

## VARUN BEVERAGES

FMCG

16 AUG 2017

Quarterly Update

**BUY**

Target Price: Rs 570

### Peak quarter hurt by GST & weak summer

Consolidated net sales declined 2% as volumes declined 6%, while EBITDA and PAT grew 3% and 21%. In the peak summer quarter, India volumes declined 6% despite a low base due to GST-led disruptions and a weak summer. OPM up 137 bps YoY at 29.4% as other expenses declined 300 bps YoY. Adj. PAT grew 21% YoY on lower finance costs (debt repayment post IPO). In Q3, it intends to acquire territories in Odisha and Madhya Pradesh which will add 6% to India volumes. Given the weak peak quarter, we lower CY17 EBITDA by 5%.

While organic volume growth is weak, growth will come from acquisition of new territories. New manufacturing plant is not required for next two years and hence capex will be lower than depreciation which will aid RoE increase (from 10.4% in CY17 to 14.1% in CY19). Maintain **BUY** with revised TP of Rs 570 based on forward EV/E of 12x.

CMP : Rs 520  
Potential Upside : 10%

#### MARKET DATA

No. of Shares : 183 mn  
Free Float : 26%  
Market Cap : Rs 95 bn  
52-week High / Low : Rs 570 / Rs 341  
Avg. Daily vol. (6mth) : 144,590 shares  
Bloomberg Code : VBL IB Equity  
Promoters Holding : 74%  
FII / DII : 11% / 1%

**India – destocking, early monsoon hurt peak quarter volumes:** Despite a low base, India sales declined 4% as volumes declined 6%. Management attributed the decline to GST implementation and early onset of monsoon. Gross margin contracted 118 bps YoY to 51% on inflationary sugar prices (company had cover till May). However, EBITDA margin expanded 89 bps YoY to 31.7%, as other expenses eased 280 bps on logistic efficiency due to business reorganization in past couple of years (added four territories, acquired two co-packers and set up one plant).

**New territory acquisition in India:** VBL announced its intent of acquiring new territories in Odisha and parts of Madhya Pradesh (will now have 100% of MP) along with three manufacturing units at Cuttack, Bargarh and Bhopal. Acquired business will form 5-6% of existing India volume, which translates into revenue of Rs 1.7 bn (deal valued at EV/S of 1x). It also hinted towards new territory addition in next couple of quarters, which is why it has added capacity ahead of time in Hardoi. As peak month utilization is at 70%, the next 40-50% growth can be serviced from existing facilities. Hence, after likely capex of Rs 5.8 bn in FY17 (Rs 3 bn toward Hardoi plant + Rs 1.8 bn new territories acquisition + Rs 1 bn maintenance capex), it expects capex to be 50-60% of depreciation for next couple of years.

#### Financial summary (Consolidated)

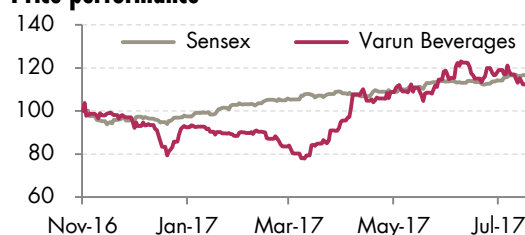
Y/E December	CY15	CY16	CY17E	CY18E
Sales (Rs mn)	33,941	38,520	38,669	44,525
Adj PAT (Rs mn)	1,130	1,513	2,049	2,676
Con. EPS* (Rs)	-	-	11.0	14.3
EPS (Rs)	8.4	8.9	11.2	14.7
Change YOY (%)	(657.1)	6.5	25.6	30.6
P/E (x)	62.0	58.2	46.3	35.4
RoE (%)	22.2	11.8	10.4	12.5
RoCE (%)	9.9	11.0	9.9	11.6
EV/E (x)	19.5	14.7	14.4	12.3
DPS (Rs)	-	-	2.5	3.3

Source: \*Consensus broker estimates, Company, Axis Capital

#### Key drivers

	CY16	CY17E	CY18E
Domestic volume	224	224	251
International volume	52	51	60
Gross margin	54.9%	54.8%	54.3%
EBITDA margin	20.6%	21.4%	21.3%

#### Price performance



**Key international markets put up a decent show:** Management highlighted that international operations in Nepal, Sri Lanka and Morocco posted strong double digit growth in Q2. However, floods in Zambia affected volumes.

