

## Volumes recover partly; focus on high priced brands

**About the stock** VST Industries (VST) is among the oldest cigarette company in India, involved in manufacturing and marketing of cigarettes and also trading unmanufactured tobacco. Incorporated in 1930, it is an associate undertaking of British American Tobacco (BAT), the global leader in cigarettes.

- VST has two cigarettes manufacturing facilities in Hyderabad, AP. It has five major brands, including, 'Total', 'Charms', 'Moment', 'Special', and 'Edition'. It has a direct distribution reach of over 1.1 million retail outlets

**Q1FY22 Results:** VST reported strong cigarette volume recovery in Q1FY22.

- Sales were up 12.1% YoY; cigarette volumes grew 35%
- EBITDA was at ₹ 92 crore, down 7.4% YoY, with margins at 33.4%
- Consequent PAT was at ₹ 70.4 crore (down 7% YoY)

**What should investors do?** VST Industries' share price has underperformed the market with 70% return in the last five years (from ₹ 2000 in July 2016 to ₹ 3476 in July 2021). The pandemic has severely impacted the cigarettes industry.

- We roll over FY24 numbers estimating a complete recovery in cigarettes business in FY23-24
- We continue to maintain our HOLD rating on the stock

**Target Price and Valuation:** We value the stock at ₹ 3850, valuing the business at 15x FY24 earnings

**Key triggers for future price performance:**

- With Covid recovery & vaccination drive, mobility is expected to increase by H2FY22
- High priced brands' ('Total' & 'Edition') volume contribution to increase in future, which would lead to favourable product mix & margin improvement
- Duties & taxes on cigarettes are expected to remain stable given increasing prevalence of illicit & contraband cigarettes
- We expect dividend payout to increase to ~70% by FY23, which would translate into dividend yield of ~5% at the current price

**Alternate Stock Idea:** We like Zydus Wellness in our FMCG coverage

- It is growing at a steady pace in nascent categories with a strong presence in health, nutrition space & margin expansion possibilities

Trading at significant discount to FMCG peers. BUY with TP of ₹ 2,800



VST Industries Ltd.

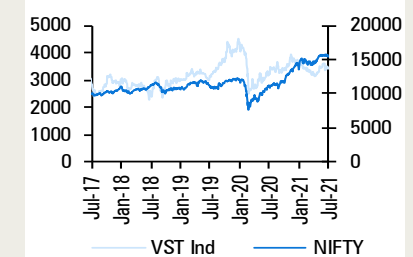
### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	5,384.3
Total Debt (FY21)	0.0
Cash and Investments (FY21)	905.2
EV	4,479.1
52 week H/L (₹)	4538 / 3140
Equity capital	₹ 15.4
Face value (₹)	10.0

### Shareholding pattern

(in %)	Sep-20	Dec-20	Mar-21	Jun-21
Promoter	34.7	34.7	34.7	34.7
FII	21.7	25.7	25.2	25.0
DII	17.7	13.6	12.6	7.4
Others	25.9	26.0	27.5	32.9

### Price Chart



### Recent event & key risks

- 'Total' is contributing ~42% of the total volumes of the company
- Key Risk:** (i) Any other severe disruption due to Covid-19 (ii) stark Increase in competitive intensity

### Research Analyst

Sanjay Manyal  
sanjay.manyal@icicisecurities.com

### Key Financial Summary

Key Financials	FY20	FY21	5 Year CAGR (FY16-21)	FY22E	FY23E	FY24E	CAGR (FY21-24E)
Net Sales	1238.1	1109.8	4.8	1214.9	1313.5	1410.5	8.3%
EBITDA	414.7	410.6	11.6	436.1	467.6	503.8	7.1%
EBITDA Margin %	33.5	37.0		35.9	35.6	35.7	
Net Profit	304.1	310.8	15.2	331.4	356.9	394.1	8.2%
EPS (₹)	196.95	201.29	15.2	214.63	231.12	255.24	8.2%
P/E	17.7	17.3		16.2	15.1	13.7	
RoNW %	38.6	33.0		33.4	36.0	40.8	
RoCE (%)	52.1	43.4		45.0	48.2	54.5	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter

