Varun Beverages (VARBEV)

CMP: ₹ 700 Target: ₹ 805 (15%) Target Period: 12 months

BUY

November 5, 2019

Robust volume growth momentum continues…

Varun Beverages (VBL) reported 49.2% YoY growth in revenues to ₹ 1739.7 led by 60.4% overall volume growth on the back of acquisition of south and west sub-territories from PepsiCo. India organic volume growth of 17.5% was led by good performance in underpenetrated territories acquired in the last two years. International volume growth of 27% was on account of double digit growth in Morocco, Zimbabwe, Nepal and Sri Lanka. EBITDA increased 54.2% to ₹ 325.7 crore with 60 bps improvement in operating margins to 18.7% on account of benign raw material cost & operating leverage in the business. Led by strong operating profit growth, net profit increased 83.4% to ₹ 81.1 crore.

Healthy business growth in domestic, international markets

VBL's domestic sales volumes in Q3CY19 were at 98 million (mn) cases with organic growth of 17.5% YoY on account of increase in distribution in under penetrated rural regions. Its international volumes were at 26 mn with organic growth of 27% driven by double digit growth in all overseas operations expect Zambia. Volume contribution from acquired territories were at 32 mn cases. With the recent acquisition, capacity utilisation for VBL was at 60% against erstwhile 70%, which gives tremendous scope for increasing utilisation levels further without going for any expansion in the near term. We expect revenue CAGR of 20.2% in CY18-21E.

Operating leverage, benign material costs aid margins

EBITDA margins increased 60 bps to 18.7% in Q3CY19 driven by operating leverage, improving product mix, lower PET prices in India & lower sugar prices in Zimbabwe. With the commencement of the Pathankot facility in June, Tropicana juices revenue would start reflecting by next quarter, growing its profitability margin. As non-carbonated beverage (NCB) enjoy highest realisations and are less seasonal than carbonates, we believe new launches in these categories augur well for long-term growth prospects and will reduce seasonality, boost profitability, augment return ratios. Also, with acquired south & west sub-territories having higher contribution of water than the existing territories and on account of full impact of commissioning of a second line of water in Morocco, packaged water would help ease cyclicality, going forward. We expect NCD & bottled water segments to clock revenue CAGR of 33.7% & 20.6% in CY18-21E, respectively.

Valuation & Outlook

We believe strong organic growth in the last couple of quarters allays concerns regarding the soft drink industry in India. Additionally, the company's focus on healthier options would help drive incremental volumes and margins. As volume growth picks up in new territories and the company participates in the manufacturing segment of Tropicana, we expect revenue & earnings CAGR of 20.2% & 28.9% in CY18-21E, respectively. We value VBL at 35x CY21E earnings. We upgrade our recommendation to **BUY** with a revised target price of ₹ 805/share.

Particulars

Particulars (₹ crore)	Amount
Market Capitalization	19877
Total Debt (CY18)	2,600.0
Cash & Investments (CY18)	43.0
EV	21,827.7
52 week H/L (₹)	727 / 456
Equity capital	273.9
Face value	10.0

Key Highlights

- Total sales volumes rose to 124 mn cases from 78 mn cases in Q3CY19
- India sales volume were at 98 mn cases (32 mn cases from acquired South & West regions) and international sales volume were at 26 mn cases
- CSD constituted 69%, juices 6% and packaged drinking water 25% of total sales volumes in Q3CY19
- Changed from HOLD to BUY with revised target price of ₹ 805/share

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Key Financial Summary

Key Financials	CY17	CY18	CY19E	CY20E	CY21E	CAGR (CY18-21E)
Net Sales	4003.5	5105.3	7024.6	7925.9	8868.5	20.2%
EBITDA	835.9	1006.6	1300.0	1410.8	1586.9	16.4%
EBITDA Margin %	20.9	19.7	18.5	17.8	17.9	
Net Profit	214.0	299.9	410.3	498.5	642.3	28.9%
EPS (₹)	11.72	16.42	14.45	17.56	22.62	
P/E	59.7	42.6	48.5	39.9	30.9	
RoNW %	12.1	15.0	12.0	13.1	14.9	
RoCE (%)	12.7	14.2	14.1	15.3	17.7	

