

Impressive volume growth aided by normal summer

About the stock Varun beverage is one of the largest franchisee 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 includes 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

Q2CY22 Results: Varun beverages splendid results with volume growth of 96.9%

- Sales were up 102.3% YoY on led by extreme summer, low base & strong growth in underpenetrated territories
- EBITDA was at ₹ 1250.6 crore, up 119.1% YoY, with margins at 25.2%
- Consequent PAT grew by 151.6% to ₹ 802 crore

What should investors do? Varun Beverage share price has given 6.2x return (from ₹149 in August 2017 to ₹926 in August 2022).

- We revise our CY22 & CY23 revenue & earnings number upward after robust volume growth in H1CY22. We are introducing CY24 numbers
- We maintain **BUY** rating on the stock

Target Price and Valuation: We value the stock at ₹ 1100, valuing the business 40x CY24 PE

Key triggers for future price performance:

- The underpenetrated territories of Bihar, MP, Jharkhand & 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 volumes growth
- With strong volume growth & capacity utilisation touching 90%, VBL would be expanding its capacity by 30% 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, Sampaan & Soulful in India market expected to drive sales and margins
- We value the stock at ₹ 910 on ascribing 55x FY24 earnings multiple



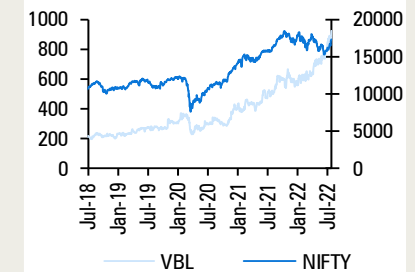
Particulars

Particulars (₹ crore)	Amount
Market Capitalization	60,170.9
Total Debt (CY21)	3,341.9
Cash & Investments (CY21)	336.0
EV	63,176.8
52 week H/L (₹)	945 / 480
Equity capital	288.7
Face value	10.0

Shareholding pattern

(in %)	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	64.9	64.9	64.9	63.9
FII	21.7	21.2	21.0	23.9
DII	6.8	7.1	7.2	5.3
Others	6.6	6.8	6.9	6.9

Price Chart



Recent event & key risks

- VBL would be enhancing its capacity by 30% in next one year to utilise potential of under penetrated territories
- Key Risk:** (i) Any weather related disruption impacting summer product demand (ii) Incessant increase in RM cost like PET may impact gross margins adversely

Research Analyst

Sanjay Manyal
sanjay.manyal@icicisecurities.com

Key Financial Summary

	CY20	CY21	5 Year CAGR (CY16 - CY21)	CY22E	CY23E	CY24E	CAGR (CY21-24E)
Net Sales	6450.1	8823.2	18.0	12338.5	13919.4	15538.8	20.8%
EBITDA	1201.9	1654.6	15.8	2566.9	2860.1	3196.1	24.5%
EBITDA Margin %	18.6	18.8		20.8	20.5	20.6	
Net Profit	362.1	746.1	73.1	1336.7	1517.3	1779.4	33.6%
Diluted EPS (₹)	5.57	11.49	34.2	20.58	23.36	27.39	33.6%
P/E	166.2	80.7		45.0	39.7	33.8	
RoNW %	10.3	18.3		26.3	25.3	27.3	
RoCE (%)	10.9	17.1		28.1	30.8	34.7	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter

Q1CY22 Results: Robust volume growth even in 3-year CAGR; operating leverage boost margins...

