

## VST Industries (VSTIND)

**₹ 3200**

### High priced cigarettes contribution inches up

- Revenue (net of GST) for the quarter increased 22.9% YoY to ₹ 315.4 crore, above our estimate of ₹ 303.1 crore. Cigarette sales increased 25% to ₹ 245 crore led by 8% volume growth and a change in product mix. Contribution of higher priced cigarettes to volumes has increased from 20% to ~27% during the quarter. The company has not taken any material price increase during the quarter. Tobacco sales increased 16.6% to ₹ 70 crore in Q3FY19
- The sales volume contribution of 64 mm category was 40% whereas 69 mm category contributed 55%. The company has 'Edition' brand in King Size category, which contributed 5% to volumes
- Operating profit increased 8% in Q3FY19E. Gross margins contracted 500 bps but 40 bps & 60 bps savings in employee cost to sales & other overheads expenditure to sales, respectively, led to a 400 bps decline in EBITDA margins. The company saw an increase in cost of all major imported raw material like filter rods, cigarettes paper largely due to currency depreciation. Leaf tobacco prices also saw an up-tick, which may impact operating margins, going forward. Net profit for the quarter, thus, jumped 11.4% YoY to ₹ 55.4 crore

### Stable taxation perks up volume growth

After four consecutive years of volume de-growth, VST witnessed strong volume growth in first nine months of FY19. The industry has seen stable taxation since a steep increase in GST in July 2017. This, along with low base created by de-growth in volumes in the last four years, has resulted in a sharp improvement in cigarette volumes in the last two quarters. Simultaneously, the company's strategy to increase the proportion of high priced premium cigarettes has resulted in realisation growth for the company. VST has *Edition* brand at ₹ 10 price point, *Total* is present at ₹ 5, ₹ 6 price points, *Moment* at ₹ 4, *Charms* at ₹ 6 and *Charminar* at ₹ 4 and lower. Given higher volume from the high prices cigarettes, 64 mm category contribution has dipped to 40% from more than 50% in the last two years. We expect volume growth of 8% in FY19, 4% each in FY20E and FY21E, respectively, largely on the back of a favourable product mix towards high priced cigarettes in the 69 mm and above category. We estimate net revenue CAGR of 12.0% in FY18-21E to ₹ 1329.7 crore.

### Change in sales mix to aid EBITDA/stick and margins

The company's products are targeted at the lower income segment and first time smokers. It commands a volume market share of ~8.0%. VST is largely present in low priced (₹ 4-6) cigarettes category (except 'Edition' at ₹ 10). The company has been able to defend its market share over the years in a high taxation environment while simultaneously passing on excise duty hikes by the government to the consumer and taking price hikes and changing production mix accordingly. With a favourable product mix, EBITDA/stick has improved from ₹ 0.24 in FY14 to ₹ 0.38 in FY18. Given higher sales mix of high price cigarettes (27% currently) and volume recovery, we estimate further improvement in EBITDA/stick to ₹ 0.46 in FY19 and ₹ 0.50 in FY21E.

### Improved product mix to maintain profitability growth; maintain BUY

With strong volume growth and a better product mix, we expect healthy growth in both revenues & earnings during FY18-21E. Considering more than 60% dividend payout, dividend yield for VST is 3-4%. We reiterate **BUY** on the stock with a target price of ₹ 4000/share.

Rating matrix		
Rating	:	Buy
Target	:	₹4000
Target Period	:	12-15 months
Potential Upside	:	25%

What's changed?	
Target	Unchanged
EPS FY19E	Changed from ₹159.9 to ₹149.9
EPS FY20E	Changed from ₹173.7 to ₹170.8
EPS FY21E	Introduced at ₹ 185.8
Rating	Unchanged

Quarterly performance					
	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Sales	293.0	239.0	22.6	290.2	1.0
EBITDA	86.3	79.9	8.0	90.2	-4.4
EBITDA (%)	29.5	33.4	-398 bps	31.1	-164 bps
PAT	55.4	49.8	11.4	57.1	-3.0

Key financials				
₹ Crore	FY18	FY19E	FY20E	FY21E
Gross Sales	946.4	1,127.8	1,210.3	1,309.3
EBITDA	294.8	361.6	408.3	439.9
Net Profit	181.9	231.5	263.8	286.8
EPS (₹)	117.8	149.9	170.8	185.8

