

CMP: ₹ 3276

Target: ₹ 3300 (1%)

Target Period: 12 months

HOLD

April 28, 2023

## Volume continues to slide downwards...

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

- The company has two cigarette manufacturing facilities in Hyderabad, AP. It has five major brands, which includes, 'Total', 'Charms', 'Moment', 'Special', & 'Edition' and a direct distribution reach of over 1.2 million outlets

**Q4FY23 Results:** VST reported dismal numbers with 7% de-growth in cigarettes sales mainly due to 10% volume decline.

- Sales were flat YoY; cigarette volume dip was offset by higher tobacco sales
- EBITDA was at ₹ 82.1 crore, down 22.8% YoY, with margins at 27.2%
- Consequently, PAT de-grew 21.2% to ₹ 68.7 crore

**What should investors do?** VST industries' share price has underperformed the market with mere 7% return in the last five years (from ₹ 3061 in April 2018 to ₹ 3276 in April 2023).

- We remain cautious on cigarettes volume growth prospect; the company is losing market share given its limited presence in higher price cigarettes

**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 flat cigarette volume growth in FY23 with market share loss mainly due to limited presence in high-priced cigarettes (₹ 10 price point and above). VST has brand 'Edition' at ₹ 11 price point, which only contributes 5% to sales. It has only recently launched the variant of 'Total' at ₹ 10/stick
- Duties & taxes on cigarettes to remain stable given high prevalence of illicit & contraband cigarettes. Moreover, crackdown on illicit & contrabands recently helped the cigarette industry gain volumes
- Dividend pay-out is expected to remain at ~70% in future as well. We estimate dividend per share of ₹ 175 & ₹190 in FY24E & FY25E, respectively, which translates to dividend yield of ~5%

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

- Strong innovation & premiumisation strategy in salt, tea, Sampaan & Soulful in the Indian market expected to drive sales & margins
- We value the stock at ₹980 with BUY rating



VST Industries Ltd.

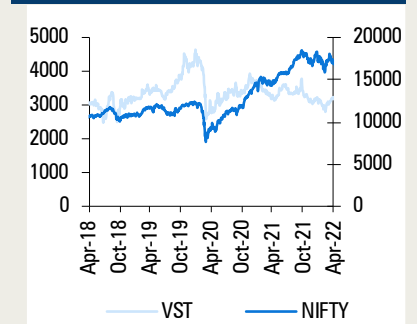
### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	5,058.8
Total Debt (FY23)	0.0
Cash and Investments (FY23)	395.4
EV	4,663.4
52 week H/L (₹)	3865 / 2856
Equity capital	₹ 15.4
Face value (₹)	10.0

### Shareholding pattern

(in %)	Jun-22	Sep-22	Dec-22	Mar-23
Promoter	32.2	32.2	32.2	32.2
FII	1.8	1.7	1.7	1.6
DII	16.6	16.6	16.6	16.9
Others	49.4	49.5	49.5	49.3

### Price Chart



### Recent event & key risks

- VST Tobacco sales grew 55% to ₹ 328 core in FY23 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

### Research Analyst

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### Key Financial Summary

Key Financials	FY21	FY22	FY23	5 Year CAGR (FY17-22)	FY24E	FY25E	CAGR (FY23-25E)
Net Sales	1109.8	1176.7	1290.1	6.4	1360.5	1469.1	6.7%
EBITDA	410.6	411.7	382.7	5.4	439.7	487.9	12.9%
EBITDA Margin %	37.0	35.0	29.7		32.3	33.2	
Net Profit	310.8	320.3	327.0	12.5	324.2	379.1	7.7%
EPS (₹)	201.3	207.4	211.8	12.5	210.0	245.5	7.7%
P/E	16.3	15.8	15.5		15.6	13.3	
RoNW %	33.0	29.8	27.7		29.3	38.2	
RoCE (%)	43.4	39.0	35.7		39.0	50.9	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter

### Q4FY23 Results: Dismal volume growth; market share loss continues

- VST Industries witnessed flat sales on the back of a 7% decline in cigarettes sales and 17% growth in tobacco sales. Cigarettes volumes de-grew 10% given the company has cut down trade margins on 'Total' brand. The company is trying to insulate demand through consumer pull rather than pushing it through higher discounts
- On a full year basis, cigarette volumes have remained flat. The company has lost market share. High priced cigarettes (₹ 10 or above) are gaining traction and this segment has grown at 20-25% in FY23. Tobacco sales witnessed growth 55% to ₹ 328 crore
- The company has introduced brand 'Total Curl' at ₹ 10/price point to increase its presence in the segment. However, it is still not gaining traction. VST would be re-launching this brand in future. It is selling in the Delhi and Chennai market currently
- Volume composition remains at the same rate. 'Total' brand contributes 40% to volumes whereas 'edition' brand contributes 5% to volumes. 'Total' brands sell at ₹ 6 & ₹ 7 price points. Edition brands sells at ₹ 11 price point
- Gross margin for the company contracted 506 bps mainly due to higher proportion of tobacco sales, which is 13% margin business. Moreover, commodity prices have increased sharply in the last six months. Tobacco prices have increased 15-20% while tow filter rod prices have increased by 50% in the last one year
- Employee spends were higher by 92 bps (percentage to sales) mainly due to negative operating leverage. Overhead spends were higher by 194 bps on the back of high freight cost due to increase in tobacco exports
- The company got the approval for the conversion of the factory/registered office premises from leasehold to freehold property in the Azamabad Industrial Area (AIA) from the Telangana government. The purchase of this property was executed at a consideration of ₹ 324.1 crore
- VST declared a dividend of ₹ 150/share, which is 70.8% dividend pay-out. The dividend yield is at 4.6%

VST Industries - 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
<b>Overall ESG Score</b>	<b>35.4</b>	<b>41.2</b>	<b>55.8</b>

### Exhibit 1: Peer comparison

Sector / Company	CMP		TP Rating	M Cap (₹ Cr)	Sales growth (%)				EBITDA Margins (%)				P/E(x)				RoE (%)				RoCE (%)			
	(₹)	(₹)			FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
ITC Limited (ITC)	420	450	Buy	467841	23.1	17.0	8.0	9.5	32.0	33.7	34.5	34.0	33.9	28.6	26.2	24.2	24.5	27.7	28.7	29.9	31.4	36.0	37.5	39.1
VST Industries (VSTIND)	3276	3300	Hold	5059	6.1	9.7	5.5	8.0	35.0	29.7	32.3	33.2	15.8	15.5	15.6	13.3	29.8	27.7	29.3	38.2	39.0	35.7	39.0	50.9

Source: Company, ICICI Direct Research

VST Industries has seen flat cigarette volume in FY23 whereas the industry is growing at mid-teen volume growth numbers. The company is losing market share given high price point cigarettes are gaining traction as its presence in the ₹ 10/stick or higher price cigarettes is limited. During the year, it saw 55% growth in tobacco sales with good opportunity in the export market. We believe the company is required to increase its presence in high priced cigarette segment to regain market share. Lower tax incidence and crackdown on illicit cigarettes has resulted in strong volume growth for high priced cigarettes. We estimate 5% and 4% volume growth for FY24E and FY25E for VST. Further, we believe tobacco sales would remain at ~₹ 300 crore. We believe traction in high priced cigarettes would define the growth path and margin expansion for the company. Currently, we remain cautious until the company gets any success in high price point cigarette. We maintain our **HOLD** rating and target price on the stock at ₹ 3300/share.

**Exhibit 2: Variance Analysis**

	Q4FY23	Q4FY23E	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	Comments
Total Operating Income	301.7	335.5	302.6	-0.3	345.8	-12.7	Net sales flat with 7% decline in cigarettes sales and 17% growth in tobacco sales aided by exports
Other Operating Income	0.9	0.5	0.6	54.4	0.4	151.4	
Raw Material Expenses	142.2	158.0	127.3	11.7	182.1	-21.9	Gross margins contracted by 506 bps on account of higher tobacco & tow filter rods prices
Employee Expense	30.0	34.6	27.3	9.9	31.0	-3.0	
Excise Duty	87.4	105.3	97.6	-10.5	96.2	-9.2	
Other operating Expenses	47.4	36.1	41.7	13.7	38.0	24.9	Overhead spends were higher due to increase in transportation cost on account of higher raw tobacco exports
EBITDA	82.1	106.8	106.3	-22.8	94.7	-13.3	Operating profit was down by 22.8% on account of decline in cigarette sales & sharp increase in RM & overhead spends
EBITDA Margin (%)	27.2	31.8	35.1	-792 bps	27.4	-19 bps	
Depreciation	8.4	8.4	8.8	-4.6	7.4	12.9	
Interest	0.0	0.0	0.0	NA	0.0	NA	
Other Income	16.1	15.9	17.5	-8.1	16.0	0.2	
PBT	89.8	120.6	115.0	-21.9	103.3	-13.1	
Tax Outgo	21.1	34.6	27.8	-24.3	24.3	-13.4	
PAT	68.7	79.6	87.2	-21.2	79.0	-13.0	Net profit dipped by 21.2% to ₹68.7 crore
<b>Key Metrics</b>							
Cigarette Sales (₹ crore)	333.6	365.7	359.1	-7.1	362.3	-7.9	Cigarette volume was down by 10% during the quarter however was flat on YoY basis
Tobacco Sales (₹ crore)	108.0	75.0	72.0	50.0	39.0	176.9	Tobacco sales were up 17% largely on the back of higher exports during the quarter