### Q1FY22 Results: Cigarettes volumes recover; trade offers restored

- Gross revenue (net of excise) witnessed growth of 12.1% to ₹ 275.4 crore on the back of a low base quarter. The base quarter saw 39% volume decline due to ~40 days of loss of sales during nationwide lockdown. VST was able to partially restore volumes during the quarter with 35% volume growth. However, due to second wave, some markets were impacted, which led to a QoQ decline in volumes. Tobacco sales were flat in Q1FY22
- Operating profit witnessed de-growth of 7.4% to ₹ 92 crore with 675 bps contraction in gross margins. Operating margins contracted 704 bps to 33.4%. The company cut down all promotional offers in the base quarter during lockdown, which were restored in H1FY21. It was able to safeguard margins in FY21 but with increasing competitive pressure & muted cigarettes volumes, it has to increase trade discounts & offers to push volumes. PAT also declined 7% to ₹ 70.4 crore with a similar dip in EBITDA
- The company sold 786.6 crore cigarettes sticks in FY21, out of which ~42% of volumes were from the brand 'Total' (launched in FY15). 'Total' brand has become largest capsule brand in the country. Moreover, it is estimated to be among top five brands in India with consumer spend of ~₹ 2000 crore. VST's Consumer spend of all cigarette brands is ₹ 4800 crore. 'Edition' brand contributes ~3% to sales and is largely concentrated in Hyderabad City
- In the last five years, the company has increased its wholesale dealers from 700 to 848 & direct retail reach from 0.8 million retail outlets to 1.1 million retail outlets. VST has enhanced its presence Delhi, Mumbai, UP & Bihar
- VST's new age brand 'Total' & 'Edition' are now contributing 45% of volumes whereas heritage brands 'Charms', 'Moment' & 'Special' contribute 55% to sales. 'Charms' is the eighth largest Indian brand. The company is continuously looking to innovate & introduce new products in cigarettes category
- Legal cigarette industry in India constitutes 9% of tobacco consumption but its contribution towards duties & taxes is 80% of total tobacco products. On the other hand, other tobacco products (bidis, non-smoke tobacco products) contribute 91% to volumes but only 20% to the duties & taxes
- VST sources 20,000 tonnes of tobacco from more than 15,000 farmers every year for trading & manufacturing cigarettes in its two factories. The company had an employee strength of 780 during FY21 with 421 being factory employees and 359 being management staff

### Exhibit 1: Peer Comparison

Sector / Company	CMP		TP Rating	M Cap (₹ Cr)	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹)			FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
ITC Limited (ITC)	209	240	Hold	261086	3.7	9.1	9.0	32.2	36.6	37.6	19.8	17.7	15.8	22.1	24.2	25.9	25.6	30.8	33.9
VST Industries (VSTIND)	3487	3850	Hold	5384	-10.4	9.5	8.1	37.0	35.9	35.6	17.3	16.2	15.1	33.0	33.4	36.0	43.4	45.0	48.2

Source: Company, ICICI Direct Research

The cigarette category has suffered the most in the last 18 months with supply disruption in March-May 2021 and subsequent adverse impact on demand conditions given restaurants, pubs have not been fully operational throughout the year. Moreover, trend of work from home has also adversely impacted demand conditions. Though the impact of Covid-19 second wave was minimal, cigarette demand has not yet reached pre-Covid levels. We believe cigarettes consumption should be fully restored with reduction in Covid-19 cases & progress of vaccination drive (H2FY22 is likely to result in higher mobility). In the last four years, taxation of cigarettes has become stable given the industry & subsequently tobacco farmers have suffered due to incessant tax increase during FY11-18. We believe taxation on cigarettes would remain stable, going forward, which would help the organised industry to regain volumes from the illicit & contraband market. We value the stock at 15x FY24E earnings to arrive at a target price of ₹ 3850/share & maintain our HOLD rating.