Source: Company, ICICI Direct Research

Exhibit 1: Variance Analysis

Particulars (₹ crore)	Q3CY19	Q3CY18	YoY (%)	Q2CY19	QoQ (%)	Comments
Net Sales	1,739.7	1,165.7	49.2	2,810.5	-38.1	Net sales witnessed growth of 49.2% led by 60.4% overall volume growth well supported by India organic volume growth of 17.5% and international volume growth of 27%
Raw Material Expenses	747.2	526.7	41.9	1,329.5	-43.8	Gross margins expanded 223 bps on account of lower PET prices in India and lower sugar prices in Zimbabwe territory
Employee Expenses	229.6	148.6	54.5	199.2	15.3	Employee expenses were up 54.% due to acquisition of south & west region sub-territories
Other operating Expenses	437.3	279.2	56.6	493.9	-11.5	
EBITDA	325.7	211.2	54.2	787.9	-58.7	
EBITDA Margin (%)	18.7	18.1	60 bps	28.0	-931 bps	Operating margins improved 60 bps on account of operating leverage in business
Depreciation	127.3	99.9	27.5	125.4	1.5	Depreciation increased 27.5% on account of capitalisation of Pathankot plant and consolidation of south and west India sub-territories
Interest	86.7	47.2	83.9	84.8	2.3	Finance cost increased 83.9% as purchase consideration for acquisition of south and west India sub-territories was funded through debt
Other Income	1.8	0.6	214.7	3.3	-46.0	
PBT	113.4	64.8	74.9	581.0	-80.5	
Exceptional Items	0.0	-0.1		0.0		
Tax Outgo	34.5	21.2	62.8	177.3	-80.5	
PAT	81.1	44.2	83.4	405.0	-80.0	Net profit increased 83.4% positively impacted by increase in sales volumes

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

	CY19E			CY20E			CY21E			
(₹ Crore)	Old	New	% Change	Old	New	% Change	Old	New	% Change	Comments
Net Sales	7,257.0	7,024.6	-3.2	8,182.9	7,925.9	-3.1	9,150.3	8,868.5	-3.1	We slightly revise revenue estimates
EBITDA	1358.4	1300.0	-4.3	1,536.9	1,410.8	-8.2	1,680.6	1,586.9	-5.6	
EBITDA Margin(%)	18.7	18.5	-21 bps	18.8	17.8	-98 bps	18.4	17.9	-47 bps	
PAT	427.3	410.3	-4.0	505.6	498.5	-1.4	592.8	642.3	8.3	We revise upward CY21E PAT estimates as acquired South & West sub-territories have consolidated
EPS (₹)	15.05	14.45	-4.0	17.80	17.56	-1.4	20.9	22.62	8.4	

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

		Current			Earlier			
Particulars (₹ cror	**CY17**	**CY18**	**CY19E**	**CY20E**	**CY21E**	**CY19E**	**CY20E**	**CY21E**	**Comments**
Carbonated Products	124.9	145.9	220.3	242.4	261.8	220.3	242.4	261.8	No change in estimates
% Growth	-1.3	16.8	51.0	10.0	8.0	51.0	10.0	8.0	
Non Carbonated Products	7.9	12.5	16.9	21.1	25.3	16.9	21.1	25.3	
% growth	-11.1	57.1	35.0	25.0	20.0	35.0	25.0	20.0	
Drinking Water	25.6	34.6	45.0	51.8	59.0	45.0	51.8	59.0	
% growth	21.4	35.6	30.0	15.0	14.0	30.0	15.0	14.0	
Raw Material Cost									
Sugar	616.6	698.4	1,086.0	1,206.2	1,324.7	1,086.0	1,206.2	1,324.7	
% of sales	13.4	14.2	15.1	14.8	14.5	14.7	14.3	14.0	
cost/kg (₹)	38.9	37.0	36.6	36.6	38.5	36.6	36.6	38.5	

