

Insignificant presence in growing high price cigarettes

About the stock VST Industries (VST) is a cigarette company in India involved in manufacturing, marketing cigarettes and 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 distribution reach of over 1.2 million outlets

Q3FY23 Results: VST reported muted results with 7.1% dip in cigarettes sales.

- Sales were up 5.2% YoY led by high tobacco exports
- EBITDA was at ₹ 94.7 crore, down 13.2% YoY, with margins at 27.4%
- Consequently, PAT de-grew 4.5% to ₹ 79 crore

What should investors do? VST industries' share price has underperformed the market with -7% return in last five years (from ₹ 3349 in January 2018 to ₹ 3114 in January 2023).

- We cut our EPS estimate by 6% & 5% for FY23E & FY24E, respectively, given the company is losing market share due to its insignificant presence in high priced cigarettes segment. We are introducing FY25E numbers
- We continue to maintain our **HOLD** rating on the stock

Target Price and Valuation: We maintain our **HOLD** rating with a revised target price of ₹ 3300 valuing the business at 13x FY25 earnings.

Key triggers for future price performance:

- VST saw 3% cigarette volume growth in 9MFY23 with market share loss mainly due to strong growth in high-priced cigarettes (₹ 10 price point and above) helping market leader. VST has brand 'Edition' at ₹ 10 price point, which only contributes 5% to sales
- Duties & taxes on cigarettes are expected to remain stable given high prevalence of illicit and contraband cigarettes. However, a crackdown on illicit & contrabands is recently helping cigarette industry gain volumes
- Dividend payout is expected to remain ~70% in future as well. We estimate dividend per share of ₹ 160 & ₹175 in FY23E & FY24E, respectively, which would be dividend yield of ~5%

Alternate Stock Idea: We like ITC in our FMCG coverage.

- Stable taxation on cigarettes is expected to maintain current volumes run-rate. The company has been gaining market share in cigarettes
- We value the stock at ₹ 405 with BUY rating



VST Industries Ltd.

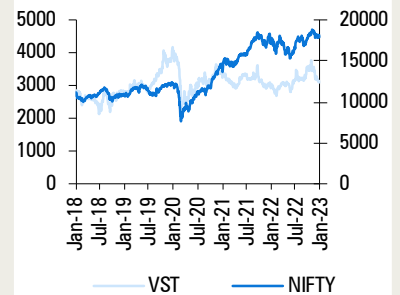
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	4,806.7
Total Debt (FY22)	0.0
Cash and Investments (FY22)	777.7
EV	4,028.9
52 week H/L (₹)	3880 / 2794
Equity capital	₹ 15.4
Face value (₹)	10.0

Shareholding pattern

(in %)	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	32.2	32.2	32.2	32.2
FII	1.8	1.8	1.7	1.7
DII	16.6	16.6	16.6	16.6
Others	49.5	49.4	49.5	49.5

Price Chart



Recent event & key risks

- Tobacco sales grew 50% to ₹ 108 core in Q3FY23 on the back of high export opportunity
- Key Risk:** (i) Any increase in GST or cess (ii) Any significant growth in below ₹ 10/stick cigarettes

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Key Financial Summary

Key Financials	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	FY25E	CAGR (FY22-25E)
Net Sales	1238.1	1109.8	1176.7	5.1	1321.4	1405.7	1508.1	8.6%
EBITDA	414.7	410.6	411.7	10.7	395.3	451.1	509.9	7.4%
EBITDA Margin %	33.5	37.0	35.0		29.9	32.1	33.8	
Net Profit	304.1	310.8	320.3	16.1	330.5	354.2	407.5	8.4%
EPS (₹)	196.9	201.3	207.4	16.2	214.1	229.4	263.9	8.4%
P/E	15.8	15.5	15.0		14.5	13.6	11.8	
RoNW %	38.6	33.0	30.0		31.9	36.9	37.1	
RoCE (%)	52.1	43.4	39.2		41.8	49.1	49.4	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

