

Market share loss continues...

About the stock: VST Industries (VST) is cigarette company in India, involved in manufacturing, marketing cigarettes & trading of unmanufactured tobacco.

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

Q2FY23 Results: VST reported muted results with 10.9% dip in operating profit.

- Sales were up 26.6% YoY led by high tobacco exports
- EBITDA was at ₹ 93 crore, down 10.9% YoY, with margins at 27%
- PAT grew 15.4% as other income includes ₹ 17.5 crore tax write-back

What should investors do? VST Industries' share price has underperformed the market with mere 6% return in the last five years (from ₹ 3433 in November 2017 to ₹ 3636 in November 2022).

- We slightly change our numbers for VST Industries. However, premium cigarettes need to gain traction to re-capture market share
- We maintain our **HOLD** rating on the stock

Target Price and Valuation: We revise our target price to ₹ 3725 valuing the business at 15x FY24 earnings.

Key triggers for future price performance:

- VST saw 9% cigarette volume growth in H1FY23. However, it is still below pre-Covid-19 levels. The company is focusing on brand building through higher spends at point of sale, consumer promotions & product innovation
- High priced cigarettes 'Total' & 'Edition' contribute ~50% to volumes. The contribution of high priced cigarettes is expected to continue to rise. The company is looking to introduce new brands at higher price points
- Duties & taxes on cigarettes are expected to remain stable given increasing prevalence of illicit & contraband cigarettes
- Dividend payout is expected to remain ~70% in future as well. We estimate dividend per share of ₹ 160 and ₹ 180 in FY23E & FY24E, respectively, with dividend yield of ~5%

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

- Strong innovation & premiumisation strategy in salt, tea, Sampann & Souful in the Indian market expected to drive sales & margins
- We value the stock at ₹ 950 with BUY rating



VST Industries Ltd.

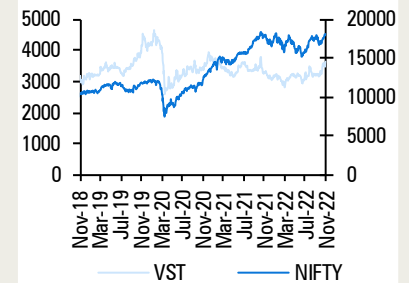
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	5,615.4
Total Debt (FY22)	0.0
Cash and Investments (FY22)	777.7
EV	4,837.6
52 week H/L (₹)	3681 / 2786
Equity capital	₹ 15.4
Face value (₹)	10.0

Shareholding pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	32.2	32.2	32.2	32.2
FII	1.8	1.8	1.8	1.7
DII	16.3	16.6	16.6	19.8
Others	49.7	49.5	49.4	46.3

Price Chart



Recent event & key risks

- VST tobacco sales grew 3x in Q2 on the back of high export opportunity
- Key Risk:** (i) Any increase in GST or cess (ii) Faster growth of high price cigarette contribution

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Key Financial Summary

Key Financials	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	CAGR (FY22-24E)
Net Sales	1238.1	1109.8	1176.7	5.1	1287.8	1396.3	8.9%
EBITDA	414.7	410.6	411.7	10.7	432.0	483.1	8.3%
EBITDA Margin %	33.5	37.0	35.0		33.6	34.6	
Net Profit	304.1	310.8	320.3	16.1	353.2	383.5	9.4%
EPS (₹)	196.95	201.29	207.44	16.2	228.74	248.33	9.4%
P/E	18.5	18.1	17.5		15.9	14.6	
RoNW %	38.6	33.0	30.0		33.3	37.5	
RoCE (%)	52.1	43.4	39.2		43.7	49.9	

Key takeaways of recent quarter

Q2FY23 Results: Absence at ₹ 10 price points cigarettes results in market share loss