Valuation summary				
	FY18	FY19E	FY20E	FY21E
P/E	27.2	21.3	18.7	17.2
Target P/E	34.0	26.7	23.4	21.5
Div. Yield	2.4	2.8	3.4	4.1
Mcap/Sales	5.2	4.4	4.1	3.8
RoNW (%)	31.3	35.1	34.7	33.8
RoCE (%)	46.9	52.5	51.5	50.2

Stock data	
	Amount
Market Capitalization (₹ Crore)	4,910.5
Total Debt (FY18) (₹ Crore)	0.0
Cash and Investments (FY18) (₹ Crore)	451.7
EV (₹ Crore)	4,458.8
52 week H/L	3442 / 2470
Equity capital	₹ 15.4 crore
Face value	₹ 10

Price performance				
% change	1M	3M	6M	12M
VST Industries	1.8	16.2	12.5	-2.4
ITC	1.0	-3.1	-1.9	-0.9
Godfrey Phillips	13.0	33.7	27.3	-2.5

### Research Analyst

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### Variance analysis

	Q3FY19	Q3FY19E	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	Comments
Total Operating Income	293.0	303.1	239.0	22.6	290.2	1.0	Net sales witnessed growth of 22.6% led by 8% volume growth & increasing contribution of high priced cigarettes
Other Operating Income	0.3	0.4	0.3	21.4	0.4	-2.9	
Raw Material Expenses	157.7	149.8	116.6	35.2	145.8	8.2	RM cost increased sharply mainly due to increasing cost of filter roads, cigarettes paper & leaf tobacco
Employee Expense	24.1	23.9	21.2	13.7	23.6	2.1	
Excise Duty	22.7	20.5	18.0	26.3	20.9	8.8	
Other operating Expenses	24.9	29.9	21.3	16.9	30.7	-18.8	
EBITDA	86.3	99.4	79.9	8.0	90.2	-4.4	Operating profit increased 8% during the quarter
EBITDA Margin (%)	29.5	32.8	33.4	-398 bps	31.1	-164 bps	Margins contracted 400 bps due to a 500 bps dip in gross margins on the back of high raw material cost
Depreciation	10.1	10.7	9.4	7.6	10.8	-6.9	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	10.1	7.3	5.5	84.4	9.2	9.0	
PBT	86.3	96.0	76.0	13.5	88.7	-2.7	
Tax Outgo	30.9	33.6	26.2	17.7	31.5	-2.1	
PAT	55.4	62.4	49.8	11.4	57.1	-3.0	Net profit increased 11.4% to ₹ 55.4 crore led by 8% increase in EBITDA & higher other income

### Key Metrics

Cigarette Sales (₹ crore)	245.4	285.0	196.7	24.8	233.0	5.3	Strong cigarettes volume growth of 8% during the quarter
Tobacco Sales (₹ crore)	70.0	38.2	60.0	16.7	77.0	-9.1	Tobacco sales witnessed growth of 16% during the quarter

Source: Company, ICICI Direct Research

### Change in estimates

(₹ Crore)	FY19E			FY20E			FY21E	Comments
	Old	New	% change	Old	New	% change	New	
Net sales	1,133.2	1,127.8	-0.5	1,221.2	1,210.3	-0.9	1,309.3	
EBITDA	384.4	361.6	-5.9	413.4	408.3	-1.2	439.9	
EBITDA Margin (%)	33.9	32.0	-186 bps	33.9	33.7	-12 bps	33.6	We change our estimates for FY19 due to lower-than-expected margins in Q3
PAT	246.6	231.5	-6.1	267.2	263.8	-1.3	286.8	
EPS (₹)	159.72	149.91	-6.1	173.05	170.83	-1.3	185.76	

