

Impressive volume growth continues in CY22...

About the stock Varun Beverage (VBL) is one of the largest franchisees of PepsiCo in the world. The company produces & distributes carbonated drinks, juices & packaged drinking water in six countries including India. Some of the PepsiCo brands produced by VBL include Pepsi, Diet Pepsi, Seven-Up, Mirinda, Mountain Dew, Nimbooz, String, Slice, Tropicana, Aquafina among others.

- The company has operations in India (except Andhra Pradesh, J&K & Ladakh), Sri Lanka, Nepal, Morocco, Zambia and Zimbabwe

Q3CY22 Results: Varun Beverages witnessed robust volume growth of 24%.

- Sales were up 32.5% YoY led by low base and strong growth in underpenetrated territories
- EBITDA was at ₹ 699 crore, up 41.3% YoY, with margins at 22%
- Consequent PAT grew 53.3% to ₹ 395.5 crore

What should investors do? Varun Beverage's share price has given 7.3x return (from ₹ 150 in October 2017 to ₹ 1107 in October 2022).

- We revise our CY22 and CY23 revenue and earnings numbers upward after robust volume growth in 9MCY22
- Given most positives are already factored in valuation, we change our rating on the stock from BUY to **HOLD**

Target Price and Valuation: We value the stock at ₹ 1235, valuing the business at 40x CY24 PE

Key triggers for future price performance:

- The underpenetrated territories of Bihar, Madhya Pradesh, Jharkhand and acquired southern & western territories are growing to their potential after distribution expansion to 3 million outlets
- The growth in newer brands like 'Sting' & milk based beverages growing at faster pace, supporting overall volume growth
- With strong volume growth & capacity utilisation touching 90% (May), VBL is expanding its capacity by 20% with capex of ₹ 1200 crore in CY23

Alternate Stock Idea: We like Tata Consumer Products in our FMCG coverage.

- Strong innovation & premiumisation strategy in salt, tea, Sampann & Soulful in India market expected to drive sales and margins
- We value the stock at ₹ 950 on ascribing 55x FY24 earnings multiple



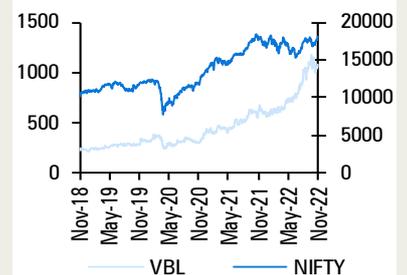
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	71,888.7
Total Debt (CY21)	3,341.9
Cash & Investments (CY21)	336.0
EV	74,894.6
52 week H/L (₹)	1194 / 545
Equity capital	288.7
Face value	10.0

Shareholding pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	64.9	64.9	63.9	63.9
FII	21.2	21.0	23.9	25.0
DII	7.1	7.2	5.3	4.5
Others	6.8	6.9	6.9	6.6

Price Chart



Recent event & key risks

- VBL is witnessing strong growth in Sting, which has contributed 8.5% to volumes in 9MCY22
- Key Risk:** (i) Possibility of softer summer product demand due to adverse weather conditions in CY23 (ii) Incessant increase in RM cost like PET may impact gross margins adversely

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Key Financial Summary

	CY20	CY21	5 Year CAGR (CY16 - CY21)	CY22E	CY23E	CY24E	CAGR (CY21-24E)
Net Sales	6450.1	8823.2	18.0	12811.0	14461.3	16156.5	22.3%
EBITDA	1201.9	1654.6	15.8	2728.3	3090.4	3474.5	28.1%
EBITDA Margin %	18.6	18.8		21.3	21.4	21.5	
Net Profit	362.1	746.1	73.1	1509.2	1739.3	2007.8	39.1%
Diluted EPS (₹)	5.57	11.49	34.2	23.23	26.78	30.91	39.1%
P/E	132.4	64.2		47.6	41.3	35.8	
RoNW %	10.3	18.3		29.0	29.4	30.8	
RoCE (%)	10.9	17.1		30.3	33.5	37.7	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

Q3CY22 Results: Strong volume growth continues...