- VST witnessed growth of 26.6% to ₹ 344 crore led by strong tobacco exports. The company clocked tobacco sales of ₹ 108 crore during the quarter against ₹ 37 crore in the corresponding quarter. Cigarette sales were up 2.3% led by 8% volume growth. Trade promotions increased significantly and the company has not taken any price hikes or cut in Q2
- The high growth in tobacco sales was mainly led by high export demand due to global shortage of tobacco. Given India works as fillers in global supplies, it has been able to supply high quantity of leaf tobacco during the quarter
- Gross margins contracted 11 percentage points on account of higher contribution of low margin tobacco business & higher trade promotions in cigarettes business. Tobacco business gross margin was ~13% while cigarette business gross margin was ~45%
- Employee spends were down 153 bps (percentage to sales). Overhead spends were up 172 bps on account of increase in ad-spends at point of sale. The increase in advertisement at point of sale, trade & consumer promotions resulted in operating profit dip of 10.9% to ₹ 93 crore
- Other income increased sharply from ₹ 10.2 crore to ₹ 33 crore, mainly on account of write-back of ₹ 17.5 crore tax liability due to settlement of luxury tax dispute with the Telangana government under amnesty scheme. This resulted in net profit growth of 15.4% to ₹ 92.2 crore
- Cigarette volume grew 8% YoY but dipped sequentially by 5%. In H1FY23, cigarette volume growth was 9%. Cigarette selling at price point of ₹ 6-7 contributes 45% of volumes whereas ₹ 10-11 price point cigarettes contribute 6% of volumes
- Industry wide ₹ 10 price points for cigarettes are witnessing significant growth. The company has launched variant of 'Total' at ₹10/ stick price point recently but it has not yet gained traction. It would be re-launching it soon
- The stable taxation & crackdown at illicit & contraband cigarettes is resulting in industry gaining market share from illicit cigarettes. It expects taxation to remain stable, going forward, as well
- Total distribution has reached to 1.13 million outlets vs. 0.7 million in 2014-15. Its operational coverage has increased to 80% of the country against 60% in 2014-15. This has been driven by brand portfolio changing retail presence from one to two SKUs per region to three to four SKUs per region

Exhibit 1: Peer Comparison

Sector / Company	CMP	TP	M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)		
	(₹)	(₹) Rating		(₹ Cr)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E
ITC Limited (ITC)	354	405 Buy	429858	23.1	19.4	6.8	32.0	32.5	35.5	28.5	24.8	21.2	24.5	27.1	29.7	31.4	35.3	38.8
VST Industries (VSTIND)	3636	3725 Hold	5615	6.1	9.5	6.2	35.0	33.6	34.6	17.5	15.9	14.6	30.0	33.3	37.5	39.2	43.7	49.9

Source: Company, ICICI Direct Research

Though, VST has seen 8% cigarettes volume growth in Q2, it is still below pre-Covid-19 level. The company has been losing market share in the last one year given ₹ 10 price point cigarettes are gaining very strong traction. Given VST only recently launched a variant of brand 'Total' at ₹ 10/stick price point, it has been unable to take advantage of a change in consumption trend. Moreover, stable taxation and crackdown of illicit cigarettes has resulted in industry gaining market share from illicit cigarettes. VST has been increasing its spends at point of sale branding, trade promotions as well as consumer promotions to gain volumes. It has also started focusing on higher price points cigarettes by launching 'Total K3' in slim format in core markets. We believe all these efforts could result in regaining volumes specifically from illicit cigarettes. We maintain our HOLD rating and target price on the stock at ₹ 3725 (earlier: ₹ 3425).

