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## Company update

## Beverages

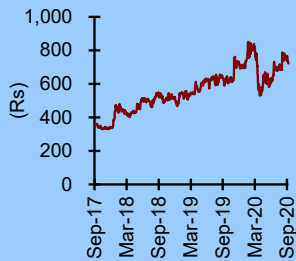
Target price: Rs750

## Shareholding pattern

	Dec '19	Mar '20	Jun '20
Promoters	68.4	68.0	66.4
Institutional investors	25.7	26.1	26.9
MFs and others	6.0	5.8	5.9
Banks/FIs	0.0	0.1	0.1
FIs	19.7	20.2	20.9
Others	5.9	5.9	6.7

Source: BSE

## Price chart



## INDIA

## Varun Beverages

**HOLD**  
Maintained

**Expect 100% volume recovery by end of Q3CY20 Rs727**

With opening up of general trade and HoReCa, Varun's volumes are expected to be ~100% of pre-Covid levels by end of Q3CY20. That's the insight we got post interacting with management and channel checks. Other highlights: (1) packaged beverages are gaining market shares from road-side juices / coconut water, (2) there is better recovery in North and East compared to West and South India, (3) Packaged water segment volumes are ~90% of pre-Covid levels whereas there is low single digit growth in off-take of carbonated soft drinks and juices. With deflation in input prices (sugar and packaging material), there is likely gross margin expansion in H2CY20. We model Varun to report PAT CAGR of 7.7% over CY19-21 with improving RoE. However, we need more comfort on valuations to turn bullish. Retain HOLD with target price of Rs750 (40x CY21E).

- **Expect 100% recovery by end of Q3CY20:** Post interacting with management and channel checks, we believe 100% volume recovery is possible by end of Q3CY20. Key reasons are (1) most general trade stores are open now, (2) HoReCa outlets are too open now and (3) market share gains from roadside juices/ coconut water.
- **Segment-wise performance:** Carbonated soft drinks (CSD) and Juice segments are growing at low single digits. Increase in in-home consumption is higher than loss of out-of-home consumption. Packaged drinking water (mostly out-of-home consumption) has also recovered to ~90% compared to pre-Covid levels.
- **Region-wise performance:** There is better recovery in North and East India as the Covid cases are relatively lower. However, there is still some impact on volumes in South and West India. There is healthy growth in North-East.
- **International business doing better than India:** Covid cases were lower in Varun's International markets (Morocco, Nepal, Zimbabwe, and Sri Lanka). Also the lockdown was less stringent than India. Hence, we expect low single digit volume growth in International business in H2CY20.
- **Deflationary trend in input prices indicate higher gross margin:** There is still deflation in key input prices (sugar and packaging material). We expect Varun can report better gross margin without resorting to price hikes.
- **Maintain HOLD:** We model Varun to report revenue and PAT CAGRs of 4.9% and 7.7% respectively over CY19-CY21E. While Varun will benefit from its relationship with PepsiCo, pan-India distribution and backward integration, we believe the stock price upside is capped at current valuation and maintain HOLD with revised target price of Rs750 (40x CY22E).

Market Cap	Rs210bn/US\$2.9bn	<b>Year to December</b>	<b>CY18</b>	<b>CY19</b>	<b>CY20E</b>	<b>CY21E</b>
Reuters/Bloomberg	VARB.BO / VBL IN	Revenue (Rs mn)	51,053	71,296	62,945	78,510
Shares Outstanding (mn)	288.7	Adj. Net Profit (Rs mn)	2,740	5,285	2,793	5,439
52-week Range (Rs)	850/529	Dil. Rec. EPS (Rs)	10.7	16.2	9.7	18.8
Free Float (%)	33.6	% Chg YoY	39.3	52.0	(40.5)	94.8
FII (%)	20.9	P/E (x)	68.0	44.8	75.2	38.6
Daily Volume (US\$'000)	2,800	CEPS (Rs)	24.9	33.1	28.9	38.5
Absolute Return 3m (%)	17.6	EV/EBITDA (x)	22.6	16.4	19.9	15.8
Absolute Return 12m (%)	22.7	Dividend Yield (%)	0.2	0.3	0.3	0.3
Sensex Return 3m (%)	16.5	RoCE (%)	13.2	15.8	9.2	14.0
Sensex Return 12m (%)	5.4	RoE (%)	13.5	18.4	7.6	13.5

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## Expect 100% volume recovery by end of Q3CY20

