

## Distribution expansion, new products driving volumes

**About the stock** Varun Beverage (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 India. Some of the PepsiCo brands produced by VBL include Pepsi, Diet Pepsi, Seven-Up, Mirinda, Mountain Dew, Nimbooz, Sting, Slice, Tropicana, Aquafina among others.

- The company has operations in India (except Andhra Pradesh, J&K & Ladakh), Sri Lanka, Nepal, Morocco, Zambia and Zimbabwe

**Q4CY22 Results:** Varun Beverages witnessed strong volume growth of 17.8%.

- Sales were up 27.7% YoY led by strong volume & superior product mix
- EBITDA was at ₹ 307.5 crore, up 48.1% YoY, with margins at 13.9%
- Consequently, PAT was at ₹ 81.5 crore, up 2.5x

**What should investors do?** Varun Beverage's share price has given 6.3x return (from ₹ 195 in February 2018 to ₹ 1221 in February 2023).

- We estimate 10% volume CAGR & sustainable operating margins above 21%. This would lead to earning CAGR of 12.1% in CY22-24E
- We maintain our **HOLD** recommendation on the stock

**Target Price and Valuation:** We value the stock at ₹ 1340, valuing the business at 45x CY24 PE.

**Key triggers for future price performance:**

- VBL has seen 15% organic volume growth in the last three years led by distribution expansion in underpenetrated territories and new launches (Sting, milk based beverages, etc). We expect volume growth to moderate to 10% level in the next two years
- It is setting up two new plants in Rajasthan & Madhya Pradesh along with brownfield expansion in six other plants, which would enhance its capacity by 20-25%. This would entail capex of ₹ 1500 crore
- Newer brands 'Sting' & milk-based beverages are growing at a faster pace, supporting overall volume growth. Energy drink 'Sting' is contributing 9.6% to overall volumes in CY22

**Alternate Stock Idea:** We like Tata Consumer Products in our FMCG coverage.

- Strong innovation & premiumisation strategy in salt, tea, Sampann & Soulful in India market expected to drive sales and margins
- We value the stock at ₹ 950 on ascribing 52x FY25 earnings multiple



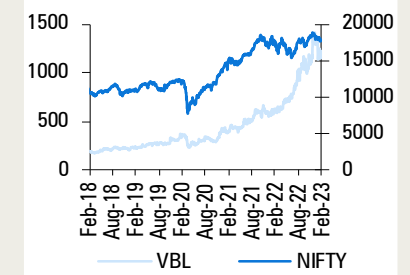
### Particulars

Particulars (₹ crore)	Amount
Market Capitalization	79,300.1
Total Debt (CY22)	3,718.4
Cash & Investments (CY22)	307.5
EV	82,710.9
52 week H/L (₹)	1432 / 557
Equity capital	288.7
Face value	10.0

### Shareholding pattern

(in %)	Mar-22	Jun-22	Sep-22	Dec-22
Promoter	64.9	63.9	63.9	63.9
FII	21.0	23.9	25.0	26.5
DII	7.2	5.3	4.5	3.4
Others	6.9	6.9	6.6	6.2

### Price Chart



### Recent event & key risks

- VBL would increase its distribution reach to 3.5 million outlets by end of CY23
- Key Risk:** (i) Possibility of softer summer product demand due to adverse weather conditions in CY23 (ii) Significant decline in PET resin prices could enhance margins positively

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### Key Financial Summary

	CY20	CY21	CY22	5 Year CAGR (CY17- CY22)	CY23E	CY24E	CAGR (CY22-24E)
Net Sales	6450.1	8823.2	13173.1	26.9	14558.6	16263.8	11.1%
EBITDA	1201.9	1654.6	2788.1	27.2	3105.3	3478.2	11.7%
EBITDA Margin %	18.6	18.8	21.2		21.3	21.4	
Net Profit	362.1	746.1	1550.1	48.6	1692.2	1946.5	12.1%
Diluted EPS (₹)	5.6	11.5	23.9	15.3	26.1	30.0	12.1%
P/E	219.0	106.3	51.2		46.9	40.7	
RoNW %	10.3	18.3	30.4		26.6	25.5	
RoCE (%)	10.9	17.1	23.8		27.2	30.6	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter

