

Varun Beverages

ADD
Maintained

Highlights from CY20 annual report – strong
focus on growth to continue

Rs975

Annual report analysis and earnings revision

Beverages

Target price: Rs1,100

Earnings revision

(%)	CY21E	CY22E
Sales	↑ 0.2	↑ 0.2
EBITDA	↑ 0.2	↑ 0.2
PAT	↑ 0.1	↑ 3.1

Target price revision

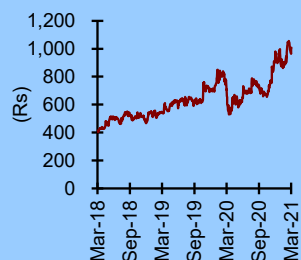
Rs1,100 from Rs1,150

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	66.4	66.4	66.4
Institutional investors	26.9	26.7	26.3
MFs and others	5.9	5.9	5.5
Banks/FIs	0.1	0.0	0.0
FIIIs	20.9	20.8	20.8
Others	6.7	6.9	7.3

Source: BSE

Price chart



Top five highlights: (1) Management remains confident on higher growth led by multiple tailwinds such as low per capita consumption, improving penetration in rural and semi-urban markets and rising in-home consumption, (2) Varun has increased investments in trade with the installation of 25,000+ visi-coolers in CY20, (3) there is reduction in trade discounts largely due to lower turnover. Most dealers were unable to achieve turnover targets, in our view, (4) there is increase in net working capital days due to lower sales but working capital in INR terms has also increased by Rs0.5bn YoY and (5) EVA creation remains negative with RoE (7.3% in CY20) < cost of capital. However, there is healthy FCF generation of Rs3.1bn in CY20. Maintain ADD with a target price of Rs1,100 (35x CY22E).

- **Increase in trade investments:** In-spite of covid and lockdown, the company has increased its investments in trade. The number of visi-coolers stands at 800,000+ in CY20 compared to 775,000 in CY19. Total reach also stands at 2mn retail outlets with 1,500 primary distributors in CY20.
- **Management confident on higher growth:** The company believes the soft drink consumption to remain on a steady-growth trajectory. Tailwinds such as (1) rising young population, (2) low per capita consumption, (3) improving retail penetration across semi-urban and rural markets, (4) better agro-economics and (5) rising trend of in-home consumption make soft drinks an attractive growth market.
- **Reduction in trade discounts:** The company's trade discounts to gross/ contracted revenues stood at 14.6% in CY20 compared to 16.3% in CY19. The savings in trade discounts were partly due to lower turnover target schemes to the trade, in our view.
- **Increase in working capital and days:** Varun's net working capital days increased to 23 in CY20 compared to 18 in CY19. The key reason was lower sales. However, we note the working capital in INR terms has also increased from Rs3.6bn in CY19 to Rs4.1bn in CY20.
- **EVA creation remains negative:** Due to lower sales, the company's RoE was lower than cost of capital even in CY20 resulting in negative EVA. However, as there was no acquisition, the company generated FCF of Rs3.1bn in CY20.
- **Maintain ADD:** We model Varun to report revenue and PAT CAGRs of 25.5% and 55.9%, respectively, over CY20-CY22E. Varun continues to benefit from its relationship with PepsiCo, pan-India distribution, backward integration, and increased in-home consumption. Maintain ADD with DCF-based target price of Rs1,100 (35x CY22E). Key risks: Sharp increase in competitive pressure and hike in raw material prices.

Market Cap	Rs281bn/US\$3.8bn
Reuters/Bloomberg	VARB.BO / VBL IN
Shares Outstanding (mn)	288.7
52-week Range (Rs)	1095/485
Free Float (%)	33.6
FII (%)	20.8
Daily Volume (US\$'000)	4,724
Absolute Return 3m (%)	0.6
Absolute Return 12m (%)	47.6
Sensex Return 3m (%)	4.8
Sensex Return 12m (%)	70.5

