

VARUN BEVERAGES

FMCG

BUY

Target Price: Rs 545

Good beginning to the summer

Consolidated net sales grew 1% YoY, aided by ~2% volume growth. Volume in CSD declined 4% YoY, was flat in juices and grew 36% in water. EBITDA margin expanded 198 bps YoY to 15.2% as gross margin expanded 313 bps YoY to 54.3%. Aided by reduced interest costs, the company has achieved an adj. PAT of Rs45mn, compared to PAT loss of Rs518mn in Q1CY16. As per management, the all critical summer season has begun well with healthy growth in April.

VBL is a long term structural play in the underpenetrated Indian soft beverages market. Higher growth potential (low per capita) and strong margin profile (OPM to sustain at ~20% in the medium term) are the key factors which will make it command a premium to global peers. VBL trades at CY18 EV/E of 11.3x and P/E of 32x. Maintain **BUY** with revised TP of Rs 545, based on fwd.EV/E of 11.5x (vs. Rs510 earlier).

CMP : Rs 485
Potential Upside : 12%

MARKET DATA

No. of Shares : 183 mn
Free Float : 26%
Market Cap : Rs 89 bn
52-week High / Low : Rs 508 / Rs 341
Avg. Daily vol. (6mth) : 99,954 shares
Bloomberg Code : VBL IB Equity
Promoters Holding : 74%
FII / DII : 11% / 1%

India – extended winter in North hurts volume growth, but Q2 looks better: Q1CY17 volumes grew a mere 2% due to weak volumes in North India. For Q2CY17 (most important quarter as it contributes to almost 60% of full year EBITDA), management highlighted good growth in April despite a high base; and, it expects the momentum to sustain in May and June as well given the subdued base. Management is looking to maintain EBITDA margin in CY17.

International volume grew 3.8%: Management highlighted that international operations in Nepal, Sri Lanka and Morocco posted double digit growth in Q1. Zambia business was hit by heavy rains and lean season (Nov and Dec are key months). In Q1CY16, the company increased its stake in Zambia subsidiary from 60% to 90% (at cost of Rs 710 mn). In CY16, Zambia unit registered sales volume of 10.7 mn case with EBITDA at Rs 467 mn. On the other hand, the company divested 41% stake in its loss-making Mozambique subsidiary in light of limited opportunity to scale-up operations to turn around the subsidiary. In CY16, the unit contributed a mere 0.6% to net sales and recorded net loss of Rs 99 mn.

Financial summary (Consolidated)

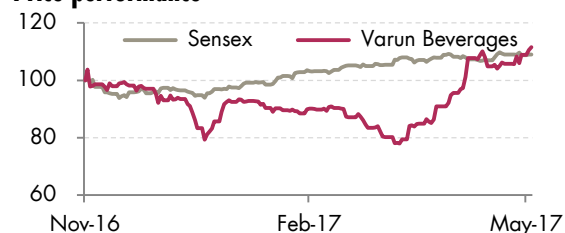
Y/E December	CY15	CY16	CY17E	CY18E
Sales (Rs mn)	33,941	38,520	42,502	48,402
Adj PAT (Rs mn)	1,130	1,513	2,311	2,792
Con. EPS* (Rs)	-	-	10.9	14.2
EPS (Rs)	8.4	8.9	12.7	15.3
Change YOY (%)	(657.1)	6.5	41.7	20.8
P/E (x)	57.8	54.3	38.3	31.7
RoE (%)	22.2	11.8	11.5	12.3
RoCE (%)	9.9	11.0	10.6	11.8
EV/E (x)	14.9	13.1	12.8	11.3
DPS (Rs)	-	-	-	-

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	CY16	CY17E	CY18E
Domestic volume	224	247	271
International volume	52	56	63
Gross margin	54.9%	53.9%	53.0%
EBITDA margin	20.6%	20.3%	19.8%

