

CMP: ₹ 3173

Target: ₹ 3425 (8%)

Target Period: 12 months

HOLD

January 22, 2022

Cigarettes volume nearly back to pre-Covid levels...

About the stock VST Industries (VST) is among the oldest cigarette players in India, involved in manufacturing and marketing cigarettes as also trading unmanufactured tobacco.

- The company has two cigarettes manufacturing facilities in Hyderabad, AP. It has five major brands, which includes, 'Total', 'Charms', 'Moment', 'Special', & 'Edition' and a direct distribution reach of over 1.1 million outlets

Q3FY22 Results: VST reported a steady set of numbers with 11% volume growth.

- Sales were up 14.5% YoY with cigarettes volumes growing 11% YoY
- EBITDA was at ₹ 109.1 crore, up 9.1% YoY, with margins at 33.2%
- Consequent PAT was at ₹ 82.7 crore (up 12.2% YoY)

What should investors do? VST industries' share price has underperformed the market with mere 32% return in the last five years (from ₹ 2413 in January 2017 to ₹ 3175 in January 2022).

- Though cigarette industry volumes have reached pre-Covid levels, we believe excessive duties, emergence of e-cigarettes, regulatory framework would keep volume growth in low-single digits in a stable tax scenario
- We continue to maintain our HOLD rating on the stock

Target Price and Valuation: We arrive at a revised target price of ₹ 3425, valuing the business at 14x FY24 earnings.

Key triggers for future price performance:

- Cigarette Industry volumes have reached pre-Covid levels but the company's volumes are slightly lower than in the pre-Covid period
- High priced cigarettes 'Total' & 'Edition' contributed 46% to volumes. The contribution of high priced cigarettes is expected to continue rising
- 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 TCPL in our FMCG coverage.

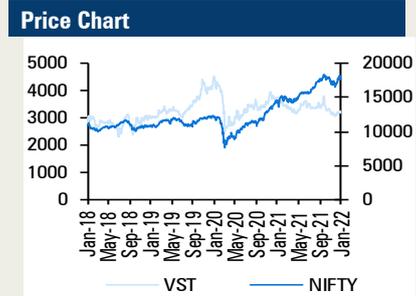
- Strong innovation & premiumisation strategy in salt, tea, Sampaan & Souful in the Indian market are expected to drive sales & margins
- We value the stock at ₹ 910 with a BUY rating



VST Industries Ltd.

Particulars	
Particulars (₹ crore)	Amount
Market Capitalization	4,899.7
Total Debt (FY21)	0.0
Cash and Investments (FY21)	905.2
EV	3,994.5
52 week H/L (₹)	3893 / 3039
Equity capital	₹ 15.4
Face value (₹)	10.0

Shareholding pattern				
(in %)	Mar-21	Jun-21	Sep-21	Dec-21
Promoter	32.2	32.2	32.2	32.2
FII	2.8	2.4	2.1	1.8
DII	17.5	17.3	16.2	16.3
Others	47.5	48.1	49.5	49.7



- Recent event & key risks**
- 'Total' brand is contributing ~40% of total volumes of the company
 - Key Risk:** (i) Any duty increase in Budget 2022 (ii) faster Increase in high price cigarette contribution

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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	1163.5	1238.7	1346.4	6.7%
EBITDA	414.7	410.6	11.6	411.8	443.3	486.2	5.8%
EBITDA Margin %	33.5	37.0		35.4	35.8	36.1	
Net Profit	304.1	310.8	15.2	313.4	335.6	377.7	6.7%
EPS (₹)	196.95	201.29	15.2	203.01	217.38	244.63	6.7%
P/E	16.1	15.8		15.6	14.6	13.0	
RoNW %	38.6	33.0		32.2	35.6	42.3	
RoCE (%)	52.1	43.4		43.4	47.6	56.6	

