

Work from home culture damaging cigarette demand

VST Industries reported flat sales (net of excise) at ₹ 300.3 crore. Gross sales increased 22% to ₹ 394 crore led by 25% growth in cigarettes sales & 7% growth in tobacco sales. Cigarette volumes were down 11% during the quarter. Trade promotional offers & schemes, which were taken back during lockdown period, have been gradually reinstated. However, cut in promotions still had a positive impact on sales during the quarter. Volumes were down 26% in H1FY21 and still have not revived completely. Significant reduction in socialising, prominent shift of work from home culture & health concerns, have negatively impacted demand condition of cigarettes. Gross margin saw a significant improvement of 395 bps with reduced promotional offers. Operating profit increased 17.2% to ₹ 113.1 crore. Employee spend to sales increased 109 bps but overhead spends to sales declined 255 bps. This resulted in operating margin expansion of 543 bps to 37.6%. PAT increased 16% to ₹ 88.5 crore.

High priced brands contribution improves; volume dip concern

The company took a price hike of 12% on 80% of its product portfolio (blended price hike of ~11%) in March, April 2020. 'Total' & 'Edition' (high priced brands) are contributing 45% to volume. We believe contribution of these brands would continue to increase given the company has been expanding its distribution in new states. The excise increase in Budget & pandemic had an adverse impact on cigarettes volumes in FY21. We believe work from home culture, health concerns would continue to impact volumes in H2FY21. We change our volume estimate from -9% to -16% in FY21E. Further, we expect the recovery in volumes to be slower with 6% (earlier estimate of 10%) & 3% volume growth in FY22E & FY23E, respectively. Moreover, the company would also face competitive pressures to continue trade promotions, which would restrict pricing growth for it, going forward. We expect 3.1% revenue growth in FY20-23E.

Strong free cash flows; high dividend payout

VST is generating more than ₹ 250 crore free cash flow every year from FY18 onwards. Despite the severe impact on volumes, it would continue to generate strong free cash flows in FY21E. Moreover, it has consistently paid ~65% dividend in last five years. We believe payout would increase to 70% given it is holding more than ₹ 700 crore of cash & equivalent and does not have any capex requirement in future. Despite expected subdued earning, we expect RoCE & RoE to improve to 51% & 38%, respectively, by FY23E.

Valuation & Outlook

The cigarettes industry has been severely impacted by excise increase & pandemic in the current year. We expect industry wide volume decline of 15% in FY21E. Moreover, a volume revival would require increase in socialising & prolonged period of stable taxation. However, VST has witnessed several such lull periods in the past and has always altered its sales strategy to drive volumes. We will wait to see the volume revival trajectory in the next few quarters. We downgrade the stock from BUY to HOLD with a revised target price of ₹ 3850/share (17x FY23E PE).

Key Financial Summary

Key Financials	FY19	FY20	FY21E	FY22E	FY23E	CAGR (FY20-23E)
Net Sales	1097.6	1238.1	1169.1	1258.2	1358.1	3.1%
EBITDA	353.1	414.7	421.6	432.4	462.6	3.7%
EBITDA Margin %	32.2	33.5	36.1	34.4	34.1	
Net Profit	226.8	304.1	318.1	327.2	345.7	4.4%
EPS (₹)	146.90	196.95	206.02	211.93	223.90	
P/E	23.4	17.5	16.7	16.2	15.4	
RoNW %	34.2	38.6	33.6	34.2	38.2	
RoCE (%)	51.4	52.1	45.3	46.1	51.7	

Source: Company, ICICI Direct Research



VST Industries Ltd.