- VBL witnessed a revenue growth of 102.3% to ₹ 4954.8 crore led by 96.9% volume growth & 2.7% realisation growth. The company sold 300 million cases during the quarter, which include 73% of the cases of carbonated soft drinks, 18% cases of water & 9% of the cases of Juices. Realisation growth was 2.7% to ₹165 / case led by price hikes in select SKUs & reduction in discounts & incentives. On a three year CAGR basis, sales & volume growth was 20.8% & 15% respectively.
- The company increased its distribution network to 3.0 million plus outlets after two years of Covid related disruptions. The 3.0 million outlets include 0.4 million 'Sting' only outlets, 0.25 million international outlets. The company would be increasing its distribution footprints by 8-10% every year.
- The high volume growth was led by extreme summer, low base of last two years, higher volumes from acquired southern, western territories and also distribution expansion in under-penetrated territories like Bihar, MP, Chhattisgarh, Odisha.
- Sales volume in India increased by 106.4% to 262 million cases & international territories saw 49.2% jump in volumes to 38 million cases. Capacity utilisation in India was close to 90% driven by high sales volumes. In certain categories like CSD PET, Tropicana, Value added drinks capacity utilisation reached 100%
- With the very high inflationary pressures, gross margins contracted by 302 bps despite the company procuring PET inventories well before the season started. Employee & overhead spends were down by 366 bps & 130 bps mainly due to effect of operating leverage. Operating profit grew by 119% to ₹1250.6 crore & operating margin seen uptick of 194 bps to 25.2%. Net profit witnessed a growth of 119.1% to ₹802 crore aided by transition to lower tax rate in India
- Net debt dipped by ₹950 crore to ₹2055.5 crore in last six months. Net working capital reduced from 24 days in June 2021 to 17 days in June 2022. In H1CY22, capex included ₹670 crore primarily setting up of new greenfield production facility in Bihar, Jammu & brownfield expansion at Sandia facility
- Newly set-up capacity in Bihar was planned for three-year perspective. However, it reached 100% utilisation in its first year of operations. The company would be undertaking capex of ₹1200 crore in CY23, which includes one each greenfield plant in MP & Rajasthan & brownfield capacity in Bihar. The company would be increasing its total capacity by 30% by CY23.
- PepsiCo's market shares in under-penetrated categories of MP, Odisha, Bihar, Jharkhand & Chhattisgarh is 15-20% & this provide huge opportunity to grow in these regions.
- Energy drink 'Sting' has witnessed a growth of 185% & it now contributed 7.2% to the volumes. Similar, dairy based products are also growing at faster pace. The company would be doubling dairy capacity in CY23 season. Currently, the company is only able to serve Northern territories given dairy plant is located in Punjab.
- The company has taken ₹31.8 crore (₹46.4 crore in H1) during the quarter write off on returnable glass bottles (RGB) lines given demand for RGB bottles reduced substantially during Covid-19 period.
- The volume growth in double digit is possible in next few years given strong demand scenario in Juices, energy drinks & milk based beverages. Further under-penetrated territories in East & acquired territories of South & West

expected to grow faster given the company's share is lower in these territories

- International territories like Nepal, Morocco are growing well with increase in margins. Zimbabwe capacity has been added in current year, which would start production in coming quarter. Sri-Lanka territory is facing disruption but it contributes 1% to the total volumes
- The company would start manufacturing Kurkure brand from October 2022. VBL would be only manufacturing the brands, marketing & distribution would be done by PepsiCo.
- The company announced a dividend of ₹2.5 /share.

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			
Nestle (NESIND)	19255	21600	Hold	184201	10.2	11.9	10.5	24.4	23.2	20.3	79.4	80.2	65.0	111.3	111.1	118.3	58.7	57.0	64.7
Tata Consumer (TATGLO)	811	910	Buy	67201	7.1	9.7	9.7	13.83	15.55	16.1	66.2	48.71	41.72	6.959	8.758	9.835	8.447	10.25	11.35
Varun Beverage (VARBEV)	926	1100	Buy	60171	36.8	39.8	12.8	18.8	20.8	20.5	53.8	45.0	39.7	18.3	26.3	25.3	17.1	28.1	30.8
Zydus Wellness (ZYDWEL)	1620	2100	Buy	10254	7.6	12.4	10.5	17.2	18.1	19.7	33.2	28.0	22.7	6.4	7.3	8.7	6.1	7.1	8.4

Source: Company, ICICI Direct Research

Varun beverage witnessed splendid volume growth during the quarter largely backed by low base, extreme summer & potential growth in acquired southern and western territories (acquired 3 years back). With the 90% utilisation of its capacity, the company was able to reach volume of 300 million cases during the quarter. Though, high commodity inflation adversely impacted gross margins, the company was still able to off-set the cost with early procurement of PET inventories. We believe the company has been able to drive the potential of underpenetrated territories of Bihar, MP, Odisha, Jharkhand & Chhattisgarh. With this kind of growth, we have upgraded our volume numbers 12% in CY22E & CY23E. The expected dip in crude based packaging costs (PET chip prices), the margins improvement is also expected in H1CY23. We remain positive on Varun beverages. We maintain **BUY** rating to the stock with the revised target price of ₹1100 (earlier: ₹900).

