

Covid-19 again adversely sways summer season...

About the stock Varun Beverages (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. 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 & Zimbabwe

Q1CY21 Results: VBL reported a partial recovery in Q1FY22 results.

- Sales were up 49.4% YoY on a low base quarter
- EBITDA was at ₹ 570.8 crore, up 51.1% YoY, with margins at 23.3%
- Consequent PAT was at ₹ 318.8 crore (up 123% YoY)

What should investors do? Varun Beverage share price has given 4x return (from ₹ 195 in November 2016 to ₹ 789 in August 2021).

- We roll over CY23 numbers with the expectation of full sales recovery in next two years
- We maintain our BUY rating on the stock

Target Price and Valuation: We value the stock at ₹ 950, valuing the business 22x CY23 EV / EBITDA

Key triggers for future price performance:

- With the expected recovery in Covid-19 cases & vaccination drive, we expect VBL to clock optimum volumes in the 2022 peak summer season with operating margins perking up due to operating leverage
- The company has launched several new brands in last two years i.e. String, 'Mountain Dew ICE', milk based beverages. New products would drive revenues, going forward
- Given no major capex in the medium term, VBL would be able to completely de-leverage its balance sheet in the next three to four years with strong free cash flow generation

Alternate Stock Idea: We also like Zydus Wellness in our FMCG coverage

- It is growing at a steady pace in nascent categories with a strong presence in health, nutrition space and margin expansion possibilities
- Trading at a significant discount to FMCG peers. BUY with TP of ₹ 2,800



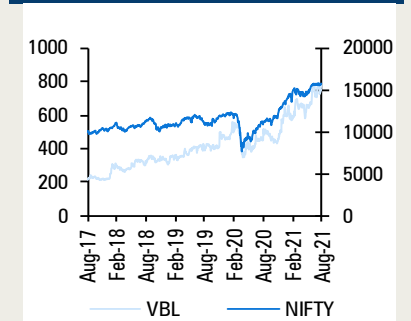
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	34,166.2
Total Debt (CY20)	2,717.9
Cash & Investments (CY20)	104.6
EV	36,779.6
52 week H/L (₹)	919 / 762
Equity capital	288.7
Face value	10.0

Shareholding pattern

(in %)	Sep-20	Dec-20	Mar-21	Jun-21
Promoter	66.4	66.4	66.4	65.8
FII	20.8	20.5	20.3	20.7
DII	6.0	5.9	5.9	5.8
Others	6.8	7.2	7.4	7.7

Price Chart



Recent event & key risks

- In H1CY21, the company incurred a capex of ₹ 190 crore
- Key Risk:** (i) Further Covid-19 disruption may impact revenue growth, (ii) Incessant increase in RM cost like PET resins may impact gross margins adversely

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Key Financial Summary

	CY19	CY20	5 Year CAGR (CY15 - CY20)	CY21E	CY22E	CY23E	CAGR (CY20-23E)
Net Sales	7129.6	6450.1	13.7	7915.2	9022.0	10113.8	16.2%
EBITDA	1447.7	1201.9	13.5	1568.3	1844.4	2021.0	18.9%
EBITDA Margin %	20.3	18.6		19.8	20.4	20.0	
Net Profit	472.2	362.1	26.2	616.2	835.0	970.2	38.9%
EPS (₹)	16.36	8.36	-0.2	14.23	19.28	22.40	38.9%
P/E	48.2	94.4		55.4	40.9	35.2	
RoNW %	14.2	10.3		15.5	17.9	17.9	
RoCE (%)	15.5	10.9		17.5	22.9	26.6	

Key takeaways of recent quarter

Q1FY22 Results: Volumes recover from low base but still remain at sub-optimal level