### Q4CY22 Results: New products (Sting, Dairy products) & distribution expansion resulting in high growth...

- Revenue witnessed growth of 27.7% to ₹ 2214.2 crore led by 17.8% volume growth & 6% realisation growth during the quarter. Consolidated sales volumes and average realisation were at 132 million cases and ₹ 164 per case, respectively, in Q4CY22
- Carbonated soft drinks (CSD), juices & water account for 65%, 5% & 30% of the total volumes for the company in Q4 whereas their contribution in CY22 was 70%, 7% & 23%, respectively
- Distribution network expansion to 3 million retail outlets along with robust demand conditions due to increased mobility after two years of Covid disruption led to the strong growth in volumes throughout the year
- Energy drink 'String' witnessed stupendous growth in CY22. It contributed 16% to volumes in Q4CY22 & 9.6% in CY22. The company expects to maintain growth momentum in 'Sting' along with volume uptick in its dairy based products in CY23
- Energy drink products have been contributing 10-15% to the beverage market in emerging markets. The availability of product at lower price points in India in last five years has led to multi-fold growth
- Realisation growth of 6% was led by selective price increases and rationalisation of trade discounts. Single serve SKUs gross as well as operating margins are better than multi-serve SKUs. Given 'Sting' largely sold in smaller pack, higher growth in the brand aided realisation growth
- Varun Beverages Morocco SA (a wholly owned subsidiary of the company) started distribution & selling PepsiCo's snack products viz. "Lays, Doritos and Cheetos" in the territory of Morocco. However, it is unlikely to get manufacturing & distribution of snacks products in India from PepsiCo
- The company has started pre-stocking of raw material as well initiated brownfield capacity addition much earlier (November-December) this year as it does not want to go out of stock in any of its line in peak summer season (March-June)
- PET resin prices are generally lower in November-December. Early procurement of key raw materials could safeguard it from volatility in peak season. South & western territories (acquired in 2019) are important and given summer season in the south starts in February, it is important to add capacities earlier now
- The company expanded its distribution reach to 3.0 million outlets. It would increase its reach by 10-15% every year. Distribution network would be enhanced to 3.5 million outlets by end of 2023. Visi coolers, trucks & related capacities would be added proportionally
- Dairy product national rollout is only possible by 2024 given new dairy capacities would come on stream by end of this year. The company is enhancing its dairy product capacity by 3x. Sourcing of milk & other raw material would not be a problem for the company
- Gross margins expanded by 91 bps in Q4CY22 on account of change in product mix (high contribution of 'Sting') & softening of PET resins prices
- Employee & overhead spends were lower by 53 bps & 48 bps, respectively. This led to operating profit growth of 48.1% to ₹ 307.5 crore with operating margin expansion of 192 bps to 13.9%. Despite higher interest cost & depreciation provisioning, net profit jumped to ₹ 81.5 crore in Q4CY22 compared to ₹ 32.6 crore in the corresponding quarter

- The company would be undertaking capex of ₹ 1500 crore in CY23, which includes two greenfield plants in Rajasthan, Madhya Pradesh & brownfield expansion in six other plants in India
- Net debt for the company increased to ₹ 3409.6 crore in December 2022 compared to ₹ 3005.3 crore in December 2021 mainly due company's capex plan in CY23. The debt levels would go down in H1CY23 with repayment of debt through large operating cash flows. Hence, interest levels are likely to remain similar to CY22 numbers
- The company declared a final dividend of ₹ 1/share. Total dividend for the year is ₹ 3.5/share. Total outflow for dividend payout is ₹ 227.2 crore in CY22