Q3FY23 Results: Market share continues to slide

- VST Industries witnessed growth of 5.2% led by 50% jump in tobacco sales. Cigarettes sales declined 7.1% to ₹ 333.6 crore whereas tobacco sales grew 50% to ₹ 108 crore
- Tobacco sales growth was led by opportunity in exports due to global shortage of tobacco. The company continues to see a second quarter of high growth in tobacco exports
- Cigarettes volume declined 7% during the quarter given the company has been losing market share in the last one year. The cigarette market is growing at a faster pace (~25%) at ₹ 10/ stick and above price points
- The company also discontinued some of the trade promotions for 'Total' brands leading to a decline in volumes. It has launched a variant of 'Total' at ₹ 10/stick price point last quarter but it is yet to make any impact on volumes
- The company has 'Edition' at above ₹ 10/stick price point, which contributes 5% to volumes. The company would continue to introduce new products at high price point to gain growing market
- The company is focusing on its core geographies to grow cigarette volumes. It has a distribution reach of 1.2 million retail outlets
- Tobacco prices have increased by 15-20% in the last six months, which has also adversely impacted gross margins during the quarter. Tobacco prices, which used to trade at ~₹ 220-230 /kg are now up to ₹ 270/kg. High inflation is mainly due to good export demand for tobacco
- Freight costs have come down significantly in the last six months, which is helping maintain ~13% margin in the tobacco business
- Gross margins contracted by 579 bps mainly due to high inflation in raw tobacco & inferior product mix. The company saw 50% growth in tobacco sales, which is a low margin business
- Employee (up 17 bps as percentage to sales) & overhead spends (down 16 bps) largely remain at similar levels. Operating profit declined 13.2% to ₹ 94.7 crore. Operating margin contracted by 581 bps to 27.4%. Other income grew 65.2% to ₹ 16 crore. Net profit declined 4.5% to ₹ 79 crore impacted by a dip in operating profit

VST Ind - ESG Disclosure Score*			
ESG Disclosure Score			
Score	FY20	FY21	FY22
Environmental	2.1	17.1	43.6
Social	19.0	21.5	32.6
Governance	84.9	84.9	91.1
Overall ESG Score	35.4	41.2	55.8

Source: Bloomberg, ICICI Direct Research, *Score ranges

Exhibit 1: Peer Comparison

Sector / Company	CMP	TP	M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)		RoE (%)			RoCE (%)				
	(₹)	(₹)		Rating	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E			
ITC Limited (ITC)	339	405	Buy	429858	23.1	19.4	6.8	32.0	32.5	35.5	27.4	23.8	20.4	24.5	27.1	29.7	31.4	35.3	38.8
VST Industries (VSTIND)	3114	3300	Hold	4807	6.1	12.3	6.4	35.0	29.9	32.1	15.0	14.5	13.6	30.0	31.9	36.9	39.2	41.8	49.1

Source: Company, ICICI Direct Research

VST Industries witnessed 3% volume growth in 9MFY23 losing market share to ITC. Insignificant presence in faster growing high price point segment (₹ 10/ stick) resulted in market share loss for the company. Though the company has 'Edition' brand at above ₹ 10 price point but it only contributes 5% to total volumes. We believe the company would launch new brands/variants at high price point, which could help it recoup the lost market share in last one year. Stable taxation in the last five years (excise only increased in 2020 budget) resulted in volume growth in ₹ 10/cigarettes but small price point cigarettes volume is still below pre-Covid levels. High inflation in tobacco in the last six months is also a potential risk for operating margins given the company would be unable to take a price hike without the leader intervening on prices. We remain cautious on growth prospects. We also believe that margins will remain under pressure in the medium term. We maintain our HOLD rating and revise our target price on the stock at ₹ 3300/share (earlier: ₹ 3725).

