

Recovery on fast track; upbeat outlook ahead...

Varun Beverages reported strong Q3CY20 results with 3.6% revenue growth given beverage remains largely an out of home consumption category. Volume were down 4% to 119 million (mn) cases with India business volume down 6.7% and international business seeing volume growth of 5.8%. Realisation increased 8%, mainly on the back of a cut in trade promotions and mix change in favour of carbonated soft drinks (CSD) Despite hotel, restaurants & cafes remaining closed, the company was able to restrict volume de-growth to single digits. India business growth of 12.9% in September month is also a sign of normalised growth. Gross margins contracted 149 bps mainly due to increase in sales of consumer promotional packs. However, a 50 bps saving in employee spends to sales & 343 bps savings in overhead spends to sales resulted in operating profit increase of 16.9% to ₹ 380.8 crore. Operating margins expanded 241 bps to 21.1%. Interest cost declined 33.2% to ₹ 58 crore mainly due to repayment of debt with QIP proceeds in September 2019 and reduction in cost of debt to 7%. This resulted in a robust jump in net profit by 99% to ₹ 161.5 crore.

Beverage segment to see full recovery in CY21

With 12.9% growth in September, the impact of lockdown and restricted out-of-home consumption seems to have been largely recovered. July & August volume were down 20% & 6%, respectively. With the 'on the go' & 'out of home' consumption impacted during Covid times, VBL has been focusing on increasing 'at-home' consumption. It has launched 1.25 litre pack at ₹ 50, which is largely driving 'at-home' consumption. We believe CY21 would be a normalised year given lockdown restrictions would be completely lifted (multiplex, restaurants, hotels, café operations are largely expected to normalise). We expect 6.1% revenue CAGR in CY19-22E largely with 21% growth recovery in CY21.

Benign commodity prices, cost rationalisation to aid margins

With a sharp fall in PET resin prices & stable sugar price, we expect gross margin expansion of 72 bps in CY21. Moreover, cost rationalisation measure would lead to operating margin expansion of 124 bps in CY21. VBL expects these cost cutting measure to remain permanent. The management has guided 21% operating margin for CY21. Further, we believe juices & CSD contribution would increase, going forward, as the company would be able to generate more margin considering its new Juice plant has already been commissioned. VBL would be re-launching milk based beverages in CY21 as launch in CY20 could not see much uptick due to lockdown.

Valuation & Outlook

Carbonated drinks, juices & water businesses are discretionary in nature with ~70% of sales contributed by 'on the go' consumptions with a single serve pack selling the most. With a significant reduction in 'out of home' category, the company has been able to recoup its volume by focusing on increasing 'at-home' consumption. We expect the full recovery to happen only in CY21 with sales surpassing CY19 levels. We value the stock at 14x CY22 EV/EBITDA with a revised target price of ₹ 730/share and **HOLD** rating.

Key Financial Summary

Key Financials	CY18	CY19	CY20E	CY21E	CY22E	CAGR (CY19-22E)
Net Sales	5105.3	7129.6	6395.0	7753.0	8513.4	6.1%
EBITDA	1006.6	1447.7	1208.9	1562.3	1709.3	5.7%
EBITDA Margin %	19.7	20.3	18.9	20.2	20.1	
Net Profit	299.9	472.2	326.5	627.1	768.0	17.6%
EPS (₹)	16.42	16.36	11.31	21.72	26.60	
P/E	41.0	41.1	59.5	31.0	25.3	
RoNW %	15.0	14.2	10.1	16.7	17.6	
RoCE (%)	14.2	15.5	12.3	18.6	20.7	

Source: Company, ICICI Direct Research



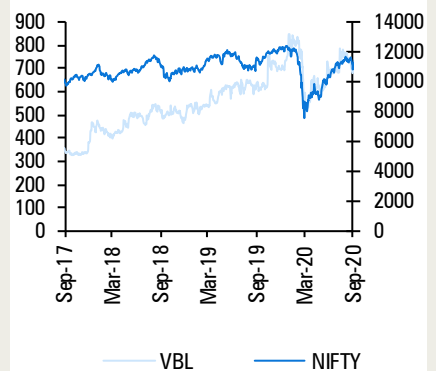
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	19,428.7
Total Debt (CY19)	2,822.5
Cash & Investments (CY19)	171.1
EV	22,080.2
52 week H/L (₹)	869 / 486
Equity capital	288.7
Face value	10.0