Particulars

Particulars (₹ crore)	Amount
Market Capitalization	5,307.4
Total Debt (FY19)	0.0
Cash and Investments (FY20)	788.6
EV	4,518.7
52 week H/L (₹)	4856 / 2550
Equity capital	₹ 15.4
Face value (₹)	10.0

Key Highlights

- Gross revenues was up 22% led by 25% growth in cigarettes sales & 7% growth in tobacco sales in Q2
- Operating margins expanded 543 bps led by gross margins expansion of 395 bps & 255 bps savings in overhead spends
- High priced brand 'Total' & 'Edition' brands are contributing 45% of volumes
- Downgrade from BUY to HOLD with revised target price of ₹ 3850/share

Research Analyst

Sanjay Manyal
sanjay.manyal@icicisecurities.com

Exhibit 1: Variance Analysis

	Q2FY21	Q2FY21E	Q2FY20	YoY (%)	Q1FY21	QoQ (%)	Comments
Total Operating Income	300.3	152.3	299.4	0.3	245.6	22.3	Revenues (net of excise) were flat with 11% volume decline. However, cutting down of promotional offers & 11% price hike taken earlier this year offset lost volumes
Other Operating Income	0.3	0.4	0.2	37.5	0.2	37.5	
Raw Material Expenses	135.0	70.1	146.4	-7.8	93.1	45.1	Gross margins expanded 395 bps largely on account of price hikes & lower trade promotions during the quarter
Employee Expense	28.1	25.9	24.8	13.5	29.3	-4.0	
Excise Duty	94.6	29.1	23.7	299.8	69.3	36.5	
Other operating Expenses	24.1	24.0	31.7	-23.9	24.0	0.7	The company cut overhead spends to sales by 255 bps
EBITDA	113.1	32.3	96.5	17.2	99.3	13.8	
EBITDA Margin (%)	37.6	21.2	32.2	543 bps	40.4	-279 bps	Operating margins expanded 543 bps with higher gross margins & cut in overhead spends
Depreciation	8.9	10.3	9.3	-4.1	8.9	0.2	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	14.7	12.0	12.3	19.7	11.6	26.6	
PBT	118.8	33.9	99.4	19.5	102.0	16.5	
Tax Outgo	30.3	9.1	23.1	31.1	26.3	15.1	
PAT	88.5	24.7	76.3	16.0	75.7	16.9	Net profit increased 16% despite lower tax in base quarter
Key Metrics							
Cigarette Sales (₹ crore)	334	323.4	265.8	25.5	274.7	21.4	Cigarettes sales increased 25.5% with 11% volume decline
Tobacco Sales (₹ crore)	61.0	60.4	57.0	7.0	40.0	52.5	Tobacco sales increased 7%

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY21E			FY22E			FY23E	Comments
	Old	New	% change	Old	New	% change	New	
Net sales	1204.5	1169.1	-2.9	1,404.6	1,258.2	-10.4	1,358.1	Our FY21E & FY22E numbers are changing due to significant decline in volumes & expected slower recovery. We introduce FY23E numbers
EBITDA	416.2	421.6	1.3	457.8	432.4	-5.5	462.6	
EBITDA Margin (%)	34.6	36.1	151 bps	32.6	34.4	177 bps	34.0	
PAT	312.0	318.1	2.0	343.7	327.2	-4.8	345.7	
EPS (₹)	202.1	206.02	1.9	222.6	211.93	-4.8	223.90	

Source: Company, ICICI Direct Research

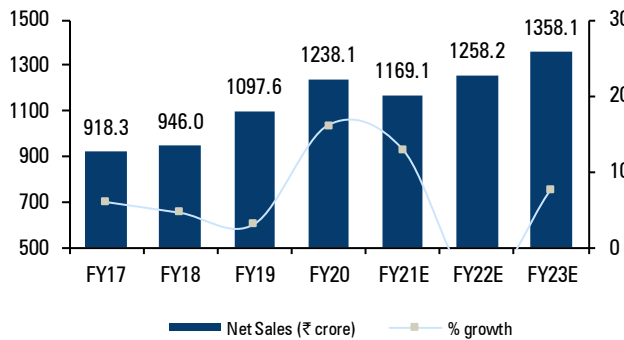
Exhibit 3: Assumptions

	FY19	FY20	FY21E	FY22E	FY23E	Earlier		Comments
						FY20E	FY21E	
Cig. Vol. (mn sticks)	8,031.1	8,753.9	7,353.3	7,794.5	8,028.3	7,966.1	8,762.7	We change our volume estimate for FY21 & FY22
Cig. Vol. Growth (%)	9.0	9.0	-16.0	6.0	3.0	-9.0	10.0	
Realization/cig (₹)	1.2	1.3	1.7	1.8	1.8	1.7	1.8	
Tobacco Sales (₹ crore)	238.9	264.7	251.5	271.9	285.6	251.5	282.1	We marginally change our tobacco sales estimates
% of <64mm in sales	40.0	40.0	40.0	40.0	40.0	40.0	40.0	
% of >64mm in sales	60.0	60.0	60.0	60.0	60.0	60.0	60.0	