Exhibit 2: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Total Operating Income	344.0	321.8	271.6	26.6	301.0	14.3	The strong revenue growth of 26.6% led by sharp increase in tobacco exports given high demand scenario
Other Operating Income	0.6	0.5	0.3	87.1	0.5	11.5	
Raw Material Expenses	176.8	136.2	109.2	61.9	119.8	47.6	High tobacco exports drags down gross margins significantly
Employee Expense	29.1	31.7	27.1	7.2	30.3	-4.0	
Excise Duty	95.7	102.4	89.3	7.2	100.9	-5.1	
Other operating Expenses	45.1	37.0	31.0	45.7	38.0	18.8	Overhead spends were higher due to increase in advertisement spends at point of sale
EBITDA	93.0	116.9	104.3	-10.9	112.9	-17.7	Operating profit was down by 10.9% due to slower growth in cigarette business & higher proportion of low margin tobacco business
EBITDA Margin (%)	27.0	36.3	38.4	-1138 bps	37.5	-1049 bps	
Depreciation	7.2	8.2	7.1	0.6	7.2	-0.6	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	33.0	11.1	10.2	221.9	11.4	190.1	Other income includes write back of ₹ 17.5 crore luxury tax in dispute settlement with Telangana Government
PBT	118.8	119.7	107.4	10.5	117.1	1.4	
Tax Outgo	26.6	30.2	27.6	-3.4	29.9	-11.2	
PAT	92.2	89.6	79.9	15.4	87.1	5.8	Net profit grew by 15.4% due to higher other income
Key Metrics							
Cigarette Sales (₹ crore)	331.1	365.4	323.6	2.3	362.3	-8.6	Cigarettes sales grew 2.3% led by 8% volume growth & lower realisation due to high trade promotions
Tobacco Sales (₹ crore)	108.0	58.4	37.0	191.9	39.0	176.9	Tobacco sales jumped ~3x due to high export demand

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	change	Old	New	change	
Net sales	1,293.4	1,287.8	-0.4	1,403.2	1,396.3	-0.5	We change our sales estimate increasing tobacco sales & lowering cigarette volume, realisation estimate according to H1FY23 numbers
EBITDA	463.8	432.0	-6.8	511.6	483.1	-5.6	Higher sales of low margin tobacco sales & lower sales of high margin cigarette sales would impact overall margins adversely
EBITDA Margin (%)	35.8	33.5	-230 bps	36.5	34.6	-186 bps	
PAT	354.0	353.2	-0.2	390.5	383.5	-1.8	However, lower operating margin impact would be off-set by higher other income in Q2 due to tax provision write back
EPS (₹)	229.3	228.7	-0.2	252.9	248.3	-1.8	

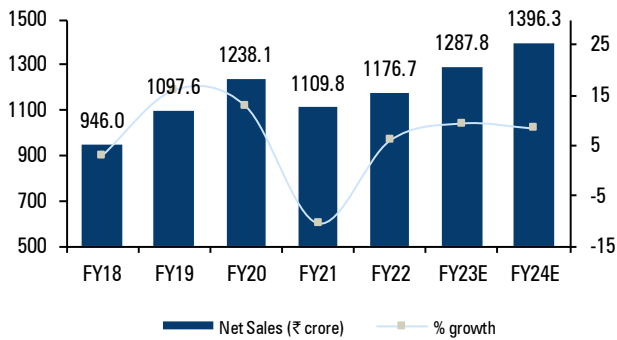
Source: ICICI Direct Research

Exhibit 4: Assumptions

	Current				Earlier				Comments
	FY19	FY20	FY21	FY22	FY23E	FY24E	FY23E	FY24E	
Cig. Vol. (mn sticks)	8,556.0	9,492.0	7,860.0	8,340.0	8,757.0	9,165.5	8,785.5	9,195.4	
Cig. Vol. Growth (%)	16.1	10.9	-17.2	6.1	5.0	4.7	5.3	4.7	We change our cigarettes volume estimate slightly for FY23
Realization/cig (₹)	1.1	1.2	1.6	1.6	1.6	1.7	1.7	1.7	We also change our realisation estimate downwards for FY23
Tobacco Sales(₹ crore)	238.9	238.8	200.0	212.0	260.8	273.9	233.4	245.2	Given high tobacco sales in Q2 due to high export demand, we revise tobacco sales estimate upwards
% of <64mm in sales	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	