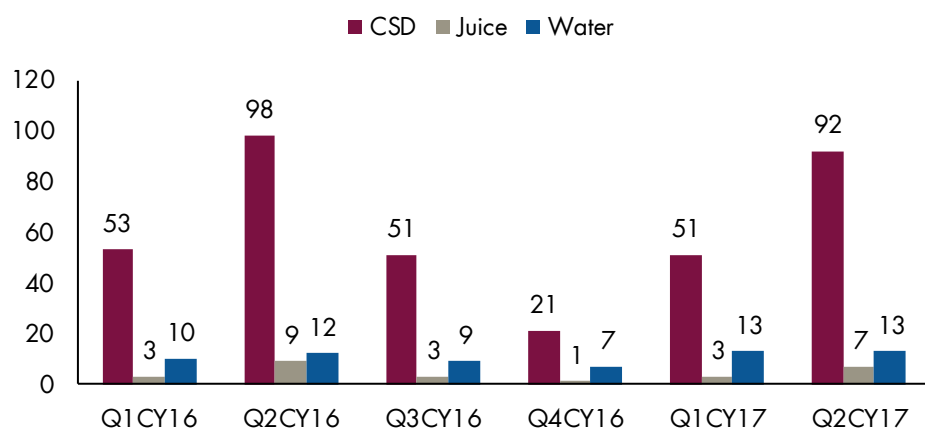
### Other highlights

- ♦ The company has announced an interim dividend of Rs 2.5 (total payout Rs 456 mn). As a dividend policy, the company is looking to part 10-30% of annual profit after tax on standalone financials with shareholders (after considering financial and external parameters)
- ♦ The company has also framed guidelines for acquisitions as (a) consideration for target territory / sub-territory shall be up to 1x revenue +/-20%, (b) to make sure Consolidated debt / EBITDA remains under 3x (post acquisition), (c) should be EV/EBITDA of under 6x and (d) Any M&A related to PepsiCo franchise in the target territory/sub-territory shall be through VBL only
- ♦ Net debt to equity stood at 1.20 x and net working capital requirement was 28 days as on June 30, 2017. During H1CY17, net capex (including change in CWIP) was Rs 4 bn. During Q2, the company has commenced manufacturing facility at Sandila, Hardoi, Uttar Pradesh (effective 3 May 2017)

### Exhibit 1: Result update

(Rs. mn)	Jun-17	Jun-16	% Chg
<b>Net Sales</b>	<b>16,334</b>	<b>16,605</b>	<b>(1.6)</b>
Raw Material Cost	7,830	7,759	0.9
(% of Net Sales)	47.9	46.7	121 bps
Staff Expenditure	1,171	1,120	4.5
(% of Net Sales)	7.2	6.7	42 bps
Other Expenses	2,528	3,069	(17.6)
(% of Net Sales)	15.5	18.5	-301 bps
<b>EBITDA</b>	<b>4,805</b>	<b>4,656</b>	<b>3.2</b>
EBITDA margin (%)	29.4	28.0	137 bps
Other income	47	63	(25.4)
<b>PBIDT</b>	<b>4,852</b>	<b>4,719</b>	<b>2.8</b>
Depreciation	907	769	18.0
Interest	513	1,114	(54)
<b>PBT</b>	<b>3,431</b>	<b>2,837</b>	<b>21.0</b>
Tax	981	824	19.1
Minority interest	(6)	(18)	(66.8)
<b>Adjusted PAT</b>	<b>2,456</b>	<b>2,031</b>	<b>20.9</b>
<b>Reported PAT</b>	<b>2,456</b>	<b>2,031</b>	<b>20.9</b>

Source: Company, Axis Capital

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


Source: Company, Axis Capital

## Financial summary (Consolidated)

## Profit &amp; loss (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Net sales	33,941	38,520	38,669	44,525
Other operating income	-	-	-	-
<b>Total operating income</b>	<b>33,941</b>	<b>38,520</b>	<b>38,669</b>	<b>44,525</b>
Cost of goods sold	(17,165)	(17,363)	(17,494)	(20,368)
Gross profit	16,777	21,157	21,176	24,157
Gross margin (%)	49.4	54.9	54.8	54.3
Total operating expenses	(10,406)	(13,205)	(12,911)	(14,655)
<b>EBITDA</b>	<b>6,371</b>	<b>7,952</b>	<b>8,264</b>	<b>9,502</b>
EBITDA margin (%)	18.8	20.6	21.4	21.3
Depreciation	(3,174)	(3,724)	(3,957)	(4,312)
<b>EBIT</b>	<b>3,197</b>	<b>4,228</b>	<b>4,308</b>	<b>5,190</b>
Net interest	(1,688)	(2,148)	(1,772)	(1,928)
Other income	143	348	304	421
<b>Profit before tax</b>	<b>1,906</b>	<b>2,428</b>	<b>2,840</b>	<b>3,683</b>
Total taxation	(789)	(829)	(791)	(1,007)
Tax rate (%)	41.4	34.1	27.9	27.3
Profit after tax	1,118	1,600	2,049	2,676
Minorities	-	(111)	-	-
Profit/ Loss associate co(s)	13	23	-	-
<b>Adjusted net profit</b>	<b>1,130</b>	<b>1,513</b>	<b>2,049</b>	<b>2,676</b>
Adj. PAT margin (%)	3.3	3.9	5.3	6.0
Net non-recurring items	-	-	-	-
<b>Reported net profit</b>	<b>1,130</b>	<b>1,513</b>	<b>2,049</b>	<b>2,676</b>