- VBL witnessed growth of 32.5% to ₹ 3176.6 crore led by 24% volume growth & 6.8% realisation growth. Consolidated sales volume and average realisation were at 190 million cases and ₹ 167/case, respectively
- India sales volume grew 22% to 148 million cases while international sales volume increased 31.3% to 42 million cases. The growth in international territories was largely driven by Morocco, which has seen very high volume growth in the water business
- The higher realisation was mainly due to better product mix. VBL sold smaller SKUs of 250 ml specifically energy drink brand 'Sting'. With strong growth in energy drinks, the contribution of Sting has been 11% in Q3CY22 and 8.5% in 9MCY22. Sting realisation is up 65% compared to CSD products
- Carbonated soft drink (CSD) constitutes 70% of total volume whereas juices & water contributes 5% & 25% to total volumes, respectively
- Gross margin during the quarter improved 90 bps despite raw material pressure. Though crude prices have come off from the highs, it still remains higher compared to historic averages. We believe the company would be holding low cost raw material inventory given it has procured higher raw material before the season in January-February 2022 itself
- The company was able to save 130 bps (percentage to sales) through lower employee spends. However, overhead spends were up 83 bps mainly due to higher fuel prices. Operating profit witnessed growth of 41% to ₹ 699 crore with operating margin expansion of 138 bps to 22%. Higher contribution of energy brand 'Sting' resulted in higher margin in Q3CY22
- Lower tax provisioning due to shift in new tax regime in India along with strong revenue growth & uptick in margins led by 53.3% growth in net profit to ₹ 395.5 crore
- VBL and PepsiCo enter into an agreement to distribute & sell *Lays*, *Doritos* and *Cheetos* for PepsiCo's wholly owned subsidiaries in the territory of Morocco with effect from January 2023
- As per the co-manufacturing agreement dated February 28, 2022, the manufacturing plant in Kosi, Uttar Pradesh commenced trial production of Kurkure Puffcorn for PepsiCo India
- VBL is continuously increasing its distribution network. Its retail reach is 3 million outlets and it is looking to increase it by 10-12% every year. Some underpenetrated territories are growing extremely fast. Bihar and MP territories are growing at 50%. The reach for 'Sting' brand is 2 million outlets
- The company is increasing its overall capacity by 20% with a capex of ₹ 1200-1300 crore in CY23. The CSD capacity addition would be completed before 2023 season. However, the second plant for juices, Sting & dairy product would only be commissioned by June 2023. VBL is doubling capacity of juices, energy drinks & dairy products through this second plant
- The current debt is at ₹ 2300 crore (reduction of ₹ 700 crore in CY22)
- On the raw material front, PET resins prices have started softening, which would be reflected in margin, going forward. The company would be aiming to achieve and maintain 21% operating margins
- With the shift to the new tax regime in India, the blended tax rate is likely to come down to 23%. We have estimated the same for CY23E and CY24E

- The company is witnessing a favourable demand scenario after two years of Covid-19 disruption. Further, out of home consumption is outpacing pre-Covid levels

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
Nestle (NESIND)	20590	22400	Hold	190912	10.2	14.3	10.5	24.5	22.3	24.1	92.6	80.5	68.4	111.3	103.6	110.3	58.7	57.1	63.0
Dabur India (DABIND)	564	700	Buy	97076	13.9	9.1	13.1	20.7	19.8	20.7	57.2	51.9	44.5	20.8	21.4	22.6	24.9	24.6	26.5
Varun Beverage (VARBEV)	1107	1235	Hold	71889	36.8	45.2	12.9	18.8	21.3	21.4	64.3	47.6	41.3	18.3	29.0	29.4	17.1	30.3	33.5
Zydus Wellness (ZYDWEL)	1735	2100	Buy	10254	7.6	12.4	10.5	17.2	18.1	19.7	35.7	30.2	24.5	6.4	7.3	8.7	6.1	7.1	8.4

Source: Company, ICICI Direct Research

VBL is witnessing very strong volume driven growth in India as well as in overseas territory after two years of Covid-19 disruption. The base quarter was still low given many out of home spaces like restaurants, pubs, cinema halls along with education institutions were not fully operational in the base quarter. However, despite that, such high volume growth is very impressive. We believe the company is able to drive higher volumes from its acquired territories of south & west. Moreover, some newer brands like 'Sting' in energy drinks & 'Creambell' in dairy based beverages are getting strong traction and driving volume growth. We believe the efforts towards increasing distribution network and setting up manufacturing units in some under penetration territories (Uttar Pradesh, Bihar, Madhya Pradesh, Chhattisgarh and Rajasthan) would boost volumes in future. We remain positive on growth prospects. As most positives are factored in current valuation multiples, we changing our rating on the stock to **HOLD** with a revised target price of ₹1235 (earlier: ₹ 1100).