**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)	19022	22400	Hold	190912	10.2	14.3	10.5	24.5	22.3	24.1	85.5	74.4	63.2	111.3	103.6	110.3	58.7	57.1	63.0
Dabur India (DABIND)	545	700	Buy	97880	13.9	5.9	10.6	20.7	19.6	20.7	55.3	53.1	45.3	20.8	20.5	22.2	24.9	23.9	26.1
Varun Beverage (VARBEV)	1222	1340	Hold	79300	36.8	49.3	10.5	18.8	21.2	21.3	70.9	51.2	46.9	18.3	30.4	26.6	17.1	23.8	27.2
Zydus Wellness (ZYDWEL)	1465	2000	Buy	8979	23.1	14.3	21.6	17.2	17.3	18.8	30.2	26.6	21.7	6.4	7.1	8.3	6.1	6.8	8.1

Source: Company, ICICI Direct Research

VBL witnessed 49.3% sales growth led by 40.9% volume growth in CY22 mainly on account of aggressive distribution expansion and significant improvement in mobility after two years of Covid-19 related disruption. Further, new product launched in last two years like 'Sting' & 'Dairy based beverages' has seen a robust growth in last one year. The company also remain relatively insulated with commodity inflation given it pro-actively procured 'PET resin' before the season. Operating leverage helped in expanding margins in CY22. The company is continuing its expansion spree in relatively weak markets like Rajasthan, Madhya Pradesh, UP & Bihar. Though we remain positive on growth prospects, it would be difficult to grow for the company at a very high pace on such a huge base in CY23. We remain positive on the company from a long-term perspective. We maintain our HOLD rating with a revised target price of ₹ 1340 (earlier: ₹ 1235).

**Exhibit 2: Variance Analysis**

Particulars (₹ crore)	Q4CY22	Q4CY21	YoY (%)	Q3CY22	QoQ (%)	Comments
Net Sales	2,214.2	1,734.3	27.7	3,176.6	-30.3	Net sales witnessed growth of 27.7% led by 17.8% volume growth & strong realisation growth due to change in product mix
Raw Material Expenses	967.8	773.8	25.1	1,471.3	-34.2	Gross margins improved by 91 bps with stabilisation of RM prices & better product mix
Employee Expenses	319.9	259.8	23.1	311.2	2.8	
Other operating Expenses	619.0	493.1	25.5	695.1	-11.0	
EBITDA	307.5	207.6	48.1	699.0	-56.0	
EBITDA Margin (%)	13.9	12.0	192 bps	22.0	-812 bps	Operating margin improved by 192 bps largely due to gross margin expansion & operating leverage
Depreciation	179.7	129.3	39.0	153.1	17.3	Higher depreciation providing due to commissioning of new capacities
Interest	47.5	37.3	27.3	45.3	4.9	Increase in interest cost due to higher debt levels
Other Income	9.2	0.9	982.6	10.6	-12.9	
PBT	89.6	41.9	114.1	511.2	-82.5	
Exceptional Items	0.0	0.0		0.0		
Tax Outgo	8.1	9.3	-12.8	115.7	-93.0	
PAT	81.5	32.6	150.2	395.5	-79.4	Net profit growth was led by robust operating profit growth & dip in tax rate after switching to new tax regime
Adj. PAT	81.5	32.6	150.2	395.5	-79.4	

Source: Company, ICICI Direct Research

**Exhibit 3: Change in estimates**

(₹ Crore)	CY23E			CY24E			Comments
	Old	New	% Change	Old	New	% Change	
Net Sales	14,461.3	14,558.6	0.7	16,156.5	16,263.8	0.7	We largely maintain our sales estimate
EBITDA	3,090.4	3,105.3	0.5	3,474.5	3,478.2	0.1	
EBITDA Margin(%)	21.4	21.3	-4 bps	21.5	21.4	-12 bps	
PAT	1,739.3	1,692.2	-2.7	2,007.8	1,946.5	-3.1	We raise our interest cost estimate given the company continues to maintain more than ₹ 3000 crore of debt
EPS (₹)	26.8	26.1	-2.8	30.9	30.0	-3.0	