Key Highlights

- Total sales volumes down 4% to 119 million cases. Realisation up 8% mainly due to cut in promotions & change in mix
- Operating margins expand 240 bps with various cost rationalisation measures in place
- Maintain HOLD rating with revised target price of ₹ 730/share

Price Chart



Research Analyst

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Exhibit 1: Variance Analysis

Particulars (₹ crore)	Q3CY20	Q3CY19	YoY (%)	Q2CY20	QoQ (%)	Comments
Net Sales	1,802.6	1,739.7	3.6	1,640.2	9.9	Net sales grew 3.6% on the back of 8% realisation growth and 4% volume decline
Raw Material Expenses	801.0	747.2	7.2	741.1	8.1	Gross margins contracted 150 bps mainly due to cut in promotional spends
Employee Expenses	229.6	229.6	0.0	199.3	15.2	
Other operating Expenses	391.3	437.3	-10.5	322.1	21.5	The company took cost rationalisation measures, which resulted in 10% decline in overhead costs
EBITDA	380.8	325.7	16.9	377.7	0.8	
EBITDA Margin (%)	21.1	18.7	241 bps	23.0	-190 bps	Operating margins improved 240 bps despite gross margin contraction, mainly due to cost cutting measures
Depreciation	134.6	127.3	5.7	124.3	8.3	
Interest	58.0	86.7	-33.2	74.2	-21.9	Significant decline in interest cost due to repayment of debt from funds raised by QIP & lower interest cost at 7%
Other Income	3.5	1.8	92.8	2.7	30.6	
PBT	191.7	113.4	69.1	181.9	5.4	
Exceptional Items	0.0	0.0		0.0		
Tax Outgo	30.2	34.5	-12.4	38.9	-22.2	
PAT	161.5	81.1	99.0	143.0	12.9	With strong operating profit & lower interest cost, net profit increased 99% to ₹ 161.5 crore
Adj. PAT	161.5	81.1	99.0	143.0	12.9	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	CY20E			CY21E			CY22E		Comments
	Old	New	% Change	Old	New	% Change	New		
Net Sales	6,053.3	6,395.0	5.6	7,336.9	7,753.0	5.7	8,513.4	We increased our sales & margins estimates after stronger results in Q3. We introduce CY22 numbers	
EBITDA	1,107.0	1,208.9	9.2	1,430.7	1,562.3	9.2	1,709.3		
EBITDA Margin(%)	18.3	18.9	62 bps	19.5	20.2	65 bps	20.1		
PAT	281.1	326.5	16.1	531.1	627.1	18.1	768.0		
EPS (₹)	9.74	11.31	16.1	18.40	21.72	18.1	-26.6		

Source: Company, ICICI Direct Research

Exhibit 3: Assumptions

Particulars (in million cases)	Current							Earlier		Comments
	CY17	CY18	CY19E	CY20E	CY21E	CY22	CY20E	CY21E		
Carbonated Products	220.0	257.0	388.1	345.4	414.5	443.5	322.1	386.5	We change our sales estimates mainly on account of better-than-expected recovery in Q3. We introduce CY22 numbers	
% Growth	-1.3	16.8	51.0	-11.0	20.0	7.0	-17.0	20.0		
Non Carbonated Products	14.0	22.0	29.7	28.2	33.3	35.3	28.2	33.3		
% growth	-11.1	57.1	35.0	-5.0	18.0	6.0	-5.0	18.0		
Raw Material Cost										
Sugar	616.6	698.4	1,086.0	922.6	1,114.6	1,251.3	865.1	1,045.0		
% of sales	13.4	14.2	15.1	14.1	14.1	14.5	14.0	13.9		
cost/kg (₹)	38.9	37.0	36.6	34.8	36.5	38.4	34.8	36.5		