Exhibit 2: Variance Analysis

	Q3FY23	Q3FY23E	Q3FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Total Operating Income	345.8	333.4	328.6	5.2	344.0	0.5	Net sales grew 5.2% led by 50% jump in tobacco sales. However, cigarettes sales declined 7% during the quarter
Other Operating Income	0.4	0.5	0.3	2.9	0.6	-39.7	
Raw Material Expenses	182.1	153.3	154.1	18.2	176.8	3.0	Gross margins contracted by 589 bps mainly on account of inferior product mix & 15% increase in tobacco prices
Employee Expense	31.0	31.5	28.8	7.3	29.1	6.4	
Excise Duty	96.2	105.3	102.9	-6.5	95.7	0.5	
Other operating Expenses	38.0	36.1	36.6	3.7	45.1	-15.8	
EBITDA	94.7	112.4	109.1	-13.2	93.0	1.9	
EBITDA Margin (%)	27.4	33.7	33.2	-581 bps	27.0	36 bps	Operating margins impacted by lower gross margins
Depreciation	7.4	7.7	7.8	-4.6	7.2	3.6	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	16.0	15.9	9.7	65.2	33.0	-51.4	
PBT	103.3	120.6	111.0	-6.9	118.8	-13.0	
Tax Outgo	24.3	31.3	28.3	-14.0	26.6	-8.6	
PAT	79.0	89.2	82.7	-4.5	92.2	-14.3	Net profit dipped by 4.5%
Key Metrics							
Cigarette Sales (₹ crore)	333.6	365.4	359.1	-7.1	362.3	-7.9	Cigarette sales were down 7.1% entirely due to volume de-growth
Tobacco Sales (₹ crore)	108.0	58.4	72.0	50.0	39.0	176.9	Tobacco sales up by 50% due to strong export demand

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			FY25E	Comments
	Old	New	change	Old	New	change	New	
Net sales	1,287.8	1,321.4	2.6	1,396.3	1,405.7	0.7	1,508.1	We increase our tobacco sales estimate upwards & cut our cigarette sales estimate. We introduce FY25E numbers
EBITDA	432.0	395.3	-8.5	483.1	451.1	-6.6	509.9	Lower than estimate cigarette sales & high inflation in tobacco prices to adversely impact margins
EBITDA Margin (%)	33.5	29.9	-368 bps	34.6	32.1	-251 bps	33.8	
PAT	353.2	330.5	-6.4	383.5	354.2	-7.6	407.5	We slightly increase our other income estimate FY23 according to current run rate
EPS (₹)	228.7	214.1	-6.4	248.3	229.4	-7.6	263.9	

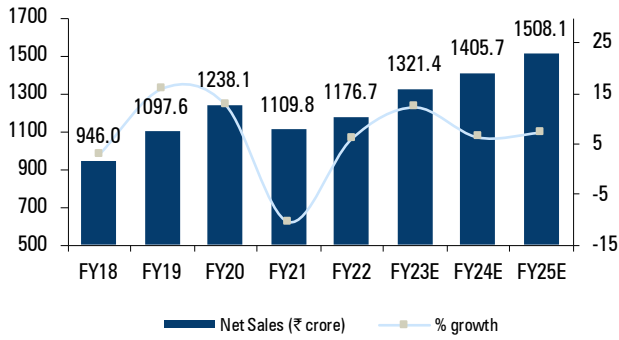
Source: ICICI Direct Research

Exhibit 4: Assumptions

	Current						Earlier		Comments
	FY20	FY21	FY22	FY23E	FY24E	FY25	FY23E	FY24E	
Cig. Vol. (mn sticks)	9,492.0	7,860.0	8,340.0	8,631.9	9,063.5	9,426.0	8,785.5	9,195.4	We cut our volume growth estimate for FY23 according to current run rate
Cig. Vol. Growth (%)	10.9	-17.2	6.1	3.5	5.0	4.0	5.3	4.7	
Realization/cig (₹)	1.2	1.6	1.6	1.6	1.7	1.7	1.7	1.7	Small change in FY23 realisation estimate
Tobacco Sales (₹ crore)	238.8	200.0	212.0	328.8	315.5	331.4	233.4	245.2	We raise our tobacco sales estimate given opportunity for export has open up after rise in tobacco prices