Exhibit 2: Variance Analysis

	Q1FY22	Q1FY22E	Q1FY21	YoY (%)	Q4FY21	QoQ (%)	Comments
Total Operating Income	275.4	284.8	245.6	12.1	278.1	-1.0	Revenue grew by 12.1% led by 35% volume growth. The company has restored trade discounts & offers in H2FY21. These were withdrawn in Q1FY21
Other Operating Income	0.3	0.4	0.2	37.5	0.3	17.9	
Raw Material Expenses	122.9	124.1	93.1	32.1	121.5	1.2	Gross margins contracted by 675 bps mainly due to restoration of trade discounts & offers
Employee Expense	32.2	28.6	29.3	9.9	27.6	16.6	
Excise Duty	92.8	89.6	69.3	33.9	104.6	-11.3	
Other operating Expenses	28.3	26.6	24.0	18.1	30.8	-8.0	
EBITDA	92.0	105.6	99.3	-7.4	98.3	-6.4	Operating profit down 7.4%, largely impacted by contraction in gross margins
EBITDA Margin (%)	33.4	37.1	40.4	-704 bps	35.3	-194 bps	
Depreciation	6.4	9.5	8.9	-28.2	7.9	-18.6	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	9.3	10.5	11.6	-20.3	6.3	46.6	
PBT	94.8	106.6	102.0	-7.1	96.7	-2.0	
Tax Outgo	24.4	26.9	26.3	-7.4	23.9	2.0	
PAT	70.4	79.7	75.7	-7.0	72.8	-3.3	Net profit down 7%, impacted by lower EBITDA
<b>Key Metrics</b>							
Cigarette Sales (₹ crore)	327.8	311.6	274.7	19.3	320.1	2.4	Gross cigarettes sales grew 19.3% on the back of 35% volume growth
Tobacco Sales (₹ crore)	40.0	62.5	40.0	0.0	60.0	-33.3	Tobacco sales remained flat during the quarter

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E			FY24E	Comments
	Old	New	% change	Old	New	% change	New	
Net sales	1,216.3	1,214.9	-0.1	1,313.0	1,313.5	0.0	1,410.5	
EBITDA	452.4	436.1	-3.6	483.7	467.6	-3.3	503.8	We change our operating profit estimates due to re-storation of trade discount & promotions
EBITDA Margin (%)	37.2	35.9	-130 bps	36.8	35.6	-124 bps	35.7	
PAT	337.8	331.4	-1.9	362.7	356.9	-1.6	394.1	
EPS (₹)	218.8	214.6	-1.9	234.9	231.1	-1.6	255.2	

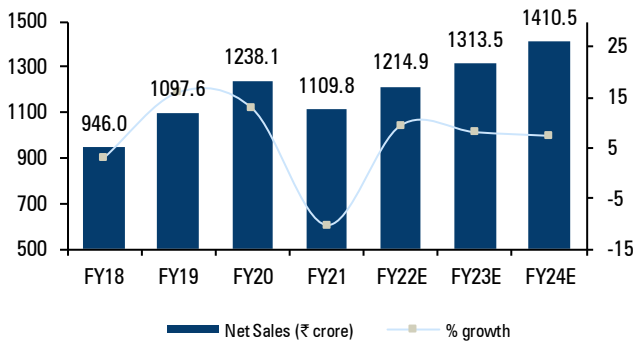
Source: ICICI Direct Research

Exhibit 4: Assumptions

	Current						Earlier		Comments
	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	
Cig. Vol. (mn sticks)	8,031.1	8,753.9	7,866.0	8,652.6	8,912.2	9,179.5	7,701.7	7,932.8	We change volume estimates upward with expected full recovery in cigarettes volumes in H2FY22
Cig. Vol. Growth (%)	9.0	9.0	-10.1	10.0	3.0	3.0	6.0	3.0	
Realization/cig (₹)	1.2	1.3	1.7	1.6	1.6	1.7	1.7	1.8	We change our realisation estimates downwards with restoration of promotional discounts & offers
Tobacco Sales(₹ crore)	238.9	238.8	200.0	271.9	285.6	300.1	271.9	285.6	