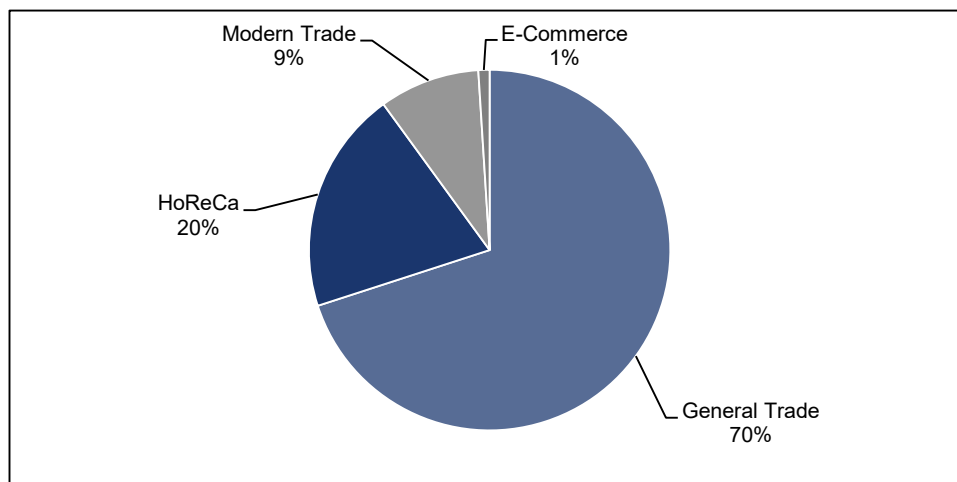
Post our interaction with the management and channel checks, we believe the volumes will be near pre-Covid levels by end of Q3CY20. Though the out-of-home consumption is still impacted, we believe there is higher growth in in-home consumption.

### Re-opening of general trade driving growth

General trade is the key channel for the company. Total reach of VBL is 1.75mn retail outlets. As most stores are open now, there is improvement in off-take now. The company has also increased its investments in Modern trade and E-commerce.

From our channel checks, we note there is impact on the consumption of roadside juices and juice drinks. Also there is reduction in consumption of coconut water but consumers prefer to buy packaged beverages like Pepsi and other carbonated drinks and juices. Varun is net beneficiary of this trend.

**Chart 1: Channel revenue contribution**



Source: Company, I-Sec research

### Improving performance on MoM basis

We believe the off-take is improving MoM. The company is doing well in North and East (these markets were relatively less impacted due to Covid). Opening up of HoReCa has also resulted in higher growth of beverage consumption.

**Table 1: Region-wise performance of Varun**

Region	Expected Performance	Comments
South and West (MH, TN and Kerala)	Decline of ~35%	Higher number of Covid cases.
North (Rajasthan, UP)	Strong performance	Relatively lower number of Covid cases
East (WB and Orissa)	Slight decline	Localized lockdown impact
North East	Growth trajectory	Healthy improvement in off-take

Source: Company, I-Sec research

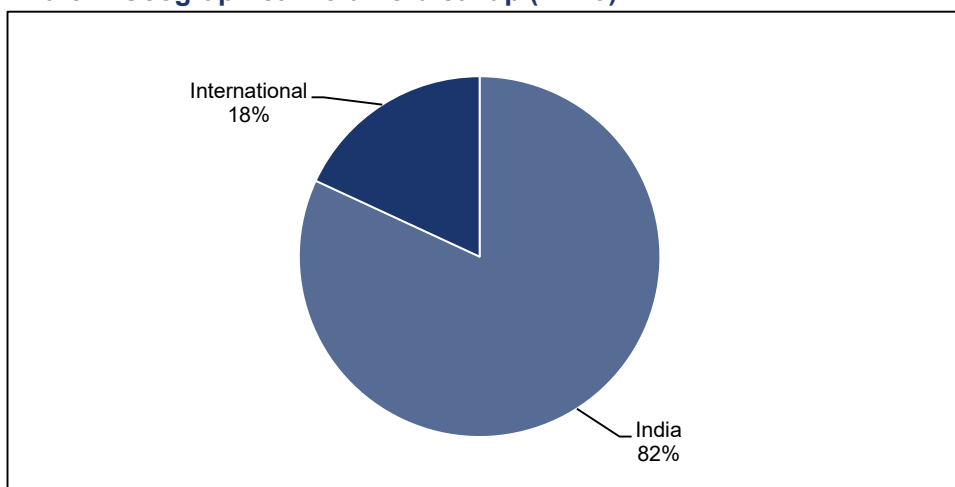
### Segment-wise performance of beverages

We believe consumption of packaged drinking water (mostly out-of-home consumption) has recovered to ~90% of its pre-Covid volumes (especially in northern states). Carbonated soft drinks (CSD) and Juices are expected to report low single digit revenue growth.