Source: Company, ICICI Direct Research

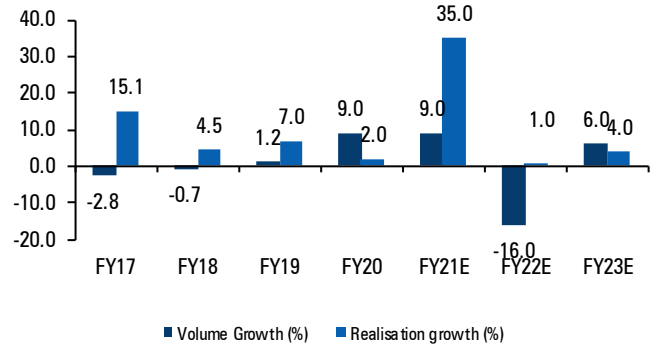
Key Metrics

Exhibit 4: Net revenue to grow at 3.1% CAGR over FY20-23E



Source: ICICI Direct Research, Company

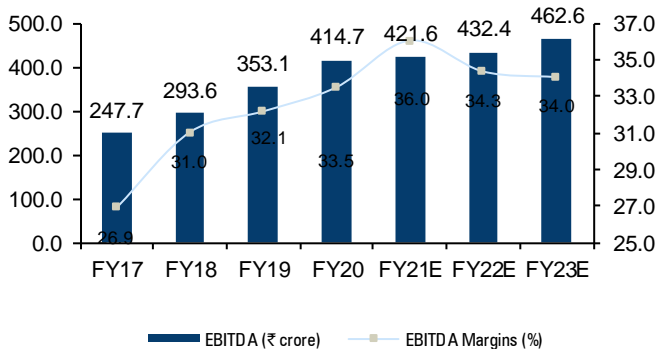
Exhibit 5: Steeper than expected volume decline in FY23E



Source: ICICI Direct Research, Company

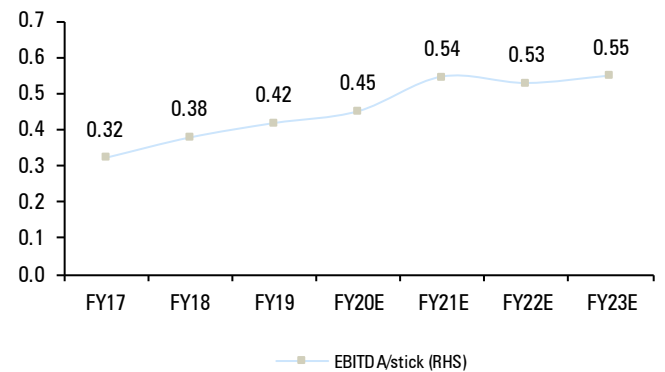
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Exhibit 6: Improved product mix to aid EBITDA margins