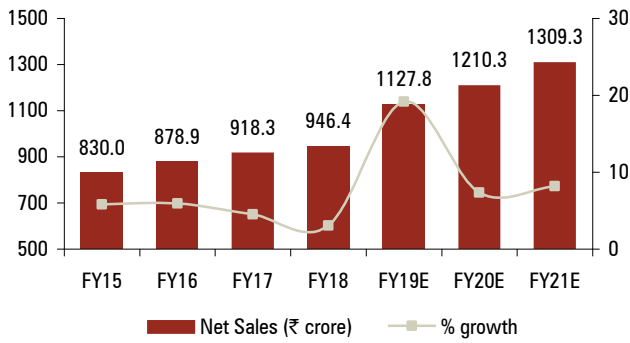
Source: Company, ICICI Direct Research

### Assumptions

	FY19E		Current				Earlier		Comments
	FY17	FY18	FY19E	FY17E	FY20E	FY21E	FY19E	FY20E	
Cig. Vol. (mn sticks)	7,258.7	7,302.2	7,886.4	7,478.6	8,201.9	8,529.9	7,886.4	8,201.9	We introduce FY21E numbers
Cig. Vol. Growth (%)	-1.0	0.6	8.0	2.0	4.0	4.0	8.0	4.0	
Realization/cig (₹)	2.8	2.9	1.2	2.8	1.3	1.3	1.4	1.4	
Tobacco Sales(₹ crore)	275.0	250.0	247.2	294.8	257.1	267.5	115.9	120.6	
% of <64mm in sales	55.0	50.0	40.0	55.0	40.0	40.0	40.0	40.0	No significant change in our estimates
% of >64mm in sales	45.0	50.0	60.0	45.0	60.0	60.0	60.0	60.0	