Exhibit 2: Variance Analysis

Particulars (₹ crore)	Q3CY22	Q3CY21	YoY (%)	Q2CY22	QoQ (%)	Comments
Net Sales	3,176.6	2,398.2	32.5	4,954.8	-35.9	Revenues were boosted by robust 24% volume growth and 6.8% realisation growth
Raw Material Expenses	1,471.3	1,132.4	29.9	2,451.8	-40.0	Despite steep inflation in pet resin prices, gross margin inched up 90 bps. We believe the company benefited from low cost inventory procured before the summer season in February 2022
Employee Expenses	311.2	266.2	16.9	310.4	0.2	
Other operating Expenses	695.1	504.9	37.7	941.9	-26.2	Overhead spends were higher mainly on account of higher fuel prices
EBITDA	699.0	494.7	41.3	1,250.6	-44.1	Operating profit grew a robust 41.3% largely due to higher sales & operating leverage
EBITDA Margin (%)	22.0	20.6	138 bps	25.2	-324 bps	Operating margins were up 138 bps
Depreciation	153.1	138.5	10.6	153.1	0.0	
Interest	45.3	42.7	6.1	46.4	-2.4	
Other Income	10.6	36.9	-71.2	10.5	1.4	
PBT	511.2	350.4	45.9	1,061.6	-51.8	
Exceptional Items	0.0	0.0		0.0		
Tax Outgo	115.7	92.5	25.1	259.6	-55.4	Taxation provisioning was relatively lower due to shift to new tax regime in India
PAT	395.5	257.9	53.3	802.0	-50.7	Net profit grew 53.3%
Adj. PAT	395.5	257.9	53.3	802.0	-50.7	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	CY22E			CY23E			CY24E			Change	Comments
	Old	New	% Change	Old	New	% Change	Old	New	% Change		
Net Sales	12,338.5	12,811.0	3.8	13,919.4	14,461.3	3.9	15,538.8	16,156.5	4.0	We estimate higher volume growth considering robust growth in 9MFY23	
EBITDA	2,566.9	2,728.3	6.3	2,860.1	3,090.4	8.1	3,196.1	3,474.5	8.7		
EBITDA Margin(%)	20.8	21.3	49 bps	20.5	21.4	82 bps	20.6	21.5	94 bps	We estimate uptick in margin due to operating leverage benefit	
PAT	1,336.7	1,509.2	12.9	1,517.3	1,739.3	14.6	1,779.4	2,007.8	12.8	We consider lower depreciation & income tax provisioning after taking into account 9MFY23 numbers	
EPS (₹)	20.6	23.2	12.9	23.4	26.8	14.6	27.4	30.9	12.8		

Source: ICICI Direct Research

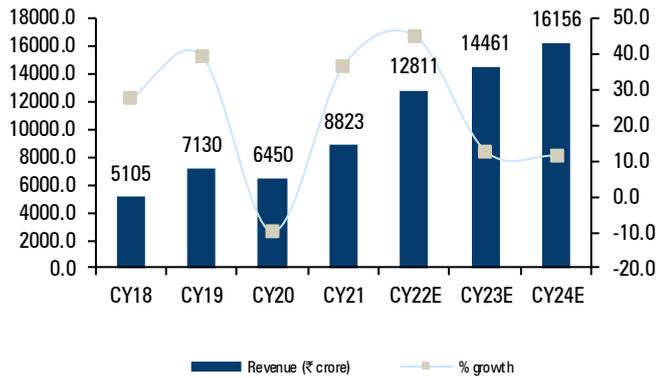
Exhibit 4: Assumptions

Particulars (in million cases)	Current						Earlier				Comments
	CY18	CY19	CY20	CY21	CY22E	CY23E	CY24E	CY22E	CY23E	CY24E	
Carbonated Products	257.0	347.0	309.0	399.8	553.8	609.2	664.0	543.8	598.2	652.0	We raise volume growth estimate considering 9MFY23 numbers
Non Carbonated drinks	22.0	33.0	26.0	36.1	57.8	64.8	72.5	47.0	52.6	58.9	
Water	61.0	111.0	90.0	132.3	183.9	207.8	228.6	178.6	201.8	222.0	
Sugar	679.3	948.1	814.0	1,188.2	1,901.2	2,199.6	2,524.2	1,818.9	2,103.9	2,413.3	
% of sales	13.0	13.3	12.4	13.3	14.5	14.9	15.3	14.5	14.9	15.3	
cost/kg (₹)	37.0	36.6	34.8	38.6	40.6	42.6	44.7	40.2	42.2	44.3	