Key takeaways of recent quarter

Q3FY22 Results: Cigarette volumes closer to pre-Covid levels

- Gross revenue grew 13.4% to ₹ 431.1 crore led by similar growth in cigarettes sales. Sales (net of excise) grew 14.5%. The reduction in trade incentives resulted in lower stocking by trade in Q2, which was reversed in the current quarter. Further, cigarette volumes for the company are slightly lower than pre-Covid levels. Cigarettes volume growth was 11% during the quarter. On a sequential basis, volume growth was 15%
- Tobacco exports were adversely impacted by a sharp increase in container prices in Q2. With the cool off in container prices, tobacco sales picked up. The company clocked ₹ 72 crore of sales in Q3. On a 9MFY22 basis, tobacco revenue was flat
- 'Total' brand contributes 40% to volume and is present at price points of ₹ 6/stick and ₹ 7/stick. 'Edition' brand contributes 6% to total volumes and is present at ₹ 11/stick price point. 'Charms' brand is present in ₹ 5/stick and ₹ 7/stick price points. 'Moment' brand is available at ₹ 5/stick price point
- The company has moved away from consistent trade discounts and is only continuing higher discounts and offers for a particular period. However, it has increased marketing spends at the points of sales to improve the brand visibility and brand building
- The company attempted to enter Gujrat last quarter. However, its priority is registering higher than pre-Covid volumes in its core geographies. It would be looking to consolidate its presence in Telangana, Andhra Pradesh, West Bengal, Bihar, Uttar Pradesh & North East states. The company launched new variants 'Total Royal Twist' under the brand 'Total' in Q2FY22
- VST 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 the 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 on all cigarette brands is ₹ 4800 crore. 'Edition' brand contributes ~3% to sales & is largely concentrated in Hyderabad city
- In the last five years, the company has increased its wholesale dealers from 700 to 848 and direct retail reach from 0.8 million (mn) retail outlets to 1.1 mn retail outlets. VST has enhanced its presence Delhi, Mumbai, UP & Bihar
- The legal cigarette industry in India constitutes 9% of tobacco consumption while 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 duties and taxes. Illegal & contraband is ~8% of total volumes while a consistent increase in duties & taxes on legal cigarettes industry is counterproductive with consumption shift from legal to contrabands

Exhibit 1: Peer Comparison

Sector / Company	CMP		TP Rating	M Cap (₹ Cr)	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹)			FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
ITC Limited (ITC)	217	260	Hold	268462	11.1	8.9	10.7	36.0	37.6	37.9	18.1	15.9	14.2	24.2	26.2	27.6	30.6	34.2	36.8
VST Industries (VSTIND)	3173	3425	Hold	4900	4.9	6.5	8.7	35.4	35.8	36.1	15.6	14.6	13.0	32.2	35.6	42.3	43.4	47.6	56.6

Source: Company, ICICI Direct Research

The cigarette category was adversely impacted by disruptions in the last two years. However, stable taxation and normalisation of out of home activity resulted in cigarette volume recovering to pre-Covid levels. The long term trend in cigarette volume & tobacco sales has been dismal with excessing taxation, global trend towards e-cigarettes & other regulatory controls. We believe volume growth in the segment would be in low single digits with stable taxation. We remain cautious on growth prospects but valuation multiples are extremely attractive. We maintain our **HOLD** rating on the stock with a revised target price of ₹ 3425/share (earlier ₹ 3700/share).

Exhibit 2: Variance Analysis

	Q3FY22	Q3FY22E	Q3FY21	YoY (%)	Q2FY21	QoQ (%)	Comments
Total Operating Income	328.6	290.6	286.9	14.5	271.6	21.0	Revenue grew 14.5% led by strong volume growth in cigarettes segment
Other Operating Income	0.3	0.4	0.3	0.0	0.3	9.7	
Raw Material Expenses	154.1	122.1	129.4	19.1	109.2	41.1	The company has moved away from consistent trade discounts and increased marketing spends at the point of sales
Employee Expense	28.8	29.9	29.4	-1.9	27.1	6.3	
Excise Duty	102.9	107.1	93.5	10.1	89.3	15.3	
Other operating Expenses	36.6	27.6	28.2	29.9	31.0	18.3	
EBITDA	109.1	111.1	100.0	9.1	104.3	4.6	Operating profit increased 9.1%
EBITDA Margin (%)	33.2	38.2	34.8	-164 bps	38.4	-521 bps	
Depreciation	7.8	7.9	9.4	-17.1	7.1	9.3	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	9.7	10.5	9.2	5.7	10.2	-5.3	
PBT	111.0	113.7	99.7	11.3	107.4	3.3	
Tax Outgo	28.3	28.6	26.0	8.6	27.6	2.6	
PAT	82.7	85.0	73.7	12.2	79.9	3.6	Net profit increased 12.2% in line with sales growth
Key Metrics							
Cigarette Sales (₹ crore)	359.1	342.9	316.0	13.7	323.6	11.0	Cigarettes volume grew 11% during the quarter
Tobacco Sales (₹ crore)	72.0	54.5	90.0	-20.0	37.0	94.6	Tobacco exports recovered sequentially after the cool off in container prices