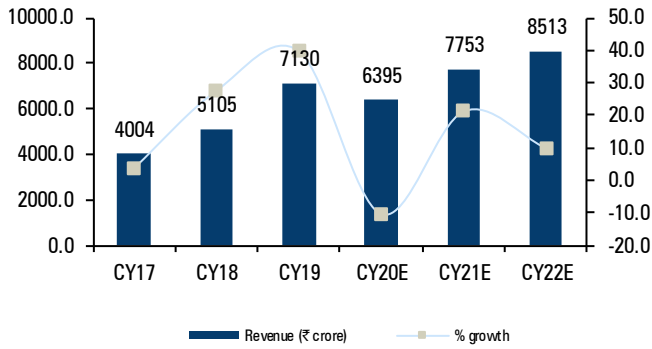
Source: Company, ICICI Direct Research

Conference Call Highlights

- Revenues witnessed growth of 3.8% led by 8% realisation growth due to a cut in trade promotions spends & change in product mix in favour of carbonated soft drinks (CSD). Volumes were down 4% due to 6.7% volume decline in India business and 5.5% growth in international business
- The recovery in the growth was largely contributed by rural & semi-urban territories. Moreover, the company pushed 'at-home' consumption with the launch of 1.25 litre pack at ₹ 50. The management said the growth in 'at-home' consumption is ~25%
- Volume declined 4% to 119 mn cases. Out of this, 74% was contributed by CSD whereas juices & water categories contributed 6% & 24%, respectively
- The company recorded 20% & 6% decline in July & August sales, respectively, whereas September sales were up 12.9% with out of home activity starting to normalise to pre-Covid levels. With the resumption of multiplexes, hotels, cafes & restaurant operations, we believe CY21 would be a normalised year from both demand & supply side
- The company expects to clock operating margins of 21%, going forward, given PET resin prices are down, sugar prices are stable and the company has rationalised many overhead costs
- VBL would look to kick-start the next season activation earlier than usual with the joint strategy adopted by Pepsi and VBL
- Rural & semi-urban sales contribute ~30-40% of overall sales. Institutional sales contribute 2-3% to revenues
- The company would be installing, on an average, 40,000 visi coolers. CY20 has seen a slower installation of visi coolers due to Covid. However, the gap will be made up by putting up additional coolers in CY21
- VBL would be commissioning a Tropicana plant in South India, which would aid juices volumes, going forward. The company is currently witnessing 19% growth in the juices segment
- The debt levels are currently at ₹ 2830 crore. Cash profit in nine months was a ₹ 750 crore with capex of ₹ 400 crore. Free cash flow in nine months has been ₹ 350 crore
- Free cash has been utilised as ₹ 100 crore debt reduction, ₹ 85-90 crore dividend payment and ₹ 100 crore for capex & other payments
- The company will be re-launching milk based beverages in CY21 as launch of the product in February 2020 was not successful due to the lockdown imposed in March 2020

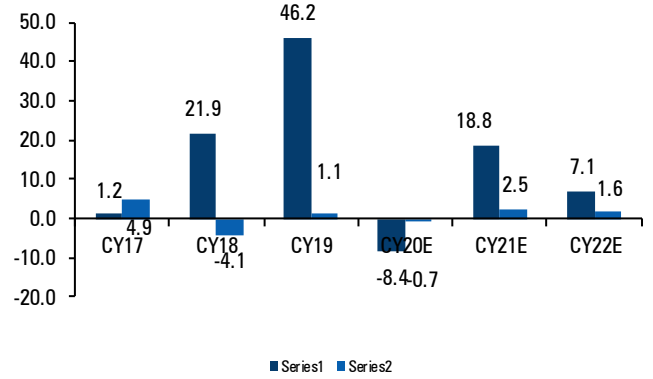
Key Metrics

Exhibit 4: Revenue growth trend



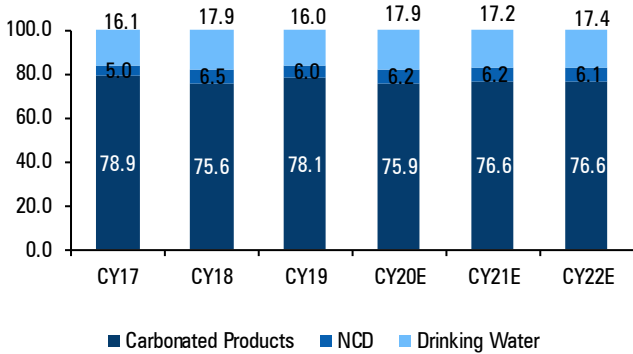
Source: Company, ICICI Direct Research

Exhibit 5: Volume growth to drive revenue



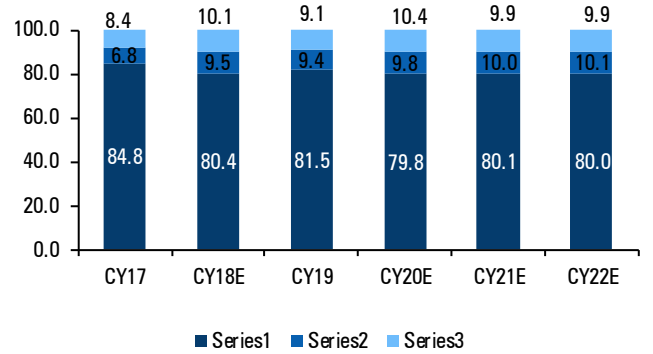
Source: Company, ICICI Direct Research

Exhibit 6: Segment wise volume contribution (%)