Exhibit 2: Variance Analysis

Particulars (₹ crore)	Q2CY22	Q2CY21	YoY (%)	Q1CY22	QoQ (%)	Comments
Net Sales	4,954.8	2,449.8	102.3	2,827.5	75.2	Robust sales growth was led by 96.9% growth in volume & 2.7% growth in realisation
Raw Material Expenses	2,451.8	1,138.3	115.4	1,370.2	78.9	Gross margins contracted by 302 bps on account of high inflation in crude which led to considerable increase in PET resin prices
Employee Expenses	310.4	243.2	27.6	275.1	12.9	
Other operating Expenses	941.9	497.5	89.3	651.2	44.6	Overhead spend increased by 89.3% on account of high fuel prices
EBITDA	1,250.6	570.8	119.1	531.0	135.5	Despite lower gross margins, operating profits grew by 119.1% benefited through operating leverage
EBITDA Margin (%)	25.2	23.3	194 bps	18.8	646 bps	
Depreciation	153.1	128.8	18.9	131.3	16.6	
Interest	46.4	46.8	-0.8	47.0	-1.2	Interest cost remain flat as strong cash flow generation utilised to repay debt in last six months
Other Income	10.5	24.4	-57.1	8.5	23.1	
PBT	1,061.6	419.7	153.0	361.2	193.9	
Exceptional Items	0.0	0.0		0.0		
Tax Outgo	259.6	100.9	157.4	90.1	188.0	
PAT	802.0	318.8	151.6	271.1	195.8	Led by high operating profit & flat interest cost, net profit grew by stupendous 151.6%
Adj. PAT	802.0	318.8	151.6	271.1	195.8	

Source: Company, ICICI Direct Research

Exhibit 3: Change in estimates

(₹ Crore)	CY22E			CY23E			CY24E		Comments
	Old	New	% Change	Old	New	% Change	New		
Net Sales	10,911.7	12,338.5	13.1	12,172.5	13,919.4	14.4	15,538.8	We are changing our sales growth estimates upwards after robust volume growth in H1CY22. We are introducing CY24 numbers	
EBITDA	2,217.7	2,566.9	15.7	2,481.9	2,860.1	15.2	3,196.1		
EBITDA Margin(%)	20.3	20.8	48 bps	20.4	20.5	16 bps	20.6	Operating leverage benefits to change our operating margin estimates	
PAT	1,120.8	1,336.7	19.3	1,312.6	1,517.3	15.6	1,779.4	We are estimating lower income tax rate after the company moved to new tax regime	
EPS (₹)	17.3	20.6	19.3	20.2	23.4	15.6	27.4		

Source: ICICI Direct Research

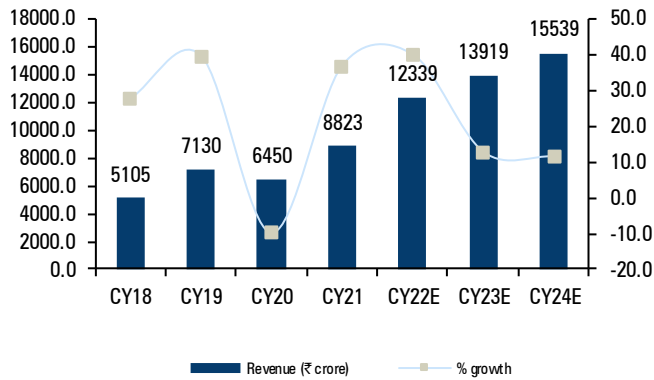
Exhibit 4: Assumptions

Particulars (in million cases)	Current							Earlier		Comments
	CY18	CY19	CY20	CY21	CY22E	CY23E	CY24E	CY22E	CY23E	
Carbonated Products	257.0	347.0	309.0	399.8	543.8	598.2	652.0	479.8	523.5	We have incresed our volume estimates after robust volume growth in 2022 summer season
Non Carbonated drinks	22.0	33.0	26.0	36.1	47.0	52.6	58.9	44.5	49.8	
Water	61.0	111.0	90.0	132.3	178.6	201.8	222.0	165.4	185.2	