Source: ICICI Direct Research

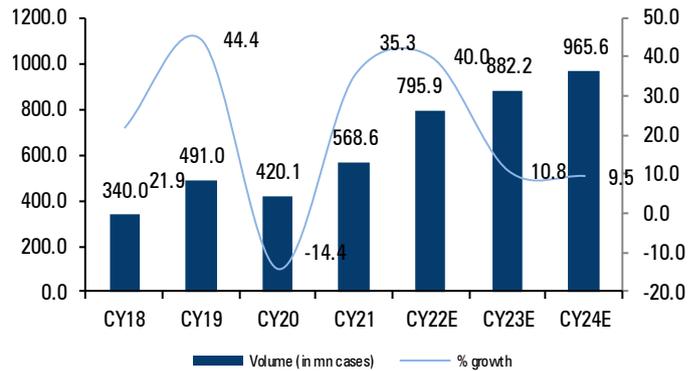
Key Metrics

Exhibit 5: Revenue growth trend (₹ crore)



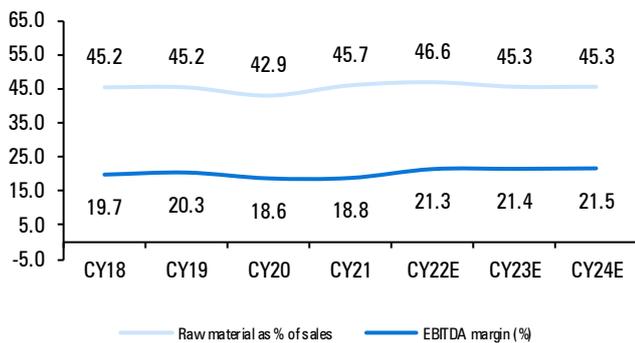
Source: Company, ICICI Direct Research

Exhibit 6: Volume recovery to drive growth



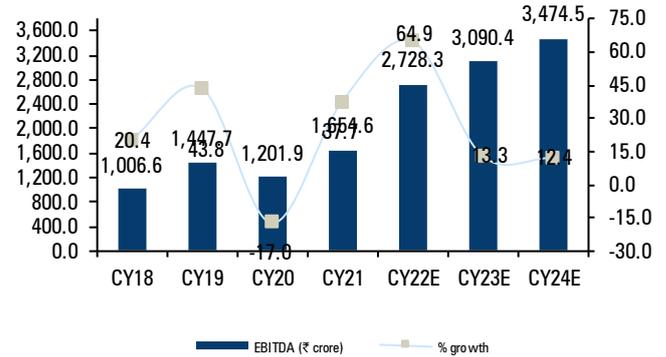
Source: Company, ICICI Direct Research

Exhibit 7: Raw material to sales & EBITDA margins (%)



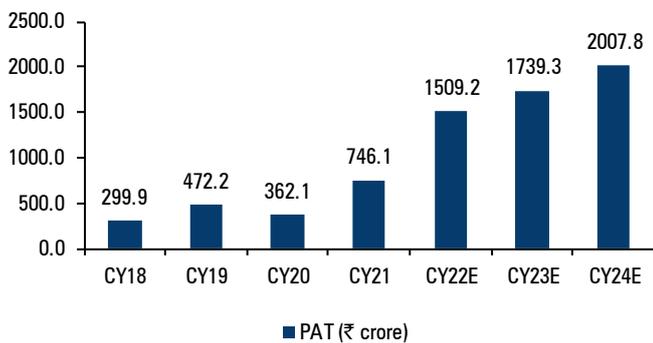
Source: Company, ICICI Direct Research

Exhibit 8: EBITDA (₹ crore) & EBITDA growth (%) trend



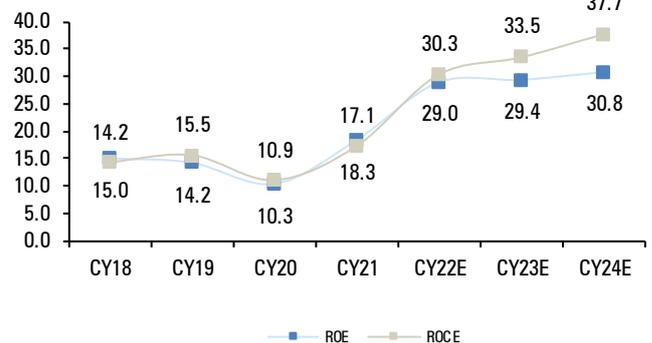
Source: Company, ICICI Direct Research

Exhibit 9: Earnings to grow on low base in CY21E (₹ crore)



