Q2CY21 Update I FMCG I 3 August 2021

Varun Beverages Ltd.

Resilient performance demonstrated

Varun delivered a healthy performance with a topline growth of 49.4% YoY. The higher growth rate was on account of robust volume growth (152 mln cases in Q2CY21 vs. 105 mln cases in Q2CY20) and marginal increase in realisations. The resurgence of Covid-19 pandemic in India caused significant disturbance and led to slowdown in economic activity and business operations of the Company in the month of May. As Covid cases declined, the business operations of the Company showed significant growth in the month of June. Realisation per case improved marginally by 2.8% to Rs 160.8 per case in Q2CY21 led by higher realisations in international territories partially offset by higher mix of water. Gross Margin declined by 128 bps YoY during Q2CY21 primarily due to change in product mix and marginal increase in raw material prices. EBITDA margin was maintained for the quarter because of cost optimisation initiatives. There are no plans of any price hikes this year. Best endeavours will be made to maintain the full year EBITDA margin in line with CY17-CY19. South and West India territories have huge potential for growth, however the peak season in CY20 and CY21 was completely wasted because of the pandemic, hence the full potential has not been achieved. Having said that, South and West territories have been growing at a higher rate than North and East territories. Roughly 1/3 of domestic sales was contributed by South and West India and balance by North and East India. Varun is positive about the rest of the calendar year unless of course the impact of third wave of Covid 19 is severe. CY22e should be a normal year by all counts and deeper penetration of South and West India territories is possible on that year. Further, the dual engines of at-home consumption and on-the –go consumption augurs well for Varun. Based on fundamentals , we maintain a "Hold" rating on the stock.

Strong performance continues

- Varun delivered a healthy performance with a topline growth of 49.4% YoY as noted above.
- On the profitability front, Varun was able to sustain most of the cost optimization measures that it had undertaken last year, allowing it to report stable EBITDA margin at 23.3%.
- PAT increased by 123.0%, primarily driven by lower finance cost on account of lowering of average cost of borrowing and reduction in total debt.
- In-line with Varun's dividend policy the Board of Director's have recommended an interim dividend of Rs. 2.5 per share.
- The impact of lockdowns was less in international territories compared to India.
- Q2CY21 saw higher growth of large SKUs as well as at-home consumption.
- CY20 saw more rural growth compared to urban growth. This year to date growth has been even.
- The energy drink, Sting has really taken off and forms a very important part of the domestic mix. In H1CY21, Sting has crossed the 10 million mark. Because of the price advantage against Red Bull, Sting has been able to do very well.

Outlook and Valuation:

- We are positive about the growth prospects connected with Varun. Expected deeper penetration in South and West India territories and dual growth engines of at-home and on-the-go consumption made us rerate the P/E valuation multiple to 35x. Based on FY23e EPS the **Target Price works out as Rs 793. We maintain a "Hold" rating on the stock.**

Y/E Mar (Rs mn)	Q2 CY21	Q2 CY20	YoY (%)	Q1 CY21	QoQ (%)
Net sales	**2,450**	**1,640**	**49.4%**	**2,241**	**9.3%**
Operating costs	1,879	1,262	48.9%	1,859	1.1%
EBITDA	**571**	**378**	**50.9%**	**382**	**49.5%**
EBITDA Margin (%)	**23.3%**	**23.1%**	**20 bps**	**17.0%**	**630 bps**
Depreciation	129	124	3.6%	135	-4.4%
Interest	47	74	-36.9%	58	-19.3%
Other income	24	3	816.9%	6	326.0%
PBT	**420**	**182**	**130.8%**	**195**	**115.6%**
Provision for tax	101	39	159.4%	58	74.1%
Effective tax rate (%)	24.0%	21.4%	(133) bps	29.8%	(580) bps
PAT (Reported)	**308**	**141**	**118.9%**	**129**	**138.4%**
NPM (%)	**12.6%**	**8.6%**	**399 bps**	**5.8%**	**680 bps**