- Revenue increased 49.4% to ₹ 2449.8 crore led by 45.4% jump in volumes. The company sold 152.3 million cases against 104.8 million cases in the corresponding quarter. Out of total sales volume of 152.3 million cases, India contributes 127 million cases and other international geographies contribute 25 million cases. Out of India region volumes, two-third are contributed by the north & east regions while one-third is contributed by west & south regions. Going forward, newly acquired territories (south & west) would grow faster than north territories
- Volume growth was strong in April but the second Covid-19 wave impacted business in the peak demand month of May with a staggered recovery witnessed in June. Out of the seven months of 2021, the company saw strong growth in five
- Realisation per case improved by 2.8% to ₹ 160.8/case, led by higher realisation in international territories, which was partially offset by contribution of water business. International business margins are higher and currency gains also contribute to margins uptick. Average Indian realisation is ₹160/case while average international realisation is ₹ 180/case
- CSD constituted 78% of volumes whereas juices & water contributed 7% & 15% volumes, respectively. The company launched 'Mountain Dew ICE' before the season but due to the second wave of Covid-19, the sales traction was below expectations. Sting has become a core brand and will be a major growth driver
- The management believes there is enough potential in products launched in the last two years and the company would grow these brands before introducing any new products in future
- Gross margins contracted 128 bps due to inferior product mix and increase in raw material prices. Other overheads were also increased 67 bps given the company took cost cutting measures during national lockdown. However, VBL was able to save 222 bps in employee spends to safeguard operating margins. The company saved the cost through transportation, lower trade discounts & plant consolidation
- High PET resin prices kept the working capital high. However, the company was holding low cost PET resin inventories from previous quarters. The slow growth in May led to the absorption of only old inventories. Freight cost was high during the quarter given goods were transferred from one region (lockdown impacted regions) to the other region to safeguard product expiry related losses
- Operating profit increased 51% to ₹ 570.8 crore. It was able to maintain its operating margins at 23.3% (expansion of 27 bps). PAT increased 123% to ₹ 318.8 crore led by 36.9% decline in interest cost with lower cost of debt & repayments
- Total debt was at ₹ 2549.2 crore against ₹ 3015.8 crore in the corresponding quarter. The company repaid ₹ 466 crore in H1CY21 while further debt reduction of ₹ 100-200 crore can be done in the remaining part of the year. The organic capex was ₹ 190 crore in India, Morocco and Zimbabwe. Capacity expansion would be equivalent to depreciation
- During the quarter, an amount of ₹ 11.4 crore from the total foreign currency provisions in Zimbabwe was reversed due to corresponding reduction in the total foreign currency liability in Zimbabwe. The total reversal from Zimbabwe would be US\$15 million, which would be realised in quarterly tranches of US\$2-3 million
- Last year, rural regions were growing faster than urban. In the current year, both regions are growing equally well

Exhibit 1: Peer Comparison

Sector / Company	CMP	TP	M Cap	Sales growth (%)			EBITDA Margins (%)			P/E(x)			RoE (%)			RoCE (%)			
	(₹)	(₹) Rating		(₹ Cr)	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Nestle (NESIND)	17715	20450	Hold	173556	7.9	11.1	9.4	24.1	24.8	25.1	83.3	72.0	64.4	86.5	87.8	86.3	50.9	54.9	56.4
Tata Consumer (TATGLO)	760	725	Buy	60728	20.39	13.34	8.553	13.31	13.67	14.21	65.27	53.08	45.46	6.416	7.589	8.54	8.016	9.084	10.02
Varun Beverage (VARBEV)	789	950	Buy	34166	-9.5	22.7	14.0	18.6	19.8	20.4	94.4	55.4	40.9	10.3	15.5	17.9	10.9	17.5	22.9
Zydus Wellness (ZYDWEL)	2178	2800	Buy	13537	5.8	13.4	9.6	18.4	19.7	20.7	114.0	36.8	31.2	5.5	7.7	9.0	6.2	7.5	8.7

Source: Company, ICICI Direct Research

Though, Varun Beverage witnessed a strong recovery during the quarter, sales volumes are still below pre-Covid levels given the second wave impacted sales in May and June after the localised and state wise mobility restrictions were announced. Carbonated drinks, juices & water are a few of the worst impacted FMCG categories as most of the sales occur 'on-the-go'. Restriction on restaurants & pubs have also taken a toll on volumes. However, we believe reducing Covid-19 cases & progress in vaccination drive would result in a recovery in the next few quarters while next summer would see normalised volumes. The company is aggressively reducing its debt, which would result in a steep jump in profitability in the next two years. We are positive on the volume recovery and profitability growth. We maintain our BUY recommendation with a target price of ₹ 950/share.

