint President and Chief Financial Officer. Diageo seems to have forgotten and ignored this. It has ignored the fact that the meeting to approve the accounts had to be called not once, not twice, but three times before these could be finalized. The company actually rewarded him with a Rs 50 mn one-time bonus in FY15, in addition to revising his remuneration upwards. Would Diageo have similarly rewarded their CFO? Would Diageo have even retained their CFO?

Multinational companies for the most have a different yard sticks at parent and subsidiary levels. They are concerned about maintaining the sanctity of their parent board and its operations. These governance standards are forgotten when it comes to subsidiary companies.

Note a modified version of this comment has been published on <u>The Firm</u> website.

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