Source: ICICI Direct Research

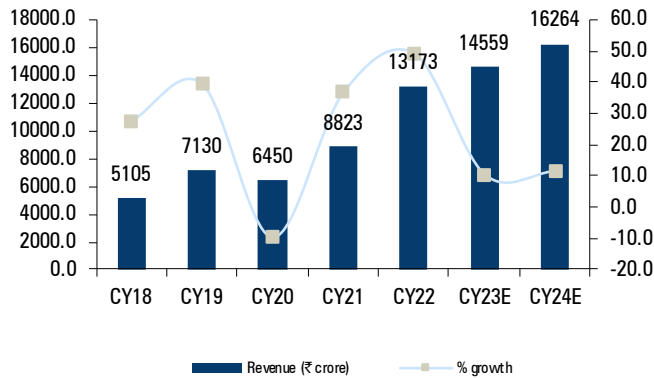
**Exhibit 4: Assumptions**

Particulars (in million cases)	Current				Earlier				Comments
	CY19	CY20	CY21	CY22	CY23E	CY24E	CY23E	CY24E	
Carbonated Products	347.0	309.0	399.8	562.0	618.2	673.8	609.2	664.0	
Non Carbonated drinks	33.0	26.0	36.1	57.0	63.8	71.5	64.8	72.5	We slightly change our volume estimates
Water	111.0	90.0	132.3	182.0	205.7	226.2	207.8	228.6	

Source: ICICI Direct Research

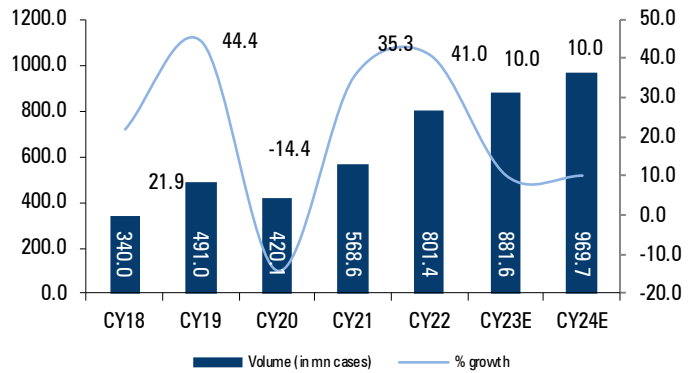
## Key Metrics

Exhibit 5: Revenue growth trend (₹ crore)