Exhibit 2: Variance Analysis

Particulars (₹ crore)	Q1CY21	Q1CY21	YoY (%)	Q4CY21	QoQ (%)	
Net Sales	2,449.8	1,640.2	49.4	2,240.9	9.3	Net sales witnessed growth of 49.4% on low base quarter. The company saw strong growth in April but with the second Covid-19 wave, sales in May were adversely impacted
Raw Material Expenses	1,138.3	741.1	53.6	990.2	15.0	Gross margins contracted by 128 bps on account of high PET resin prices
Employee Expenses	243.2	199.3	22.1	238.4	2.0	The company was able to safeguard margins through saving in employee spends by 222 bps
Other operating Expenses	497.5	322.1	54.4	630.7	-21.1	Ovehead spends increased marginally given the company took cost rationalisation measures in base quarter
EBITDA	570.8	377.7	51.1	381.6	49.6	
EBITDA Margin (%)	23.3	23.0	27 bps	17.0	627 bps	The company was able to maintain operating margins with cost rationalisation measures
Depreciation	128.8	124.3	3.6	134.7	-4.4	
Interest	46.8	74.2	-36.9	57.9	-19.3	Interest cost was down due to repayment of debt & reduction in interest rates
Other Income	24.4	2.7	816.9	5.7	326.0	
PBT	419.7	181.9	130.8	194.7	115.5	
Exceptional Items	0.0	0.0		0.0		
Tax Outgo	100.9	38.9	159.4	57.9	74.1	
PAT	318.8	143.0	123.0	136.8	133.1	Net profit grew by 123% to ₹ 318.8 crore
Adj. PAT	318.8	143.0	123.0	136.8	133.1	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	CY21E			CY22E			CY23E	Comments
	Old	New	% Change	Old	New	Change	New	
Net Sales	7,915.2	7,915.2	0.0	9,357.7	9,022.0	-3.6	10,113.8	We change our CY22 sales estimates given the company is looking to consolidate existing territories & brands
EBITDA	1,563.6	1,568.3	0.3	1,885.4	1,844.4	-2.2	2,021.0	
EBITDA Margin(%)	19.8	19.8	6 bps	20.1	20.4	30 bps	20.0	We expect better product mix in CY22 given increasing mobility to drive sales of water
PAT	612.6	616.2	0.6	897.3	835.0	-6.9	970.2	
EPS (₹)	14.15	14.23	0.6	20.72	19.28	-6.9	22.4	Due to the impact of second wave, we expect lower debt repayment & hence higher interest cost. This would impact earnings in CY22

Source: ICICI Direct Research

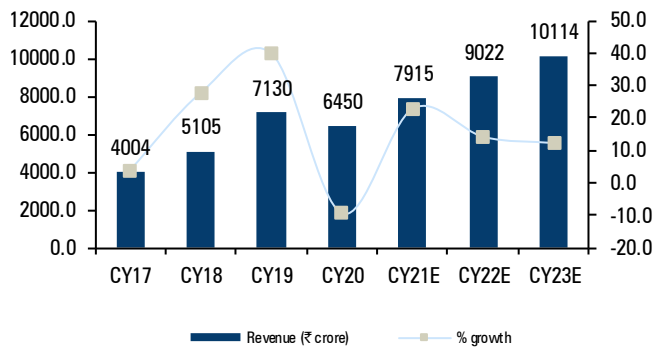
Exhibit 4: Assumptions

Particulars (in million cases)	Current						Earlier			Comments
	CY17	CY18	CY19E	CY20E	CY21E	CY22	CY23	CY21E	CY22	
Carbonated Products	220.0	257.0	388.1	345.4	421.4	463.5	505.2	421.4	484.6	We change our CY22 estimates given the company would look to consolidate existing territories & brands
% Growth	-1.3	16.8	51.0	-11.0	22.0	10.0	9.0	22.0	15.0	
Non Carbonated Products	14.0	22.0	29.7	22.3	29.0	34.7	41.7	29.0	34.7	
% growth	-11.1	57.1	35.0	-25.0	30.0	20.0	20.0	30.0	20.0	
Raw Material Cost										
Sugar	616.6	698.4	1,086.0	907.9	1,110.3	1,253.0	1,402.9	1,131.6	1,422.5	We change our raw material price estimates according to the prevailing demand-supply scenario
% of sales	13.4	14.2	15.1	14.0	13.7	13.7	13.7	14.0	15.0	
cost/kg (₹)	38.9	37.0	36.6	34.8	36.2	36.9	37.6	36.9	40.2	