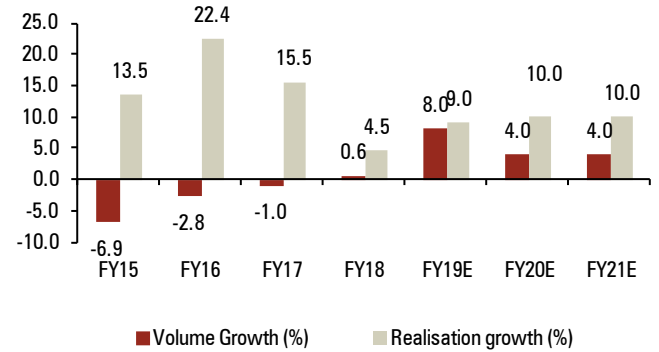
Source: Company, ICICI Direct Research

**Exhibit 1: Net revenue to grow at CAGR of 11.4% over FY18-21E...**



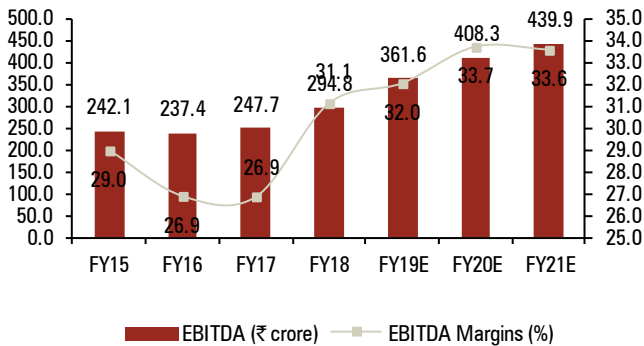
Source: Company, ICICI Direct Research

**Exhibit 2: Led by realisation growth; volume growth to improve, going forward**



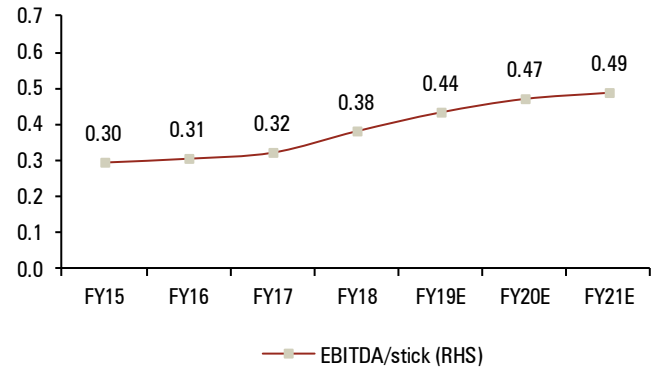
Source: Company, ICICI Direct Research

**Exhibit 3: Improved product mix to aid EBITDA margin expansion**



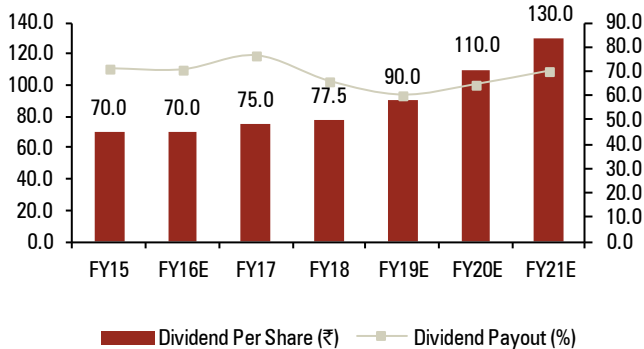
Source: Company, ICICI Direct Research

**Exhibit 4: Healthy growth in EBITDA/stick (₹)**



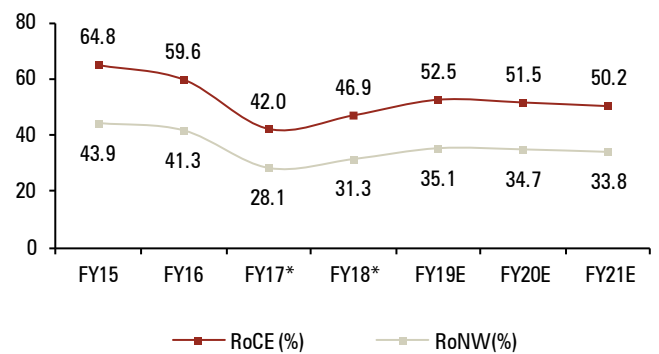
Source: Company, ICICI Direct Research

**Exhibit 5: High dividend payout to continue**



Source: Company, ICICI Direct Research

**Exhibit 6: Return ratios to improve**



Source: Company, ICICI Direct Research; \* Not comparable to previous years due to change in accounting standard

## Outlook & valuation

We expect VST to clock net revenue CAGR of 11.4% over FY18-21E aided by 6% CAGR in volume over the same period. EBITDA for the company is expected to grow at a CAGR of 14.3% over FY18-21E with EBITDA margin of 33.6% in FY21E. EBITDA/stick is estimated to increase to ₹ 0.49 per stick on the back of an improvement in product mix towards newly added products (currently contributing ~20% to total volumes) at a CAGR of 15% in FY18-21E. Thus, PAT is estimated to grow at 20.4% CAGR in FY18-21E.

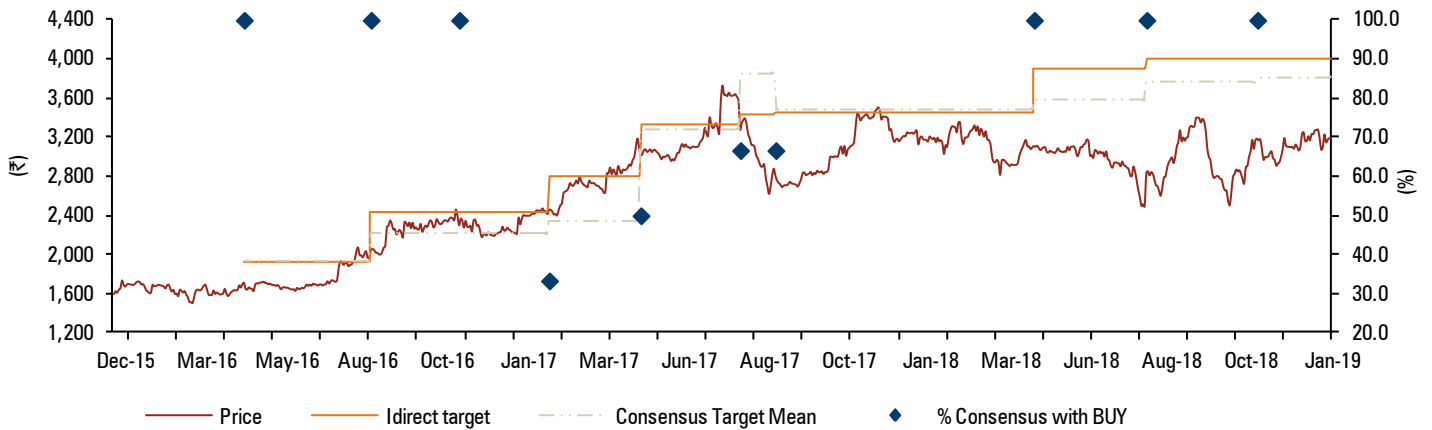
We believe further growth in revenue would be a combination of better realisation, product mix and recovery in volumes (on a low base). We reiterate our **BUY** recommendation on the stock with a target price of ₹ 4000/share, valuing it at 21x FY21E earnings.