Source: AceEquity, SMIFS research

Rating: **Hold** Upside/(Downside): **1%**
Current Price: **789** Target Price: **793**

|Earlier recommendation

Previous Rating:	Hold
Previous Target Price:	1,020

|Market data

Bloomberg:	VBL IN
52-week H/L (Rs):	919/430
Mcap (Rs bn/USD mn):	341.7/4,602.7
Shares outstanding (mn):	433
Free float:	34.00%
Avg. daily vol. 3mth (3M Avg – in '000):	47.4
Face Value (Rs):	10
Group:	S&P BSE 200

Source: Bloomberg, SMIFS research

|Shareholding pattern (%)

	Jun-21	Mar-21	Dec-20	Sep-20
Promoter	65.8%	66.4%	66.4%	66.4%
Institutions	26.6%	26.2%	26.3%	26.7%
Non Insti	7.6%	7.4%	7.3%	6.9%
Total	100.0%	100.0%	100.0%	100.0%

Source: BSE

|Price performance (%)*

	1M	3M	12M	36M
BSE Sensex	0.2	7.8	39.3	40.3
VBL	4.4	20.0	67.0	146

**as on 30th July 2021; Source: AceEquity, SMIFS research*

Shantanu Basu
Senior Research Analyst
9830796604
shantanu.basu@smifs.co.in

Y/E Mar (Rs cr)	Revenue	YoY (%)	EBITDA	EBITDA (%)	PAT (Adj)	YoY (%)	EPS (Adj)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
CY18	5,105	28%	1,007	19.7%	293	39%	6.8	14.7%	14.5%	116.7	36.6
CY19	7,130	40%	1,448	20.3%	469	60%	10.8	14.1%	15.5%	72.9	25.4
CY20	6,450	-10%	1,202	18.6%	329	-30%	7.6	9.3%	11.2%	103.9	30.6
CY21e	8,221	27%	1,430	17.4%	486	48%	11.2	12.5%	15.8%	70.3	25.7
CY22e	10,190	24%	2,038	20.0%	981	102%	22.7	20.6%	25.4%	34.8	18.1

Source: AceEquity, SMIFS research

Q1FY22— Key takeaways from the management call

Margins:

- Gross Margin declined by 128 bps YoY during Q2CY21 primarily due to change in product mix and marginal increase in raw material prices. Besides inventories were transferred from one place to another because of which there was additional freight costs.

- There are no plans of any price hikes this year. Best endeavours will be made to maintain the full year EBITDA margin in line with CY17-CY19.

Aspects connected with revenue growth:

- South and West India territories have huge potential for growth, however the peak season in CY20 and CY21 was completely wasted because of the pandemic, hence the full potential has not been achieved. Having said that, South and West territories have been growing at a higher rate than North and East territories. Roughly 1/3 of domestic sales was contributed by South and West India and balance by North and East India.

- While the long term goal is to add 1 lakh outlets every year, CY21 would be an exception and growth of new outlets in CY21 would be miniscule because of the pandemic situation, which affected the peak season.

- The impact of lockdowns was less in international territories compared to India.

- Q2CY21 saw higher growth of large SKUs as well as at-home consumption.
-
- CY20 saw more rural growth compared to urban growth. This year to date growth has been even.

Product categories:

- The energy drink, Sting has really taken off and forms a very important part of the domestic mix. In H1CY21, Sting has crossed the 10 million mark. Because of the price advantage against Red Bull, Sting has been able to do very well. Majority of Sting sales were in small pack, which is primarily dependent on the on-the-go channel. Thus, as the situation normalises, sales of Sting should pick up further.

- Dairy based beverages have been re-launched in North India. Once traction is achieved, a nationwide re-launch would happen.

- Varun will not diversify into any more new products in the near future. It will focus on ensuring growth of Sting, Mountain Dew Ice and Dairy based beverages before venturing into other product additions or extensions.

Other Aspects:

- Maximum limit of Capex for CY21 and CY22 would be the yearly depreciation.