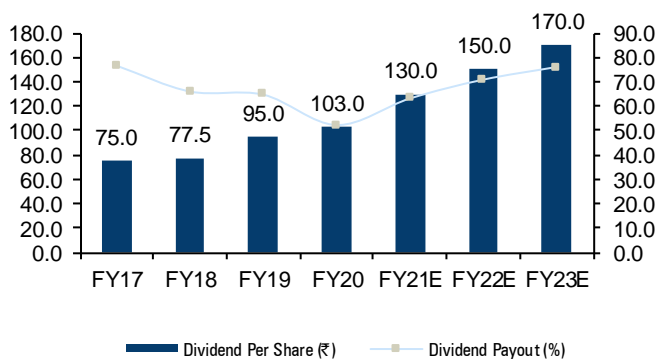
Source: Company, ICICI Direct Research

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



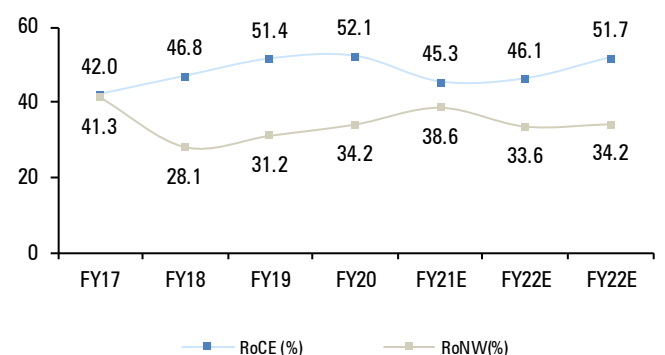
Source: Company, ICICI Direct Research

Exhibit 8: High dividend payout to continue



Source: Company, ICICI Direct Research

Exhibit 9: Attractive return ratios (%) (except bump in FY21)



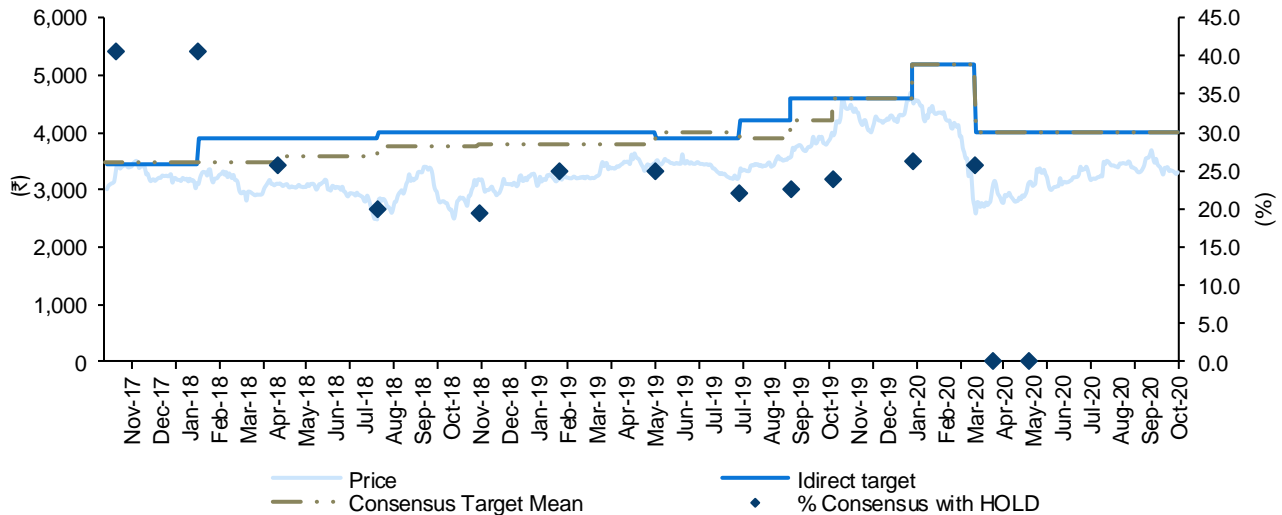
Source: Company, ICICI Direct Research

Exhibit 10: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY20	1238.1	12.8	196.9	34.1	17.5	12.6	38.6	52.1
FY21E	1169.1	-5.6	206.0	4.6	16.7	12.1	33.6	45.3
FY22E	1258.2	7.6	211.9	2.9	16.2	12.0	34.2	46.1
FY23E	1358.1	7.9	223.9	5.6	15.4	11.4	38.2	51.7

Source: Company, ICICI Direct Research

Exhibit 11: Recommendation History vs. Consensus



Source: Bloomberg, Company, ICICI Direct Research

Exhibit 12: Top 10 Shareholders

Rank	Investor Name	Filing Date	% O/S	Position (m)	Change (m)
1	Bright Star Investme	30-Jun-20	26.0	4.0	0.0
2	Raleigh Investment C	30-Jun-20	23.5	3.6	0.0
3	British American Tob	30-Jun-20	8.7	1.3	0.0
4	Hdfc Asset Managemen	31-Mar-20	7.1	1.1	1.1
5	Damani S Radhakrishna	31-Mar-20	5.0	0.8	0.8
6	Damani Radhakishan	30-Jun-20	5.0	0.8	0.8
7	Radhakishan Shivkish	31-Mar-20	5.0	0.8	0.8
8	Matthews Intl Capita	30-Jun-20	3.4	0.5	-0.1
9	L&T Mutual Fund	30-Sep-20	2.7	0.4	0.0
10	L&T Mutual Fund Trus	31-Mar-20	2.7	0.4	0.4