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY22E			FY23E			FY24E			Comments
	Old	New	change	Old	New	change	Old	New	change	
Net sales	1,161.0	1,163.5	0.2	1,256.9	1,238.7	-1.4	1,351.0	1,346.4	-0.3	We largely maintain our sales estimates
EBITDA	423.9	411.8	-2.8	455.1	443.3	-2.6	488.6	486.2	-0.5	
EBITDA Margin (%)	36.5	35.4	-111 bps	36.2	35.7	-42 bps	36.2	36.1	-5 bps	With the increase in marketing spends at point of sales & branding exercise, we change our margins estimates
PAT	322.3	313.4	-2.8	344.4	335.6	-2.5	379.5	377.7	-0.5	
EPS (₹)	208.8	203.0	-2.8	223.1	217.4	-2.5	245.8	244.6	-0.5	

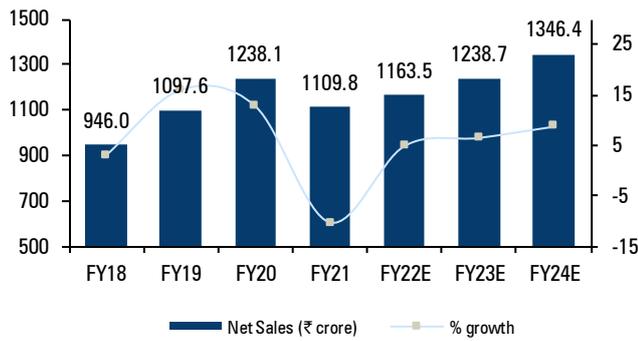
Source: ICICI Direct Research

Exhibit 4: Assumptions

	Current						Earlier			Comments
	FY19	FY20	FY21	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	
Cig. Vol. (mn sticks)	8,031.1	8,753.9	7,866.0	8,338.0	8,754.9	9,105.1	8,652.6	8,912.2	9,179.5	We expected cigarette volumes to recover to 95% of pre-Covid levels in FY22E
Cig. Vol. Growth (%)	9.0	9.0	-10.1	6.0	5.0	4.0	10.0	3.0	3.0	
Realization/cig (₹)	1.2	1.3	1.7	1.6	1.6	1.7	1.6	1.6	1.7	
Tobacco Sales(₹ crore)	238.9	238.8	200.0	218.0	229.1	240.6	218.0	229.1	240.6	
% of <64mm in sales	40.0	40.0	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	60.0	60.0	