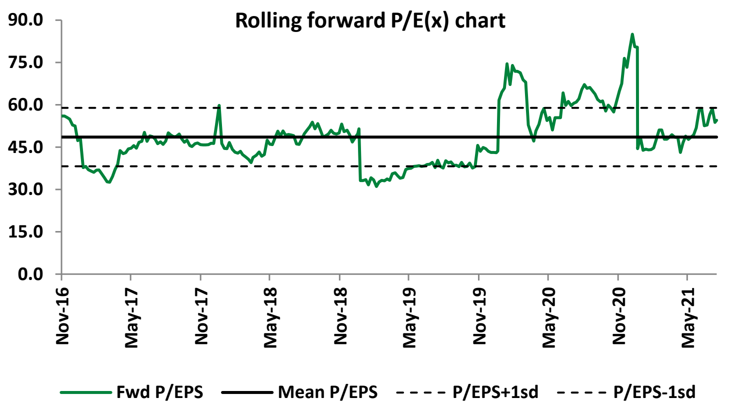
- For the first 6 months, Rs 4660 million of debt has been repaid. Additional Rs 2000 million can get repaid in the remaining part of this year.

- With respect to Zimbabwe there is still a liability of USD 50 million. Every quarter, it is expected that USD 2-3 million will get reversed through P&L.

Outlook and Valuations

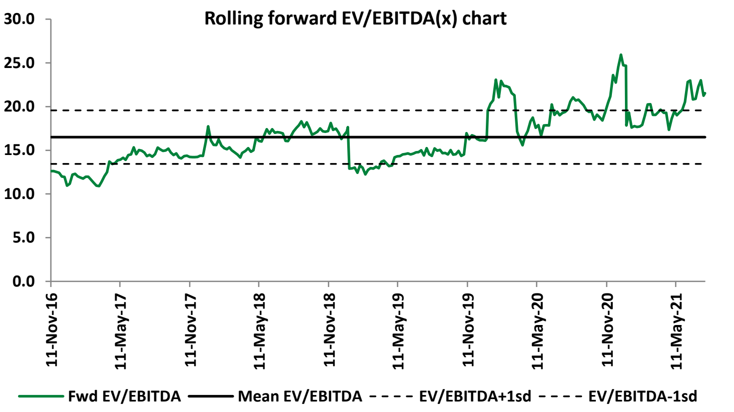
We are positive about the growth prospects connected with Varun. Expected deeper penetration in South and West India territories and dual growth engines of at-home and on-the-go consumption made us rerate the P/E valuation multiple to 35x. Based on FY23e EPS the **Target Price works out as Rs 793, which leads to a 1% upside. We maintain a "Hold" rating on the stock.**

Fig 1: 1-year forward P/E



Source: AceEquity, SMIFS research

Fig 2: 1-year forward EV/EBITDA



Source: AceEquity, SMIFS research

Quarterly financials

Fig 3: Quarterly Financials

Y/E March (Rs cr)	Q3CY19	Q4CY19	Q1CY20	Q2CY20	Q3CY20	Q4CY20	Q1CY21	Q2CY21
Net Sales	**1,740**	**1,220**	**1,676**	**1,640**	**1,803**	**1,331**	**2,241**	**2,450**
COGS	747	544	691	741	801	530	990	1,138
Employee Costs	230	224	229	199	230	232	238	243
Other Expenditure	437	337	485	322	391	397	631	497
EBITDA	**326**	**116**	**271**	**378**	**381**	**172**	**382**	**571**
Depreciation	127	137	135	124	135	135	135	129
Interest	87	79	87	74	58	62	58	47
Other Income	2	36	25	3	3	6	6	24
Reported PBT	**116**	**(64)**	**8**	**182**	**192**	**(19)**	**195**	**420**
Tax	35	(10)	(52)	39	30	(12)	58	101
Tax rate (%)	29.8%	15.9%	-670.1%	21.4%	15.8%	61.6%	29.8%	24.0%
Reported PAT	**81**	**(59)**	**55**	**141**	**153**	**(20)**	**129**	**308**
YoY Growth (%)								
Revenue	*49.2%*	*55.3%*	*23.3%*	*-41.6%*	*3.6%*	*9.1%*	*33.7%*	*49.4%*
EBITDA	*54.2%*	*142.1%*	*24.2%*	*-52.1%*	*16.9%*	*48.8%*	*40.7%*	*51.1%*
PAT	*91.0%*	*NA*	*35.2%*	*-65.4%*	*89.6%*	*NA*	*135.4%*	*118.9%*
QoQ Growth (%)								
Revenue	*-38.1%*	*-29.9%*	*37.4%*	*-2.2%*	*9.9%*	*-26.2%*	*68.4%*	*9.3%*
EBITDA	*-58.7%*	*-64.5%*	*134.3%*	*39.3%*	*0.8%*	*-54.8%*	*121.6%*	*49.6%*
PAT	*-80.2%*	*-173.5%*	*NA*	*156.3%*	*8.7%*	*-112.9%*	*NA*	*138.4%*
Margin (%)								
RMC/revenue (%)	*42.9%*	*44.6%*	*41.2%*	*45.2%*	*44.4%*	*39.9%*	*44.2%*	*46.5%*
Gross margin (%)	*57.1%*	*55.4%*	*58.8%*	*54.8%*	*55.6%*	*60.1%*	*55.8%*	*53.5%*
Employee cost/revenue (%)	*13.2%*	*18.3%*	*13.7%*	*12.2%*	*12.7%*	*17.4%*	*10.6%*	*9.9%*
Other expenses/revenue (%)	*25.1%*	*27.6%*	*28.9%*	*19.6%*	*21.7%*	*29.8%*	*28.1%*	*20.3%*
EBITDA margin (%)	*18.7%*	*9.5%*	*16.2%*	*23.0%*	*21.1%*	*12.9%*	*17.0%*	*23.3%*
PAT margin (%)	*4.6%*	*-4.9%*	*3.3%*	*8.6%*	*8.5%*	*-1.5%*	*5.8%*	*12.6%*