## 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	18,616	20,579
Net worth	6,743	18,939	20,439	22,402
Borrowing	30,008	22,482	25,194	22,194
Other non-current liabilities	2,000	3,237	3,268	3,301
<b>Total liabilities</b>	<b>38,751</b>	<b>44,657</b>	<b>48,901</b>	<b>47,896</b>
Gross fixed assets	46,325	52,437	60,819	64,419
Less: Depreciation	(11,369)	(14,936)	(18,893)	(23,205)
Net fixed assets	34,956	37,501	41,927	41,215
Add: Capital WIP	379	3,088	2,821	2,821
Total fixed assets	35,335	40,589	44,748	44,036
Total Investment	33	56	56	56
Inventory	4,247	4,899	4,652	5,262
Debtors	979	1,303	1,269	1,428
Cash & bank	581	657	821	689
Loans & advances	2,994	4,577	4,569	4,560
Current liabilities	5,561	7,566	7,356	8,276
Net current assets	3,333	3,969	4,053	3,761
Other non-current assets	50	43	43	43
<b>Total assets</b>	<b>38,751</b>	<b>44,657</b>	<b>48,901</b>	<b>47,896</b>

Source: Company, Axis Capital

## Cash flow (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Profit before tax	1,906	2,428	2,840	3,683
Depreciation & Amortisation	3,174	3,724	3,957	4,312
Chg in working capital	(419)	820	79	161
<b>Cash flow from operations</b>	<b>5,548</b>	<b>8,303</b>	<b>7,888</b>	<b>9,110</b>
Capital expenditure	(2,645)	(7,999)	(8,116)	(3,600)
<b>Cash flow from investing</b>	<b>(2,997)</b>	<b>(10,680)</b>	<b>(8,116)</b>	<b>(3,600)</b>
Equity raised/ (repaid)	-	7,014	-	-
Debt raised/ (repaid)	(6,652)	1,025	2,712	(3,000)
Dividend paid	-	-	-	-
<b>Cash flow from financing</b>	<b>(2,360)</b>	<b>2,459</b>	<b>940</b>	<b>(4,928)</b>
Net chg in cash	191	82	712	582

## Key ratios

Y/E December	CY15	CY16	CY17E	CY18E
<b>OPERATIONAL</b>				
FDEPS (Rs)	8.4	8.9	11.2	14.7
CEPS (Rs)	32.0	31.0	32.9	38.3
DPS (Rs)	-	-	2.5	3.3
Dividend payout ratio (%)	-	-	22.2	22.1
<b>GROWTH</b>				
Net sales (%)	35.6	13.5	0.4	15.1
EBITDA (%)	65.7	24.8	3.9	15.0
Adj net profit (%)	(660.8)	33.8	35.5	30.6
FDEPS (%)	(657.1)	6.5	25.6	30.6
<b>PERFORMANCE</b>				
RoE (%)	22.2	11.8	10.4	12.5
RoCE (%)	9.9	11.0	9.9	11.6
<b>EFFICIENCY</b>				
Asset turnover (x)	1.1	1.0	0.9	1.0
Sales/ total assets (x)	0.9	0.8	0.7	0.8
Working capital/ sales (x)	0.1	0.1	0.1	0.1
Receivable days	10.5	12.3	12.0	11.7
Inventory days	56.2	58.5	55.8	54.8
Payable days	24.4	32.8	33.8	32.4
<b>FINANCIAL STABILITY</b>				
Total debt/ equity (x)	5.9	1.8	1.3	1.0
Net debt/ equity (x)	5.8	1.7	1.2	1.0
Current ratio (x)	1.6	1.5	1.6	1.5
Interest cover (x)	1.9	2.0	2.4	2.7
<b>VALUATION</b>				
PE (x)	62.0	58.2	46.3	35.4
EV/ EBITDA (x)	19.5	14.7	14.4	12.3
EV/ Net sales (x)	3.7	3.0	3.1	2.6
PB (x)	10.4	4.6	4.6	4.2
Dividend yield (%)	-	-	0.5	0.6
Free cash flow yield (%)	-	-	-	0.1

Source: Company, Axis Capital

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

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