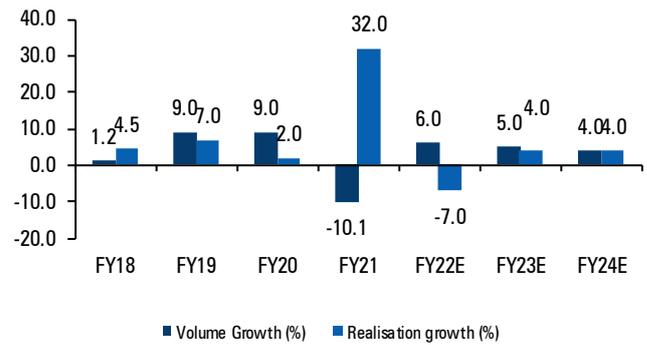
Source: ICICI Direct Research

Exhibit 5: Net revenue to grow at 6.7% CAGR over FY21-24E



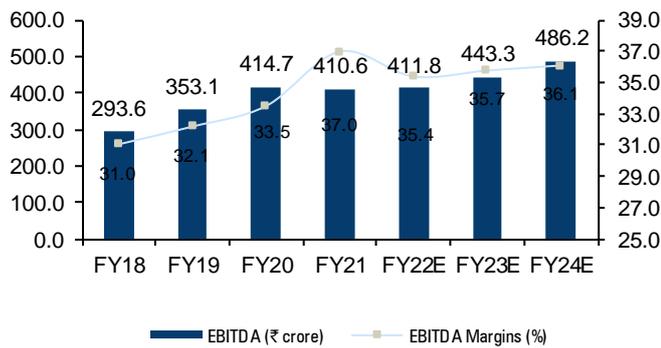
Source: ICICI Direct Research, Company

Exhibit 6: Volume recovery expected in FY22E onwards



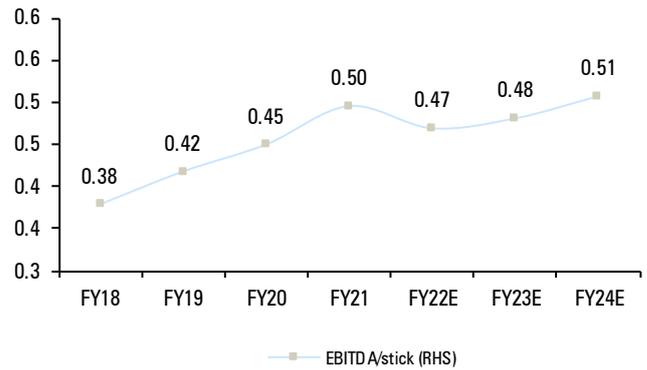
Source: ICICI Direct Research, Company

Exhibit 7: Improved product mix to aid EBITDA margins



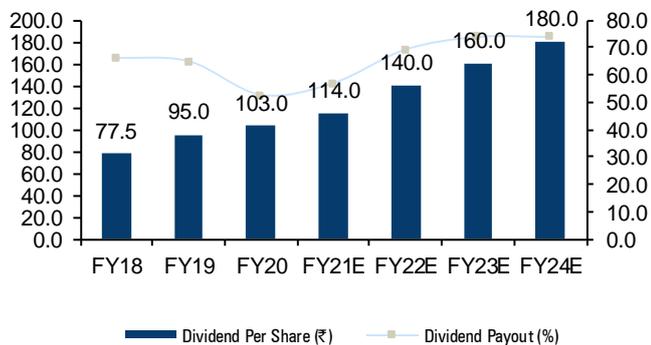
Source: ICICI Direct Research, Company

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



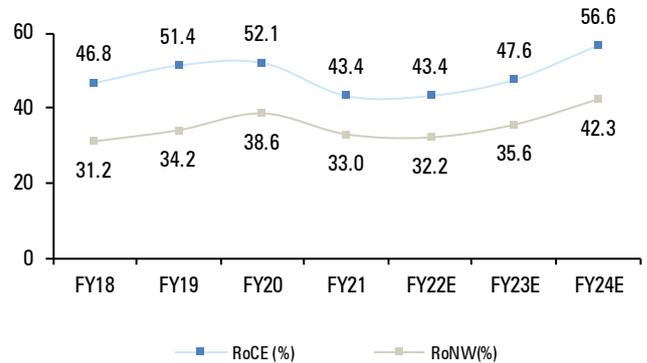
Source: ICICI Direct Research, Company

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	15.8	11.8	33.0	43.4
FY22E	1163.5	4.8	203.0	0.9	15.6	11.8	32.2	43.4
FY23E	1238.7	6.5	217.4	7.1	14.6	11.0	35.6	47.6
FY24E	1346.4	8.7	244.6	12.5	13.0	10.0	42.3	56.6

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Total Operating Income	1111.0	1164.9	1240.4	1348.4
Growth (%)	-10.4	4.9	6.5	8.7
Raw Material Expenses	478.9	503.5	549.4	595.6
Employee Expenses	114.4	119.8	127.6	138.7
Excise Duty	361.9	376.2	433.6	455.3
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	107.1	129.7	120.2	127.9
Total Operating Expenditure	700.4	753.1	797.1	862.2
EBITDA	410.6	411.8	443.3	486.2
Growth (%)	-1.0	0.3	7.6	9.7
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	423.6	450.5	507.0
Others	41.8	42.2	40.1	42.1
Total Tax	106.5	110.1	114.9	129.3
PAT	310.8	313.4	335.6	377.7
Growth (%)	2.2	0.9	7.1	12.5
EPS (₹)	201.3	203.0	217.4	244.6

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Profit after Tax	310.8	313.4	335.6	377.7
Add: Depreciation	35.1	30.5	32.9	21.3
(Inc)/dec in Current Assets	-103.6	-17.0	-4.7	26.8
Inc/(dec) in CL and Provisions	-66.8	-6.9	33.4	47.8
CF from operating activities	175.4	320.0	397.2	473.7
(Inc)/dec in Investments	-0.9	1.1	-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	-18.6	0.2	0.3
CF from investing activities	-34.7	-52.5	-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	-159.0	-280.9	-365.2	-428.9
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	-157.4	-280.9	-365.2	-428.9
Net Cash flow	-16.7	-13.4	-2.9	10.0
Opening Cash	26.2	9.6	-3.8	-6.7
Closing Cash	20.8	7.4	4.5	14.4