Source: AceEquity, SMIFS research

Financial Statements

Income Statement					
YE March (Rs cr)	CY18	CY19	CY20	CY21e	CY22e
Net Sales	**5,105**	**7,130**	**6,450**	**8,221**	**10,190**
COGS	2,244	3,219	2,764	3,700	4,565
% of sales	44.0%	45.2%	42.9%	45.0%	44.8%
Personnel	583	811	890	963	1141
% of sales	11.4%	11.4%	13.8%	11.7%	11.2%
Other Exp.	1272	1652	1595	2128	2446
% of sales	24.9%	23.2%	24.7%	25.9%	24.0%
EBITDA	**1,007**	**1,448**	**1,202**	**1,430**	**2,038**
EBITDA Margin (%)	19.7%	20.3%	18.6%	17.4%	20.0%
Depreciation & Amortisation	385	489	529	548	534
EBIT	**622**	**959**	**673**	**882**	**1,504**
Interest Expenses	213	310	281	214	132
EBT	**409**	**649**	**392**	**669**	**1,372**
Other Income	22	43	37	50	60
Reported PBT	**434**	**696**	**363**	**719**	**1,432**
Tax-Total	134	224	5	187	358
Effective tax rate (%)	30.9%	32.2%	1.4%	26.0%	25.0%
Extraord. items - Adj.	-	-	67	-	-
Reported PAT	**293**	**469**	**329**	**486**	**981**

Balance Sheet					
YE March (Rs cr)	CY18	CY19	CY20	CY21e	CY22e
Sources of funds					
Capital	183	289	289	433	433
Reserves & Surplus	1,816	3,040	3,235	3,469	4,342
Shareholders' Funds	**1,999**	**3,328**	**3,524**	**3,902**	**4,775**
Minority Interest	8	31	65	111	203
Total Debt	2,358	2,823	2,693	1,986	1,333
Deferred Tax Liabilities	192	283	226	226	226
Other Non Current Liabilities	112	171	229	165	205
Total Liabilities	**4,668**	**6,635**	**6,737**	**6,390**	**6,741**
Application of funds					
Net Block	4,385	6,455	6,384	6,257	6,142
Capital WIP	352	64	67	50	50
Non-current Asset	140	174	183	152	170
Net Non Current Assets	**4,877**	**6,692**	**6,634**	**6,459**	**6,362**
Investments	11	0	0	0	0
Goodwill	2	24	24	24	24
Inventories	578	882	929	977	1,220
Sundry Debtors	128	173	242	203	251
Other Current Assets	341	447	439	354	385
Cash & Bank Balances	93	171	190	61	55
Total Current Assets	**1,141**	**1,672**	**1,800**	**1,595**	**1,911**
Creditors	317	478	511	527	650
Other Current Liabilities	1,030	1,245	1,177	1,134	881
Current Provisions	16	30	33	28	25
Total Current Liabilities	**1,363**	**1,753**	**1,721**	**1,689**	**1,556**
Net Current Assets	**-222**	**-81**	**79**	**-93**	**355**
Total Assets	**4,668**	**6,635**	**6,737**	**6,390**	**6,741**