Source: Company, ICICI Direct Research

**Exhibit 3: Change in estimates**

(₹ Crore)	FY24E			FY25E			Comments
	Old	New	% change	Old	New	% change	
Net sales	1,405.7	1,360.5	-3.2	1,508.1	1469.1	-2.6	We revise cigarettes volume sales downwards
EBITDA	451.1	439.7	-2.5	509.9	487.9	-4.3	
EBITDA Margin (%)	32.1	32.3	23 bps	33.8	33.2	-60 bps	
PAT	354.2	324.2	-8.5	407.5	379.1	-7.0	
EPS (₹)	229.2	210.0	-8.4	263.9	245.5	-7.0	

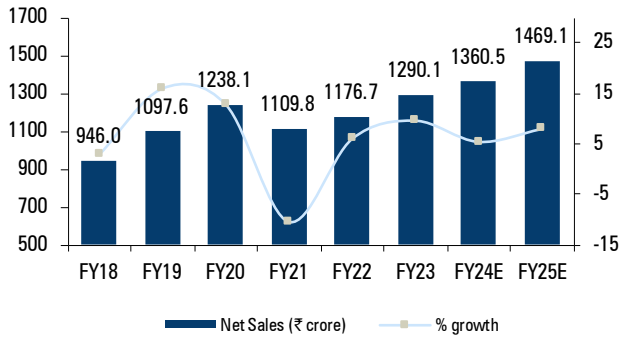
Source: ICICI Direct Research

**Exhibit 4: Assumptions**

	Current					Earlier			Comments
	FY20	FY21	FY22	FY23	FY24E	FY25	FY24E	FY25	
Cig. Vol. (mn sticks)	9,492.0	7,860.0	8,340.0	8,340.0	8,757.0	9,107.3	9,063.5	9,426.0	We revise our cigarette volume estimates given the company is losing market share due to lower presence in high priced cigarettes
Cig. Vol. Growth (%)	10.9	-17.2	6.1	0.0	5.0	4.0	5.0	4.0	
Realization/cig (₹)	1.2	1.6	1.6	1.6	1.7	1.7	1.7	1.7	
Tobacco Sales(₹ crore)	238.8	200.0	212.0	328.8	298.9	329.2	315.5	331.4	We revise tobacco sales slightly downwards as high base of FY23 sales would be difficult to maintain