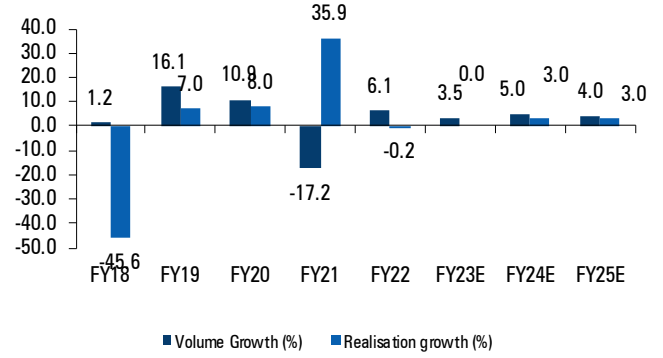
Source: ICICI Direct Research

Exhibit 5: Net sales to grow at 8.6% CAGR over FY22-25E



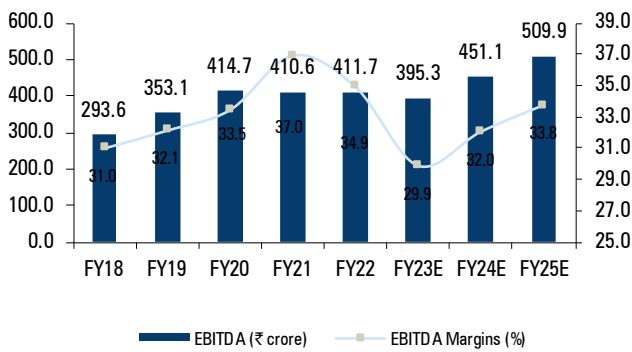
Source: ICICI Direct Research, Company

Exhibit 6: Volume growth to remain dismal



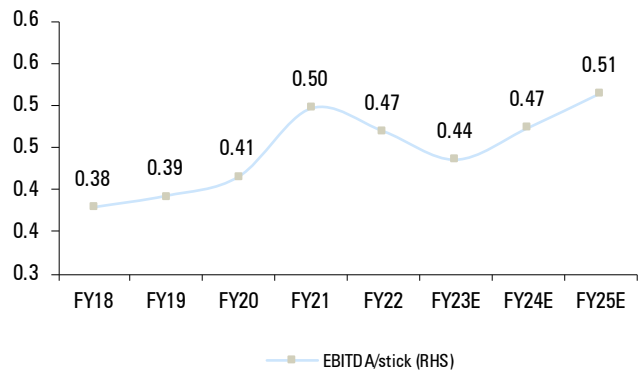
Source: ICICI Direct Research, Company

Exhibit 7: EBITDA margins trend



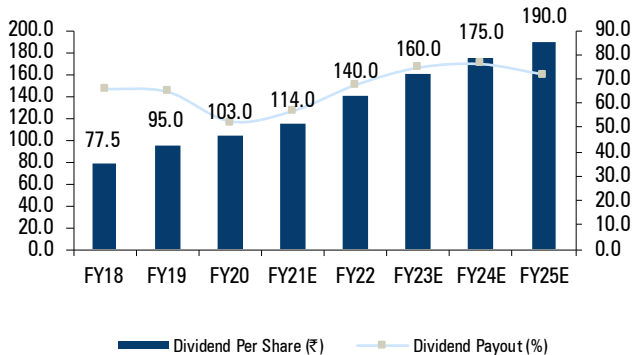
Source: ICICI Direct Research, Company

Exhibit 8: EBITDA/stick to inch up (₹)



