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Institutional Investor Advisory Services India Limited
15th Floor, West Wing, PJ Tower
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# United Spirits breaks away from Mallya and Diageo picks up the tab

***The terms of exit suggest that Diageo and United Spirits Limited (USL) want a clean break from Dr. Vijay Mallya. While USL's shareholders have been short-changed, the decision to untangle the company from the UB group is in their long term interest. Diageo is picking up the tab for this exit – but Diageo's shareholders must hold its board accountable for its inability to break free from the Mallya stranglehold.***

We have all along believed that Dr. Vijay Mallya must step down from USL's board. Given his status as a wilful defaulter, relating to loans extended to Kingfisher airlines, Dr. Mallya' position as Chairperson risked freezing the companies access to bank finance and compromised USL's overall governance quality and its reputation. Following the discovery of financial impropriety, USL's board asked Mallya to step down, but a shareholder agreement between Dr. Mallya ensured Dr Mallya continued as Chairman, defanging its board.

The entire tangle between Dr Vijay Mallya, USL and Diageo does not make good reading and is summarized:

1. Diageo entered into a transaction with Dr Mallya to buy shares in USL even as the market was awash with rumours of USL extending loans to various companies associated with the existing management.
2. Having acquired control, the company allowed Vijay Mallya to chair the board and let the exiting CFO continue – and rewarded him with a bonus, even as the board refused to sign-off on its accounts. It was only after the accounts were brought to board the third time around and the company took a write-down on loans of over Rs. 20 bn, did the board present these to the shareholders.
3. The company then brought in 9 resolutions to do business with UB group entities, several of these contingent upon Dr Mallya's remaining on USL's board. Not just that, Diageo supported Dr Vijay Mallya being re-appointed as Chairman, even as a forensic audit was underway. See voting advisory.
4. Its only when Diageo could no longer afford to look the other way, it absolves Dr Vijay Mallya of all liabilities and rewards him for walking away. See this and this.

## Where does this leave USL, Diageo and their shareholder?

USL has made a clean break. The company can now look forward to integrating more fully with Diageo, introducing its brands in the Indian market and exploiting synergies between its business in India and Diageo's business globally.

The same holds true for USL's shareholders - though not entirely. There is a hole (i.e the write-off's) to be filled. Given Diageo's deal with Dr. Mallya allowing him to walk-away, leaves them short-changed. They can either pursue this with regulatory authorities in India (- possibly without the company's support since it has allowed Dr. Mallya to walk), or, exult in the clean break from then past and wait for the new owners to deliver.

Given Diageo's missteps at each stage, they are paying then price, but its shareholders will want to know what the board was drinking as they staggered through this transaction.

**Box 1: Diageo's cost of USL's acquisition**

| Transaction | Year | $ mn. |
|---|---|---|
| Acquisition of 25% stake in USL | 2012 | 880 |
| Open market purchase of equity stake | 2013 | 76 |
| Open market purchase of equity stake | 2014 | 138 |
| Open offer for ~ 26% stake | 2014 | 1,920 |
| **Cost of acquiring 54.78% equity in USL** | | **3,014** |
| | | |
| Losses on sale of Whyte & Macay | 2013-14 | 719 |
| Loans to UB group written off | 2013-14 | 163 |
| Loans to UB group written off | 2014-15 | 159 |
| Diminution in value of assets | 2014-15 | 149 |
| Payments under non-approved agreements | 2014-15 | NA |
| Total | | 1188 |
| **Diageo's 54.8% interest** | | **651** |
| | | |
| **Payout to Dr. Mallya on resignation as Chairman** | **2015-16** | **75** |
| **Standard Chartered loan to Watson Limited guaranteed by Diageo, currently in defaulted** | **2015-16** | **141** |
| | | |
| **Estimated cost of USL to Diageo** | | **3,881** |

*USD Exchange rate: Rs.60.1 as on March 31, 2014; Rs.62.6 as on March 31, 2015*

Source: Market, IiAS estimates

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**Office**
Institutional Investor Advisory Services
15th Floor, West Wing
P J Tower, Dalal Street
Fort, Mumbai – 400 001
India

**Contact**
solutions@iias.in
T: +91 22 2272 1570-3
F: +91 22 22721574