

## High priced cigarettes driving profitability

Revenue (net of GST) for the quarter declined 2.3% YoY to ₹ 272.6 crore, below our estimate of ₹ 308.3 crore. Our estimates suggest volume growth of ~5% in the cigarettes business. The company has been witnessing 8-9% volume growth in FY19. We believe this volume growth momentum would continue with stable taxation and moderate price hikes. Operating profit increased 2% in Q4FY19E. Gross margins expanded 137 bps while employee costs reduced by 126 bps. However, a 139 bps contraction in other overheads to sales restricted operating margin improvement to 124 bps. Net profit for the quarter increased 9.7% YoY to ₹ 53 crore.

## Positive volume growth trajectory continues

With stable taxation post July 2017, cigarette companies are seeing strong volume growth. VST's cigarettes volume growth has been ~8% in FY19. Moreover, ITC's selective price hike in 64, 69 mm categories has provided further manoeuvrability to VST to increase prices. Moreover, it is steadily increasing its product mix in favour of high priced ₹ 6 & ₹ 10 cigarettes. Currently, 'Edition' & 'Total' contribute 20% of volumes. We expect volume growth of 4% each in FY20E, FY21E, respectively, driven by a favourable product mix towards high priced cigarettes (69 mm & above category). We estimate net revenue CAGR of 10% in FY19-21E to ₹ 1321.8 crore.

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

With a favourable product mix, EBITDA/stick has improved from ₹ 0.24 in FY14 to ₹ 0.43 in FY19. Given higher sales mix of high price cigarettes (20%+) and volume recovery, we estimate a further improvement in EBITDA/stick to ₹ 0.46 in FY19 and ₹ 0.47 in FY21E. In addition, VST declared a dividend of ₹ 95 per share translating into dividend payout of 65%. At the CMP, dividend yield is ~3%. VST is generating strong cash flows from its cigarettes business. Also, given low capex requirement, maximum of its cash flows are distributed as dividend. With high dividend payout, the business enjoys healthy return ratios (FY19: RoCE – 53.2%, RoNW – 34.6%).

## Valuation & Outlook

With over 85 years of presence, VST Industries is the third largest player in the Indian cigarette market, with a significant presence in West Bengal, Andhra Pradesh, Telangana, Bihar and Uttar Pradesh. The company's fundamentals are driven by strong capital structure, steady cash flows and adequate liquidity. VST has a healthy portfolio of investments and cash of ₹ 610 crore as on FY19, supporting liquidity. The company has a robust margin profile with its operating margin at 32.3% for FY19. However, with tepid volume growth this growth, we revise our recommendation on the stock to **HOLD** with a revised target price of ₹ 3,900/share.



VST Industries Ltd.

### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	5,347.5
Total Debt (FY19)	0.0
Cash and Investments (FY19)	609.9
EV	4,737.6
52 week H/L (₹)	3838 / 2470
Equity capital	₹ 15.4
Face value (₹)	10.0

### Key Highlights

- The contribution of premium brands 'Total' & 'Edition' has increased to 20% of volumes in last four quarters
- We believe the increasing contribution of high priced cigarettes coupled with strong volume growth have been aiding operating margins of the company
- We revise our recommendation on the stock to **HOLD** with a revised target price of ₹ 3,900 per share

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### Key Financial Summary

Key Financials	FY17	FY18	FY19E	FY20E	FY21E	CAGR (FY19-21E)
Net Sales	918.3	946.4	1097.6	1222.3	1321.8	9.7%
EBITDA	247.7	294.8	354.5	393.6	423.9	9.4%
EBITDA Margin %	27.0	31.2	32.3	32.2	32.1	
Net Profit	151.5	181.9	226.8	253.9	276.0	10.3%
EPS (₹)	98.13	117.80	146.90	164.44	178.78	
P/E	35.3	29.4	23.6	21.1	19.4	
RoNW %	28.1	31.3	34.2	34.4	33.9	
RoCE (%)	42.0	46.9	51.4	51.1	50.3	