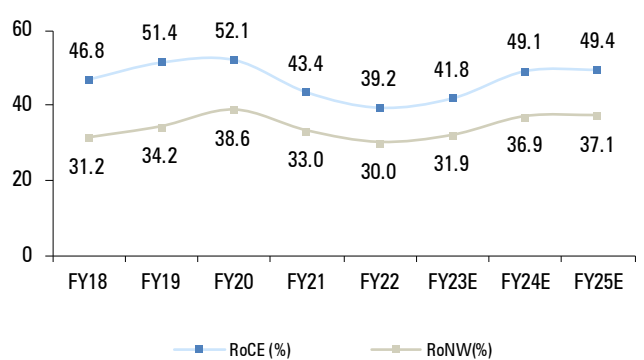
Source: ICICI Direct Research, Company

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 (%)
FY22	1176.7	6.0	207.4	3.1	15.0	11.1	30.0	39.2
FY23E	1321.4	12.3	214.1	3.2	14.5	12.0	31.9	41.8
FY24E	1405.7	6.4	229.4	7.1	13.6	10.5	36.9	49.1
FY25E	1508.1	7.3	263.9	15.1	11.8	9.2	37.1	49.4

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Total Operating Income	1178.2	1323.3	1407.9	1510.7
Growth (%)	6.1	12.3	6.4	7.3
Raw Material Expenses	513.5	653.2	681.3	711.3
Employee Expenses	116.4	122.9	132.1	143.3
Excise Duty	382.5	401.6	417.7	438.6
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	136.7	152.0	143.4	146.3
Total Operating Expenditure	766.5	928.0	956.8	1,000.8
EBITDA	411.7	395.3	451.1	509.9
Growth (%)	0.3	-4.0	14.1	13.0
Depreciation	30.1	30.8	34.1	24.3
Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
PBT	428.3	434.9	473.4	544.8
Others	46.7	70.5	56.4	59.2
Total Tax	108.0	104.4	119.2	137.3
PAT	320.3	330.5	354.2	407.5
Growth (%)	3.1	3.2	7.2	15.1
EPS (₹)	207.4	214.1	229.4	263.9

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Profit after Tax	320.3	330.5	354.2	407.5
Add: Depreciation	30.1	30.8	34.1	24.3
(Inc)/dec in Current Assets	103.3	-189.5	-8.9	-131.8
Inc/(dec) in CL and Provisions	-29.9	67.8	62.7	45.5
CF from operating activities	423.8	239.6	442.0	345.5
(Inc)/dec in Investments	-200.4	201.2	-0.1	-0.1
(Inc)/dec in Fixed Assets	-29.4	-12.8	-35.0	-35.0
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0
Others	-12.9	-19.0	0.3	0.3
CF from investing activities	-242.7	169.5	-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	-280.9	-362.0	-431.7	-270.2
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	-191.7	-362.0	-431.7	-270.2
Net Cash flow	-10.7	47.0	-24.5	40.5
Opening Cash	9.6	-1.1	45.9	21.4
Closing Cash	10.1	57.2	32.7	73.1

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY22	FY23E	FY24E	FY25E
Liabilities				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	1,053.6	1,022.1	944.6	1,081.9
Total Shareholders funds	1,069.0	1,037.5	960.0	1,097.3
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	23.0	4.0	4.2	4.5
Total Liabilities	1092.0	1041.5	964.2	1101.9
Assets				
Gross Block	395.8	425.8	455.8	485.8
Less: Acc Depreciation	223.1	253.9	288.0	312.3
Net Block	195.0	171.9	167.8	173.5
Capital WIP	10.5	15.5	20.5	25.5
Deferred Tax Asset	21.6	21.6	21.6	21.6
Non Current Investments	203.1	1.8	1.9	2.1
LT Loans & Advances/Others	18.5	18.5	18.5	18.5
Current Assets				
Inventory	295.6	318.6	338.9	363.6
Debtors	33.3	36.2	19.3	20.7
Cash	10.1	57.2	32.7	73.1
Loans & Advances	0.4	9.1	9.6	10.3
Current Investments	767.6	917.6	917.6	1,017.6
Other CA	29.7	34.7	39.7	44.7
Current Liabilities				
Creditors	103.4	126.7	161.7	173.5
Provisions	0.0	0.0	0.0	0.0
Other CL	390.0	434.4	462.1	495.8
Net Current Assets	643.4	812.2	733.9	860.7
Total Assets	1092.0	1041.5	964.2	1101.9