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22E	FY23E	FY24E
Liabilities				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	925.0	957.5	927.9	876.8
Total Shareholders funds	940.5	973.0	943.4	892.2
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	22.1	3.5	3.7	4.0
Total Liabilities	962.5	976.4	947.1	896.3
Assets				
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	1.6	1.7	1.8
LT Loans & Advances/Others	1.1	1.1	1.1	1.1
Current Assets				
Inventory	297.2	280.5	298.7	324.6
Debtors	15.2	15.9	17.0	18.4
Cash	20.8	7.4	4.5	14.4
Loans & Advances	0.0	8.0	8.5	9.2
Current Investments	884.4	904.4	884.4	824.4
Other CA	33.1	38.1	43.1	48.1
Current Liabilities				
Creditors	131.5	133.9	142.5	154.9
Provisions	0.0	0.0	0.0	0.0
Other CL	391.8	382.5	407.3	442.7
Net Current Assets	727.4	737.9	706.3	641.6
Total Assets	962.5	976.4	947.1	896.3

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY21	FY22E	FY23E	FY24E
Per share data (₹)				
EPS	201.3	203.0	217.4	244.6
Cash EPS	224.0	222.7	238.7	258.4
BV	609.1	630.2	611.0	577.8
DPS	114.0	140.0	160.0	180.0
Cash Per Share	13.5	4.8	2.9	9.4
Operating Ratios (%)				
EBITDA Margin	37.0	35.4	35.7	36.1
PBT / Net Sales	37.6	36.4	36.4	37.7
PAT Margin	28.0	26.9	27.1	28.1
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
Return Ratios (%)				
RoE	33.0	32.2	35.6	42.3
RoCE	43.4	43.4	47.6	56.6
RoIC	21.3	21.1	23.4	28.5
Valuation Ratios (x)				
P/E	15.8	15.6	14.6	13.0
EV / EBITDA	11.8	11.8	11.0	10.0
EV / Net Sales	4.4	4.2	3.9	3.6
Market Cap / Sales	4.4	4.2	4.0	3.6
Price to Book Value	5.2	5.0	5.2	5.5
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.4	2.4	2.3	2.0
Quick Ratio	1.8	1.9	1.7	1.5

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	FY23E
Colgate (COLPAL)	1,444	1,800	Buy	39,979	38.1	38.3	41.1	37.9	37.7	35.1	8.3	7.7	7.1	106.4	110.5	113.2	88.8	84.8	87.0
Dabur India (DABIND)	552	745	Buy	103,817	9.6	10.5	12.1	57.6	52.4	45.6	10.9	9.4	8.5	24.5	25.7	27.3	22.1	22.2	23.3
Hindustan Unilever (HINLEV)	2,330	2,460	Hold	537,543	33.9	37.2	41.0	68.8	62.6	56.8	11.9	10.6	9.7	18.9	23.7	25.9	17.1	18.5	20.3
ITC Limited (ITC)	217	260	Hold	268,462	10.7	12.0	13.7	20.2	18.0	15.8	5.6	5.0	4.6	28.2	31.4	34.1	22.1	24.2	26.2
Jyothy Lab (JYOLAB)	140	170	Hold	5,040	5.2	5.0	6.7	27.0	28.3	21.0	2.7	2.3	2.1	26.0	21.5	27.3	20.4	18.8	23.7
Marico (MARLIM)	478	630	Buy	65,058	9.3	10.4	11.5	51.4	46.1	41.5	8.1	7.0	6.5	39.6	42.8	46.6	36.3	38.4	40.4
Nestle (NESIND)	18,984	20,450	Hold	191,903	216.0	249.9	279.6	87.9	76.0	67.9	14.4	13.0	11.9	50.9	54.9	56.4	86.5	87.8	86.3
Tata Consumer (TATGLO)	728	910	Buy	67,833	10.1	11.8	14.1	72.1	61.9	51.7	5.8	5.4	5.0	8.0	8.9	9.9	6.4	7.2	8.3
VST Industries (VSTIND)	3,173	3,425	Hold	4,900	201.3	203.0	217.4	15.8	15.6	14.6	4.4	4.2	4.0	43.4	43.4	47.6	33.0	32.2	35.6
Varun Beverage (VARBEV)	910	1,020	Buy	36,864	8.4	16.0	20.3	108.8	56.8	44.8	5.7	4.4	3.9	10.9	19.6	23.4	10.3	17.2	18.9
Zydus Wellness (ZYDWEL)	1,707	2,800	Buy	11,738	18.7	56.2	67.8	91.5	30.4	25.2	6.3	5.6	5.1	6.2	7.3	8.6	5.5	7.5	9.0

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%



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