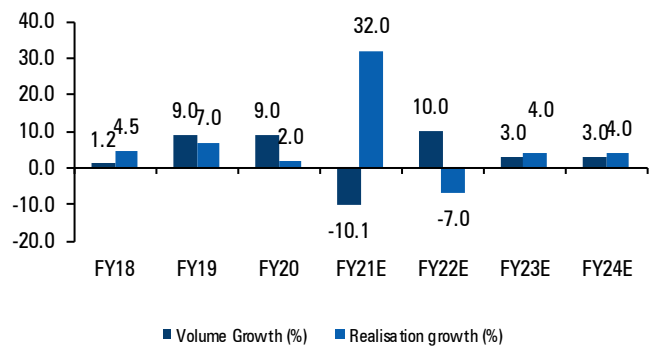
Source: ICICI Direct Research

Exhibit 5: Net revenue to grow at 8.3% CAGR over FY21-24E



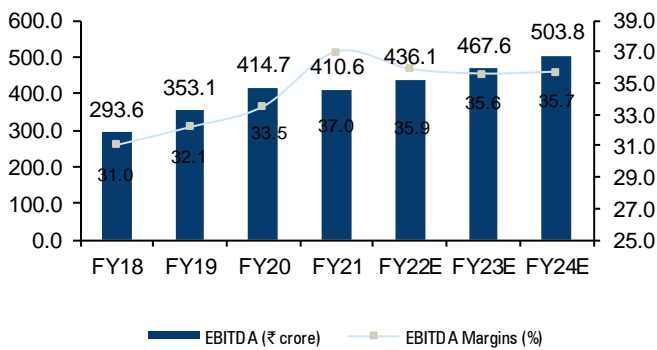
Source: ICICI Direct Research, Company

Exhibit 6: Volume recovery expected in FY22E



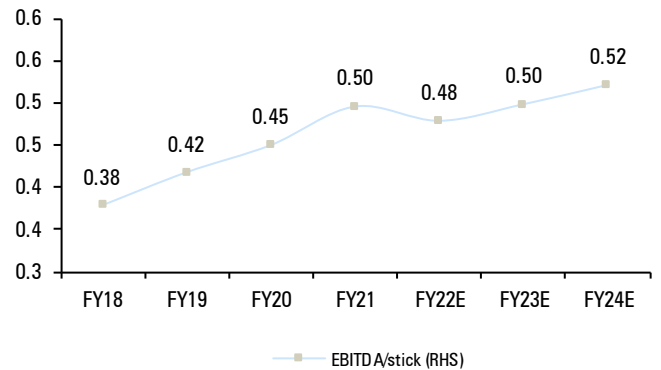
Source: ICICI Direct Research, Company

Exhibit 7: Improved product mix to aid EBITDA margins



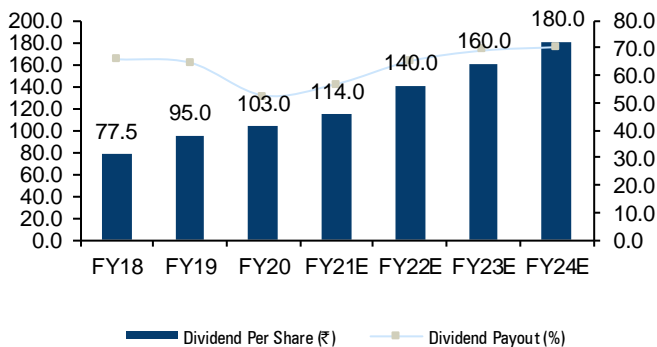
Source: ICICI Direct Research, Company

Exhibit 8: Healthy growth in EBITDA/stick (₹)



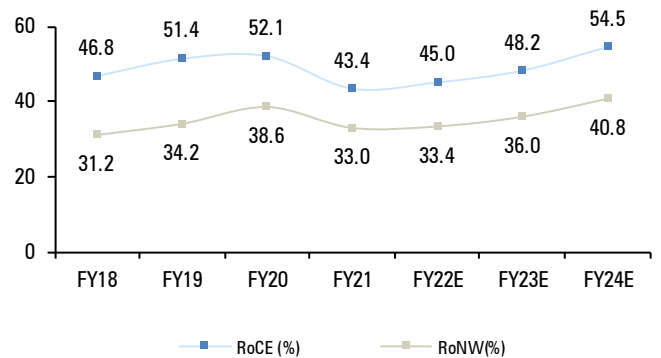
Source: ICICI Direct Research, Company

Exhibit 9: High dividend payout to continue



Source: ICICI Direct Research, Company

Exhibit 10: Attractive return ratios %



Source: ICICI Direct Research, Company

Exhibit 11: Valuations

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY21	1109.8	-10.4	201.3	2.2	17.3	13.0	33.0	43.4
FY22E	1214.9	9.5	214.6	6.6	16.2	12.2	33.4	45.0
FY23E	1313.5	8.1	231.1	7.7	15.1	11.4	36.0	48.2
FY24E	1410.5	7.4	255.2	10.4	13.7	10.6	40.8	54.5