Year to December	CY19	CY20	CY21E	CY22E
Revenue (Rs mn)	71,296	64,501	91,315	1,01,644
Adj. Net Profit (Rs mn)	5,285	2,665	7,039	9,179
Dil. Rec. EPS (Rs)	16.2	13.2	24.4	31.8
% Chg YoY	52.0	(18.9)	85.0	30.4
P/E (x)	60.0	74.0	40.0	30.7
CEPS (Rs)	33.1	32.5	44.4	52.4
EV/EBITDA (x)	21.5	25.9	17.9	15.9
Dividend Yield (%)	0.3	0.3	0.3	0.4
RoCE (%)	15.8	9.5	16.3	18.9
RoE (%)	18.4	7.3	17.4	19.3

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Highlights from CY20 annual report

Varun Beverages' value creation was impacted in CY20 due to covid-related lockdown. The company lost revenue in its peak season of Q2CY20. While there was strong recovery in H2CY20, its organic volume growth declined in CY20.

Due to lower sales, RoE was less than cost of capital in CY20. However, as there was no acquisition in CY20, the company generated strong FCF.

Table 1: EVA creation and FCF

Particulars	CY12	CY13	CY14	CY15	CY16	CY17	CY18	CY19	CY20	CY21E	CY22E
RoE (%) ... [A]	10.3%	-15.3%	-8.1%	29.4%	2.7%	10.9%	13.5%	18.4%	7.3%	17.4%	19.3%
Cost of Capital (%) ... [B]	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%
Net Worth (Rs mn)... [C]	2,427	2,754	2,209	3,707	18,154	19,116	21,573	35,981	37,389	43,563	51,587
EVA Generation (Rs mn) [(A-B)*C]	(52)	(765)	(456)	627	(1,779)	(300)	209	2,111	(1,957)	2,131	3,505
FCF Generation (Rs mn)	(2,466)	(4,372)	469	(1,905)	(4,405)	(6,475)	(1,052)	(13,334)	3,146	10,790	12,122
Cumulative EVA Generation CY12-20	(2,363)										
Cumulative FCF Generation CY12-20				(30,393)							

Source: Company, I-Sec research

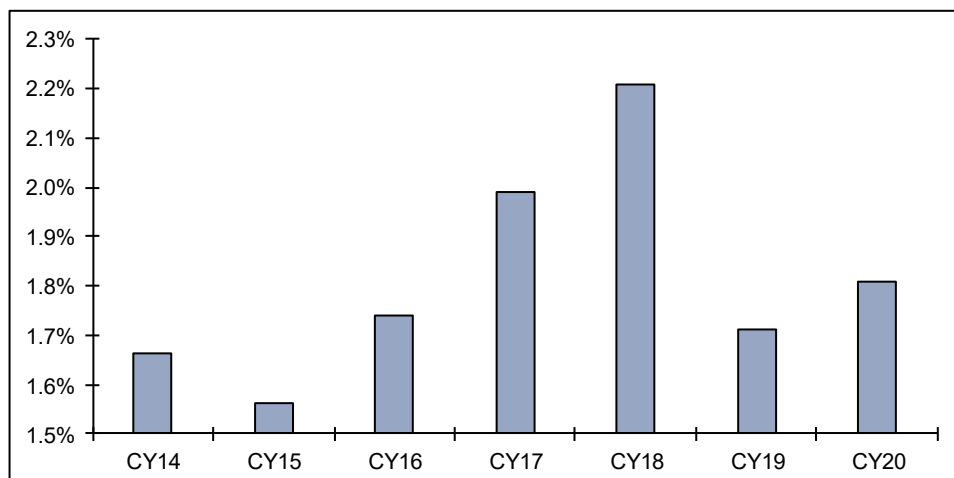
Increase in investments in trade: Despite the challenges of covid and lockdown, the company has increased its investments in trade. Visi-cooler volume has increased from 775,000 in CY19 to 800,000 in CY20. The retail outlets serviced by the company stood at 2mn as of Dec'20.