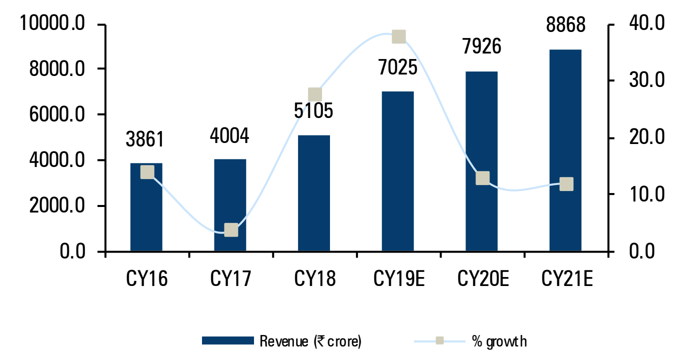
Source: Company, ICICI Direct Research

Conference Call Highlights

- Revenues increased 49.2% YoY to ₹ 1739.7 crore led by 60.4% overall volume growth well supported by India organic volume growth of 17.5% led by good performance in underpenetrated territories acquired in last two years and international organic volume growth of 27% on account of double digit growth in Morocco, Zimbabwe, Nepal and Sri Lanka. Realisation per case has come down by ~7% essentially on account of a change in product mix in India post consolidation of south and west sub-territories, introduction of water in Morocco and lower sales realisation in Zimbabwe
- Total sales volumes rose to 124 million (mn) cases during the quarter from 78 mn cases in Q3CY18. India sales volume were at 98 mn cases (32 mn cases from acquired south & west regions) while international sales volume was at 26 mn cases. International volumes were higher on account of the full impact of the commissioning of a second line of water unit in Morocco and double digit growth in all international territories except de-growth in Zambia
- Carbonated soft drink (CSD) constituted 69%, juice 6% and packaged drinking water 25% of total sales volumes in Q3CY19
- Gross margins expanded 223 bps YoY to 57.1% on account of lower PET prices in India and lower sugar prices in Zimbabwe territory
- EBITDA increased 54.2% to ₹ 325.7 crore translating into blended EBITDA margins of 18.7% (up 60 bps YoY). The margin improvement was driven by operating leverage in the business
- Led by strong operating profit growth, net profit increased 83.4% to ₹ 81.1 crore, positively impacted by increase in sales volumes
- Gross debt was at ₹ 2900 crore in Q3CY19 against ₹ 3730 crore as on Q2CY19 helped by ₹ 900 crore raised via QIP during the quarter. D/E ratio was at 0.9x as on Q3CY19. Capex was at ₹ 2200 crore for CY19
- The company has no plans of setting up a greenfield plant in future. Any expansion would be met through brownfield expansion
- The company is still evaluating a shift towards lower corporate tax regime and shall take a decision on it in Q4CY19. It uses MAT credit and wants to use the same, going forward
- The company has concluded acquisition of two production facilities - one in Dharwad, Karnataka and second at Tirunelveli, Tamil Nadu for a total consideration of ₹ 95 crore
- During the quarter, VBL acquired 20% stake in Lunarmech Technologies Pvt Ltd for ₹ 15 crore taking its stake in the company to 55%
- As per the management, realisation should increase driven by manufacturing of Tropicana juices and the recently launched dairy-based beverages
- Organic volume growth in CSD, water & juices was at 19.2%, 13.3% & 11.6%, respectively
- On an annualised basis, 135 mn cases were sold by Pepsi when they owned south and west territories. VBL expects around 60% of it to flow in this year
- During the quarter, VBL launched three value added dairy beverages – Belgian Chocolate, Cold Coffee and Mango shake at ₹ 30 for 200 ml PET bottle