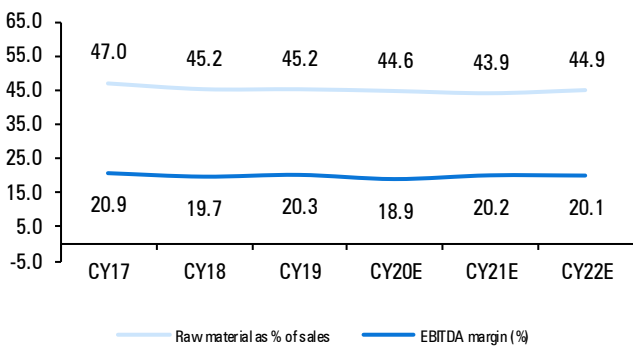
Source: Company, ICICI Direct Research

Exhibit 7: Segment wise value contribution (%)



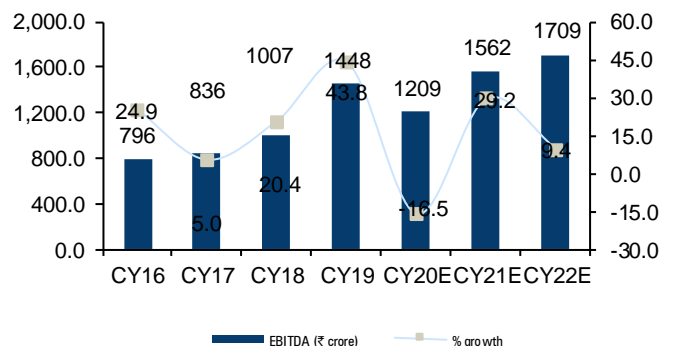
Source: Company, ICICI Direct Research

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



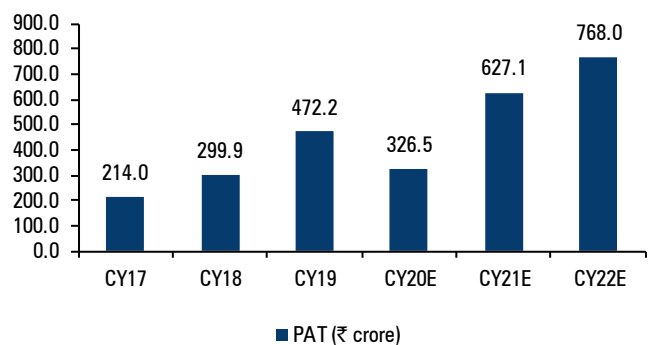
Source: Company, ICICI Direct Research

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



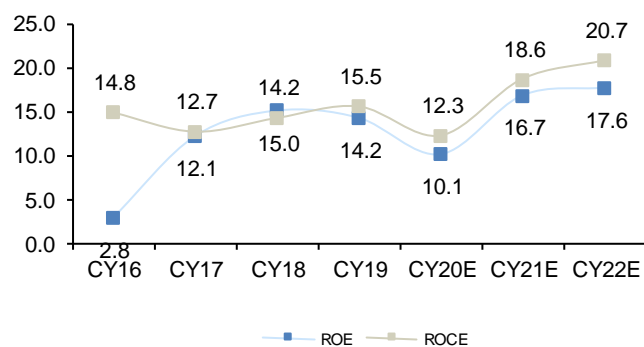
Source: Company, ICICI Direct Research

Exhibit 10: Earnings to witness significant dip in CY20E



Source: Company, ICICI Direct Research

Exhibit 11: Return ratios to improve (%)



Source: Company, ICICI Direct Research

Exhibit 12: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
CY19	7129.6	39.7	16.4	-0.4	41.1	15.3	14.2	15.5
CY20E	6395.0	-10.3	11.3	-30.9	59.5	17.7	10.1	12.3
CY21E	7753.0	21.2	21.7	92.1	31.0	13.3	16.7	18.6
CY22E	8513.4	9.8	26.6	22.5	25.3	11.7	17.6	20.7