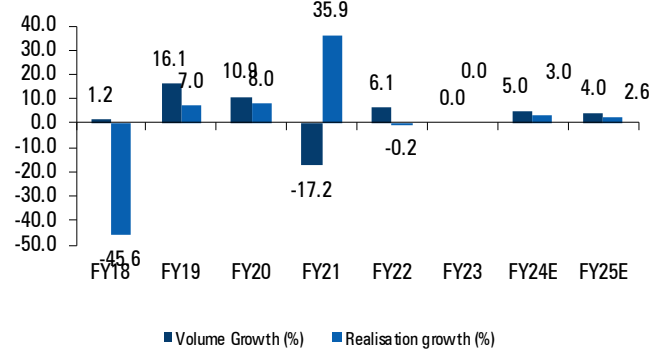
Source: ICICI Direct Research

Exhibit 5: Net revenue to grow at 6.7% CAGR over FY23-25E



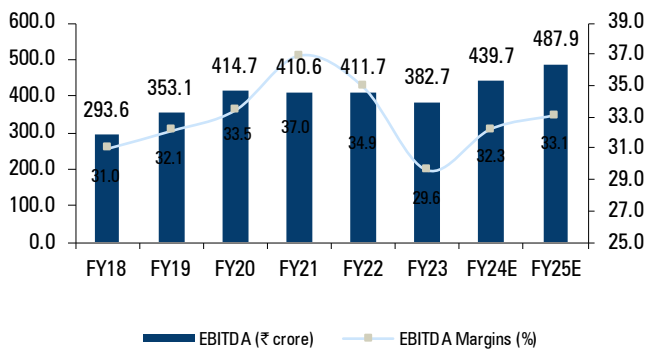
Source: ICICI Direct Research, Company

Exhibit 6: Volumes remain dismal



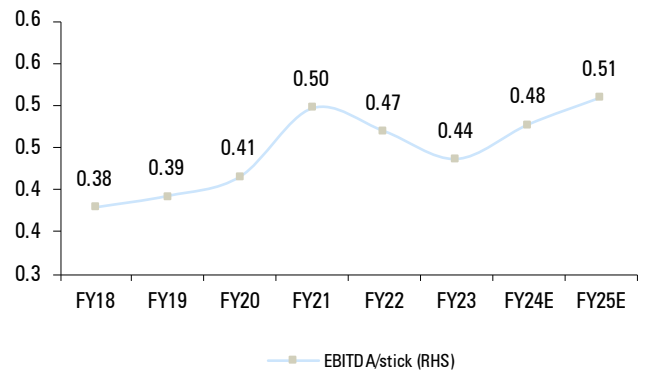
Source: ICICI Direct Research, Company

Exhibit 7: EBITDA margins trend



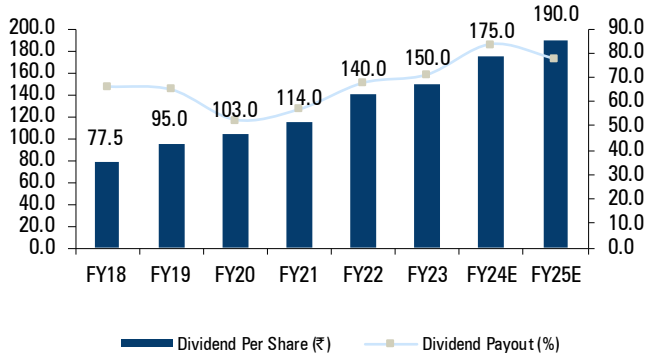
Source: ICICI Direct Research, Company

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



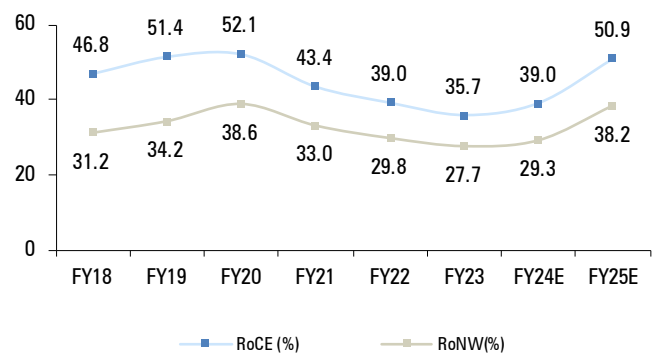
Source: ICICI Direct Research, Company

Exhibit 9: High dividend pay-out 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	15.8	11.7	29.8	39.0
FY23	1290.1	9.6	211.8	2.1	15.5	12.6	27.7	35.7
FY24E	1360.5	5.5	226.1	6.8	14.5	9.7	30.8	41.0
FY25E	1450.5	6.6	253.2	12.0	12.9	8.8	31.2	41.5