Source: Reuters, ICICI Direct Research

Exhibit 13: Shareholding Pattern

(in %)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Promoter	32.2	32.2	32.2	32.2	32.2
FII	7.8	6.8	5.5	4.6	3.6
DII	18.5	16.7	15.5	15.6	17.0
Others	41.5	44.4	46.8	47.6	47.3

Source: Company, ICICI Direct Research

Financial summary

Exhibit 14: Profit and loss statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Total Operating Income	1239.4	1170.7	1260.0	1360.2
Growth (%)	12.8	-5.5	7.6	8.0
Raw Material Expenses	598.6	524.6	594.8	635.6
Employee Expenses	102.4	113.4	119.5	133.1
Excise Duty	131.1	364.2	386.0	397.6
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	123.7	111.1	113.2	129.0
Total Operating Expenditure	824.7	749.0	827.6	897.7
EBITDA	414.7	421.6	432.4	462.6
Growth (%)	17.4	1.7	2.6	7.0
Depreciation	41.8	39.6	39.0	42.0
Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
PBT	420.3	429.8	442.2	470.3
Others	47.4	47.8	48.8	49.8
Total Tax	116.2	111.8	115.0	124.6
PAT	304.1	318.1	327.2	345.7
Growth (%)	34.1	4.6	2.9	5.6
EPS (₹)	196.9	206.0	211.9	223.9

Source: Company, ICICI Direct Research

Exhibit 15: Cash flow statement				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Profit after Tax	314.8	318.1	327.2	345.7
Add: Depreciation	41.8	39.6	39.0	42.0
(Inc)/dec in Current Assets	-29.0	67.0	-153.1	-61.1
Inc/(dec) in CL and Provisions	49.6	-64.8	33.1	44.3
CF from operating activities	331.4	359.9	246.2	370.9
(Inc)/dec in Investments	-133.3	0.2	-0.1	-0.1
(Inc)/dec in Fixed Assets	-21.9	-40.0	-35.0	-35.0
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0
Others	0.5	-16.3	0.3	0.3
CF from investing activities	-154.8	-56.2	-34.9	-34.8
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	-176.9	-159.0	-317.6	-395.5
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	-176.9	-159.0	-317.6	-395.5
Net Cash flow	-0.2	144.7	-106.3	-59.5
Opening Cash	26.4	26.2	170.9	64.7
Closing Cash	37.4	182.2	75.9	16.5

Source: Company, ICICI Direct Research

Exhibit 16: Balance sheet				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Liabilities				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	771.7	930.7	940.3	890.5
Total Shareholders funds	787.1	946.2	955.7	905.9
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	19.9	3.5	3.8	4.1
Total Liabilities	806.9	949.7	959.5	910.0
Assets				
Gross Block	345.0	375.0	405.0	435.0
Less: Acc Depreciation	157.9	197.5	236.5	278.5
Net Block	187.1	177.5	168.5	156.5
Capital WIP	12.7	22.7	27.7	32.7
Deferred Tax Asset	26.4	26.4	26.4	26.4
Non Current Investments	1.8	1.6	1.7	1.9
LT Loans & Advances/Others	5.4	5.4	5.4	5.4
Current Assets				
Inventory	297.7	278.7	303.3	327.4
Debtors	15.4	14.4	17.2	18.6
Cash	37.4	182.2	75.9	16.5
Loans & Advances	0.0	8.0	8.6	9.3
Current Investments	751.2	691.2	811.2	841.2
Other CA	62.0	67.0	72.0	77.0
Current Liabilities				
Creditors	142.8	140.9	144.8	156.3
Provisions	0.0	0.0	0.0	0.0
Other CL	447.3	384.4	413.6	446.5
Net Current Assets	573.6	716.1	729.9	687.2
Total Assets	806.9	949.7	959.5	910.0