Table 2: Increase in investments in trade

Particulars	CY16	CY17	CY18	CY19	CY20
Manufacturing units	21	25	26	38	37
Visi-coolers	4,58,000	4,74,500	5,50,000	7,75,000	8,00,000
Depots	71	72	80	90	90
Vehicles	2,024	2,100	2,400	2,500	2,500
Primary distributors	1,186	1,000	1,100	1,500	1,500
Retail outlets (mn)	-	1	2	2	2

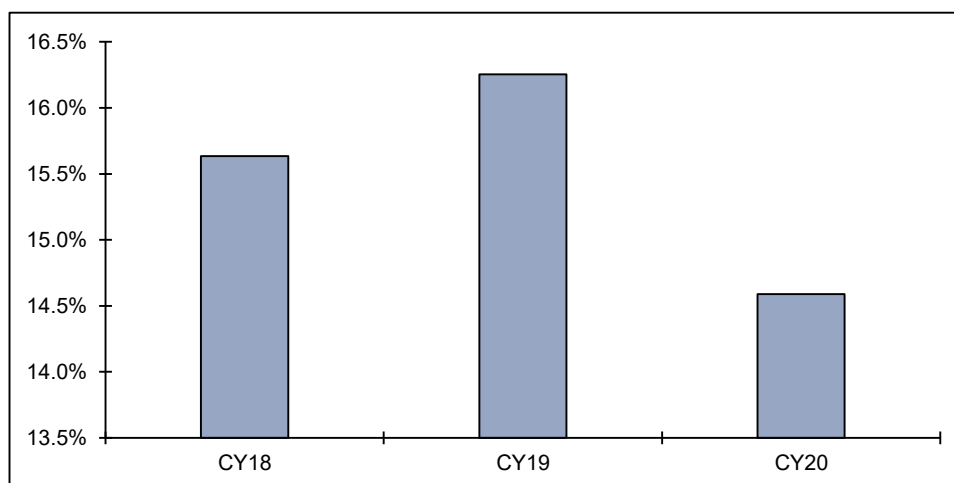
Source: Company, I-Sec research

Strong investments in brand-building activities: The company has maintained ad-spend to sales of 1.8% even in CY20. Average ad-spend to sales over CY14-19 was also 1.8%. While some consumer companies have curtailed the ad-spend, Varun has maintained its investments in brand-building.

Chart 1: Ad-spend as % of net sales in CY20 was at average of CY14-19

Source: Company, I-Sec research

Reduction in discounts to trade: The company has cut down some trade incentives and discounts as % of contracted/gross sales stood at 14.6% in CY20 compared to 16.3% in CY19. Considering only limited number of outlets were open during the year, the company was able to reduce trade schemes, especially turnover target schemes in our view.

Chart 2: Reduction in discounts* to trade in CY20

Source: Company, I-Sec research *Discount as % of Gross/Contracted revenues

Change in remuneration of directors: The management's remuneration was up 15.6% YoY in CY20. It has increased at a CAGR of 14.9% over CY18-20. The remuneration to directors has increased from 3.3% of PBT in CY18 to 4.4% in CY20.

Table 3: Remuneration of directors

(Rs mn)	CY18	CY19	CY20	CAGR (%)
Varun Jaipuria	31.3	31.5	43.7	
Raj Gandhi	48.7	48.6	41.6	
Kapil Agarwal	47.5	57.2	68.3	
Rajinder Jeet Singh Bagga	-	18.5	31.6	
Ravi Gupta	0.7	1.9	1.0	
Pradeep Sardana	0.3	0.8	0.4	
Rashmi Dhariwal	0.8	3.0	1.3	
Sita Khosla	0.3	1.9	0.9	
Kamlesh Kumar Jain	12.3	-	-	
Ravindra Dhariwal	0.4	-	-	
Girish Kumar Ahuja	0.5	-	-	
Geeta Kapoor	0.2	-	-	
Total	143	163	189	14.9%
Profit before tax	4,308	6,919	4,290	-0.2%
Remuneration of Directors / PBT (%)	3.3	2.4	4.4	