Source: Company, ICICI Direct Research

**Exhibit 1: Variance Analysis**

	Q4FY19	Q4FY19E	Q4FY18	YoY (%)	Q3FY19	QoQ (%)	Comments
Total Operating Income	272.6	308.3	279.1	-2.3	293.0	-6.9	Net sales witnessed de-growth of 2.3%
Other Operating Income	0.3	0.3	0.3	-12.5	0.3	-17.6	
Raw Material Expenses	146.2	162.8	153.5	-4.8	157.7	-7.3	
Employee Expense	21.2	28.8	25.2	-16.0	24.1	-12.1	
Excise Duty	21.6	21.8	20.8	3.9	22.7	-5.0	
Other operating Expenses	24.1	26.4	20.8	15.9	24.9	-3.1	
EBITDA	81.1	90.4	79.6	1.9	86.3	-6.0	Operating profit increased 2% during the quarter
EBITDA Margin (%)	29.8	29.3	28.5	124 bps	29.5	31 bps	Margins expanded 124 bps driven by 137 bps improvement in gross margins
Depreciation	11.2	12.6	11.1	0.7	10.1	10.7	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	10.8	9.3	7.8	37.9	10.1	7.1	
PBT	80.8	87.1	76.4	5.8	86.3	-6.4	
Tax Outgo	27.8	30.7	28.0	-1.0	30.9	-10.0	
PAT	53.0	56.4	48.3	9.7	55.4	-4.3	Net profit increased 9.7% led by higher other income
<b>Key Metrics</b>							
Cigarette Sales (₹ crore)		252.3	209.6	-100.0	245.4	-100.0	Cigarettes volumes grew a strong 8% during the quarter
Tobacco Sales (₹ crore)		77.5	90.0	-100.0	70.0	-100.0	Tobacco sales witnessed growth of 16% during the quarter

Source: Company, ICICI Direct Research

**Exhibit 2: Change in estimates**

(₹ Crore)	FY20E			FY21E			Comments
	Old	New	% change	Old	New	% change	
Net sales	1210.3	1222.3	1.0	1,309.3	1,321.8	1.0	We slightly change our estimates
EBITDA	408.3	393.6	-3.6	439.9	423.9	-3.6	
EBITDA Margin (%)	33.7	32.2	-154 bps	33.6	32.1	-153 bps	
PAT	263.8	253.9	-3.8	286.8	276.0	-3.8	
EPS (₹)	170.83	164.44	-3.7	185.8	178.78	-3.8	

Source: Company, ICICI Direct Research

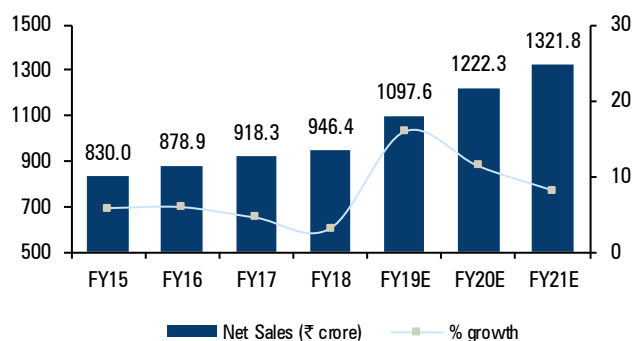
**Exhibit 3: Assumptions**

	Current					Earlier		Comments
	FY17	FY18	FY19E	FY20E	FY21E	FY20E	FY21E	
Cig. Vol. (mn sticks)	7,258.7	7,302.2	7,886.4	8,201.9	8,529.9	8,201.9	8,529.9	No significant change in our estimates
Cig. Vol. Growth (%)	-1.0	0.6	8.0	4.0	4.0	4.0	4.0	
Realization/cig (₹)	2.8	2.9	1.2	1.3	1.3	1.3	1.3	
Tobacco Sales(₹ crore)	275.0	250.0	259.5	270.0	280.9	120.6	267.5	
% of <64mm in sales	55.0	50.0	40.0	40.0	40.0	40.0	40.0	
% of >64mm in sales	45.0	50.0	60.0	60.0	60.0	60.0	60.0	