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E
<b>Total Operating Income</b>	<b>1178.2</b>	<b>1292.4</b>	<b>1363.3</b>	<b>1472.4</b>
Growth (%)	6.1	9.7	5.5	8.0
Raw Material Expenses	513.5	621.0	656.9	702.5
Employee Expenses	116.4	120.3	127.9	139.6
Excise Duty	382.5	380.1	395.3	415.0
Administrative Expenses	0.0	0.0	0.0	0.0
Other expenses	136.7	168.5	138.8	142.5
Total Operating Expenditure	766.5	909.8	923.6	984.5
<b>EBITDA</b>	<b>411.7</b>	<b>382.7</b>	<b>439.7</b>	<b>487.9</b>
Growth (%)	0.3	-7.0	14.9	11.0
Depreciation	30.1	30.2	67.5	45.2
Interest	0.0	0.0	0.0	0.0
Other Income	0.0	0.0	0.0	0.0
PBT	428.3	428.9	433.3	506.9
Others	46.7	76.4	61.1	64.2
Total Tax	108.0	101.9	109.1	127.7
<b>PAT</b>	<b>320.3</b>	<b>327.0</b>	<b>324.2</b>	<b>379.1</b>
Growth (%)	3.1	2.1	-0.8	16.9
EPS (₹)	207.4	211.8	210.0	245.5

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E
Profit after Tax	322.1	335.0	324.2	379.1
Add: Depreciation	30.1	30.2	67.5	45.2
(Inc)/dec in Current Assets	-11.0	-78.0	-168.4	-33.4
Inc/(dec) in CL and Provisions	-19.7	-33.1	151.4	48.2
<b>CF from operating activities</b>	<b>277.2</b>	<b>181.5</b>	<b>374.7</b>	<b>439.1</b>
(Inc)/dec in Investments	-48.2	-403.9	199.9	-0.1
(Inc)/dec in Fixed Assets	146.0	431.1	-35.0	-35.0
(Inc)/dec in LT Loans & Adv.	0.0	0.1	0.0	0.0
Others	-193.6	19.4	-17.4	0.3
<b>CF from investing activities</b>	<b>-95.8</b>	<b>46.7</b>	<b>147.4</b>	<b>-34.8</b>
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	-186.7	-223.6	-395.6	-495.4
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
<b>CF from financing activities</b>	<b>-186.7</b>	<b>-223.6</b>	<b>-395.6</b>	<b>-495.4</b>
Net Cash flow	-5.2	4.6	126.4	-91.1
Opening Cash	9.4	4.2	8.8	135.3
<b>Closing Cash</b>	<b>15.4</b>	<b>19.7</b>	<b>146.2</b>	<b>55.0</b>

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	FY22	FY23	FY24E	FY25E
<b>Liabilities</b>				
Equity Capital	15.4	15.4	15.4	15.4
Reserve and Surplus	1,058.9	1,164.3	1,092.8	976.5
Total Shareholders funds	1,074.3	1,179.7	1,108.3	992.0
Total Debt	0.0	0.0	0.0	0.0
Long Term Provisions	23.0	21.5	4.1	4.4
<b>Total Liabilities</b>	<b>1097.3</b>	<b>1201.2</b>	<b>1112.3</b>	<b>996.4</b>
<b>Assets</b>				
Gross Block	395.8	843.6	873.6	903.6
Less: Acc Depreciation	223.1	253.3	320.8	366.0
Net Block	195.0	590.2	552.8	537.6
Capital WIP	10.5	0.3	5.3	10.3
Deferred Tax Asset	21.6	17.8	17.8	17.8
Non Current Investments	203.1	201.7	1.9	2.0
LT Loans & Advances/Others	18.5	11.6	11.6	11.6
<b>Current Assets</b>				
Inventory	295.6	349.3	328.0	354.2
Debtors	33.3	43.2	18.6	20.1
Cash	15.4	19.7	146.2	55.0
Loans & Advances	0.4	0.0	9.3	10.1
Current Investments	767.6	375.6	575.6	575.6
Other CA	29.7	44.1	49.1	54.1
<b>Current Liabilities</b>				
Creditors	103.4	96.8	156.6	169.0
Provisions	0.0	0.0	0.0	0.0
Other CL	390.0	355.6	447.3	483.0
Net Current Assets	648.7	379.5	523.0	417.1
<b>Total Assets</b>	<b>1097.3</b>	<b>1201.2</b>	<b>1112.4</b>	<b>996.4</b>