Source: ICICI Direct Research

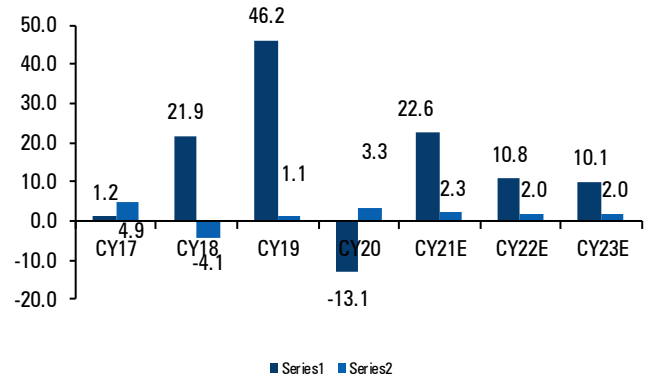
Key Metrics

Exhibit 5: Revenue growth trend (₹ crore)



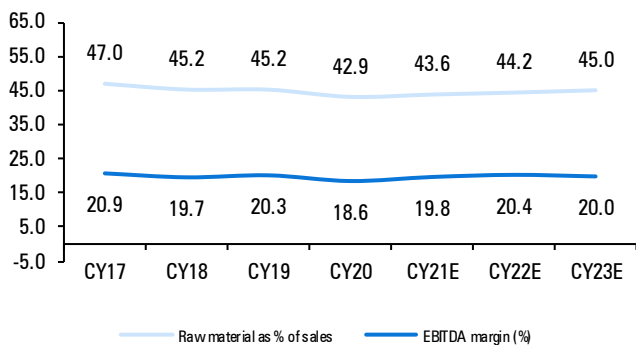
Source: Company, ICICI Direct Research

Exhibit 6: Volume growth to drive growth



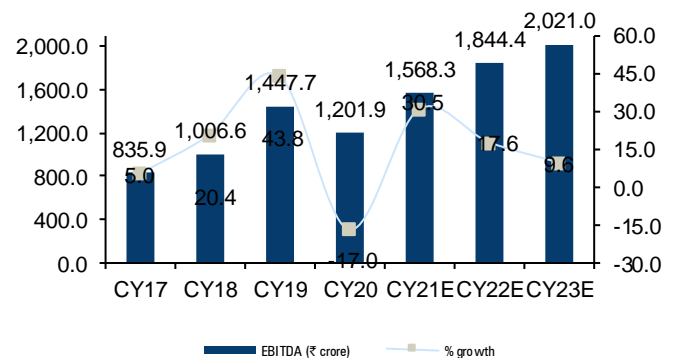
Source: Company, ICICI Direct Research

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



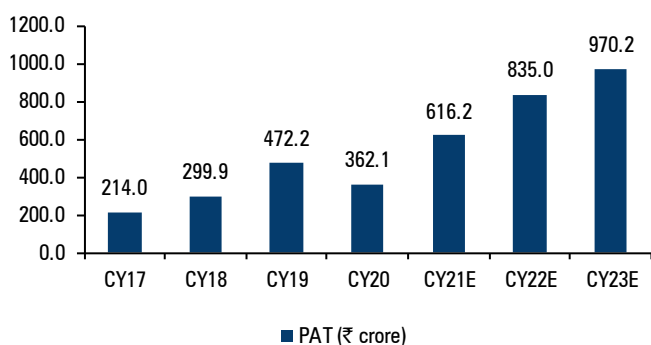
Source: Company, ICICI Direct Research

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



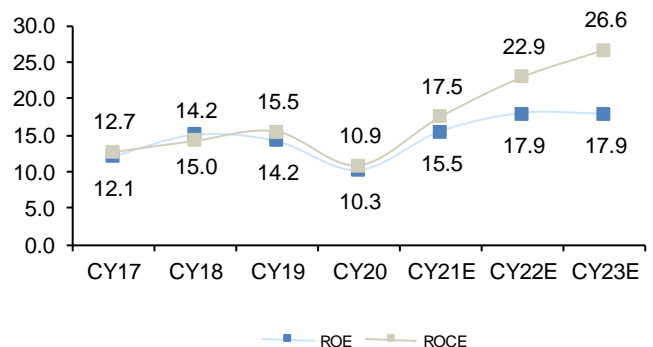
Source: Company, ICICI Direct Research

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 (%)
CY20	6450.1	-9.5	8.4	-48.9	94.4	30.6	10.3	10.9
CY21E	7915.2	22.7	14.2	70.2	55.4	22.8	15.5	17.5
CY22E	9022.0	14.0	19.3	35.5	40.9	18.9	17.9	22.9
CY23E	10113.8	12.1	22.4	16.2	35.2	16.8	17.9	26.6