Price performance



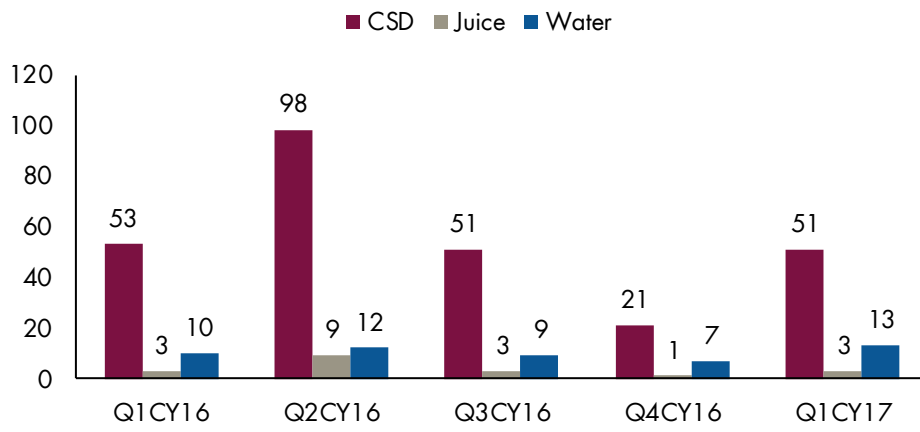
Conference call highlights

- ◆ **Capex guidance:** The company maintained its capex guidance (in line with depreciation for CY17). Going ahead, capex to reduce substantially (50-60% of depreciation). In Q2CY16, the company commenced production/ operation from its new unit at Hardoi, Uttar Pradesh.
- ◆ **Quarterly mix**
 - **Volume mix:** 18-19% in Q1, 45-46% in Q2, 22-23% in Q3 and 12-14% in Q4
 - **EBITDA mix:** 15% in Q1, 60% in Q2, 12.5% in Q3 and 12.5% in Q4
 - **PAT mix:** For the first time, the company has recorded PAT profit in first quarter. Usually the company makes 120-130% of annual PAT in Q2, 20% of annual in Q3 and balance loss in Q4
- ◆ The company has guided for interest cost of Rs 1.7 bn for CY17 (under IGAAP). Under Ind-AS, the cost will further increase by Rs 450 mn as a reflection of fair value of interest-free loan from PepsiCo and deferred benefit from the government
- ◆ Management highlighted that credit rating for long term debt has been upgraded from CRISIL A+/Positive to CRISIL AA-/Stable. The company had already secured top rating for short term debt i.e. CRISIL A1+
- ◆ The company has repaid annual installment of Rs 3,235 mn towards interest free deferred acquisition payment to PepsiCo during Q1CY17. The last installment of Rs3 bn is pending (due in Feb-18)

Exhibit 1: Result update

(Rs. mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg
Net Sales	8,746	8,634	1.3	4,201	108.2
Raw Material Cost	4,001	4,220	(5.2)	1,739	130.1
(% of Net Sales)	45.7	48.9	-313 bps	41.4	435 bps
Staff Expenditure	1,100	972	13.1	1,019	7.9
(% of Net Sales)	12.6	11.3	132 bps	24.3	-1168 bps
Other Expenses	2,319	2,303	0.7	1,291	79.6
(% of Net Sales)	26.5	26.7	-16 bps	30.7	-423 bps
EBITDA	1,326	1,138	16.5	151	776.6
EBITDA margin (%)	15.2	13.2	198 bps	3.6	1156 bps
Other income	182	104	74.0	93	96.1
PBIDT	1,508	1,243	21.3	244	518.1
Depreciation	801	775	3.4	926	(13.5)
Interest	566	1,090	(48.1)	499	13.5
PBT	141	-622	nm	-1,181	nm
Tax	74	-61	nm	-289	nm
Minority interest	22	-43	nm	15	49.7
Adjusted PAT	45	-518	nm	-906	nm
Reported PAT	45	-518	nm	-906	nm

Source: Company, Axis Capital

Exhibit 2: Category-wise sale volume (mn cases)


Source: Company, Axis Capital

Financial summary (Consolidated)

Profit & loss (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Net sales	33,941	38,520	42,502	48,402
Other operating income	-	-	-	-
Total operating income	33,941	38,520	42,502	48,402
Cost of goods sold	(17,165)	(17,363)	(19,584)	(22,771)
Gross profit	16,777	21,157	22,918	25,631
<i>Gross margin (%)</i>	<i>49.4</i>	<i>54.9</i>	<i>53.9</i>	<i>53.0</i>
Total operating expenses	(10,406)	(13,205)	(14,271)	(16,069)
EBITDA	6,371	7,952	8,648	9,563
<i>EBITDA margin (%)</i>	<i>18.8</i>	<i>20.6</i>	<i>20.3</i>	<i>19.8</i>
Depreciation	(3,174)	(3,724)	(3,912)	(4,231)
EBIT	3,197	4,228	4,735	5,332
Net interest	(1,688)	(2,148)	(1,652)	(1,733)
Other income	143	348	130	288
Profit before tax	1,906	2,428	3,214	3,886
Total taxation	(789)	(829)	(903)	(1,095)
<i>Tax rate (%)</i>	<i>41.4</i>	<i>34.1</i>	<i>28.1</i>	<i>28.2</i>
Profit after tax	1,118	1,600	2,311	2,792
Minorities	-	(111)	-	-
Profit/ Loss associate co(s)	13	23	-	-
Adjusted net profit	1,130	1,513	2,311	2,792
<i>Adj. PAT margin (%)</i>	<i>3.3</i>	<i>3.9</i>	<i>5.4</i>	<i>5.8</i>
Net non-recurring items	-	-	-	-
Reported net profit	1,130	1,513	2,311	2,792