Source: Company, ICICI Direct Research

Exhibit 17: Key ratios				
	₹ crore			
(Year-end March)	FY20	FY21E	FY22E	FY23E
Per share data (₹)				
EPS	196.9	206.0	211.9	223.9
Cash EPS	224.0	231.7	237.2	251.1
BV	509.8	612.8	619.0	586.7
DPS	103.0	130.0	150.0	170.0
Cash Per Share	24.3	118.0	49.2	10.7
Operating Ratios (%)				
EBITDA Margin	33.5	36.0	34.3	34.0
PBT / Net Sales	33.9	36.8	35.1	34.6
PAT Margin	24.6	27.2	26.0	25.5
Inventory days	87.8	87.0	88.0	88.0
Debtor days	4.5	4.5	5.0	5.0
Creditor days	42.1	44.0	42.0	42.0
Return Ratios (%)				
RoE	38.6	33.6	34.2	38.2
RoCE	52.1	45.3	46.1	51.7
RoIC	25.3	27.2	24.1	25.2
Valuation Ratios (x)				
P/E	17.5	16.7	16.2	15.4
EV / EBITDA	12.6	12.1	12.0	11.4
EV / Net Sales	4.2	4.4	4.1	3.9
Market Cap / Sales	4.3	4.5	4.2	3.9
Price to Book Value	6.7	5.6	5.6	5.9
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	1.9	2.0	2.2	2.1
Quick Ratio	1.4	1.5	1.6	1.6

Source: Company, ICICI Direct Research

Exhibit 18: ICICI Direct coverage universe (FMCG)

Sector / Company	CMP		TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)		
	(₹)	(₹)			Rating	(₹ Cr)	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20
Colgate (COLPAL)	1,544	1,700	Buy	38,812	30.0	33.4	35.4	51.4	46.3	43.6	8.6	8.4	7.7	60.7	83.5	100.8	51.2	64.2	78.0
Dabur India (DABIND)	524	565	Buy	88,708	8.2	8.8	10.3	63.9	59.4	51.1	10.2	10.1	8.7	26.1	24.0	24.7	21.9	20.9	21.4
Hindustan Unilever (HINLEV)	2,178	2,500	Buy	510,548	31.2	32.4	38.8	69.8	67.2	56.1	13.3	12.0	10.4	89.5	24.5	28.5	85.7	18.6	21.9
ITC Limited (ITC)	167	250	Buy	218,801	12.5	11.7	13.0	13.4	14.3	12.8	4.7	4.6	4.1	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	139	150	Hold	5,141	4.3	5.3	5.8	32.4	26.2	23.9	3.1	2.9	2.6	24.3	29.7	29.9	21.7	24.2	24.1
Marico (MARLIM)	357	380	Hold	45,802	8.1	8.5	9.6	44.1	41.9	37.3	6.3	6.2	5.5	41.0	42.3	46.2	34.5	35.6	39.5
Nestle (NESIND)	17,230	18,000	Hold	152,970	204.3	223.4	253.4	84.3	77.1	68.0	12.4	11.5	10.4	56.9	59.9	66.6	101.9	119.1	139.2
Tata Consumer Products (TATGLO)	500	525	Buy	49,578	5.0	9.8	11.7	100.2	51.2	42.9	5.1	4.6	4.3	6.9	8.8	9.4	4.6	6.6	7.5
VST Industries (VSTIND)	3,437	3,850	Hold	5,307	196.9	206.0	211.9	17.5	16.7	16.2	4.3	4.5	4.2	52.1	45.3	46.1	38.6	33.6	34.2
Varun Beverage (VARBEV)	671	700	Hold	19,948	16.4	9.7	17.8	41.0	68.9	37.6	2.8	3.3	2.7	15.5	11.3	16.3	14.2	8.8	14.2
Zydus Wellness (ZYDWEL)	1,851	2,300	Buy	10,725	24.6	43.4	66.4	75.3	42.7	27.8	6.1	5.8	5.1	5.9	7.0	8.3	5.4	5.9	8.6

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com

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