Source: Company, ICICI Direct Research

Financial summary

Exhibit 13: Profit and loss statement				
	₹ crore			
	CY19	CY20E	CY21E	CY22E
Total operating income	7129.6	6395.0	7753.0	8513.4
Growth (%)	39.7	-10.3	21.2	9.8
Raw Material Expenses	3219.4	2851.5	3401.2	3820.2
Employee Expenses	810.8	927.3	1007.9	1089.7
Marketing Expenses	122.1	65.4	118.8	129.2
Other expenses	1529.6	1342.0	1662.8	1765.0
Total Operating Expenditure	5681.9	5186.1	6190.7	6804.1
EBITDA	1,447.7	1,208.9	1,562.3	1,709.3
Growth (%)	43.8	-16.5	29.2	9.4
Depreciation	488.6	528.1	528.5	553.3
Interest	309.6	283.0	222.5	156.5
Other Income	42.5	36.9	40.5	44.6
PBT	691.9	434.7	851.8	1044.1
Total Tax	224.1	113.0	230.0	281.9
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	4.4	4.8	5.3	5.8
PAT	472.2	326.5	627.1	768.0
Growth (%)	57.5	-30.9	92.1	22.5
EPS (₹)	16.4	11.3	21.7	26.6

Source: Company, ICICI Direct Research

Exhibit 14: Cash flow statement				
	₹ crore			
(Year-end March)	CY19	CY20E	CY21E	CY22E
Profit After Tax	907.7	604.6	844.3	918.7
Add: Depreciation	482.6	528.1	528.5	553.3
(Inc)/dec in Current Assets	-319.3	348.7	-244.5	-136.9
Inc/(dec) in CL and Provisions	234.1	-116.6	262.4	189.6
CF from operating activities	1,305.2	1,364.8	1,357.7	1,491.6
(Inc)/dec in Investments	73.1	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	-2,358.2	-405.9	-429.5	-431.0
Others	22.1	0.0	0.0	0.0
CF from investing activities	-2,319.2	-405.9	-429.5	-431.0
Issue/(Buy back) of Equity	900.2	0.0	0.0	0.0
Inc/(dec) in loan funds	648.7	-500.0	-600.0	-600.0
Dividend paid & dividend tax	-78.2	-65.3	-125.4	-153.6
Others	-317.5	-283.0	-222.5	-156.5
CF from financing activities	1,109.7	-856.3	-924.1	-885.1
Net Cash flow	95.7	102.7	4.1	175.5
Opening Cash	106.9	171.1	306.8	344.0
Other Bank balance	33.1	33.1	33.1	33.1
Closing Cash	171.1	306.8	344.0	552.7

Source: Company, ICICI Direct Research

Exhibit 15: Balance sheet				
	₹ crore			
(Year-end March)	CY19	CY20E	CY21E	CY22E
Liabilities				
Equity Capital	288.7	288.7	288.7	288.7
Reserve and Surplus	3039.7	2957.3	3459.0	4073.4
Total Shareholders funds	3328.4	3246.0	3747.7	4362.1
LT Borrowings & Provisions	2355.4	1955.4	1455.4	955.4
Deferred Tax Liability	282.5	296.6	311.5	327.0
Total Liabilities	6168.1	5677.7	5703.2	5842.7
Assets				
Gross Block	7,710.6	8,124.4	8,524.4	8,924.4
Less: Acc Depreciation	2,186.7	2,714.7	3,243.3	3,796.6
Net Block	5,892.5	5,409.7	5,281.1	5,127.8
Capital WIP	63.8	50.0	50.0	50.0
Net Intangible Assets	562.3	590.4	619.9	650.9
Non-current Investments	0.9	0.9	0.9	0.9
Goodwill	24.2	24.2	24.2	24.2
Current Assets				
Inventory	881.5	621.7	753.8	827.7
Debtors	172.6	159.9	193.8	212.8
Loans and Advances	6.9	177.6	215.4	236.5
Other Current Assets	219.8	14.2	17.2	18.9
Cash	171.1	306.8	344.0	552.7
Deferred Tax Assets	12.8	12.8	12.8	12.8
Current Liabilities				
Creditors	477.7	497.4	516.9	567.6
Provisions	30.0	53.3	64.6	70.9
Short term debt & other CL	1,697.5	1,433.0	1,559.3	1,586.1
Application of Funds	6,168.1	5,677.7	5,703.2	5,842.7