### Expect low single revenue growth in International business in H2CY20

Key International markets of Varun (Nepal, Sri Lanka, and Zimbabwe) had lower number of Covid cases compared to India. Also the lockdown was not as stringent as India. Hence, we expect International business to report low single digit revenue growth in H2CY20.

**Chart 2: Geographical volume breakup (CY19)**

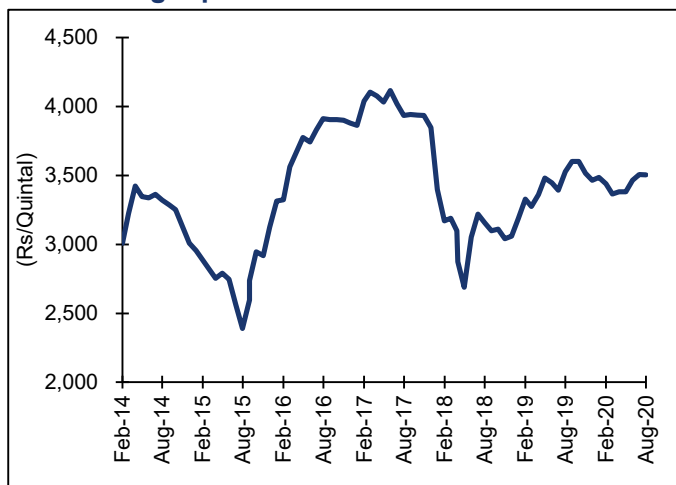


Source: Company, I-Sec research

### Negligible inflation in input costs

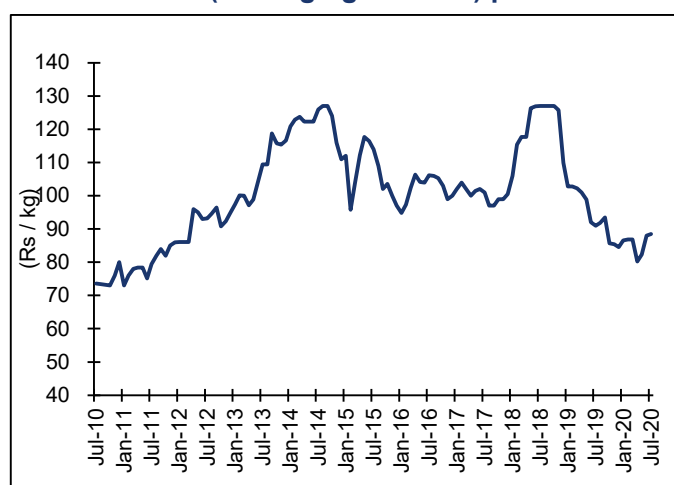
There is no material inflation in raw material prices (sugar and packaging material). We expect better gross margins in H2CY20.

**Chart 4: Sugar prices**



Source: Company data; I-Sec research

**Chart 5: HPDE (Packaging material) prices**



Source: Company data; I-Sec research

## Valuation

We have valued Varun Beverages (Varun) as per the DCF methodology. Our DCF valuation indicates a value of Rs750 per share. The implied P/E multiple at our target price and CY21E EPS works out to 40x. We maintain HOLD rating on the stock.