Source: Company, I-Sec research

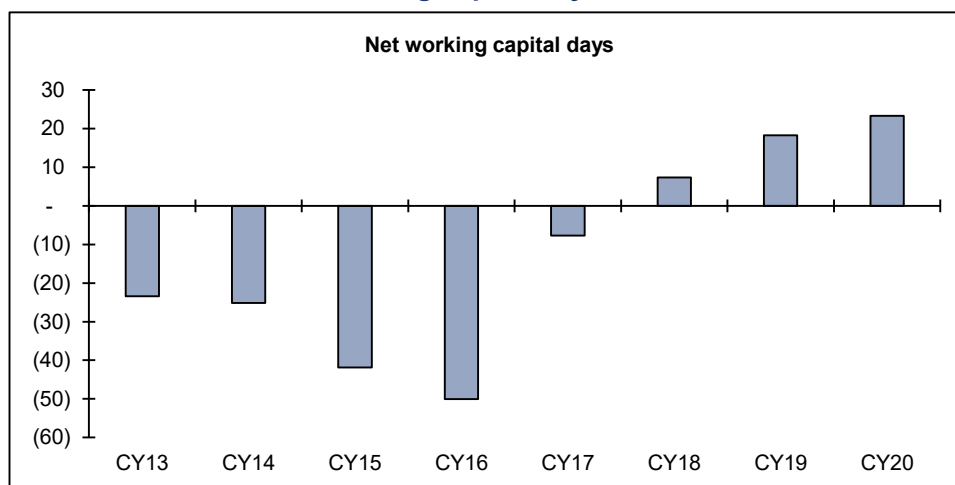
Salary increments remain healthy: The company has given median increment of 5.86% to its employees in CY20. Median remuneration stood at Rs0.33mn in CY20 compared to Rs0.31mn in CY19.

Table 4: Salary increments remain healthy

Particulars	FY18	FY19	FY20
Permanent employees (No.)	5,662	8,570	7,808
Median remuneration (Rsmn)	0.28	0.31	0.33
Increase in median remuneration (%)	7.69	10.71	5.86

Source: Company, I-Sec research

Increase in working capital days attributable to lower sales: The net working capital days have increased from 18 in CY19 to 23 days in CY20. While we note lower revenues resulted in higher working capital in CY20, absolute working capital has also increased from Rs3,577mn in CY19 to Rs4,120mn in CY20.

Chart 3: Increase in net working capital days due to lower sales

Source: Company, I-Sec research

Volume growth details: The company has reported volume decline of 13.6% in CY20 over CY19. Volumes were flat in international markets. The entire decline was in Indian markets. However, revenue mix improved during CY20 with slightly higher revenue share of carbonated soft drinks (CSD).

Table 5: Volume growth details

Particulars	CY16	CY17	CY18	CY19	CY20
Sales volumes in Cases (mn)					
India	224	224	274	403	337
International	52	55	66	89	88
Total	276	279	340	492	425
Revenue per case (Rs)					
Revenue per case (Rs)	140	143	150	145	152
EBITDA per case (Rs)	29	30	30	30	29
Volume breakup of the company (%)					
Carbonated Soft drink	80.9%	79.0%	75.6%	70.6%	72.7%
Packaged drinking water	13.4%	16.0%	18.0%	22.7%	6.1%
Fruit juice/drink	5.7%	5.0%	6.4%	6.7%	21.2%
Total	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company, I-Sec research

Key highlights from management discussion:

- In the beginning of CY20, there was broad-based growth in domestic soft drinks market but post covid, there was decline in demand and consumption.
- Post lockdown there was higher in-home consumption of beverages. After the first phase of lockdown was over, in-home consumption remained at elevated levels.
- In the second half of CY20, there was strong recovery in demand especially in rural and semi-urban markets.
- The company believes soft drink consumption will remain on a steady-growth trajectory. Rising young population, low per capita consumption, improving retail penetration across semi-urban and rural markets, better agro-economics and rising trend of in-home consumption makes it an attractive growth market.
- The realisation improved to Rs151.8 per case in CY20 from Rs144.9 in CY19 due to favourable mix and better realisations in international markets.