Source: Company, ICICI Direct Research

Exhibit 10: Return ratio trend (%)



Source: Company, ICICI Direct Research

Exhibit 11: Valuation

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
CY21	8823.2	36.8	17.2	106.1	64.2	44.8	18.3	17.1
CY22E	12811.0	45.2	23.2	34.9	47.6	26.8	29.0	30.3
CY23E	14461.3	12.9	26.8	15.2	41.3	23.5	29.4	33.5
CY24E	16156.5	11.7	30.9	15.4	35.8	20.7	30.8	37.7

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
	CY21	CY22E	CY23E	CY24E
Total operating income	8823.2	12811.0	14461.3	16156.5
Growth (%)	36.8	45.2	12.9	11.7
Raw Material Expenses	4034.7	5970.1	6556.3	7323.5
Employee Expenses	1007.7	1191.4	1590.7	1777.2
Marketing Expenses	0.0	157.0	221.4	247.3
Other expenses	2126.2	2764.1	3002.4	3334.0
Total Operating Expenditure	7168.6	10082.7	11370.8	12681.9
EBITDA	1,654.6	2,728.3	3,090.4	3,474.5
Growth (%)	37.7	64.9	13.3	12.4
Depreciation	531.3	596.5	714.2	768.4
Interest	184.7	180.6	164.2	128.9
Other Income	67.9	42.5	46.7	30.4
PBT	1006.6	1993.7	2258.8	2607.6
Total Tax	260.6	484.5	519.5	599.7
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	0.0	0.0	0.0	0.0
PAT	746.1	1,509.2	1,739.3	2,007.8
Growth (%)	106.1	102.3	15.2	15.4
EPS (₹)	17.2	23.2	26.8	30.9

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	CY21	CY22E	CY23E	CY24E
Profit After Tax	968.9	1,689.8	1,903.5	2,136.8
Add: Depreciation	531.3	596.5	714.2	768.4
(Inc)/dec in Current Assets	-596.8	-866.3	-400.1	-407.3
Inc/(dec) in CL and Provisions	328.1	993.2	239.2	652.9
CF from operating activities	1,231.4	2,413.3	2,456.8	3,150.7
(Inc)/dec in Investments	0.0	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	0.0	0.0	1.0
(Inc)/dec in Fixed Assets	-815.4	-636.7	-879.3	-930.8
Others	-87.7	0.0	0.0	0.0
CF from investing activities	-1,010.6	-636.7	-879.3	-930.8
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	109.7	-800.0	-650.0	-600.0
Dividend paid & dividend tax	-108.3	-377.3	-1,043.6	-1,405.5
Others	-179.1	-397.1	-164.2	-128.9
CF from financing activities	-177.7	-1,448.7	-1,830.4	-2,105.7
Net Cash flow	43.1	328.0	-253.0	114.2
Opening Cash	104.6	150.8	478.7	225.8
Other Bank balance	185.9	185.9	185.9	185.9
Closing Cash	150.8	478.7	225.8	340.0

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	CY21	CY22E	CY23E	CY24E
Liabilities				
Equity Capital	433.0	649.5	649.5	649.5
Reserve and Surplus	3646.9	4562.3	5258.0	5860.3
Total Shareholders funds	4079.9	5211.8	5907.5	6509.9
LT Borrowings & Provisions	1813.3	1113.3	613.3	213.3
Deferred Tax Liability	311.1	326.7	343.0	360.2
Total Liabilities	6561.6	6871.5	7094.5	7325.6
Assets				
Gross Block	8,974.6	9,621.2	10,821.2	11,821.2
Less: Acc Depreciation	3,246.6	3,843.1	4,557.3	5,325.7
Net Block	5,728.0	5,778.1	6,263.9	6,495.5
Capital WIP	496.6	500.0	150.0	50.0
Net Intangible Assets	558.6	586.5	615.8	646.6
Non-current Investments	0.8	0.8	0.8	0.8
Goodwill	24.2	24.2	24.2	24.2
Current Assets				
Inventory	1,448.1	1,957.2	2,209.4	2,468.3
Debtors	221.2	320.3	361.5	403.9
Loans and Advances	9.5	14.2	20.1	22.4
Other Current Assets	301.9	462.6	522.2	583.4
Cash	150.8	478.7	225.8	340.0
Deferred Tax Assets	2.4	2.4	2.4	2.4
Current Liabilities				
Creditors	711.8	1,032.0	1,164.9	1,301.5
Provisions	49.7	71.2	80.3	89.8
Short term debt & other CL	2,244.8	2,841.6	2,788.7	3,095.6
Application of Funds	6,561.6	6,871.5	7,094.5	7,325.6