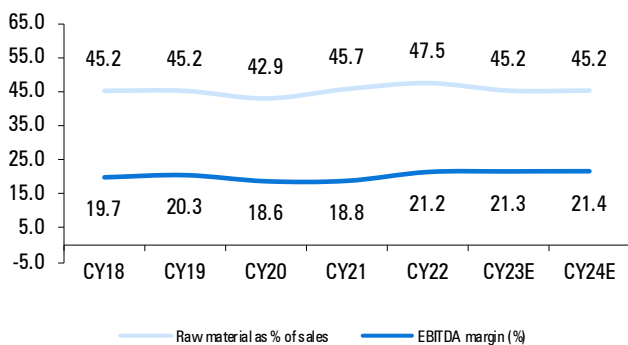
Source: Company, ICICI Direct Research

Exhibit 6: Volume recovery to drive growth



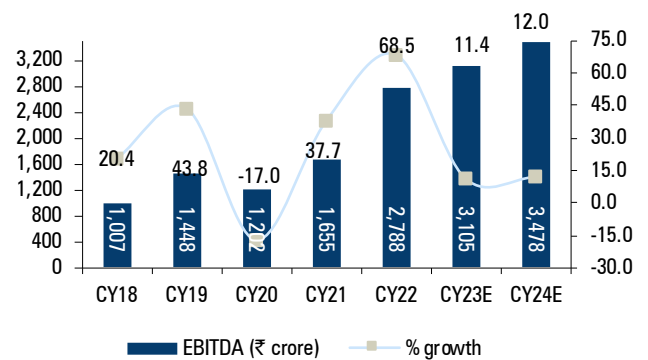
Source: Company, ICICI Direct Research

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



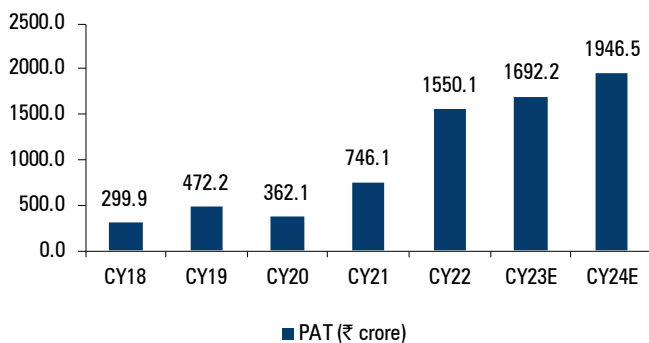
Source: Company, ICICI Direct Research

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



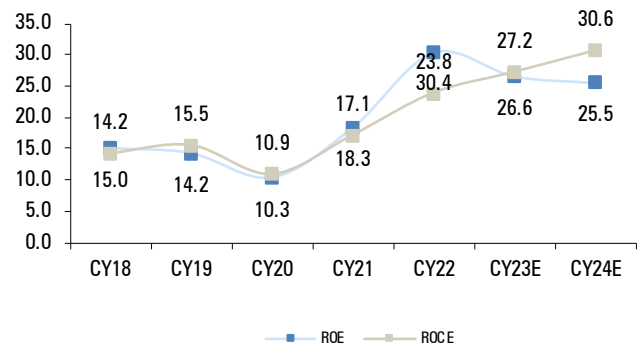
Source: Company, ICICI Direct Research

Exhibit 9: Robust earnings growth in last five years (₹ 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	70.9	49.3	18.3	17.1
CY22	13173.1	49.3	23.9	38.5	51.2	29.7	30.4	23.8
CY23E	14558.6	10.5	26.1	9.2	46.9	26.1	26.6	27.2
CY24E	16263.8	11.7	30.0	15.0	40.7	23.0	25.5	30.6

Source: Company, ICICI Direct Research

## Financial Summary

Exhibit 12: Profit and loss statement				
	₹ crore			
	CY21	CY22	CY23E	CY24E
<b>Total operating income</b>	<b>8823.2</b>	<b>13173.1</b>	<b>14558.6</b>	<b>16263.8</b>
Growth (%)	36.8	49.3	10.5	11.7
Raw Material Expenses	4034.7	6261.2	6586.0	7357.2
Employee Expenses	1007.7	1216.6	1412.2	1610.1
Other expenses	2126.2	2907.2	3455.2	3818.3
Total Operating Expenditure	<b>7168.6</b>	<b>10385.0</b>	<b>11453.3</b>	<b>12785.6</b>
<b>EBITDA</b>	<b>1,654.6</b>	<b>2,788.1</b>	<b>3,105.3</b>	<b>3,478.2</b>
Growth (%)	37.7	68.5	11.4	12.0
Depreciation	531.3	617.2	774.0	824.0
Interest	184.7	186.1	204.5	201.8
Other Income	67.9	38.8	42.7	43.2
PBT	1006.6	2023.6	2169.5	2495.5
Total Tax	260.6	473.5	477.3	549.0
Minority interest	0.0	0.0	0.0	0.0
Profit from Associates	0.0	0.0	0.0	0.0
<b>PAT</b>	<b>746.1</b>	<b>1,550.1</b>	<b>1,692.2</b>	<b>1,946.5</b>
Growth (%)	106.1	107.8	9.2	15.0
EPS (₹)	17.2	23.9	26.1	30.0