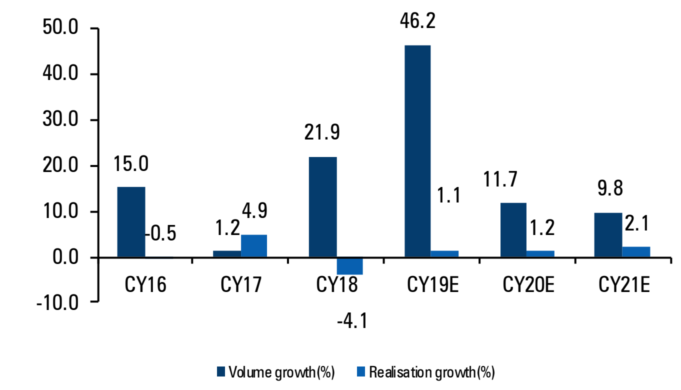
Key Metrics

Exhibit 4: Revenue growth trend



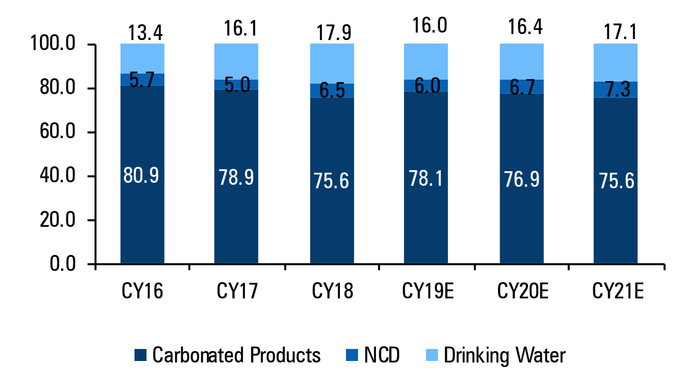
Source: Company, ICICI Direct Research

Exhibit 5: Volume growth to drive revenue



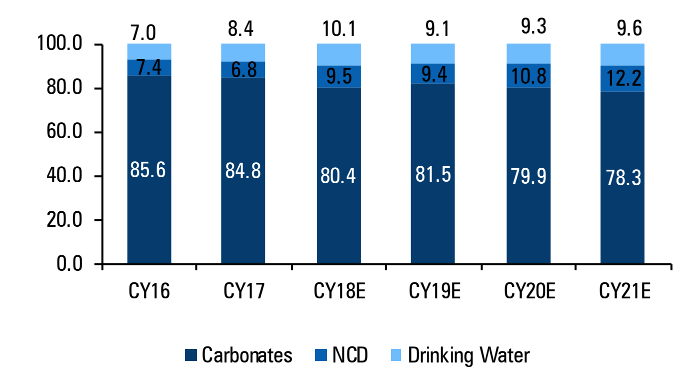
Source: Company, ICICI Direct Research

Exhibit 6: Segment wise volume contribution (%)



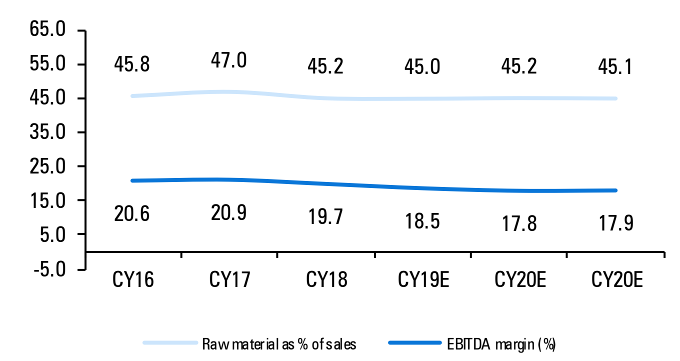
Source: Company, ICICI Direct Research

Exhibit 7: Segment wise value contribution (%)



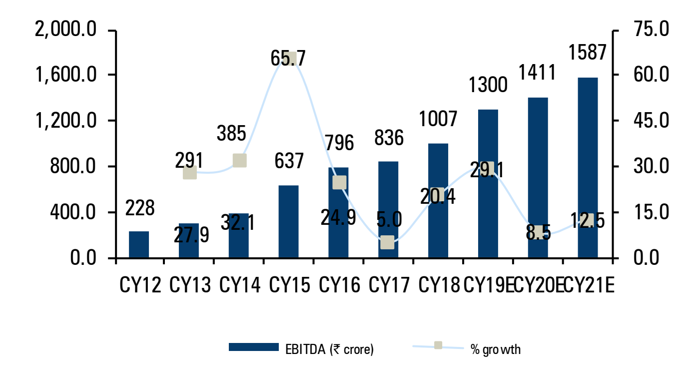
Source: Company, ICICI Direct Research

Exhibit 8: Raw material to sales & EBITDA margins (%)