Valuation

We have valued Varun Beverages (Varun) as per the DCF methodology. Our DCF valuation indicates a value of Rs1,100 per share. The implied P/E multiple at our target price and CY22E EPS works out to 35x. We maintain ADD rating.

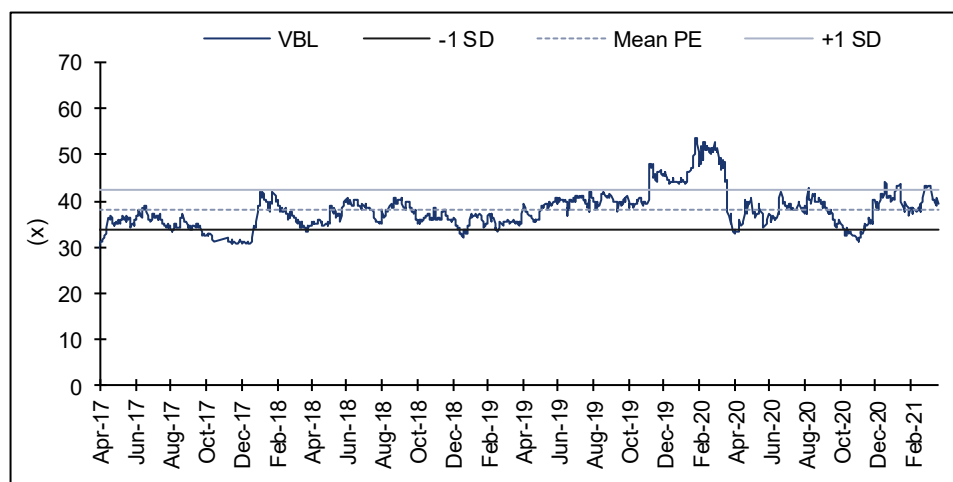
Table 6: DCF valuation

Particulars	Amt (Rs)
Cost of equity (%)	11.4%
Terminal growth rate (%)	3.0%
Discounted interim cash flows (Rsmn)	138,176
Discounted terminal value (Rsmn)	179,455
Total equity value (Rsmn)	317,632
Value per share (Rs)	1,100

Source: Company, I-Sec research

Mean P/E and standard deviations

Chart 4: Mean P/E and standard deviations



Source: Company, I-Sec research

Key risks

Steep rise in competitive pressures and input prices: Steep rise in competitive pressures and any material increase in production capacities by peers in a short timeframe can hurt Varun's earnings.

Delays in launch/failure of new products: Any delay in launch of new products and/or failure of new products may impact Varun's financials. If the company's geographical expansion plans fail or get delayed, earnings growth may be impacted.

Slowdown in urban and rural economies: Slowdown in rural as well as urban economies may impact the company's earnings.

Financial summary

Table 7: Profit & loss statement
(Rs mn, year ending December 31)

	CY19	CY20	CY21E	CY22E
Net Sales	71,296	64,501	91,315	1,01,644
Operating Expenses	56,673	52,356	73,749	81,879
EBITDA	14,623	12,145	17,567	19,765
% margins	20.5	18.8	19.2	19.4
Depreciation & Amortisation	4,886	5,287	5,729	5,914
Gross Interest	3,243	2,937	2,831	2,246
Other Income	425	370	490	764
Recurring PBT	6,919	4,290	9,496	12,368
Less: Taxes	2,241	202	2,421	3,154
Less: Minority Interest	-	-	-	-
Net Income (Reported)	4,690	3,805	7,039	9,179
Extraordinaries (Net)	596	(1,140)	-	-
Recurring Net Income	5,285	2,665	7,039	9,179

Source: Company data, I-Sec research

Table 8: Balance sheet
(Rs mn, year ending December 31)