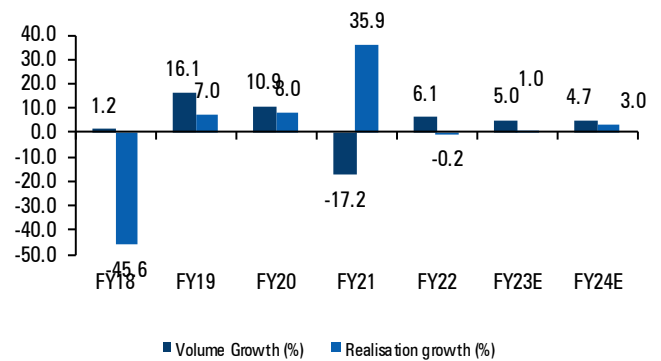
Source: ICICI Direct Research

Exhibit 5: Net revenue to grow at 8.9% CAGR over FY22-24E



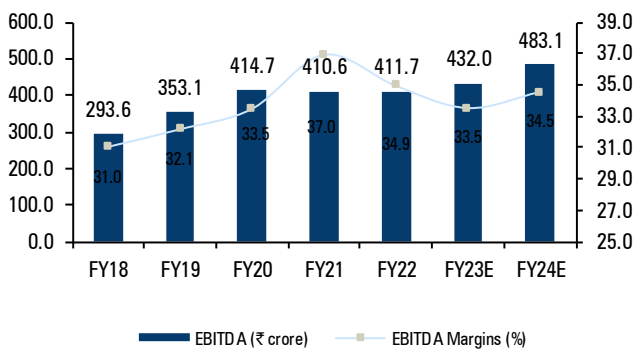
Source: ICICI Direct Research, Company

Exhibit 6: Volume recovery expected in FY22E



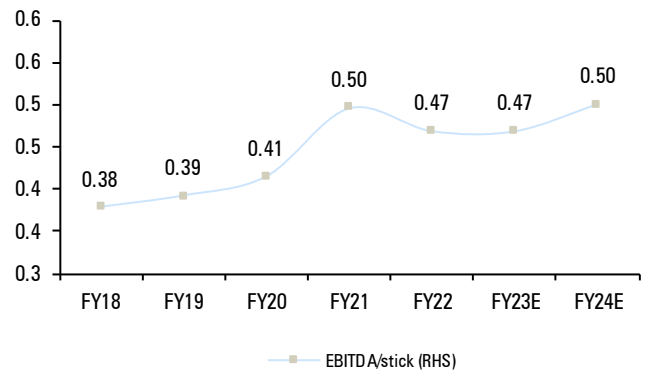
Source: ICICI Direct Research, Company

Exhibit 7: Improved product mix to aid EBITDA margins



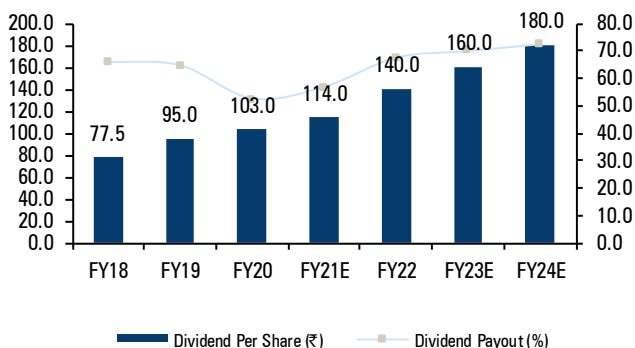
Source: ICICI Direct Research, Company

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



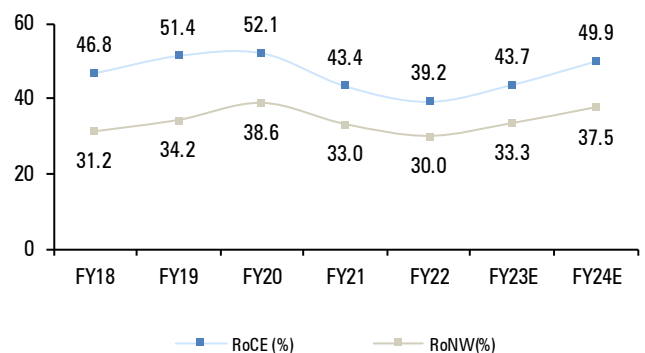
Source: ICICI Direct Research, Company

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	18.1	13.6	33.0	43.4
FY22	1176.7	6.0	207.4	3.1	17.5	13.1	30.0	39.2
FY23E	1287.8	9.4	228.7	10.3	15.9	12.9	33.3	43.7
FY24E	1396.3	8.4	248.3	8.6	14.6	11.5	37.5	49.9

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Total Operating Income	1111.0	1178.2	1289.6	1398.5
Growth (%)	-10.4	6.1	9.5	8.4
Raw Material Expenses	478.9	513.5	589.7	637.5
Employee Expenses	114.4	116.4	126.2	135.4
Excise Duty	361.9	382.5	401.6	417.7
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	107.1	136.7	141.7	142.4
Total Operating Expenditure	700.4	766.5	857.6	915.4
EBITDA	410.6	411.7	432.0	483.1
Growth (%)	-1.0	0.3	4.9	11.8
Depreciation	35.1	30.1	30.8	34.1
Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
PBT	417.3	428.3	464.7	512.5
Others	41.8	46.7	63.5	63.5
Total Tax	106.5	108.0	111.5	129.1
PAT	310.8	320.3	353.2	383.5
Growth (%)	2.2	3.1	10.3	8.6
EPS (₹)	201.3	207.4	228.7	248.3

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	310.8	320.3	353.2	383.5
Add: Depreciation	35.1	30.1	30.8	34.1