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Total Operating Income</b>	<b>1111.0</b>	<b>1216.3</b>	<b>1315.2</b>	<b>1412.5</b>
Growth (%)	-10.4	9.5	8.1	7.4
Raw Material Expenses	478.9	543.3	590.2	629.4
Employee Expenses	114.4	121.5	132.7	145.3
Excise Duty	361.9	428.5	441.4	463.4
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	107.1	115.4	124.8	134.0
Total Operating Expenditure	700.4	780.2	847.6	908.7
<b>EBITDA</b>	<b>410.6</b>	<b>436.1</b>	<b>467.6</b>	<b>503.8</b>
Growth (%)	-1.0	6.2	7.2	7.8
Depreciation	35.1	30.5	32.9	21.3
Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
PBT	417.3	447.8	479.0	529.0
Others	41.8	42.2	44.3	46.5
Total Tax	106.5	116.4	122.1	134.9
<b>PAT</b>	<b>310.8</b>	<b>331.4</b>	<b>356.9</b>	<b>394.1</b>
Growth (%)	2.2	6.6	7.7	10.4
EPS (₹)	201.3	214.6	231.1	255.2

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit after Tax	310.8	331.4	356.9	394.1
Add: Depreciation	35.1	30.5	32.9	21.3
(Inc)/dec in Current Assets	-103.6	-30.5	-50.8	-10.4
Inc/(dec) in CL and Provisions	-66.8	16.0	43.7	43.0
<b>CF from operating activities</b>	<b>175.4</b>	<b>347.3</b>	<b>382.7</b>	<b>448.1</b>
(Inc)/dec in Investments	-0.9	1.0	-0.1	-0.1
(Inc)/dec in Fixed Assets	-41.4	-35.0	-35.0	-35.0
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0
Others	7.6	-18.4	0.3	0.3
<b>CF from investing activities</b>	<b>-34.7</b>	<b>-52.4</b>	<b>-34.8</b>	<b>-34.8</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	-159.0	-280.9	-357.2	-418.1
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>-157.4</b>	<b>-280.9</b>	<b>-357.2</b>	<b>-418.1</b>
Net Cash flow	-16.7	14.0	-9.3	-4.8
Opening Cash	26.2	9.6	23.6	14.2
<b>Closing Cash</b>	<b>20.8</b>	<b>34.8</b>	<b>25.5</b>	<b>20.7</b>

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Liabilities</b>				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	925.0	975.5	975.2	951.2
Total Shareholders funds	940.5	990.9	990.6	966.7
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	22.1	3.6	3.9	4.2
<b>Total Liabilities</b>	<b>962.5</b>	<b>994.5</b>	<b>994.5</b>	<b>970.9</b>
<b>Assets</b>				
Gross Block	365.8	395.8	425.8	455.8
Less: Acc Depreciation	193.0	223.5	256.3	277.6
Net Block	172.8	172.3	169.5	178.2
Capital WIP	33.3	38.3	43.3	48.3
Deferred Tax Asset	25.2	25.2	25.2	25.2
Non Current Investments	2.7	1.7	1.8	1.9
LT Loans & Advances/Others	1.1	1.1	1.1	1.1
<b>Current Assets</b>				
Inventory	297.2	292.9	316.7	340.1
Debtors	15.2	16.6	18.0	19.3
Cash	20.8	34.8	25.5	20.7
Loans & Advances	0.0	8.3	9.0	9.7
Current Investments	884.4	904.4	924.4	904.4
Other CA	33.1	38.1	43.1	48.1
<b>Current Liabilities</b>				
Creditors	131.5	139.8	151.1	162.3
Provisions	0.0	0.0	0.0	0.0
Other CL	391.8	399.4	431.8	463.7
Net Current Assets	727.4	755.9	753.6	716.2
<b>Total Assets</b>	<b>962.5</b>	<b>994.5</b>	<b>994.5</b>	<b>970.9</b>