	CY19	CY20	CY21E	CY22E
Assets				
Total Current Assets	16,719	17,997	19,125	20,976
of which cash & cash eqv.	1,711	1,901	824	792
Total Current Liabilities & Provisions	11,431	11,976	14,702	16,365
Net Current Assets	5,288	6,020	4,423	4,612
Investments	1,608	1,723	1,723	1,723
Net Fixed Assets	64,548	63,844	61,283	58,118
Capital Work-in-Progress	638	668	-	-
Total Assets	72,325	72,497	72,671	73,695
Liabilities				
Borrowings	36,037	34,460	28,460	21,460
Deferred Tax Liability	2,697	2,149	2,149	2,149
Minority Interest	307	648	648	648
Equity Share Capital	2,887	2,887	2,887	2,887
Face Value per share (Rs)	10	10	10	10
Reserves & Surplus*	30,397	32,353	38,526	46,551
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	33,284	35,240	41,413	49,438
Total Liabilities	72,325	72,497	72,671	73,695

Source: Company data, I-Sec research

Table 9: Quarterly trend
(Rs mn, year ending December 31)

	Mar 20	June 20	Sep 20	Dec 20
Net sales	16,764	16,402	18,026	13,309
% growth (YoY)	23.3	(41.6)	3.6	9.1
EBITDA	2,712	3,777	3,808	1,722
Margin (%)	16.2	23.0	21.1	12.9
Other income	253	27	35	56
Extraordinaries (Net)	(887)	(454)	70	(20)
Adjusted Net profit	107	954	1,601	(217)

Source: Company data, I-Sec research

Table 10: Cashflow statement
(Rs mn, year ending December 31)

	CY19	CY20	CY21E	CY22E
Operating Cashflow	10,932	8,536	12,769	15,093
Working Capital	(851)	(1,108)	521	(221)
Changes				
Capital Commitments	(7,080)	(4,282)	(2,500)	(2,750)
Free Cashflow	(13,334)	3,146	10,790	12,122
Cashflow from Investing Activities	176	(516)	(5,000)	(4,000)
Issue of Share Capital	8,837	-	-	-
Inc (Dec) in Borrowings	6,053	(2,242)	(6,000)	(7,000)
Dividend paid	(782)	(722)	(866)	(1,155)
Change in Deferred Tax Liability	1,109	(547)	-	-
Chg. in Cash & Bank balance	950	(334)	(1,076)	(32)

Source: Company data, I-Sec research

Table 11: Key ratios
(Year ending December 31)

	CY19	CY20	CY21E	CY22E
Per Share Data (Rs)				
EPS	16.2	13.2	24.4	31.8
Cash EPS	33.2	31.5	44.2	52.3
Dividend per share (DPS)	2.5	2.5	3.0	4.0
Book Value per share (BV)	124.6	129.5	150.9	178.7
Growth (%)				
Net Sales	39.7	(9.5)	41.6	11.3
EBITDA	45.3	(16.9)	44.6	12.5
PAT	60.1	(18.9)	85.0	30.4
DPS	50.0	-	20.0	33.3
Valuation Ratios (x)				
P/E	60.0	74.0	40.0	30.7
P/CEPS	29.4	31.0	22.0	18.6
P/BV	7.8	7.5	6.5	5.5
EV / EBITDA	21.5	25.9	17.9	15.9
EV / Sales	4.4	4.9	3.4	3.1

Operating Ratios

Raw Material / Sales (%)	45.2	42.9	43.0	42.8
Employee cost / Sales (%)	11.4	13.8	13.0	13.0
SG&A / Sales (%)	1.7	1.8	1.7	1.7
Other Income / PBT (%)	6.1	8.6	5.2	6.2
Effective Tax Rate (%)	32.4	4.7	25.5	25.5
Working Capital (days)	18.3	23.3	14.4	13.7
Inventory Turnover (days)	45.1	52.6	45.1	45.1
Receivables (days)	8.8	13.7	9.1	9.1
Payables (days)	57.0	65.9	57.3	57.3
Net D/E (x)	1.0	0.9	0.5	0.2

Profitability Ratios (%)

Net Income Margins	6.6	6.3	7.7	9.1
RoACE	15.8	9.5	16.3	18.9
RoAE	18.4	7.3	17.4	19.3
Dividend Payout	15.4	19.0	12.3	12.6
Dividend Yield	0.3	0.3	0.3	0.4
EBITDA Margins	20.5	18.8	19.2	19.4

Source: Company data, I-Sec research

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