(Inc)/dec in Current Assets	-103.6	103.3	-227.9	-48.1
Inc/(dec) in CL and Provisions	-66.8	-29.9	42.9	83.5
CF from operating activities	175.4	423.8	199.0	452.9
(Inc)/dec in Investments	-0.9	-200.4	201.3	-0.1
(Inc)/dec in Fixed Assets	-41.4	-29.4	-12.8	-35.0
(Inc)/dec in LT Loans & Adv.	0.0	0.0	0.0	0.0
Others	7.6	-12.9	-19.1	0.3
CF from investing activities	-34.7	-242.7	169.4	-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	-362.0	-419.8
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	-191.7	-362.0	-419.8
Net Cash flow	-16.7	-10.7	6.4	-1.8
Opening Cash	26.2	9.6	-1.1	5.3
Closing Cash	20.8	10.1	16.5	14.7

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Liabilities				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	925.0	1,053.6	1,044.7	1,008.3
Total Shareholders funds	940.5	1,069.0	1,060.1	1,023.8
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	22.1	23.0	3.9	4.2
Total Liabilities	962.5	1092.0	1064.0	1028.0
Assets				
Gross Block	365.8	395.8	425.8	455.8
Less: Acc Depreciation	193.0	223.1	253.9	288.0
Net Block	172.8	195.0	171.9	167.8
Capital WIP	33.3	10.5	15.5	20.5
Deferred Tax Asset	25.2	21.6	21.6	21.6
Non Current Investments	2.7	203.1	1.8	1.9
LT Loans & Advances/Others	1.1	18.5	18.5	18.5
Current Assets				
Inventory	297.2	295.6	324.6	336.7
Debtors	15.2	33.3	38.8	19.1
Cash	20.8	10.1	16.5	14.7
Loans & Advances	0.0	0.4	8.8	9.6
Current Investments	884.4	767.6	947.6	997.6
Other CA	33.1	29.7	34.7	39.7
Current Liabilities				
Creditors	131.5	103.4	112.9	160.7
Provisions	0.0	0.0	0.0	0.0
Other CL	391.8	390.0	423.4	459.1
Net Current Assets	727.4	643.4	834.7	797.6
Total Assets	962.5	1092.0	1064.0	1028.0

