

# Varun Beverages

## Strong margin performance and decent demand recovery; FCF generation set to improve from CY21

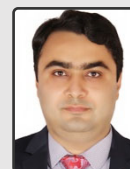
- ✓ **View** – We like the stock given a decent recovery in demand, opportunities for further penetration-led growth especially in West and South markets, strong ramp-up in international territories, potential in non-cola categories and juices and a solid balance sheet and margin profile. The stock is trading at 14x CY22 EV/EBITDA and 28x P/E for expected ROE of 20% and we believe it can slowly move towards a P/E of 35x, indicating more than 20% upside from current levels.
- ✓ **Result highlights** – Revenue growth of 9% and organic volume growth of 6% yoy led by a fast recovery across geographies; for CY20, volume decline of 14% (organic decline of 21%) coupled with a 5% increase in realizations due to better mix led to a 10% decline in revenue; gross margins up 470bps given higher mix of CSD and 13% decline in PET chips prices; EBITDA margins up 350bps given cost optimization measures; 22% decline in interest costs reduced losses to Rs 72mn from Rs 540mn.
- ✓ **Balance sheet highlights** – Net debt reduced to Rs 30.1bn from Rs 32.5bn, Rs 5.6bn capex in CY20 towards capacity expansions in India and Zimbabwe and dairy acquisition in Zambia, WC increased from 26 to 31 days due to lower sales.
- ✓ **Management commentary** – Ended year on a steady note after a difficult year with a washout in 2Q, witnessed a strong recovery in 2HCY20, sustained pandemic period cost saving initiatives, launched Mountain Dew Ice in Feb, focus remains on steady growth with strong cash flow generation.
- ✓ **Segment growth differential** – CSD and water impacted more given majority consumption on-the-go, but has now recovered fully except the institutional channel, juices saw a weak quarter after the recovery but picking up in current quarter; North India goods movement also impacted growth; On-the-go share decreased in CY20 from 56% to 40% and in-home consumption increased from 40% to 56%.
- ✓ **New launches** – New variant of Mountain Dew lemon juice launched to compete against Limca and Sprite, initial response very strong; should grow in-line with the energy drink Sting which has seen 250% growth in CY20.
- ✓ **Capex outlook** – Not much need in CY21 other than juices unless demand growth necessitates some brownfield expansion in CY21, will set up new plant in Bihar in CY22; no large dairy investments planned in CY21.
- ✓ **India business recovery** – Saw 7% volume decline in 3Q which has recovered to 1% volume growth in 4Q in India.
- ✓ **International performance** – Grew as per pandemic situation – saw volume growth of 25% growth in Nepal (16mn cases), Sri Lanka (10.5mn cases) down, flattish in Morocco (18mn cases), 40% growth in Zimbabwe (34mn cases), 17% growth in Zambia (9.2mn cases).
- ✓ **Market share outlook** – Have gained market share in CY20 to reach about 33-34%, hope to continue in CY21 as well.
- ✓ **Capital allocation** – Will aggressively reduce debt in CY22 given limited capex needs; open to considering new international territories in South East Asia or Africa is offered by Pepsico.

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- ✓ **Margin outlook** – Should sustain around current levels as while PET chip prices have gone up sharply, will not be impacted as have fully covered for CY21 purchases; should see margins better than CY19 levels.
- ✓ **Cost efficiency measures** – Expect about 60cr fixed overhead savings to be permanent in nature (given shutdown of 2 plants) which would imply about 100bps savings.

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