**Exhibit 7: Valuations**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	946.4	2.4	117.8	13.6	27.2	16.5	31.3	46.9
FY19E	1127.8	19.2	149.9	27.3	21.3	13.4	35.1	52.5
FY20E	1210.3	7.3	170.8	14.0	18.7	11.8	34.7	51.5
FY21E	1309.3	8.2	185.8	8.7	17.2	10.9	33.8	50.2

Source: Company, ICICI Direct Research

### Recommendation history vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

### Key events

Date	Event
Apr-09	Final dividend of ₹ 30/share on closing share price of ₹ 213 yielding a dividend of 14.1%
Apr-10	Final dividend of ₹ 30/share; margins decline significantly to 17.6%
Apr-11	Final dividend of ₹ 45/share; margins improve by robust 1050 bps YoY to 28.1%
Jan-12	Profits decline ~10% YoY with volume growth in cigarettes declining ~9% YoY
Feb-12	Govt increases excise duty on cigarettes above 65 mm by ~21% in FY13 Budget
Apr-12	Final dividend of ₹ 65/share
Sep-12	Profitability declines ~17% YoY led by muted sales growth of ~6% and decline in margins by ~690 bps YoY to 24.6%
Apr-13	Volume growth in cigarettes or FY13 comes in ~13% lower with a margin decline of ~600 bps to 27%. Profits also remain lower by ~11% for the year
Jul-14	Government increases excise duty on <65 mm segment cigarettes by ~72% and other lengths by 11-21%
Feb-15	Excise duty on below 65 mm category increased by 25% with above 65 mm category increased by 15% in Union Budget FY16
Feb-16	Excise hike of 10% on cigarettes in Budget 2016
Feb-17	Government announces a 6% hike in excise duty across categories of cigarette
Jul-17	Ad valorem VAT replaced by GST rate of 28% and excise duty replaced by GST compensation cess of 5% plus specific duty as per the cigarette size
Jul-17	GST Council raises specific cess on cigarettes in all categories below 75 mm

Source: Company, ICICI Direct Research

### Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	British American Tobacco PLC	30-Sep-18	31.73	4.9	0.0
2	Bright Star Investments Pvt. Ltd.	30-Sep-18	25.95	4.0	0.0
3	HDFC Asset Management Co., Ltd.	30-Sep-17	8.88	1.4	0.0
4	Matthews International Capital Management, L.L.C.	30-Sep-18	8.28	1.3	0.0
5	DSP Investment Managers Pvt. Ltd.	30-Nov-18	3.76	0.6	0.3
6	The New India Assurance Co. Ltd.	30-Sep-18	1.53	0.2	0.0
7	IDBI Asset Management Limited	30-Nov-18	0.71	0.1	0.0
8	ICICI Prudential Asset Management Co. Ltd.	30-Nov-18	0.51	0.1	0.0
9	Fidelity Management & Research (Hong Kong) Limited	30-Nov-18	0.44	0.1	0.0
10	Rothmans International Enterprises, Ltd.	30-Sep-18	0.43	0.1	0.0

Source: Reuters, ICICI Direct Research

### Shareholding Pattern

(in %)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoter	32.2	32.2	32.2	32.2	32.2
FII	9.5	9.5	9.5	9.8	9.2
DII	14.6	15.0	15.5	16.2	17.0
Others	43.7	43.4	42.8	41.9	41.6

### Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
DSP Investment Managers Pvt. Ltd.	11.80m	0.26m	Matthews International Capital Management, L.L.C.	-0.34m	-0.01m
Tata Asset Management Limited	0.46m	0.01m			
State Street Global Advisors (US)	0.06m	0.00m			
SEI Investments Canada	0.04m	0.00m			