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	CY20	CY21E	CY22E	CY23E
Total operating income	6450.1	7915.2	9022.0	10113.8
Growth (%)	-9.5	22.7	14.0	12.1
Raw Material Expenses	2763.9	3450.8	3989.5	4548.5
Employee Expenses	889.7	1029.0	1145.8	1264.2
Marketing Expenses	0.0	121.3	136.8	153.3
Other expenses	1594.6	1745.8	1905.6	2126.8
Total Operating Expenditure	5248.3	6346.8	7177.7	8092.8
EBITDA	1,201.9	1,568.3	1,844.4	2,021.0
Growth (%)	-17.0	30.5	17.6	9.6
Depreciation	528.7	555.5	580.3	605.1
Interest	281.1	249.5	188.2	162.5
Other Income	37.0	40.5	44.6	49.0
PBT	429.0	803.9	1120.5	1302.4
Total Tax	5.2	192.9	291.3	338.6
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	4.8	5.3	5.8	6.4
PAT	428.6	616.2	835.0	970.2
Growth (%)	-23.3	70.2	35.5	16.2
EPS (₹)	8.4	14.2	19.3	22.4

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	CY20	CY21E	CY22E	CY23E
Profit After Tax	599.6	860.4	1,017.4	1,126.3
Add: Depreciation	523.2	555.5	580.3	605.1
(Inc)/dec in Current Assets	-98.6	174.7	-199.2	-196.5
Inc/(dec) in CL and Provisions	-12.3	197.0	273.3	270.2
CF from operating activities	1,012.0	1,787.6	1,671.7	1,805.1
(Inc)/dec in Investments	107.4	0.0	0.0	0.0
(Inc)/dec in LT loans & advances	0.0	0.0	0.0	0.0
(Inc)/dec in Fixed Assets	-535.6	-386.1	-429.3	-430.7
Others	8.7	0.0	0.0	0.0
CF from investing activities	-471.1	-386.1	-429.3	-430.7
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-470.9	-900.0	-1,000.0	-1,000.0
Dividend paid & dividend tax	-72.2	-154.1	-167.0	-194.0
Others	-277.4	-249.5	-188.2	-162.5
CF from financing activities	-573.7	-1,346.8	-1,332.6	-1,332.8
Net Cash flow	-32.8	54.8	-90.1	41.6
Opening Cash	138.0	104.6	159.3	69.2
Other Bank balance	85.5	85.5	85.5	85.5
Closing Cash	104.6	159.3	69.2	110.7

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	CY20	CY21E	CY22E	CY23E
Liabilities				
Equity Capital	433.0	433.0	433.0	433.0
Reserve and Surplus	3091.0	3553.2	4221.1	4997.3
Total Shareholders funds	3524.0	3986.2	4654.1	5430.3
LT Borrowings & Provisions	2004.1	1204.1	304.1	-595.9
Deferred Tax Liability	225.9	237.2	249.1	261.6
Total Liabilities	6023.4	5642.4	5432.9	5332.8
Assets				
Gross Block	8,542.5	8,959.4	9,359.4	9,759.4
Less: Acc Depreciation	2,715.4	3,270.8	3,851.1	4,456.2
Net Block	5,827.2	5,688.5	5,508.2	5,303.2
Capital WIP	66.8	50.0	50.0	50.0
Net Intangible Assets	557.2	585.1	614.3	645.0
Non-current Investments	0.1	0.1	0.1	0.1
Goodwill	24.2	24.2	24.2	24.2
Current Assets				
Inventory	928.8	769.5	877.1	983.3
Debtors	241.8	197.9	225.6	252.8
Loans and Advances	10.0	219.9	250.6	280.9
Other Current Assets	251.8	17.6	20.0	22.5
Cash	104.6	159.3	69.2	110.7
Deferred Tax Assets	11.0	11.0	11.0	11.0
Current Liabilities				
Creditors	511.4	527.7	601.5	674.3
Provisions	33.2	66.0	75.2	84.3
Short term debt & other CL	1,886.5	1,933.0	2,017.5	2,099.5
Application of Funds	6,023.4	5,642.4	5,432.9	5,332.8