Source: Company, ICICI Direct Research

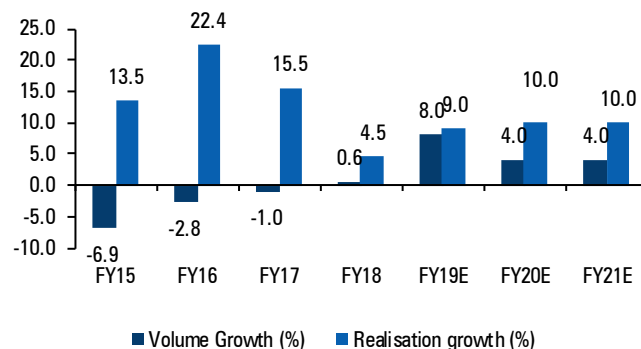
## Key Metrics

**Exhibit 4: Net revenue to grow at 10% CAGR over FY19-21E**



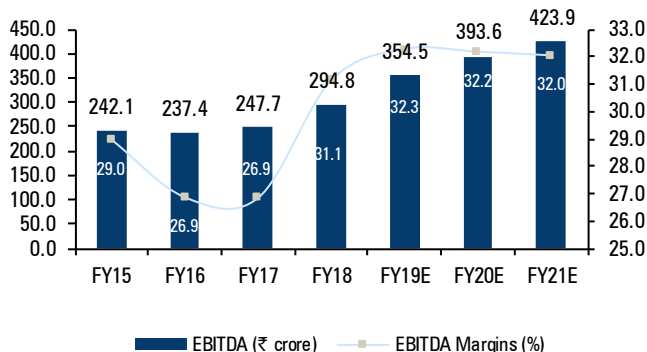
Source: ICICI Direct Research, Company

**Exhibit 5: Volume growth to stabilise, going forward**



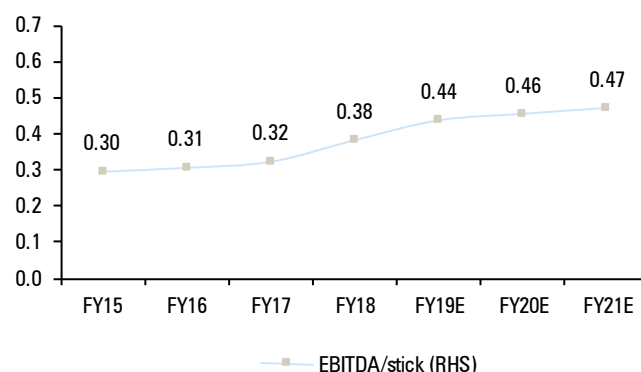
Source: ICICI Direct Research, Company

**Exhibit 6: Improved product mix to aid EBITDA margins**



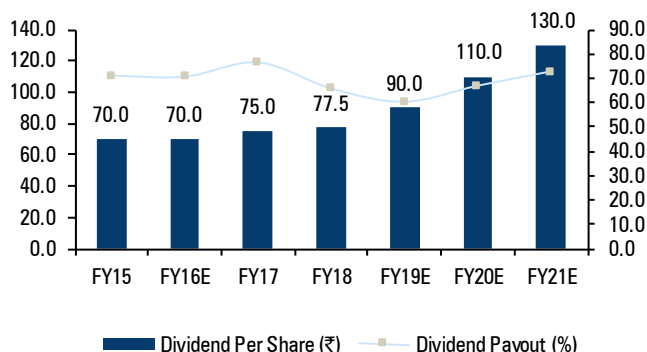
Source: Company, ICICI Direct Research

**Exhibit 7: Healthy growth in EBITDA/stick (₹)**



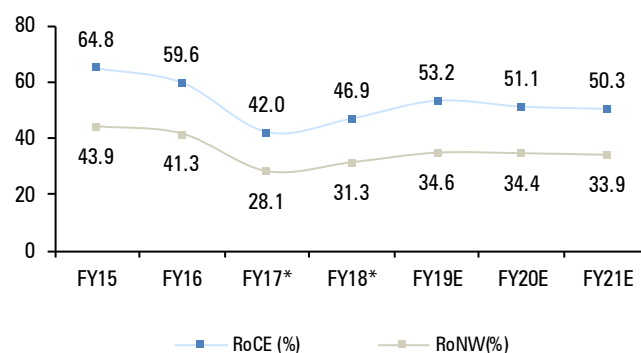
Source: Company, ICICI Direct Research

**Exhibit 8: High dividend payout to continue**



Source: Company, ICICI Direct Research

**Exhibit 9: Return ratios to improve**

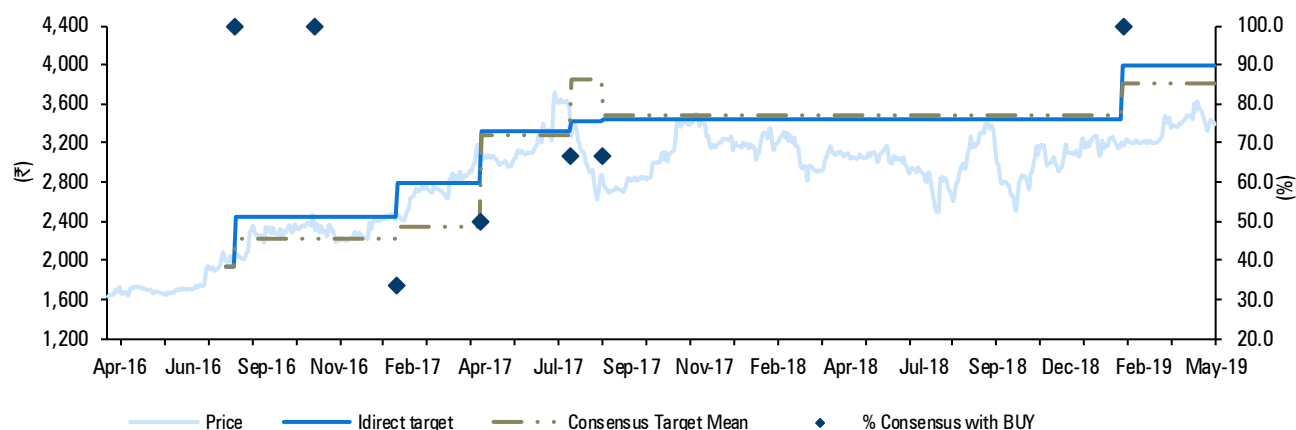


Source: Company, ICICI Direct Research

**Exhibit 10: Valuation**

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY18	946.4	2.4	117.8	13.6	29.4	17.9	31.3	46.9
FY19E	1097.6	16.0	146.9	24.7	23.6	14.9	34.2	51.4
FY20E	1222.3	11.4	164.4	11.9	21.1	13.2	34.4	51.1
FY21E	1321.8	8.1	178.8	8.7	19.4	12.3	33.9	50.3

Source: Company, ICICI Direct Research

**Exhibit 11: Recommendation History vs. Consensus**


Source: Bloomberg, Company, ICICI Direct Research

**Exhibit 12: Top 10 Shareholders**

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	British American Tobacco PLC	31-Dec-18	31.73	4.9	0.0