Source: Reuters, ICICI Direct Research

## Financial summary

Profit and loss statement		₹ Crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Gross Revenue	947.6	1129.2	1212.0	1311.2	
Growth (%)	2.7	19.2	7.3	8.2	
Raw Material Expenses	470.3	535.2	554.4	601.6	
Employee Expenses	89.2	108.3	116.2	125.7	
Excise Duty	411.1	78.4	84.1	91.0	
Administrative Expenses	12.1	0.0	0.0	0.0	
Other expenses	67.9	124.1	133.1	144.0	
Total Operating Expenditure	652.8	767.6	803.7	871.3	
EBITDA	294.8	361.6	408.3	439.9	
Growth (%)	19.0	22.7	12.9	7.8	
Depreciation	39.2	42.8	47.3	41.3	
Interest	0.0	0.0	0.0	0.0	
Other Income	0.0	0.0	0.0	0.0	
PBT	279.5	348.1	393.7	428.1	
Others	23.8	29.2	32.6	29.4	
Total Tax	97.6	116.6	129.9	141.3	
PAT	181.9	231.5	263.8	286.8	
Growth (%)	20.1	27.3	13.9	8.7	
EPS (₹)	117.8	149.9	170.8	185.8	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E	
Profit after Tax	178.4	231.5	263.8	286.8	
Add: Depreciation	39.2	42.8	47.3	41.3	
(Inc)/dec in Current Assets	5.0	280.6	-92.0	-47.3	
Inc/(dec) in CL and Provisions	221.1	-325.8	7.1	8.6	
CF from operating activities	420.1	224.6	226.1	289.4	
(Inc)/dec in Investments	-220.9	0.5	-0.1	-0.1	
(Inc)/dec in Fixed Assets	-43.2	-30.0	-30.0	-80.0	
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0	
Others	0.0	-10.8	0.2	0.3	
CF from investing activities	-264.1	-40.3	-29.9	-79.8	
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0	
Inc/(dec) in loan funds	0.0	0.0	0.0	0.0	
Dividend paid & dividend tax	-139.4	-140.0	-162.6	-198.7	
Inc/(dec) in Reval. Reserve	0.0	0.0	0.0	0.0	
Inc/(dec) in Exch. Fluc. Res.	0.0	0.0	0.0	0.0	
CF from financing activities	-139.4	-140.0	-162.6	-198.7	
Net Cash flow	16.6	44.3	33.7	10.8	
Opening Cash	11.9	28.5	72.8	106.5	
Closing Cash	28.5	72.8	106.5	117.3	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(Year-end March)	FY18	FY19E	FY20E	FY21E	
<b>Liabilities</b>					
Equity Capital	15.4	15.4	15.4	15.4	
Reserve and Surplus	566.7	644.6	745.7	833.8	
Total Shareholders funds	582.1	660.0	761.2	849.2	
Total Debt	0.0	0.0	0.0	0.0	
Long Term Provisions	14.2	3.4	3.6	3.9	
Total Liabilities	596.2	663.4	764.8	853.2	
<b>Assets</b>					
Gross Block	270.0	300.0	330.0	390.0	
Less: Acc Depreciation	75.0	117.7	165.0	206.2	
Net Block	195.1	182.3	165.1	183.8	
Capital WIP	34.2	34.2	34.2	54.2	
Deferred Tax Asset	24.8	24.8	24.8	24.8	
Non Current Investments	2.0	1.5	1.7	1.8	
LT Loans & Advances/Others	3.2	3.2	3.2	3.2	
<b>Current Assets</b>					
Inventory	252.9	278.1	298.4	322.8	
Debtors	27.3	15.4	6.6	7.2	
Cash	37.6	72.8	106.5	117.3	
Loans & Advances	0.0	7.7	8.3	9.0	
Current Investments	414.1	185.4	265.3	287.0	
Other CA	73.0	0.0	0.0	0.0	
<b>Current Liabilities</b>					
Creditors	58.1	43.3	43.1	43.0	
Provisions	0.0	0.0	0.0	0.0	
Other CL	409.8	98.9	106.1	114.8	
Net Current Assets	337.0	417.3	535.9	585.4	
Total Assets	596.2	663.4	764.8	853.2	