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY22	FY23E	FY24E	FY25E
Per share data (₹)				
EPS	207.4	214.1	229.4	263.9
Cash EPS	226.9	234.0	251.4	279.7
BV	692.4	672.0	621.7	710.7
DPS	140.0	160.0	175.0	190.0
Cash Per Share	6.6	37.0	21.2	47.4
Operating Ratios (%)				
EBITDA Margin	34.9	29.9	32.0	33.8
PBT / Net Sales	36.4	32.9	33.7	36.1
PAT Margin	27.2	25.0	25.2	27.0
Inventory days	91.7	88.0	88.0	88.0
Debtor days	10.3	10.0	5.0	5.0
Creditor days	32.1	35.0	42.0	42.0
Return Ratios (%)				
RoE	30.0	31.9	36.9	37.1
RoCE	39.2	41.8	49.1	49.4
RoIC	24.3	19.8	23.3	24.5
Valuation Ratios (x)				
P/E	15.0	14.5	13.6	11.8
EV / EBITDA	11.1	12.0	10.5	9.2
EV / Net Sales	3.9	3.6	3.4	3.1
Market Cap / Sales	4.1	3.6	3.4	3.2
Price to Book Value	4.5	4.6	5.0	4.4
Solvency Ratios				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.3	2.3	2.1	2.2
Quick Ratio	1.7	1.8	1.6	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)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Colgate (COLPAL)	1,451	1,440	Hold	39,473	39.6	37.7	40.3	36.6	38.4	36.0	7.8	7.6	7.1	77.8	79.3	84.2	62.2	60.4	64.1
Dabur India (DABIND)	563	700	Buy	97,076	9.9	10.9	12.7	57.2	51.8	44.5	8.9	8.2	7.2	24.9	24.6	26.5	20.8	21.4	22.6
Hindustan Unilever (HINLEV)	2,622	2,800	Hold	6,04,971	37.5	42.0	46.7	69.9	62.4	56.2	12.0	10.3	9.4	20.2	22.9	25.6	18.1	20.3	22.4
ITC Limited (ITC)	339	405	Buy	4,29,858	12.4	14.2	16.7	27.4	23.8	20.4	7.3	6.1	5.7	31.4	35.3	38.8	24.5	27.1	29.7
Jyothy Lab (JYOLAB)	204	215	Hold	7,482	4.3	6.7	7.8	47.9	30.6	26.2	3.5	3.1	2.8	18.7	27.5	31.4	16.6	24.2	27.0
Marico (MARLIM)	505	560	Hold	69,587	9.7	10.2	11.2	52.0	49.5	44.9	7.3	7.1	6.5	41.2	43.6	46.7	37.5	38.3	41.0
Nestle (NESIND)	19,236	22,400	Hold	1,90,912	222.4	255.8	301.1	86.5	75.2	63.9	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	1,160	1,750	Buy	50,721	27.3	30.9	43.5	42.6	37.5	26.7	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	740	950	Buy	70,169	11.0	13.9	17.1	67.2	53.2	43.2	5.6	5.1	4.6	8.4	9.2	10.8	7.0	8.2	9.7
Varun Beverage (VARBEV)	1,240	1,235	Hold	71,889	17.2	23.2	26.8	72.0	53.4	46.3	8.1	5.6	5.0	17.1	30.3	33.5	18.3	29.0	29.4
VST Industries (VSTIND)	3,114	3,300	Hold	4,807	207.4	214.1	229.4	15.0	14.5	13.6	4.1	3.6	3.4	39.2	41.8	49.1	30.0	31.9	36.9
Zydus Wellness (ZYDWEL)	1,448	2,100	Buy	10,308	48.5	56.5	70.3	29.8	25.6	20.6	5.1	4.5	4.1	6.1	7.0	8.3	6.4	7.2	8.6

Source: Bloomberg, ICICI Direct Research

RATING RATIONALE

ICICI Direct endeavours 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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