Balance sheet (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Paid-up capital	5,838	1,823	1,823	1,823
Reserves & surplus	905	17,116	19,426	22,218
Net worth	6,743	18,939	21,250	24,041
Borrowing	30,008	22,482	22,794	20,694
Other non-current liabilities	2,000	3,237	3,268	3,301
Total liabilities	38,751	44,657	47,312	48,036
Gross fixed assets	46,325	52,437	59,569	63,669
Less: Depreciation	(11,369)	(14,936)	(18,848)	(23,079)
Net fixed assets	34,956	37,501	40,721	40,590
Add: Capital WIP	379	3,088	2,821	2,821
Total fixed assets	35,335	40,589	43,542	43,411
Total Investment	33	56	56	56
Inventory	4,247	4,899	5,106	5,717
Debtors	979	1,303	1,370	1,543
Cash & bank	581	657	445	1,452
Loans & advances	2,994	4,577	4,569	4,560
Current liabilities	5,561	7,566	7,919	8,845
Net current assets	3,333	3,969	3,670	4,525
Other non-current assets	50	43	43	43
Total assets	38,751	44,657	47,312	48,036

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Profit before tax	1,906	2,428	3,214	3,886
Depreciation & Amortisation	3,174	3,724	3,912	4,231
<i>Chg in working capital</i>	<i>(419)</i>	<i>820</i>	<i>87</i>	<i>151</i>
Cash flow from operations	5,548	8,303	7,994	8,940
<i>Capital expenditure</i>	<i>(2,645)</i>	<i>(7,999)</i>	<i>(6,866)</i>	<i>(4,100)</i>
Cash flow from investing	(2,997)	(10,680)	(6,866)	(4,100)
<i>Equity raised/ (repaid)</i>	<i>-</i>	<i>7,014</i>	<i>-</i>	<i>-</i>
<i>Debt raised/ (repaid)</i>	<i>(6,652)</i>	<i>1,025</i>	<i>312</i>	<i>(2,100)</i>
<i>Dividend paid</i>	<i>-</i>	<i>-</i>	<i>-</i>	<i>-</i>
Cash flow from financing	(2,360)	2,459	(1,340)	(3,833)
Net chg in cash	191	82	(212)	1,006

Key ratios

Y/E December	CY15	CY16	CY17E	CY18E
OPERATIONAL				
FDEPS (Rs)	8.4	8.9	12.7	15.3
CEPS (Rs)	32.0	31.0	34.1	38.5
DPS (Rs)	-	-	-	-
Dividend payout ratio (%)	-	-	-	-
GROWTH				
Net sales (%)	35.6	13.5	10.3	13.9
EBITDA (%)	65.7	24.8	8.7	10.6
Adj net profit (%)	(660.8)	33.8	52.8	20.8
FDEPS (%)	(657.1)	6.5	41.7	20.8
PERFORMANCE				
RoE (%)	22.2	11.8	11.5	12.3
RoCE (%)	9.9	11.0	10.6	11.8
EFFICIENCY				
Asset turnover (x)	1.1	1.0	1.0	1.1
Sales/ total assets (x)	0.9	0.8	0.8	0.9
Working capital/ sales (x)	0.1	0.1	0.1	0.1
Receivable days	10.5	12.3	11.8	11.6
Inventory days	56.2	58.5	55.0	53.7
Payable days	24.4	32.8	32.0	30.7
FINANCIAL STABILITY				
Total debt/ equity (x)	5.9	1.8	1.1	0.9
Net debt/ equity (x)	5.8	1.7	1.1	0.8
Current ratio (x)	1.6	1.5	1.5	1.5
Interest cover (x)	1.9	2.0	2.9	3.1
VALUATION				
PE (x)	57.8	54.3	38.3	31.7
EV/ EBITDA (x)	14.9	13.1	12.8	11.3
EV/ Net sales (x)	2.8	2.7	2.6	2.2
PB (x)	9.7	4.3	4.2	3.7
Dividend yield (%)	-	-	-	-
Free cash flow yield (%)	4.4	0.4	1.3	5.5

Source: Company, Axis Capital

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BUY	More than 10%
HOLD	Between 10% and -10%
SELL	Less than -10%

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