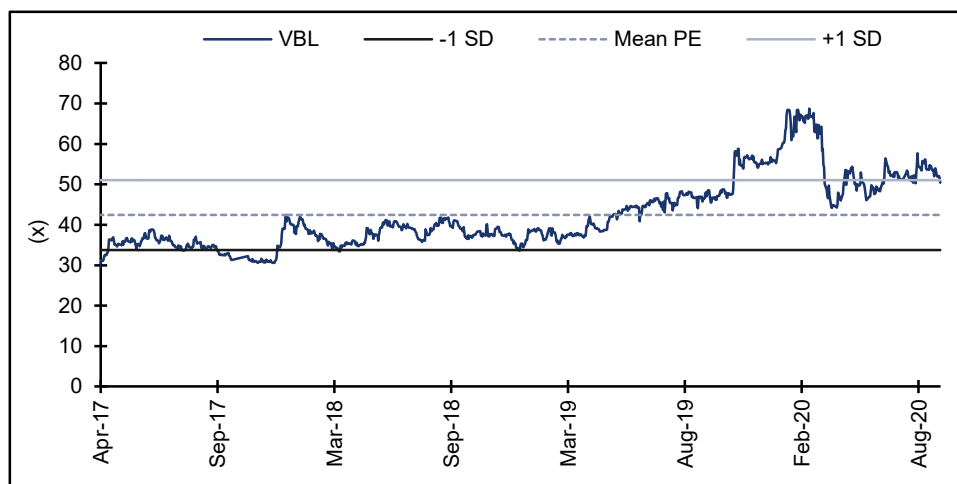
**Table 2: DCF valuation**

Particulars	Amt (Rs)
Cost of equity (%)	11.4
Terminal growth rate (%)	3.0
Discounted interim cash flows (Rsmn)	89,118
Discounted terminal value (Rsmn)	127,313
Total equity value (Rsmn)	216,431
<b>Value per share (Rs)</b>	<b>750</b>

Source: Company, I-Sec research

## Mean P/E and standard deviations

**Chart 3: Mean P/E and standard deviations**



Source: Company, I-Sec research

## Key risks

**Steep rise in competitive pressures and input prices:** Steep rise in competitive pressures and any material increase in production capacities by peers in a short timeframe can hurt Varun’s earnings.

**Delays in launch/failure of new products:** Any delay in launch of new products and/or failure of new products may impact Varun’s financials. If the company’s geographical expansion plans fail or get delayed, earnings growth may be impacted.

**Slowdown in urban and rural economies:** Slowdown in rural as well as urban economies may impact the company’s earnings.

## Financial summary

**Table 3: Profit & loss statement**
*(Rs mn, year ending December 31)*

	CY18	CY19	CY20E	CY21E
<b>Net Sales</b>	<b>51,053</b>	<b>71,296</b>	<b>62,945</b>	<b>78,510</b>
<b>Operating Expenses</b>	<b>40,987</b>	<b>56,673</b>	<b>50,901</b>	<b>63,336</b>
<b>EBITDA</b>	<b>10,066</b>	<b>14,623</b>	<b>12,043</b>	<b>15,174</b>
<i>% margins</i>	19.7	20.5	19.1	19.3
Depreciation & Amortisation	3,851	4,886	5,533	5,678
Gross Interest	2,126	3,243	2,996	2,433
Other Income	218	425	266	238
<b>Recurring PBT</b>	<b>4,308</b>	<b>6,919</b>	<b>3,780</b>	<b>7,301</b>
Less: Taxes	1,339	2,241	983	1,862
Less: Minority Interest	-	-	-	-
<b>Net Income (Reported)</b>	<b>2,928</b>	<b>4,690</b>	<b>2,793</b>	<b>5,439</b>
Extraordinaries (Net)	(189)	596	-	-
<b>Recurring Net Income</b>	<b>2,740</b>	<b>5,285</b>	<b>2,793</b>	<b>5,439</b>

Source: Company data, I-Sec research

**Table 4: Balance sheet**
*(Rs mn, year ending December 31)*

	CY18	CY19	CY20E	CY21E
<b>Assets</b>				
Total Current Assets	11,407	16,719	15,417	19,210
<i>of which cash &amp; cash eqv.</i>	935	1,711	1,366	2,513
Total Current Liabilities & Provisions	9,441	11,431	10,134	12,640
<b>Net Current Assets</b>	<b>1,967</b>	<b>5,288</b>	<b>5,283</b>	<b>6,570</b>
Investments	1,179	1,608	1,608	1,608
Net Fixed Assets	43,850	64,548	61,654	57,976
Capital Work-in-Progress	3,524	638	-	-
<b>Total Assets</b>	<b>50,540</b>	<b>72,325</b>	<b>68,788</b>	<b>66,397</b>
<b>Liabilities</b>				
<b>Borrowings</b>	<b>28,889</b>	<b>36,037</b>	<b>30,537</b>	<b>23,537</b>
<b>Deferred Tax Liability</b>	<b>1,588</b>	<b>2,697</b>	<b>2,697</b>	<b>2,697</b>
Minority Interest	78	307	307	307
Equity Share Capital	1,826	2,887	2,887	2,887
<i>Face Value per share (Rs)</i>	10	10	10	10
Reserves & Surplus*	18,159	30,397	32,360	36,969
Less: Misc. Exp. n.w.o.	-	-	-	-
<b>Net Worth</b>	<b>19,985</b>	<b>33,284</b>	<b>35,247</b>	<b>39,856</b>
<b>Total Liabilities</b>	<b>50,540</b>	<b>72,325</b>	<b>68,788</b>	<b>66,397</b>