Source: ICICI Direct Research

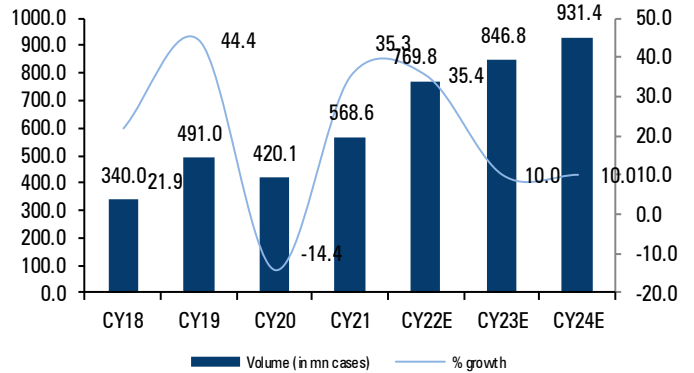
Key Metrics

Exhibit 5: Revenue growth trend (₹ crore)



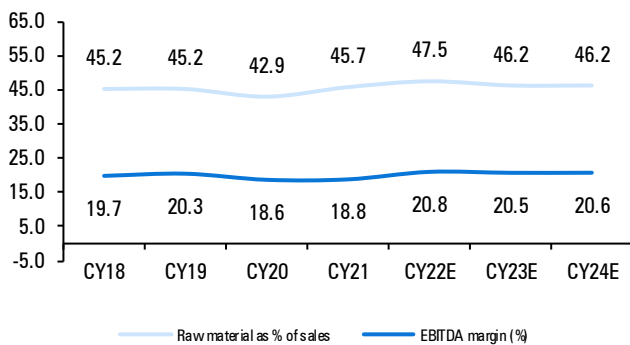
Source: Company, ICICI Direct Research

Exhibit 6: Volume recovery to drive growth



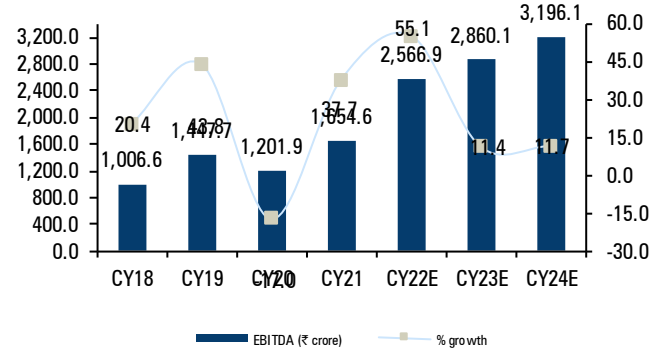
Source: Company, ICICI Direct Research

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



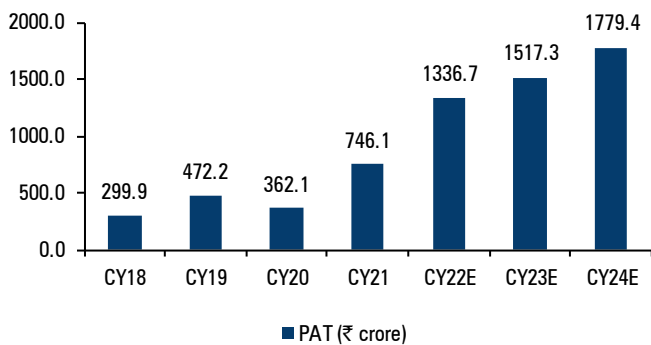
Source: Company, ICICI Direct Research

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



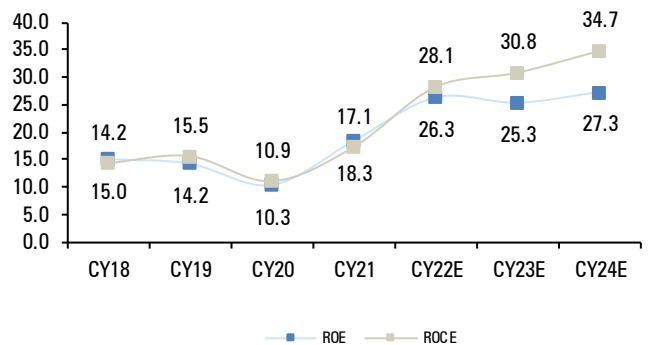
Source: Company, ICICI Direct Research

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	53.8	37.7	18.3	17.1
CY22E	12338.5	39.8	20.6	19.4	45.0	23.9	26.3	28.1
CY23E	13919.4	12.8	23.4	13.5	39.7	21.3	25.3	30.8
CY24E	15538.8	11.6	27.4	17.3	33.8	18.8	27.3	34.7

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
(Year-end March)	CY21	CY22E	CY23E	CY24E
Total operating income	8823.2	12338.5	13919.4	15538.8
Growth (%)	36.8	39.8	12.8	11.6
Raw Material Expenses	4034.7	5858.4	6434.4	7183.2
Employee Expenses	1007.7	1233.9	1531.1	1709.3
Marketing Expenses	0.0	150.7	212.4	237.1
Other expenses	2126.2	2528.7	2881.4	3213.1
Total Operating Expenditure	7168.6	9771.6	11059.4	12342.7
EBITDA	1,654.6	2,566.9	2,860.1	3,196.1
Growth (%)	37.7	55.1	11.4	11.7
Depreciation	531.3	625.4	714.2	768.4
Interest	184.7	197.0	164.2	79.2
Other Income	67.9	42.5	46.7	30.4
PBT	1006.6	1787.0	2028.4	2378.9
Total Tax	260.6	450.3	511.2	599.5
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	0.0	0.0	0.0	0.0
PAT	746.1	1,336.7	1,517.3	1,779.4
Growth (%)	106.1	79.2	13.5	17.3