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	CY20	CY21E	CY22E	CY23E
Per share data (₹)				
EPS	8.4	14.2	19.3	22.4
Cash EPS	20.6	27.1	32.7	36.4
BV	81.4	92.1	107.5	125.4
DPS	1.7	3.6	3.9	4.5
Cash Per Share	62.7	75.5	88.9	102.9
Operating Ratios (%)				
EBITDA Margin	18.6	19.8	20.4	20.0
PBT / Total Operating income	5.6	10.2	12.4	12.9
PAT Margin	5.6	7.8	9.3	9.6
Inventory days	52.6	35.5	35.5	35.5
Debtor days	13.7	9.1	9.1	9.1
Creditor days	28.9	24.3	24.3	24.3
Return Ratios (%)				
RoE	10.3	15.5	17.9	17.9
RoCE	10.9	17.5	22.9	26.6
Valuation Ratios (x)				
P/E	94.4	55.4	40.9	35.2
EV / EBITDA	30.6	22.8	18.9	16.8
EV / Net Sales	5.7	4.5	3.9	3.3
Market Cap / Sales	5.3	4.3	3.8	3.4
Price to Book Value	9.7	8.6	7.3	6.3
Solvency Ratios				
Debt/EBITDA	2.3	1.2	0.4	-0.1
Debt / Equity	0.8	0.5	0.2	0.0
Current Ratio	0.7	0.6	0.6	0.6
Quick Ratio	0.2	0.2	0.2	0.2

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
Colgate (COLPAL)	1,678	2,000	Buy	46,485	38.1	39.2	42.6	44.1	42.8	39.4	9.7	9.0	8.3	106.4	110.9	111.9	88.8	85.1	85.8
Dabur India (DABIND)	599	620	Buy	94,540	9.6	10.9	12.2	62.5	54.7	49.1	9.9	8.7	7.9	24.5	26.5	27.1	22.1	22.9	23.2
Hindustan Unilever (HINLEV)	2,333	2,750	Buy	558,687	33.9	40.5	45.0	68.9	57.6	51.8	12.3	10.6	9.9	18.9	25.6	27.7	17.1	20.0	21.6
ITC Limited (ITC)	207	240	Hold	261,086	10.7	12.0	13.5	19.3	17.3	15.4	5.4	5.0	4.6	28.2	31.3	33.6	22.1	24.2	25.9
Jyothy Lab (JYOLAB)	171	180	Hold	6,389	5.2	5.7	6.5	33.0	30.0	26.4	3.4	3.1	2.8	26.0	27.1	31.1	20.4	22.7	26.2
Marico (MARLIM)	536	630	Buy	70,503	9.3	10.4	11.5	57.6	51.7	46.5	8.8	7.6	7.0	39.6	42.8	46.6	36.3	38.4	40.4
Nestle (NESIND)	17,715	20,450	Hold	173,556	216.0	249.9	279.6	82.0	70.9	63.4	13.1	11.8	10.7	50.9	54.9	56.4	86.5	87.8	86.3
Tata Consumer Products (TAT)	760	725	Buy	60,728	10.1	12.4	14.5	75.2	61.2	52.4	5.2	4.6	4.3	8.0	9.1	10.0	6.4	7.6	8.5
VST Industries (VSTIND)	3,349	3,850	Hold	5,384	201.3	214.6	231.1	16.6	15.6	14.5	4.9	4.4	4.1	43.4	45.0	48.2	33.0	33.4	36.0
Varun Beverage (VARBEV)	789	950	Buy	34,166	8.4	14.2	19.3	94.4	55.4	40.9	5.3	4.3	3.8	10.9	17.5	22.9	10.3	15.5	17.9
Zydus Wellness (ZYDWEL)	2,178	2,800	Buy	13,537	18.7	57.8	68.3	116.7	37.7	31.9	7.3	6.4	5.8	6.2	7.5	8.7	5.5	7.7	9.0

Source: Bloomberg, ICICI Direct Research

RATING RATIONALE

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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