Source: Company, ICICI Direct Research

Exhibit 16: Key ratios				
	₹ crore			
(Year-end March)	CY19	CY20E	CY21E	CY22E
Per share data (₹)				
EPS	16.4	11.3	21.7	26.6
Cash EPS	33.3	29.6	40.0	45.8
BV	115.3	112.4	129.8	151.1
DPS	0.0	2.3	4.3	5.3
Cash Per Share	75.7	94.0	112.3	131.5
Operating Ratios (%)				
EBITDA Margin	20.3	18.9	20.2	20.1
PBT / Total Operating income	9.7	6.8	11.0	12.3
PAT Margin	6.6	5.1	8.1	9.0
Inventory days	45.1	35.5	35.5	35.5
Debtor days	8.8	9.1	9.1	9.1
Creditor days	24.5	28.4	24.3	24.3
Return Ratios (%)				
RoE	14.2	10.1	16.7	17.6
RoCE	15.5	12.3	18.6	20.7
Valuation Ratios (x)				
P/E	41.1	59.5	31.0	25.3
EV / EBITDA	15.3	17.7	13.3	11.7
EV / Net Sales	3.1	3.4	2.7	2.3
Market Cap / Sales	2.7	3.0	2.5	2.3
Price to Book Value	5.8	6.0	5.2	4.5
Solvency Ratios				
Debt/EBITDA	1.9	1.9	1.1	0.7
Debt / Equity	0.8	0.7	0.5	0.3
Current Ratio	0.6	0.6	0.6	0.6
Quick Ratio	0.1	0.2	0.2	0.2

Source: Company, ICICI Direct Research

Exhibit 17: ICICI Direct coverage universe (FMCG)

	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	FY21E
Colgate (COLPAL)	1,470	1,700	Buy	38,812	30.0	33.4	35.4	49.0	44.0	41.6	8.6	8.4	7.7	60.7	83.5	100.8	51.2	64.2	78.0
Dabur India (DABIND)	519	595	Buy	90,864	8.2	9.6	10.7	63.3	54.2	48.4	10.4	9.5	8.6	26.1	25.9	26.7	21.9	22.3	22.7
Hindustan Unilever (HINLEV)	2,061	2,500	Buy	510,548	31.2	32.4	38.8	66.1	63.6	53.1	13.3	12.0	10.4	89.5	24.5	28.5	85.7	18.6	21.9
ITC Limited (ITC)	169	250	Buy	218,801	12.5	11.7	13.0	13.6	14.4	13.0	4.7	4.6	4.1	29.4	28.3	36.1	23.8	21.7	27.7
Jyothy Lab (JYOLAB)	132	150	Hold	5,141	4.3	5.3	5.8	30.7	24.9	22.6	3.1	2.9	2.6	24.3	29.7	29.9	21.7	24.2	24.1
Marico (MARLIM)	371	440	Buy	46,834	8.1	8.8	9.5	45.9	42.1	38.9	6.4	6.2	5.6	41.0	42.3	45.1	34.5	36.3	38.5
Nestle (NESIND)	16,961	18,000	Hold	152,970	204.3	223.4	253.4	83.0	75.9	66.9	12.4	11.5	10.4	56.9	59.9	66.6	101.9	119.1	139.2
Tata Consumer Products (TATGLO)	492	525	Buy	49,578	5.0	9.8	11.7	98.5	50.3	42.2	5.1	4.6	4.3	6.9	8.8	9.4	4.6	6.6	7.5
VST Industries (VSTIND)	3,400	3,850	Hold	5,307	196.9	206.0	211.9	17.3	16.5	16.0	4.3	4.5	4.2	52.1	45.3	46.1	38.6	33.6	34.2
Varun Beverage (VARBEV)	673	730	Hold	19,429	16.4	11.3	21.7	41.1	59.5	31.0	2.7	3.0	2.5	15.5	12.3	18.6	14.2	10.1	16.7
Zydus Wellness (ZYDWEL)	1,761	2,300	Buy	11,475	24.6	27.8	65.7	71.6	63.4	26.8	6.5	6.2	5.5	5.9	6.9	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%



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