2	Bright Star Investments Pvt. Ltd.	31-Dec-18	25.95	4.0	0.0
3	HDFC Asset Management Co., Ltd.	31-Mar-19	10.67	1.6	0.0
4	Matthews International Capital Management, L.L.C.	31-Dec-18	7.56	1.2	-0.1
5	DSP Investment Managers Pvt. Ltd.	31-Dec-18	3.82	0.6	0.0
6	The New India Assurance Co. Ltd.	31-Dec-18	1.53	0.2	0.0
7	Tata Asset Management Limited	28-Feb-19	1.03	0.2	0.0
8	L&T Investment Management Limited	31-Mar-19	0.89	0.1	0.1
9	IDBI Asset Management Limited	28-Feb-19	0.71	0.1	0.0
10	ICICI Prudential Asset Management Co. Ltd.	31-Mar-19	0.51	0.1	0.0

Source: Reuters, ICICI Direct Research

**Exhibit 13: Recent Activity**

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
L&T Investment Management Limited	3.04m	0.06m	Matthews International Capital Management, L.L.C.	-5.23m	-0.11m
Samsung Asset Management Co., Ltd.	1.16m	0.03m	Dimensional Fund Advisors, L.P.	-0.12m	0.00m
DSP Investment Managers Pvt. Ltd.	0.45m	0.01m	Aditya Birla Sun Life AMC Limited	-0.03m	0.00m
Axis Asset Management Company Limited	0.14m	0.00m			
State Street Global Advisors (US)	0.01m	0.00m			

Source: Reuters, ICICI Direct Research

**Exhibit 14: Shareholding Pattern**

(in %)	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Promoter	32.2	32.2	32.2	32.2	32.2
FII	9.5	9.5	9.8	9.2	8.9
DII	15.0	15.5	16.2	17.0	17.9
Others	43.4	42.8	41.9	41.6	41.1