EPS (₹)	17.2	20.6	23.4	27.4

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	CY21	CY22E	CY23E	CY24E
Profit After Tax	968.9	1,533.7	1,681.5	1,858.6
Add: Depreciation	531.3	625.4	714.2	768.4
(Inc)/dec in Current Assets	-596.8	-752.9	-383.3	-389.1
Inc/(dec) in CL and Provisions	328.1	867.3	228.3	625.1
CF from operating activities	1,231.4	2,273.4	2,240.6	2,863.0
(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	-850.0	-600.0
Dividend paid & dividend tax	-108.3	-334.2	-606.9	-1,245.6
Others	-179.1	-413.5	-164.2	-79.2
CF from financing activities	-177.7	-1,422.0	-1,593.8	-1,896.1
Net Cash flow	43.1	214.8	-232.5	36.2
Opening Cash	104.6	150.8	365.6	133.1
Other Bank balance	185.9	185.9	185.9	185.9
Closing Cash	150.8	365.6	133.1	169.3

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	4432.9	5343.2	5877.0
Total Shareholders funds	4079.9	5082.4	5992.8	6526.6
LT Borrowings & Provisions	1813.3	1113.3	413.3	13.3
Deferred Tax Liability	311.1	326.7	343.0	360.2
Total Liabilities	6561.6	6742.1	6979.8	7142.3
Assets				
Gross Block	8,974.6	9,621.2	10,821.2	11,821.2
Less: Acc Depreciation	3,246.6	3,872.0	4,586.2	5,354.6
Net Block	5,728.0	5,749.2	6,235.0	6,466.6
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	1,885.1	2,126.6	2,374.0
Debtors	221.2	308.5	348.0	388.5
Loans and Advances	9.5	13.7	19.3	21.6
Other Current Assets	301.9	445.6	502.6	561.1
Cash	150.8	365.6	133.1	169.3
Deferred Tax Assets	2.4	2.4	2.4	2.4
Current Liabilities				
Creditors	711.8	993.9	1,121.3	1,251.7
Provisions	49.7	68.5	77.3	86.3
Short term debt & other CL	2,244.8	2,756.3	2,698.4	2,984.1
Application of Funds	6,561.6	6,742.1	6,979.8	7,142.3