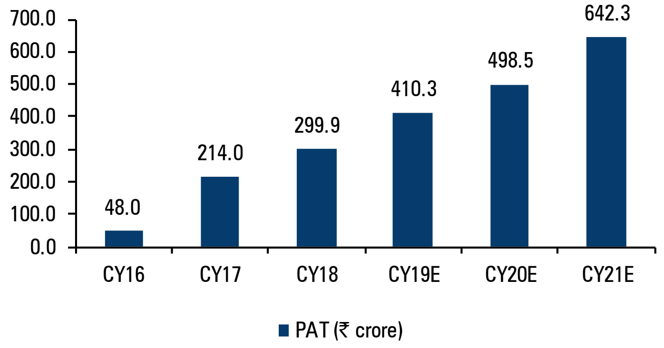
Source: Company, ICICI Direct Research

Exhibit 9: EBITDA (₹ crore) & EBITDA growth (%)



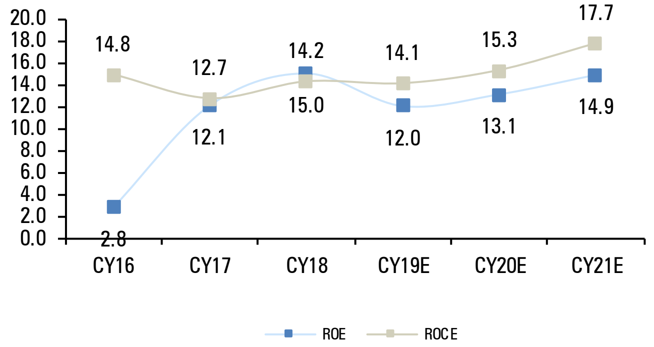
Source: Company, ICICI Direct Research

Exhibit 10: Earnings to witness CAGR of 28.9% (CY18-21E)



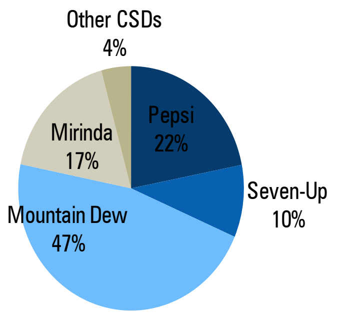
Source: Company, ICICI Direct Research

Exhibit 11: Return ratios to improve (%)



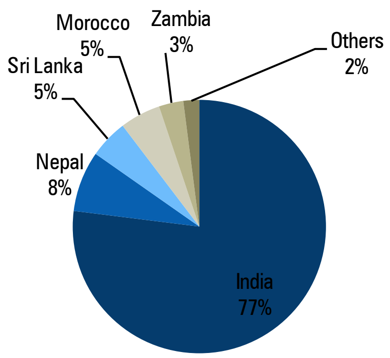
Source: Company, ICICI Direct Research

Exhibit 12: Brand wise volume contribution (%)



Source: Company, ICICI Direct Research

Exhibit 13: Geography wise revenue break up (%)