Source: Company, ICICI Direct Research

## Financial summary

Exhibit 15: Profit and loss statement ₹ crore				
(Year-end March)	FY18	FY19E	FY20E	FY21E
<b>Gross Revenue</b>	<b>947.6</b>	<b>1099.0</b>	<b>1224.0</b>	<b>1323.7</b>
Growth (%)	2.7	16.0	11.4	8.1
Raw Material Expenses	470.3	550.2	578.3	627.6
Employee Expenses	89.2	92.3	117.5	126.9
Excise Duty	411.1	85.1	85.0	91.9
Administrative Expenses	12.1	0.0	0.0	0.0
Other expenses	67.9	102.1	134.6	145.4
Total Operating Expenditure	652.8	744.6	830.4	899.9
<b>EBITDA</b>	<b>294.8</b>	<b>354.5</b>	<b>393.6</b>	<b>423.9</b>
Growth (%)	19.0	20.2	11.0	7.7
Depreciation	39.2	41.4	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	350.7	378.9	412.0
Others	23.8	37.6	32.6	29.4
Total Tax	97.6	123.8	125.1	136.0
<b>PAT</b>	<b>181.9</b>	<b>226.8</b>	<b>253.9</b>	<b>276.0</b>
Growth (%)	20.1	24.7	11.9	8.7
EPS (₹)	117.8	146.9	164.4	178.8

Source: Company, ICICI Direct Research

Exhibit 16: Cash flow statement ₹ crore				
(Year-end March)	FY18	FY19E	FY20E	FY21E
Profit after Tax	178.4	226.8	253.9	276.0
Add: Depreciation	39.2	41.4	47.3	41.3
(Inc)/dec in Current Assets	5.0	-154.5	337.4	-47.5
Inc/(dec) in CL and Provisions	221.1	56.4	-373.6	8.6
<b>CF from operating activities</b>	<b>420.1</b>	<b>165.6</b>	<b>264.9</b>	<b>278.4</b>
(Inc)/dec in Investments	-220.9	-0.2	0.6	-0.1
(Inc)/dec in Fixed Assets	-43.2	-25.7	-0.4	-80.0
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0
Others	0.0	0.0	-14.8	0.3
<b>CF from investing activities</b>	<b>-264.1</b>	<b>-26.0</b>	<b>-14.6</b>	<b>-79.8</b>
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	-171.6	-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
<b>CF from financing activities</b>	<b>-139.4</b>	<b>-140.0</b>	<b>-171.6</b>	<b>-198.7</b>
Net Cash flow	16.6	-0.3	78.7	-0.2
Opening Cash	11.9	28.5	28.2	106.8
<b>Closing Cash</b>	<b>28.5</b>	<b>28.2</b>	<b>106.8</b>	<b>106.7</b>

\*calculated, Source: Company, ICICI Direct Research

Exhibit 17: 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	648.6	722.2	799.5
Total Shareholders funds	582.1	664.0	737.6	815.0
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	14.2	18.5	3.7	4.0
<b>Total Liabilities</b>	<b>596.2</b>	<b>682.5</b>	<b>741.3</b>	<b>818.9</b>
<b>Assets</b>				
Gross Block	270.0	300.0	330.0	390.0
Less: Acc Depreciation	75.0	116.3	163.6	204.8
Net Block	195.1	213.3	166.5	185.2
Capital WIP	34.2	0.3	0.3	20.3
Deferred Tax Asset	24.8	31.0	31.0	31.0
Non Current Investments	2.0	2.3	1.7	1.8
LT Loans & Advances/Others	3.2	1.3	1.3	1.3
<b>Current Assets</b>				
Inventory	252.9	281.9	301.4	325.9
Debtors	27.3	14.3	6.7	7.2
Cash	37.6	36.9	106.8	106.7
Loans & Advances	0.0	0.0	8.4	9.1
Current Investments	414.1	573.1	267.9	289.7
Other CA	73.0	52.5	0.0	0.0
<b>Current Liabilities</b>				
Creditors	58.1	83.0	43.5	43.5
Provisions	0.0	0.0	0.0	0.0
Other CL	409.8	441.3	107.2	115.9
Net Current Assets	337.0	434.3	540.5	579.2
<b>Total Assets</b>	<b>596.2</b>	<b>682.5</b>	<b>741.3</b>	<b>818.9</b>