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	CY21	CY22E	CY23E	CY24E
Per share data (₹)				
EPS	17.2	20.6	23.4	27.4
Cash EPS	29.5	30.2	34.4	39.2
BV	94.2	78.2	92.3	100.5
DPS	2.5	5.1	9.3	19.2
Cash Per Share	75.0	59.6	70.6	82.4
Operating Ratios (%)				
EBITDA Margin	18.8	20.8	20.5	20.6
PBT / Total Operating income	11.4	14.5	14.6	15.3
PAT Margin	8.5	10.8	10.9	11.5
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	26.3	25.3	27.3
RoCE	17.1	28.1	30.8	34.7
Valuation Ratios (x)				
P/E	53.8	45.0	39.7	33.8
EV / EBITDA	37.7	23.9	21.3	18.8
EV / Net Sales	7.1	5.0	4.4	3.9
Market Cap / Sales	6.8	4.9	4.3	3.9
Price to Book Value	9.8	11.8	10.0	9.2
Solvency Ratios				
Debt/EBITDA	1.5	0.6	0.3	0.1
Debt / Equity	0.6	0.3	0.1	0.0
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)	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Colgate (COLPAL)	1,575	1,690	Hold	42,548	39.6	40.6	44.4	39.7	38.8	35.5	8.4	7.8	7.2	77.8	84.1	91.2	62.2	64.1	69.6
Dabur India (DABIND)	581	680	Buy	96,113	9.9	11.7	13.1	58.9	49.4	44.3	8.8	8.0	7.2	24.9	25.3	26.1	20.8	22.7	22.9
Hindustan Unilever (HINLEV)	2,593	2,700	Hold	6,10,844	37.5	40.9	44.8	69.1	63.4	57.8	12.1	10.8	10.1	20.2	22.5	24.6	18.1	19.7	21.5
ITC Limited (ITC)	308	310	Buy	3,60,223	12.4	14.0	15.5	24.8	21.9	19.9	6.1	5.6	5.1	31.4	34.9	36.6	24.5	26.7	28.1
Jyothy Lab (JYOLAB)	173	145	Hold	6,077	4.3	5.6	6.4	40.6	30.9	27.1	2.8	2.5	2.3	18.7	24.2	27.7	16.6	21.2	23.8
Marico (MARLIM)	523	530	Hold	64,929	9.7	10.6	11.7	53.8	49.5	44.6	6.8	6.3	5.8	41.2	46.8	52.9	37.5	41.4	47.4
Nestle (NESIND)	19,255	21,600	Hold	1,84,201	222.4	238.3	294.0	86.6	80.8	65.5	12.6	11.2	10.2	58.7	57.0	64.7	111.3	111.1	118.3
Tata Consumer Products (TAT)	811	910	Buy	67,201	11.0	15.0	17.5	73.6	54.2	46.4	5.4	4.9	4.5	8.4	10.3	11.3	7.0	8.8	9.8
VST Industries (VSTIND)	3,319	3,425	Hold	4,937	207.4	229.3	252.9	16.0	14.5	13.1	4.2	3.8	3.5	39.2	44.6	50.6	30.0	33.4	37.8
Varun Beverage (VARBEV)	926	1,100	Buy	60,171	17.2	20.6	23.4	53.8	45.0	39.6	6.8	4.9	4.3	17.1	28.1	30.8	18.3	26.3	25.3
Zydus Wellness (ZYDWEL)	1,620	2,100	Buy	10,254	48.5	57.5	71.0	33.4	28.2	22.8	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%



Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICI Direct Research Desk,
ICICI Securities Limited,
1st Floor, Akruiti Trade Centre,
Road No 7, MIDC,
Andheri (East)
Mumbai – 400 093
research@icicidirect.com**

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