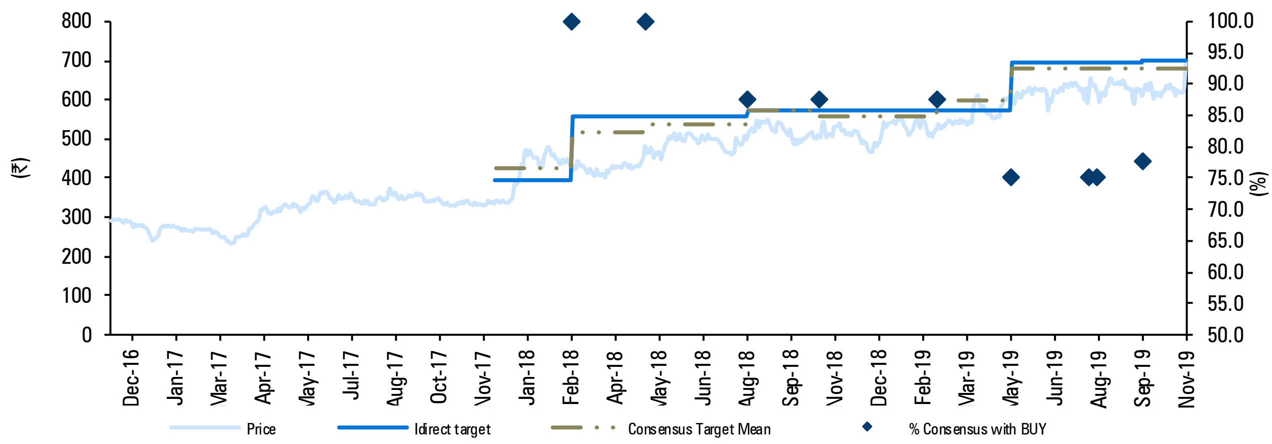
Source: Company, ICICI Direct Research

Exhibit 14: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
CY18	5105.3	27.5	16.4	40.1	42.6	22.0	15.0	14.2
CY19E	7024.6	37.6	14.4	-12.0	48.5	17.1	12.0	14.1
CY20E	7925.9	12.8	17.6	21.5	39.9	15.5	13.1	15.3
CY21E	8868.5	11.9	22.6	28.8	30.9	13.5	14.9	17.7

Source: Company, ICICI Direct Research

Exhibit 15: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 16: Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	RJ Corp Ltd.	30-Sep-19	28.07	81.0	-2.7
2	Jaipuria (Ravi Kant)	30-Jun-19	20.36	58.8	0.0
3	Jaipuria (Ravi Kant & Sons) HUF	30-Sep-19	19.91	57.5	57.5
4	Jaipuria (Varun)	30-Sep-19	17.55	50.7	0.0
5	Capital Research Global Investors	30-Sep-19	4.30	12.4	0.0
6	Jaipuria (Devyani)	30-Sep-19	2.81	8.1	0.0
7	Reliance Nippon Life Asset Management Limited	30-Sep-19	2.66	7.7	0.2
8	Sundaram Asset Management Company Limited	30-Sep-19	2.08	6.0	1.3
9	Tata Asset Management Limited	30-Sep-19	1.98	5.7	0.0
10	Norges Bank Investment Management (NBIM)	30-Sep-19	1.94	5.6	5.6

Source: Reuters, ICICI Direct Research

Exhibit 17: Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Jaipuria (Ravi Kant & Sons) HUF	507.85m	57.48m	RJ Corp Ltd.	-23.85m	-2.70m
Norges Bank Investment Management (NBIM)	49.35m	5.59m	Marina IV (Singapore) Pte. Ltd.	-7.59m	-0.83m
Stichting Depositary APG Emerging Markets Equity Pool	15.85m	1.79m	Nordea Funds Oy	-1.81m	-0.20m
Capital International Investors	15.64m	1.77m	Capital International, Inc.	-1.16m	-0.13m
Sundaram Asset Management Company Limited	11.58m	1.31m	Agarwal (Kapil)	-0.90m	-0.10m

Source: Reuters, ICICI Direct Research

Exhibit 18: Shareholding Pattern

(in %)	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19
Promoter	73.6	73.6	73.6	73.6	68.4
FII	12.7	13.0	13.5	14.2	19.2
DII	5.5	5.7	6.4	6.6	6.4
Others	8.2	7.7	6.5	5.6	6.0