Source: Company data, I-Sec research

**Table 5: Quarterly trend**
*(Rs mn, year ending December 31)*

	Sep 19	Dec 19	Mar 20	Jun 20
Net sales	17,397	12,202	16,764	16,402
% growth (YoY)	49.2	55.3	23.3	(41.6)
<b>EBITDA</b>	<b>3,257</b>	<b>1,157</b>	<b>2,712</b>	<b>3,777</b>
Margin (%)	18.7	9.5	16.2	23.0
Other income	18	360	253	27
Extraordinaries (Net)	(666)	674	(887)	(454)
<b>Adjusted Net profit</b>	<b>142</b>	<b>81</b>	<b>328</b>	<b>954</b>

Source: Company data, I-Sec research

**Table 6: Cashflow statement**
*(Rs mn, year ending December 31)*

	CY18	CY19	CY20E	CY21E
<b>Operating Cashflow</b>	<b>8,028</b>	<b>10,932</b>	<b>8,325</b>	<b>11,117</b>
Working Capital Changes	(501)	(851)	(340)	(140)
Capital Commitments	(8,088)	(7,080)	(2,000)	(2,000)
<b>Free Cashflow</b>	<b>(1,052)</b>	<b>(13,334)</b>	<b>5,985</b>	<b>8,977</b>
<b>Cashflow from Investing Activities</b>	<b>(210)</b>	<b>176</b>	-	-
Issue of Share Capital	7	8,837	-	-
Inc (Dec) in Borrowings	1,546	6,053	(5,500)	(7,000)
Dividend paid	(511)	(782)	(830)	(830)
<b>Change in Deferred Tax Liability</b>	<b>166</b>	<b>1,109</b>	-	-
<b>Chg. in Cash &amp; Bank balance</b>	<b>(220)</b>	<b>950</b>	<b>(345)</b>	<b>1,147</b>

Source: Company data, I-Sec research

**Table 7: Key ratios**
*(Year ending December 31)*

	CY18	CY19	CY20E	CY21E
<b>Per Share Data (Rs)</b>				
EPS	10.7	16.2	9.7	18.8
Cash EPS	24.7	33.2	28.8	38.5
Dividend per share (DPS)	1.7	2.5	2.5	2.5
Book Value per share (BV)	78.7	124.6	131.4	147.4
<b>Growth (%)</b>				
Net Sales	27.5	39.7	(11.7)	24.7
EBITDA	20.4	45.3	(17.6)	26.0
PAT	39.3	60.1	(40.5)	94.8
DPS	-	50.0	-	-
<b>Valuation Ratios (x)</b>				
P/E	68.0	44.8	75.2	38.6
P/CEPS	29.4	21.9	25.2	18.9
P/BV	9.2	5.8	5.5	4.9
EV / EBITDA	22.6	16.4	19.9	15.8
EV / Sales	4.5	3.4	3.8	3.1
<b>Operating Ratios</b>				
Raw Material / Sales (%)	44.0	45.2	45.5	45.4
Employee cost / Sales (%)	11.4	11.4	12.5	12.5
SG&A / Sales (%)	2.2	1.7	1.7	1.7
Other Income / PBT (%)	5.1	6.1	7.0	3.3
Effective Tax Rate (%)	31.1	32.4	26.0	25.5
Working Capital (days)	7.4	18.3	22.7	18.9
Inventory Turnover (days)	41.4	45.1	44.7	44.7
Receivables (days)	9.2	8.8	9.1	9.1
Payables (days)	66.3	57.0	57.3	57.3
Net D/E (x)	1.3	1.0	0.8	0.5
<b>Profitability Ratios (%)</b>				
Net Income Margins	5.8	6.6	4.4	6.9
RoACE	13.2	15.8	9.2	14.0
RoAE	13.5	18.4	7.6	13.5
Dividend Payout	15.6	15.4	25.8	13.3
Dividend Yield	0.2	0.3	0.3	0.3
EBITDA Margins	19.7	20.5	19.1	19.3

Source: Company data, I-Sec research

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