Source: Company, ICICI Direct Research

Exhibit 13: Cash flow statement				
	₹ crore			
(Year-end March)	CY21	CY22	CY23E	CY24E
Profit After Tax	1,067.4	1,835.8	1,896.7	2,148.3
Add: Depreciation	531.3	583.1	774.0	824.0
(Inc)/dec in Current Assets	-596.8	-1,005.9	-460.2	-599.9
Inc/(dec) in CL and Provisions	328.1	420.7	1,419.6	623.8
<b>CF from operating activities</b>	<b>1,231.4</b>	<b>1,790.0</b>	<b>3,630.1</b>	<b>2,996.2</b>
(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	-1,749.9	-1,028.9	-878.9
Others	-87.7	45.3	0.0	0.0
<b>CF from investing activities</b>	<b>-1,010.6</b>	<b>-1,704.6</b>	<b>-1,028.9</b>	<b>-878.9</b>
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	109.7	339.6	-1,700.0	-1,200.0
Dividend paid & dividend tax	-108.3	-162.4	-423.1	-681.3
Others	-179.1	-171.7	-204.5	-201.8
<b>CF from financing activities</b>	<b>-177.7</b>	<b>-17.9</b>	<b>-2,579.0</b>	<b>-2,054.7</b>
Net Cash flow	43.1	67.5	22.2	62.6
Opening Cash	104.6	150.8	154.3	176.6
Other Bank balance	185.9	185.9	185.9	185.9
<b>Closing Cash</b>	<b>150.8</b>	<b>154.3</b>	<b>176.6</b>	<b>239.2</b>

Source: Company, ICICI Direct Research

Exhibit 14: Balance Sheet				
	₹ crore			
(Year-end March)	CY21	CY22	CY23E	CY24E
<b>Liabilities</b>				
Equity Capital	433.0	649.5	649.5	649.5
Reserve and Surplus	3646.9	4452.8	5722.0	6987.2
Total Shareholders funds	4079.9	5102.4	6371.5	7636.8
LT Borrowings & Provisions	1813.3	1727.0	1227.0	577.0
Deferred Tax Liability	311.1	336.8	353.7	371.4
<b>Total Liabilities</b>	<b>6561.6</b>	<b>7649.5</b>	<b>8167.2</b>	<b>8810.8</b>
<b>Assets</b>				
Gross Block	8,974.6	10,220.9	11,727.5	12,677.5
Less: Acc Depreciation	3,246.6	3,863.8	4,637.8	5,461.9
Net Block	5,728.0	6,357.1	7,089.7	7,215.7
Capital WIP	496.6	606.6	150.0	50.0
Net Intangible Assets	558.6	550.9	578.5	607.4
Non-current Investments	0.8	0.0	0.0	0.0
Goodwill	24.2	24.2	24.2	24.2
<b>Current Assets</b>				
Inventory	1,448.1	1,993.9	2,305.1	2,710.6
Debtors	221.2	299.3	364.0	451.8
Loans and Advances	9.5	0.0	20.2	22.6
Other Current Assets	301.9	427.8	525.7	587.3
Cash	150.8	154.3	176.6	239.2
Deferred Tax Assets	2.4	0.0	0.0	0.0
<b>Current Liabilities</b>				
Creditors	711.8	824.3	889.7	993.9
Provisions	49.7	29.2	80.9	90.4
Short term debt & other CL	2,244.8	3,039.7	3,217.8	3,177.9
<b>Application of Funds</b>	<b>6,561.6</b>	<b>7,649.5</b>	<b>8,167.2</b>	<b>8,810.8</b>