Source: Company, ICICI Direct Research

Exhibit 18: Key ratios ₹ crore				
(Year-end March)	FY18	FY19E	FY20E	FY21E
<b>Per share data (₹)</b>				
EPS	117.8	146.9	164.4	178.8
Cash EPS	143.2	173.7	195.0	205.5
BV	377.0	430.0	477.7	527.8
DPS	77.5	95.0	110.0	130.0
Cash Per Share	24.3	23.9	69.2	69.1
<b>Operating Ratios (%)</b>				
EBITDA Margin	31.1	32.3	32.2	32.0
PBT / Net Sales	29.5	31.9	31.0	31.2
PAT Margin	19.2	20.7	20.8	20.9
Inventory days	97.5	93.7	90.0	90.0
Debtor days	10.5	4.8	2.0	2.0
Creditor days	22.4	27.6	13.0	12.0
<b>Return Ratios (%)</b>				
RoE	31.3	34.2	34.4	33.9
RoCE	46.9	51.4	51.1	50.3
RoIC	51.7	53.9	57.7	58.2
<b>Valuation Ratios (x)</b>				
P/E	29.4	23.6	21.1	19.4
EV / EBITDA	17.9	14.9	13.2	12.3
EV / Net Sales	5.6	4.8	4.3	3.9
Market Cap / Sales	5.7	4.9	4.4	4.0
Price to Book Value	9.2	8.1	7.2	6.6
<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	1.8	3.9	4.0
Quick Ratio	1.1	1.2	1.9	1.9

Source: Company, ICICI Direct Research

**Exhibit 19: 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)	1,165	1,350	Hold	34,950	28.9	31.9	35.8	40.4	36.5	32.6	7.8	7.1	6.5	62.1	59.2	55.4	43.3	41.7	38.8
Dabur India (DABIND)	380	450	Buy	66,747	8.2	9.2	10.2	46.4	41.5	37.4	7.8	7.0	6.3	29.6	28.1	28.4	25.7	24.0	24.3
GSK CH (GLACON)	6,920	8,340	Buy	31,205	166.5	221.2	242.3	41.6	31.3	28.6	7.1	6.5	6.0	29.8	35.6	33.6	20.1	23.6	22.9
Hindustan Unilever (HINLEV)	1,670	1,900	Hold	378,000	28.5	32.9	37.9	58.5	50.8	44.1	9.9	8.7	7.6	100.8	123.7	162.3	87.2	106.9	141.3
ITC Limited (ITC)	303	340	Buy	340,127	10.3	11.3	12.4	29.3	26.8	24.4	7.6	6.9	6.4	35.8	35.7	37.5	24.9	24.7	26.0
Jyothy Lab (JYOLAB)	180	240	Buy	6,617	5.1	5.8	6.6	35.5	31.0	27.4	3.7	3.3	3.0	33.7	37.8	39.3	24.9	28.0	29.1
Marico (MARLIM)	350	400	Hold	47,221	7.4	8.8	9.9	47.5	39.7	35.3	6.3	5.5	4.9	42.2	44.3	43.1	34.5	36.2	34.8
Nestle (NESIND)	10,450	12,000	Buy	99,795	166.7	203.4	243.5	62.7	51.4	42.9	8.9	7.8	6.9	41.4	42.6	44.3	44.5	43.0	42.1
Tata Global Bev (TATGLO)	204	240	Buy	12,938	7.2	7.9	8.7	28.2	25.8	23.4	1.8	1.7	1.6	8.4	9.1	9.5	6.5	7.2	7.6
VST Industries (VSTIND)	3,463	3,900	Buy	5,348	146.9	164.4	178.8	23.6	21.1	19.4	4.9	4.4	4.0	51.4	51.1	50.3	34.2	34.4	33.9
Varun Beverage (VARBEV)	900	860	Hold	14,585	11.7	16.4	20.1	76.8	54.8	44.9	3.6	2.9	2.6	12.7	15.4	17.8	12.1	14.3	17.2

Source: Company, ICICI Direct Research

## RATING RATIONALE

ICICI Direct endeavours to provide objective opinions and recommendations. ICICI Direct assigns ratings to its stocks according to their notional target price vs. current market price and then categorizes them as Buy, Hold, Reduce and Sell. The performance horizon is two years unless specified and the notional target price is defined as the analysts' valuation for a stock

Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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## ANALYST CERTIFICATION

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