Source: Company, ICICI Direct Research

Key ratios					
(Year-end March)	FY18	FY19E	FY20E	FY21E	
<b>Per share data (₹)</b>					
EPS	117.8	149.9	170.8	185.8	
Cash EPS	143.2	177.6	201.4	212.5	
BV	377.0	427.4	493.0	550.0	
DPS	77.5	90.0	110.0	130.0	
Cash Per Share	24.3	47.2	69.0	75.9	
<b>Operating Ratios (%)</b>					
EBITDA Margin	31.1	32.0	33.7	33.6	
PBT / Net Sales	29.5	30.9	32.5	32.7	
PAT Margin	19.2	20.5	21.8	21.9	
Inventory days	97.5	90.0	90.0	90.0	
Debtor days	10.5	5.0	2.0	2.0	
Creditor days	22.4	14.0	13.0	12.0	
<b>Return Ratios (%)</b>					
RoE	31.3	35.1	34.7	33.8	
RoCE	46.9	52.5	51.5	50.2	
RoIC	51.7	60.5	60.7	61.2	
<b>Valuation Ratios (x)</b>					
P/E	27.0	21.2	18.6	17.1	
EV / EBITDA	16.4	13.3	11.7	10.8	
EV / Net Sales	5.1	4.3	3.9	3.6	
Market Cap / Sales	5.2	4.4	4.1	3.8	
Price to Book Value	8.4	7.4	6.5	5.8	
<b>Solvency Ratios</b>					
Debt/EBITDA	0.0	0.0	0.0	0.0	
Debt / Equity	0.0	0.0	0.0	0.0	
Current Ratio	1.6	3.4	3.9	4.0	
Quick Ratio	1.1	1.5	1.9	1.9	

Source: Company, ICICI Direct Research

## ICICI Direct coverage universe (FMCG)

Sector / Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Colgate (COLPAL)	1,305	1,430	Hold	34,950	28.9	31.9	35.8	45.2	40.9	36.5	7.8	7.1	6.5	62.1	59.2	55.4	43.3	41.7	38.8
Dabur India (DABIND)	435	475	Buy	76,408	8.6	9.8	11.2	50.6	44.2	38.9	8.7	7.7	6.9	26.8	28.4	29.3	23.9	25.0	25.4
GSK CH (GLACON)	7,315	8,145	Hold	31,710	166.5	200.9	224.1	43.9	36.4	32.6	7.2	6.5	5.9	29.8	32.1	32.3	20.1	21.9	22.0
Hindustan Unilever (HINLEV)	1,770	1,900	Hold	378,000	28.5	32.9	37.9	62.0	53.9	46.7	9.9	8.7	7.6	100.8	123.7	162.3	87.2	106.9	141.3
ITC Limited (ITC)	282	340	Buy	340,127	10.3	11.3	12.4	27.3	25.0	22.7	7.6	6.9	6.4	35.8	35.7	37.5	24.9	24.7	26.0
Jyothy Lab (JYOLAB)	182	240	Buy	6,617	5.1	5.8	6.6	35.9	31.3	27.7	3.7	3.3	3.0	33.7	37.8	39.3	24.9	28.0	29.1
Marico (MARLIM)	372	400	Buy	49,673	7.5	8.8	9.9	49.8	42.2	37.5	6.4	5.8	5.2	42.4	44.1	42.9	34.9	36.0	34.6
Nestle (NESIND)	11,450	12,000	Buy	106,062	176.7	202.2	240.5	64.8	56.6	47.6	9.4	8.3	7.3	43.7	42.7	44.2	45.9	42.0	41.2
VST Industries (VSTIND)	3,200	4,000	Buy	4,941	149.9	170.8	185.8	21.3	18.7	17.2	4.4	4.1	3.8	52.5	51.5	50.2	35.1	34.7	33.8
Varun Beverage (VARBEV)	775	860	Buy	13,856	11.7	15.7	19.7	66.1	49.5	39.3	3.5	2.8	2.4	12.7	15.6	17.5	12.1	14.7	17.0

Source: Company, ICICI Direct Research

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