Source: Company, ICICI Direct Research

Financial summary

Exhibit 19: Profit and loss statement ₹ crore

	CY18	CY19E	CY20E	CY21E
Total operating Income	**5105.3**	**7024.6**	**7925.9**	**8868.5**
Growth (%)	27.5	37.6	12.8	11.9
Raw Material Expenses	2244.1	3164.5	3584.4	4000.9
Employee Expenses	583.0	843.0	990.7	1108.6
Marketing Expenses	112.7	107.6	122.5	137.1
Other expenses	1159.0	1609.6	1817.4	2035.1
Total Operating Expenditure	4098.7	5724.6	6515.0	7281.6
EBITDA	**1,006.6**	**1,300.0**	**1,410.8**	**1,586.9**
Growth (%)	20.4	29.1	8.5	12.5
Depreciation	385.1	478.1	502.9	527.7
Interest	212.6	291.9	259.3	215.3
Other Income	21.8	33.5	36.9	40.5
PBT	430.8	563.5	685.5	884.4
Total Tax	133.9	157.8	191.9	247.6
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	3.0	4.5	5.0	5.5
PAT	**299.9**	**410.3**	**498.5**	**642.3**
Growth (%)	40.1	36.8	21.5	28.8
EPS (₹)	16.4	14.4	17.6	22.6

Source: Company, ICICI Direct Research

Exhibit 20: Cash flow statement ₹ crore

(Year-end March)	CY18	CY19E	CY20E	CY21E
Profit After Tax	664.8	697.7	752.9	852.1
Add: Depreciation	385.1	478.1	502.9	527.7
(Inc)/dec in Current Assets	-278.0	133.7	-381.4	-154.0
Inc/(dec) in CL and Provisions	227.9	-194.4	150.2	9.5
CF from operating activities	**999.8**	**1,114.9**	**1,024.6**	**1,235.4**
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-857.9	-1,844.9	-427.6	-428.9
Others	-15.5	0.0	0.0	0.0
CF from investing activities	**-873.4**	**-1,844.9**	**-427.6**	**-428.9**
Issue/(Buy back) of Equity	0.7	900.0	0.0	0.0
Inc/(dec) in loan funds	756.6	150.0	-300.0	-500.0
Dividend paid & dividend tax	-51.1	0.0	-99.7	-128.5
Others	-488.6	-291.9	-259.3	-215.3
CF from financing activities	**-84.4**	**866.9**	**-643.1**	**-827.0**
Net Cash flow	42.0	136.9	-46.1	-20.6
Opening Cash	64.9	93.5	198.3	152.2
Other Bank balance	50.5	0.0	0.0	0.0
Closing Cash	**93.5**	**198.3**	**152.2**	**131.6**

Source: Company, ICICI Direct Research

Exhibit 21: Balance sheet ₹ crore

(Year-end March)	CY18	CY19E	CY20E	CY21E
Liabilities				
Equity Capital	182.6	284.0	284.0	284.0
Reserve and Surplus	1815.9	3126.2	3525.0	4038.8
Total Shareholders funds	1998.5	3410.1	3808.9	4322.8
LT Borrowings & Provisions	1980.1	2180.1	1980.1	1680.1
Deferred Tax Liability	192.2	201.8	211.9	222.5
Total Liabilities	**4290.5**	**5909.6**	**6124.4**	**6355.0**
Assets				
Gross Block	5,558.2	7,710.6	8,110.6	8,510.6
Less: Acc Depreciation	1,698.0	2,176.1	2,678.9	3,206.6
Net Block	3,860.2	5,534.5	5,431.6	5,304.0
Capital WIP	352.4	50.0	50.0	50.0
Net Intangible Assets	524.9	551.1	578.7	607.6
Non-current Investments	0.8	0.8	0.8	0.8
Goodwill	1.9	1.9	1.9	1.9
Current Assets				
Inventory	578.4	682.9	880.7	985.4
Debtors	128.0	156.1	176.1	197.1
Loans and Advances	1.6	58.5	220.2	246.3
Other Current Assets	198.4	15.6	17.6	19.7
Cash	93.5	198.3	152.2	131.6
Deferred Tax Assests	33.4	33.4	33.4	33.4
Current Liabilities				
Creditors	316.8	487.8	550.4	591.2
Provisions	16.0	58.5	66.0	73.9
Short term debt & other CL	1,375.6	913.0	888.1	643.5
Application of Funds	**4,290.5**	**5,909.6**	**6,124.4**	**6,355.0**