Key Ratios					
YE March	CY18	CY19	CY20	CY21e	CY22e
Growth ratios (%)					
Net sales	27.5%	39.7%	-9.5%	27.5%	23.9%
EBITDA	20.4%	43.8%	-17.0%	19.0%	42.5%
Adjusted PAT	39.3%	60.1%	-29.8%	47.7%	101.9%
Margin Ratio (%)					
EBITDA Margin	19.7%	20.3%	18.6%	17.4%	20.0%
EBIT Margin	12.2%	13.5%	10.4%	10.7%	14.8%
PBT (Adjusted) Margin	8.5%	9.8%	5.6%	8.7%	14.0%
PAT (Adjusted) Margin	5.7%	6.6%	5.1%	5.9%	9.6%
Return Ratio (%)					
ROE	14.7%	14.1%	9.3%	12.5%	20.6%
ROCE	14.5%	15.5%	11.2%	15.8%	25.4%
Turnover Ratio days (days)					
Inventory Period	100	109	126	101	101
Debtors Period	9	9	14	9	9
Creditors	52	54	68	52	52
Cash Conversion Cycle	58	64	72	58	58
Solvency Ratio (%)					
Debt-equity (x)	1.4	1.0	0.9	0.7	0.3
Net Debt-equity (x)	1.3	0.9	0.9	0.6	0.3
Liquidity ratio (x)	0.7	0.8	0.7	0.6	0.8
Interest coverage ratio (x)	2.9	3.1	2.4	4.1	11.4
Per share (Rs)					
Adjusted EPS	6.76	10.83	7.60	11.22	22.66
CEPS	15.65	22.11	19.81	23.87	35.00
Book value	46.15	76.86	81.38	90.10	110.27
Dividend per share	2.50	2.50	2.50	2.50	2.50
Dividend Payout (%)	37%	23%	33%	22%	11%
Dividend Yield (%)	0.3%	0.3%	0.3%	0.3%	0.3%
Valuation					
P/E	116.7	72.9	103.9	70.3	34.8
P/BV	17.1	10.3	9.7	8.8	7.2
P/S	6.7	4.8	5.3	4.2	3.4
EV/EBITDA	36.6	25.4	30.6	25.7	18.1

Cash Flow					
YE March (Rs cr)	CY18	CY19	CY20	CY21e	CY22e
Operating profit before WC changes	**1,123**	**1,510**	**1,200**	**1,480**	**2,098**
Net change in working capital	-50	-85	-111	64	-102
Cash flow from operating activities (a)	**1,000**	**1,305**	**1,012**	**1,357**	**1,638**
Capital expenditure (organic)	-809	-733	-536	-403	-420
FCF	191	572	476	954	1,218
Cash flow from investing activities (b)	**-873**	**-2,319**	**-471**	**-368**	**-420**
Cash flow from financing activities (c)	**-84**	**1,110**	**-574**	**-1,083**	**-1,225**
Net change in cash (a+b+c)	42	96	-33	-93	-6
Opening cash balance	65	43	138	105	11
Unrealised exchange loss	-64	-1	-1	-	-
Ending cash balance	**43**	**138**	**105**	**11**	**5**
Other bank balances	51	33	85	50	50
Cash and Bank on BS	**93**	**171**	**190**	**61**	**55**

Source: Company, SMIFS research

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Contact us:

SMIFS Limited. (https://www.smifs.com/)

Compliance Officer: Sudipto Datta

5F Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.

Contact No.: (D) +91 33 4011 5414, (D) +91 33 6634 5414

Email Id.: compliance@smifs.com

Mumbai Office: 5G Court Chambers, 35 New Marine Lines, Mumbai 400 021, India

Contact No: (D) +91 22 4200 5508, (B) +91 22 4200 5500

Email Id: institutional.equities@smifs.com

Kolkata Office: 5F Vaibhav, 4 Lee Road, Kolkata 700020, West Bengal, India.

Contact No: (B) +91 33 6634 5408, (D) +91 33 4011 5400

Email Id: smifs.institutional@smifs.com