Source: Company, ICICI Direct Research

Exhibit 15: Key ratios				
(Year-end March)	CY21	CY22	CY23E	CY24E
<b>Per share data (₹)</b>				
EPS	17.2	23.9	26.1	30.0
Cash EPS	29.5	33.4	38.0	42.7
BV	94.2	78.6	98.1	117.6
DPS	2.5	6.0	6.5	10.5
Cash Per Share	75.0	59.5	71.4	84.1
<b>Operating Ratios (%)</b>				
EBITDA Margin	18.8	21.2	21.3	21.4
PBT / Total Operating income	11.4	15.4	14.9	15.3
PAT Margin	8.5	11.8	11.6	12.0
Inventory days	60	55	58	61
Debtor days	9	8	9	10
Creditor days	29	23	22	22
<b>Return Ratios (%)</b>				
RoE	18.3	30.4	26.6	25.5
RoCE	17.1	23.8	27.2	30.6
<b>Valuation Ratios (x)</b>				
P/E	70.9	51.2	46.9	40.7
EV / EBITDA	49.3	29.7	26.1	23.0
EV / Net Sales	9.2	6.3	5.6	4.9
Market Cap / Sales	9.0	6.0	5.4	4.9
Price to Book Value	13.0	15.5	12.4	10.4
<b>Solvency Ratios</b>				
Debt/EBITDA	1.5	1.3	0.6	0.2
Debt / Equity	0.6	0.7	0.3	0.1
Current Ratio	0.7	1.2	0.8	0.8
Quick Ratio	0.1	0.2	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)	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Colgate (COLPAL)	1,457	1,440	Hold	39,473	39.6	37.7	40.3	36.8	38.6	36.2	7.8	7.6	7.1	77.8	79.3	84.2	62.2	60.4	64.1
Dabur India (DABIND)	545	700	Buy	97,880	9.9	10.3	12.0	55.3	53.1	45.3	9.0	8.5	7.7	24.9	23.9	26.1	20.8	20.5	22.2
Hindustan Unilever (HINLEV)	2,638	2,800	Hold	6,04,971	37.5	42.0	46.7	70.3	62.7	56.5	12.0	10.3	9.4	20.2	22.9	25.6	18.1	20.3	22.4
ITC Limited (ITC)	383	450	Buy	4,67,841	12.4	14.7	16.0	30.9	26.1	23.9	7.9	6.8	6.2	31.4	36.0	37.5	24.5	27.7	28.7
Jyothy Lab (JYOLAB)	213	215	Hold	7,485	4.3	6.7	7.8	50.2	32.0	27.4	3.5	3.1	2.8	18.7	27.5	31.4	16.6	24.2	27.0
Marico (MARLIM)	505	555	Hold	63,710	9.7	10.3	11.1	51.9	49.0	45.4	6.7	6.5	6.0	41.2	44.0	46.2	37.5	38.5	40.6
Nestle (NESIND)	19,022	22,400	Hold	1,90,912	222.4	255.8	301.1	85.5	74.4	63.2	13.0	11.4	10.3	58.7	57.1	63.0	111.3	103.6	110.3
Patanjali Foods (RUCSOY)	938	1,750	Buy	50,721	27.3	30.9	43.5	34.4	30.3	21.6	2.1	1.7	1.5	13.2	15.6	17.3	13.1	11.3	14.2
Tata Consumer Products (TAT)	730	950	Buy	66,879	11.0	14.3	15.8	66.2	50.9	46.2	5.4	4.9	4.4	8.4	8.8	10.3	7.0	7.6	9.0
Varun Beverage (VARBEV)	1,222	1,340	Hold	79,300	17.2	23.9	26.1	70.9	51.2	46.9	9.0	6.0	5.4	17.1	23.8	27.2	18.3	30.4	26.6
VST Industries (VSTIND)	3,010	3,300	Hold	4,807	207.4	214.1	229.4	14.5	14.1	13.1	4.1	3.6	3.4	39.2	41.8	49.1	30.0	31.9	36.9
Zydus Wellness (ZYDWEL)	1,465	2,000	Buy	8,979	48.5	55.0	67.4	30.2	26.6	21.7	4.5	4.0	3.6	6.1	6.8	8.1	6.4	7.1	8.3

Source: Bloomberg, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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