Source: Company, ICICI Direct Research

Exhibit 22: Key ratios ₹ crore

(Year-end March)	CY18	CY19E	CY20E	CY21E
Per share data (₹)				
EPS	16.4	14.4	17.6	22.6
Cash EPS	37.5	31.3	35.3	41.2
BV	109.4	120.1	134.1	152.2
DPS	0.0	0.0	3.5	4.5
Cash Per Share	93.0	76.6	94.3	112.9
Operating Ratios (%)				
EBITDA Margin	19.7	18.5	17.8	17.9
PBT / Total Operating income	8.4	8.0	8.6	10.0
PAT Margin	5.9	5.8	6.3	7.2
Inventory days	41.4	35.5	40.6	40.6
Debtor days	9.2	8.1	8.1	8.1
Creditor days	22.6	25.3	25.3	24.3
Return Ratios (%)				
RoE	15.0	12.0	13.1	14.9
RoCE	14.2	14.1	15.3	17.7
Valuation Ratios (x)				
P/E	42.6	48.5	39.9	30.9
EV / EBITDA	22.0	17.1	15.5	13.5
EV / Net Sales	4.3	3.2	2.8	2.4
Market Cap / Sales	3.9	2.8	2.5	2.2
Price to Book Value	6.4	5.8	5.2	4.6
Solvency Ratios				
Debt/EBITDA	2.3	1.9	1.6	1.1
Debt / Equity	1.2	0.7	0.6	0.4
Current Ratio	0.5	0.8	1.0	1.1
Quick Ratio	0.1	0.2	0.3	0.3

Source: Company, ICICI Direct Research

Exhibit 23: ICICI Direct coverage universe (FMCG)

Sector / Company	CMP	TP		M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)	Rating	(₹ Cr)	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Colgate (COLPAL)	1,520	1,400	Hold	37,806	28.5	34.0	37.1	53.3	44.7	41.0	8.5	7.9	7.3	70.7	73.5	69.4	52.2	57.2	53.9
Dabur India (DABIND)	465	520	Buy	78,164	8.2	9.3	10.3	56.8	50.1	45.2	9.2	8.4	7.6	29.6	29.9	30.0	25.7	26.8	26.7
GSK CH (GLACON)	9,170	8,780	Hold	35,327	233.7	272.5	N.A.	39.2	33.7	N.A.	7.4	6.8	N.A.	36.1	32.6	N.A.	24.0	24.8	N.A.
Hindustan Unilever (HINLEV)	2,160	2,075	Hold	440,640	27.9	34.7	40.7	77.3	62.2	53.1	11.7	10.5	9.2	85.3	103.9	111.2	80.9	89.7	96.5
ITC Limited (ITC)	260	320	Buy	306,114	10.3	12.3	13.8	25.3	21.1	18.9	6.9	6.4	5.9	30.8	30.9	30.9	21.5	23.8	23.8
Jyothy Lab (JYOLAB)	177	185	Hold	6,363	5.3	5.9	6.5	33.3	30.0	27.2	3.6	3.3	3.0	28.6	28.5	30.6	22.6	22.4	23.5
Marico (MARLIM)	365	410	Hold	50,705	8.8	8.5	9.3	41.5	43.2	39.2	6.9	6.4	5.9	38.0	41.4	43.5	31.6	34.1	35.7
Nestle (NESIND)	14,700	14,575	Hold	129,685	166.7	223.9	267.9	88.2	65.7	54.9	11.6	10.3	9.1	42.9	43.0	44.6	45.6	48.8	47.7
Tata Global Bev (TATGLO)	302	350	Buy	18,933	7.2	9.2	10.1	41.7	32.8	29.8	2.6	2.5	2.3	8.4	10.2	10.6	6.5	8.4	8.7
VST Industries (VSTIND)	3,920	4,600	Buy	5,714	146.9	193.1	210.5	26.7	20.3	18.6	5.2	4.5	4.2	51.4	50.7	48.6	34.2	38.1	36.5
Varun Beverage (VARBEV)	650	805	Buy	19,877	11.7	16.4	14.4	55.4	39.6	45.0	5.0	3.9	2.8	12.7	14.2	14.1	12.1	15.0	12.0

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%

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