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per share data (₹)				
EPS	201.3	207.4	228.7	248.3
Cash EPS	224.0	226.9	248.7	270.4
BV	609.1	692.4	686.6	663.0
DPS	114.0	140.0	160.0	180.0
Cash Per Share	13.5	6.6	10.7	9.5
Operating Ratios (%)				
EBITDA Margin	37.0	34.9	33.5	34.5
PBT / Net Sales	37.6	36.4	36.1	36.7
PAT Margin	28.0	27.2	27.4	27.5
Inventory days	97.7	91.7	92.0	88.0
Debtor days	5.0	10.3	11.0	5.0
Creditor days	43.2	32.1	32.0	42.0
Return Ratios (%)				
RoE	33.0	30.0	33.3	37.5
RoCE	43.4	39.2	43.7	49.9
RoIC	21.3	24.3	20.7	23.0
Valuation Ratios (x)				
P/E	18.1	17.5	15.9	14.6
EV / EBITDA	13.6	13.1	12.9	11.5
EV / Net Sales	5.0	4.6	4.3	4.0
Market Cap / Sales	5.1	4.8	4.4	4.0
Price to Book Value	6.0	5.3	5.3	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	2.3	2.5	2.3
Quick Ratio	1.8	1.7	1.9	1.7

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)	1,588	1,610	Hold	43,606	39.6	38.6	42.3	40.1	41.1	37.6	8.6	8.2	7.5	77.8	82.6	92.7	62.2	62.9	70.8
Dabur India (DABIND)	554	700	Buy	97,076	9.9	10.9	12.7	56.2	50.9	43.7	8.9	8.2	7.2	24.9	24.6	26.5	20.8	21.4	22.6
Hindustan Unilever (HINLEV)	2,533	2,800	Hold	6,23,766	37.5	42.4	46.5	67.5	59.7	54.4	12.4	10.8	9.9	20.2	22.8	25.1	18.1	20.3	22.0
ITC Limited (ITC)	354	405	Buy	4,29,858	12.4	14.2	16.7	28.5	24.8	21.2	7.3	6.1	5.7	31.4	35.3	38.8	24.5	27.1	29.7
Jyothy Lab (JYOLAB)	194	145	Hold	6,077	4.3	5.6	6.4	45.7	34.8	30.6	2.8	2.5	2.3	18.7	24.2	27.7	16.6	21.2	23.8
Marico (MARLIM)	505	560	Hold	69,587	9.7	10.2	11.2	51.9	49.4	44.9	7.3	7.1	6.5	41.2	43.6	46.7	37.5	38.3	41.0
Nestle (NESIND)	20,480	22,400	Hold	1,90,912	222.4	255.8	301.1	92.1	80.1	68.0	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	1,360	1,750	Buy	50,721	27.3	30.9	43.5	49.9	44.0	31.3	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	772	950	Buy	70,169	11.0	13.9	17.1	70.1	55.5	45.1	5.6	5.1	4.6	8.4	9.2	10.8	7.0	8.2	9.7
Varun Beverage (VARBEV)	1,142	1,235	Hold	71,889	17.2	23.2	26.8	66.3	49.1	42.6	8.1	5.6	5.0	17.1	30.3	33.5	18.3	29.0	29.4
VST Industries (VSTIND)	3,636	3,725	Hold	5,615	207.4	228.7	248.3	17.5	15.9	14.6	4.8	4.4	4.0	39.2	43.7	49.9	30.0	33.3	37.5
Zydus Wellness (ZYDWEL)	1,731	2,100	Buy	10,254	48.5	57.5	71.0	35.7	30.1	24.4	5.1	4.5	4.1	6.1	7.1	8.4	6.4	7.3	8.7

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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