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	FY22	FY23	FY24E	FY25E
<b>Per share data (₹)</b>				
EPS	207.4	211.8	210.0	245.5
Cash EPS	226.9	231.3	253.7	274.8
BV	695.8	764.1	717.7	642.5
DPS	140.0	150.0	175.0	190.0
Cash Per Share	10.0	12.8	94.7	35.6
<b>Operating Ratios (%)</b>				
EBITDA Margin	34.9	29.6	32.3	33.1
PBT / Net Sales	36.4	33.2	31.9	34.5
PAT Margin	27.2	25.3	23.8	25.8
Inventory days	91.7	98.8	88.0	88.0
Debtor days	10.3	12.2	5.0	5.0
Creditor days	32.1	27.4	42.0	42.0
<b>Return Ratios (%)</b>				
RoE	29.8	27.7	29.3	38.2
RoCE	39.0	35.7	39.0	50.9
RoIC	24.3	26.6	24.7	30.0
<b>Valuation Ratios (x)</b>				
P/E	15.8	15.5	15.6	13.3
EV / EBITDA	11.7	12.6	11.1	10.2
EV / Net Sales	4.1	3.7	3.6	3.4
Market Cap / Sales	4.3	3.9	3.7	3.4
Price to Book Value	4.7	4.3	4.6	5.1
<b>Solvency Ratios</b>				
Debt/EBITDA	0.0	0.0	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	2.3	1.8	1.6	1.6
Quick Ratio	1.7	1.0	1.1	1.0

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	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E	FY22	FY23E	FY24E	FY25E
Colgate (COLPAL)	1,581	1,440	Hold	39,473	39.6	37.7	40.3	41.7	39.9	41.9	39.3	38.0	7.8	7.6	7.1	6.7	77.8	81.9	92.8	99.9	62.2	62.4	70.9	76.5
Dabur India (DABIND)	534	700	Buy	97,880	9.9	10.3	12.0	13.4	54.1	52.0	44.3	39.7	9.0	8.5	7.7	6.9	24.9	23.9	26.1	27.2	20.8	20.5	22.2	22.7
Hindustan Unilever (HINLEV)	2,437	2,780	Hold	5,79,879	37.5	42.4	45.4	51.1	64.9	57.5	53.7	47.7	11.5	10.0	9.2	8.4	20.2	22.0	23.7	25.9	18.1	19.9	20.6	22.5
ITC Limited (ITC)	420	450	Buy	4,67,841	12.4	14.7	16.0	17.4	33.9	28.6	26.2	24.2	7.9	6.8	6.2	5.7	31.4	36.0	37.5	39.1	24.5	27.7	28.7	29.9
Jyothy Lab (JYOLAB)	195	215	Hold	7,485	4.3	6.7	7.8	8.5	45.7	29.2	25.0	22.9	3.5	3.1	2.8	2.6	18.7	27.5	31.4	32.6	16.6	24.2	27.0	27.9
Marico (MARLIM)	500	555	Hold	63,710	9.7	10.3	11.1	12.4	51.4	48.5	44.9	40.3	6.7	6.5	6.0	5.6	41.2	44.0	46.2	49.9	37.5	38.5	40.6	43.8
Nestle (NESIND)	21,370	23,000	Hold	1,99,195	222.4	247.9	299.9	352.7	96.1	86.2	71.3	60.6	13.6	11.9	10.5	9.5	57.3	54.4	57.0	61.6	104.1	87.0	84.5	86.5
Patanjali Foods (RUCSOY)	935	1,750	Buy	50,721	27.3	30.9	43.5	52.7	34.3	30.2	21.5	17.7	2.1	1.7	1.5	1.4	13.2	15.6	17.3	19.0	13.1	11.3	14.2	15.3
Tata Consumer Products (TAT)	759	980	Buy	68,740	11.0	14.2	16.4	19.0	68.9	53.4	46.4	39.9	5.5	5.0	4.5	4.1	8.4	8.7	10.5	11.6	7.0	7.4	9.0	10.1
Varun Beverage (VARBEV)	1,453	1,340	Hold	79,300	17.2	23.9	26.1	30.0	84.4	60.9	55.8	48.5	9.0	6.0	5.4	4.9	17.1	23.8	27.2	30.6	18.3	30.4	26.6	25.5
VST Industries (VSTIND)	3,276	3,300	Hold	5,059	207.4	211.8	210.0	245.5	15.8	15.5	15.6	13.3	4.3	3.9	3.7	3.4	39.0	35.7	39.0	50.9	29.8	27.7	29.3	38.2
Zydus Wellness (ZYDWEL)	1,540	2,000	Buy	8,979	48.5	55.0	67.4	75.6	31.7	28.0	22.8	20.4	4.5	4.0	3.6	3.2	6.1	6.8	8.1	9.2	6.4	7.1	8.3	9.0

Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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