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	201.3	214.6	231.1	255.2
Cash EPS	224.0	234.4	252.4	269.0
BV	609.1	641.8	641.6	626.0
DPS	114.0	140.0	160.0	180.0
Cash Per Share	13.5	22.5	16.5	13.4
<b>Operating Ratios (%)</b>				
EBITDA Margin	37.0	35.9	35.6	35.7
PBT / Net Sales	37.6	36.9	36.5	37.5
PAT Margin	28.0	27.3	27.2	27.9
Inventory days	97.7	88.0	88.0	88.0
Debtor days	5.0	5.0	5.0	5.0
Creditor days	43.2	42.0	42.0	42.0
<b>Return Ratios (%)</b>				
RoE	33.0	33.4	36.0	40.8
RoCE	43.4	45.0	48.2	54.5
RoIC	21.3	22.6	23.9	27.1
<b>Valuation Ratios (x)</b>				
P/E	17.3	16.2	15.1	13.7
EV / EBITDA	13.0	12.2	11.4	10.6
EV / Net Sales	4.8	4.4	4.1	3.8
Market Cap / Sales	4.9	4.4	4.1	3.8
Price to Book Value	5.7	5.4	5.4	5.6
<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	2.4	2.3	2.2	2.1
Quick Ratio	1.8	1.8	1.7	1.6

Source: Company, ICICI Direct Research

**Exhibit 16: ICICI Direct coverage universe (FMCG)**

	CMP	TP	M Cap	EPS (₹)			P/E (x)			Price/Sales (x)			RoCE (%)			RoE (%)			
	(₹)	(₹)		Rating	(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E
Colgate (COLPAL)	1,796	1,900	Buy	42,892	38.1	39.1	42.7	47.2	46.0	42.1	8.9	8.3	7.7	106.4	110.4	111.7	88.8	85.1	86.1
Dabur India (DABIND)	593	620	Buy	94,540	9.6	10.9	12.2	61.8	54.2	48.6	9.9	8.7	7.9	24.5	26.5	27.1	22.1	22.9	23.2
Hindustan Unilever (HINLEV)	2,361	2,750	Buy	558,687	33.9	40.5	45.0	69.7	58.3	52.4	12.3	10.6	9.9	18.9	25.6	27.7	17.1	20.0	21.6
ITC Limited (ITC)	209	240	Hold	261,086	10.7	12.0	13.5	19.5	17.4	15.5	5.4	5.0	4.6	28.2	31.3	33.6	22.1	24.2	25.9
Jyothy Lab (JYOLAB)	173	160	Hold	5,324	5.2	6.3	7.1	33.4	27.4	24.4	2.8	2.6	2.4	26.0	27.2	28.5	20.4	22.7	23.7
Marico (MARLIM)	530	490	Buy	53,027	9.3	9.6	10.7	57.1	55.1	49.6	6.6	5.9	5.3	40.3	42.5	45.5	37.0	37.4	39.7
Nestle (NESIND)	17,988	19,300	Hold	164,840	216.0	254.8	283.8	83.3	70.6	63.4	12.4	11.2	10.2	54.6	62.7	69.1	103.1	124.2	142.1
Tata Consumer Products (TAT)	755	725	Buy	60,728	10.1	12.4	14.5	74.8	60.8	52.1	5.2	4.6	4.3	8.0	9.1	10.0	6.4	7.6	8.5
VST Industries (VSTIND)	3,487	3,850	Hold	5,384	201.3	214.6	231.1	17.3	16.2	15.1	4.9	4.4	4.1	43.4	45.0	48.2	33.0	33.4	36.0
Varun Beverage (VARBEV)	759	800	Buy	33,343	8.4	14.1	20.7	90.8	53.7	36.6	5.2	4.2	3.6	10.9	17.4	23.4	10.3	15.4	19.1
Zydus Wellness (ZYDWEL)	2,150	2,800	Buy	13,502	18.7	60.8	72.0	115.2	35.4	29.9	7.2	6.4	5.8	6.2	7.8	9.1	5.5	8.1	9.4

Source: Bloomberg, ICICI Direct Research

## RATING RATIONALE

ICICI Direct endeavors 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%



Pankaj Pandey

Head – Research

[pankaj.pandey@icicisecurities.com](mailto:pankaj.pandey@icicisecurities.com)

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

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