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	CY21	CY22E	CY23E	CY24E
Per share data (₹)				
EPS	17.2	23.2	26.8	30.9
Cash EPS	29.5	32.4	37.8	42.7
BV	94.2	80.2	90.9	100.2
DPS	2.5	5.8	16.1	21.6
Cash Per Share	75.0	59.2	70.2	82.0
Operating Ratios (%)				
EBITDA Margin	18.8	21.3	21.4	21.5
PBT / Total Operating income	11.4	15.6	15.6	16.1
PAT Margin	8.5	11.8	12.0	12.4
Inventory days	59.9	55.8	55.8	55.8
Debtor days	9.2	9.1	9.1	9.1
Creditor days	29.4	29.4	29.4	29.4
Return Ratios (%)				
RoE	18.3	29.0	29.4	30.8
RoCE	17.1	30.3	33.5	37.7
Valuation Ratios (x)				
P/E	64.2	47.6	41.3	35.8
EV / EBITDA	44.8	26.8	23.5	20.7
EV / Net Sales	8.4	5.7	5.0	4.5
Market Cap / Sales	8.1	5.6	5.0	4.4
Price to Book Value	11.7	13.8	12.2	11.0
Solvency Ratios				
Debt/EBITDA	1.5	0.6	0.3	0.1
Debt / Equity	0.6	0.3	0.2	0.1
Current Ratio	0.7	0.7	0.7	0.7
Quick Ratio	0.1	0.1	0.1	0.1

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)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Colgate (COLPAL)	1,623	1,610	Hold	43,606	39.6	38.6	42.3	40.9	42.0	38.4	8.6	8.2	7.5	77.8	82.6	92.7	62.2	62.9	70.8
Dabur India (DABIND)	564	700	Buy	97,076	9.9	10.9	12.7	57.2	51.9	44.5	8.9	8.2	7.2	24.9	24.6	26.5	20.8	21.4	22.6
Hindustan Unilever (HINLEV)	2,552	2,800	Hold	6,23,766	37.5	42.4	46.5	68.0	60.1	54.8	12.4	10.8	9.9	20.2	22.8	25.1	18.1	20.3	22.0
ITC Limited (ITC)	350	405	Buy	4,29,858	12.4	14.2	16.7	28.2	24.5	21.0	7.3	6.1	5.7	31.4	35.3	38.8	24.5	27.1	29.7
Jyothy Lab (JYOLAB)	196	145	Hold	6,077	4.3	5.6	6.4	46.0	35.0	30.7	2.8	2.5	2.3	18.7	24.2	27.7	16.6	21.2	23.8
Marico (MARLIM)	531	515	Hold	67,645	9.7	10.3	11.4	54.6	51.6	46.6	7.1	7.0	6.4	41.2	43.8	47.0	37.5	38.5	41.2
Nestle (NESIND)	20,590	22,400	Hold	1,90,912	222.4	255.8	301.1	92.6	80.5	68.4	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	1,411	1,750	Buy	50,721	27.3	30.9	43.5	51.8	45.6	32.5	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	775	950	Buy	70,169	11.0	13.9	17.1	70.3	55.7	45.2	5.6	5.1	4.6	8.4	9.2	10.8	7.0	8.2	9.7
Varun Beverage (VARBEV)	1,107	1,235	Hold	71,889	17.2	23.2	26.8	64.3	47.6	41.3	8.1	5.6	5.0	17.1	30.3	33.5	18.3	29.0	29.4
VST Industries (VSTIND)	3,510	3,425	Hold	4,937	207.4	229.3	252.9	16.9	15.3	13.9	4.2	3.8	3.5	39.2	44.6	50.6	30.0	33.4	37.8
Zydus Wellness (ZYDWEL)	1,735	2,100	Buy	10,254	48.5	57.5	71.0	35.7	30.2	24.5	5.1	4.5	4.1	6.1	7.1	8.4	6.4	7.3	8.7

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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