

Consumer Staples & Discretionary

DRHP Analysis #2: Deep-dive into Devyani prospectus and insights for QSRs in India

Insights for Domino's (JUBI) and McDonald's (Westlife) from our analysis of Devyani red herring prospectus are (1) JUBI has best-in-class operating metrics – 2x throughput and superior EBITDA margin in the listed QSR space; 2) Westlife (WLDL) leads on throughput while KFC has better margin profile; the former's focus on all-day meals and beverages has helped improve its throughput (despite being more value focus); 3) Tata Starbucks is executing well in the chained-café market (Costa Coffee has shut down stores in the past two years); 4) QSR is likely to be the fastest growing and dominant format (54% of outlets and 34% of total food services market); and 5) there is huge potential for chained players to improve store throughput. We remain bullish on JUBI and WLDL's resilient models to outperform the food service market. Maintain ADD on both.

Our discussion on Pizza Hut, KFC and Costa Coffee pertains to only the outlets operated by Devyani International as per its DRHP.

Link to our DRHP Analysis #1: Burger King ([link](#))

- ▶ **Why JUBI is best-in-class?** We believe JUBI's superior margin profile is sometimes underappreciated on the pretext that *Pizza is a high GM product (vs Burgers)*. While it is true that pizza as a category does have superior margins (both PH and JUBI have 75% gross margin), JUBI's 2x throughput of PH places it at the top (across burger formats as well) in terms of store-level EBITDA margin. JUBI has been able to double its store throughput in the past 10 years on the back of superior execution. Secondly, given JUBI's less dependence on high-street locations along with better capex efficiency gives it the ability to make deeper inroads.
- ▶ **KFC leads on EBITDA margin while WLDL and BKIL are ahead on throughput.** KFC's current store-level throughput is 21%/8% lower than WLDL/BKIL; interestingly, WLDL had higher throughput than KFC even in 2014 (when they were of similar size). Other key observations are: 1) gross margins of all three are in the range of 64-65%; WLDL has delivered well on GM expansion despite the overall value-focus; 2) BK's adspends are slightly higher (possibly because they are late entrants); 3) KFC is slightly efficient on other costs structures despite WLDL enjoying the best lease terms; 4) royalty outgo for KFC/WLDL/BKIL stands at 6.3/4.0/4-5%; WLDL's royalty rate can be contractually increased to 8% in FY25; 5) even as WLDL leads on absolute unit EBITDA, KFC has slightly better operating margins.
- ▶ **Tata Starbucks benefits from yet another struggling player.** Costa Coffee has cut 23 stores in the past two years, reducing its footprint to 44 stores at the end of FY21. On the other hand, Starbucks has added 75 stores during the same timeframe and now has a network of 221 stores.
- ▶ **QSR will likely be the fastest growing and dominant format.** QSR continues to be the dominant format, constituting 54% of the total outlets and 34% of the total food services sector. Over 2020-2025, the number of outlets (for the industry) is expected to grow at a CAGR of 4.5%, in which QSR outlets will grow at 6.5% CAGR.
- ▶ **We see potential for chained players to improve throughput:** Our comparison of QSR players shows that the Indian players currently operate at 30-50% of their global counterparts. We note that Domino's India operates at 70-120% sales throughput of developed regions like Australia, Japan and Europe.

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Comparison of burger, pizza and coffee chains when they were of similar size (number of stores)

We compare the financial performance and store economics of restaurants serving burgers (KFC, WLDL and BKIL), pizzas (Pizza Hut and JUBI) and coffee (Costa Coffee and Tata Starbucks) when they were of similar size in terms of the number of stores. Please note that we have not discussed FY21 numbers below given the impact of lockdowns during the year.

Please note the below discussion is based on store level costs structures (excludes corporate G&A) for better comparison. Hence, certain assumptions have been made for the determining the same wherever required. Discussion on JUBI pertains to Dominos India and WLDL is for McDonald's west and south operations.

Observations

- **Throughput:** We note that the pizza outlets structurally operate at a lower throughput than a burger or snacking player: a) KFC has the lowest throughput in the 'burgers' category compared to WLDL and BKIL. KFC's current (2020) throughput is 8%/21% lower than BKIL/WLDL. b) In the pizza category, Pizza Hut's throughput is almost half that of JUBI. Interestingly, Pizza Hut's current throughput was equal to that of JUBI's throughput in 2010. c) In the coffee/café category, Costa Coffee's throughput is significantly lower than Starbucks.
- **Gross margin:** The structurally higher gross margins of pizza outlets is also true for Pizza Hut, having similar gross margins (~75%) as JUBI. a) Gross margins for the three burger restaurants are broadly similar (64.2-65.2%). WLDL has probably shown the best improvement in gross margins on the back of: 1) focus on adding 'meal-parts' and beverages, and 2) driving premiumisation, b) Pizza Hut and JUBI have broadly similar gross margins (~75%). c) Costa Coffee has better gross margins than Tata Starbucks; one of the possible reasons can be lower share of food products for Costa (vs. Starbucks).
- **Employee costs:** KFC has the lowest employee costs across the players. Pizza Hut, WLDL and BKIL's staff costs are at 11-13% of sales, while Domino's (given its higher reliance on the delivery model) has employee expenses of 17% (as a percentage of sales). Higher employee costs for Domino's is (likely) partly offset by lower commissions to delivery aggregators.
- **Adspends:** KFC and Pizza Hut are required to contribute 6.0% of sales on advertising expenses. Of this 6% charge, 5% is contributed to Yum Brands and 1% is incurred on local store marketing. Please note that the contribution arrangement can be slightly different for old stores vs. new. In FY20, BKIL, WLDL and JUBI have all spent 5-6% of their revenues on adspends/promotions. We believe BKIL should be spending slightly more (and rightly so) compared to others due to it being a late entrant in the QSR market.
- **Royalty:** JUBI and BK have similar royalty rates (3.5-4.0% of sales). WLDL already pays a higher rate (c.4.6%) and this is likely to increase to 8.0% (excluding taxes) by FY26. KFC and Pizza Hut have a royalty rate of 6.3% (excluding taxes) and Costa Coffee has a royalty rate of 6.0% (excluding taxes). The significant likely increase in royalty rate of WLDL from FY26, puts it at a slight disadvantage compared to other QSRs.

- **Rent and other expenses.** When all the burger brands were of similar size, WLDL and KFC spent similar amounts on rent and other expenses while BKIL's spends were higher. We believe WLDL would be enjoying the benefit of lower rentals compared to the other brands here. The sharp increase in other expenses for WLDL can be partly explained by higher store operating timings compared to other brands.
- **Store-level EBITDA:** For FY20, WLDL has the best store-level EBITDA. We note that WLDL's higher sales throughput compared to other brands puts it ahead in terms of absolute contribution. In terms of store-level margins, JUBI leads the pack (~18.5% as per our math) by a wide margin. KFC (16%) is ahead of WLDL in terms store-level EBITDA margin while for Pizza Hut it is weak at 10.5%. BKIL has the lowest margin. We note that for Pizza Hut, driving store-level throughput is essential to improve store dynamics; ramp-up of delivery business is likely to be key here.

Figure 1: Comparison of KFC, WLDL and BKIL when they were of similar size in terms of store network

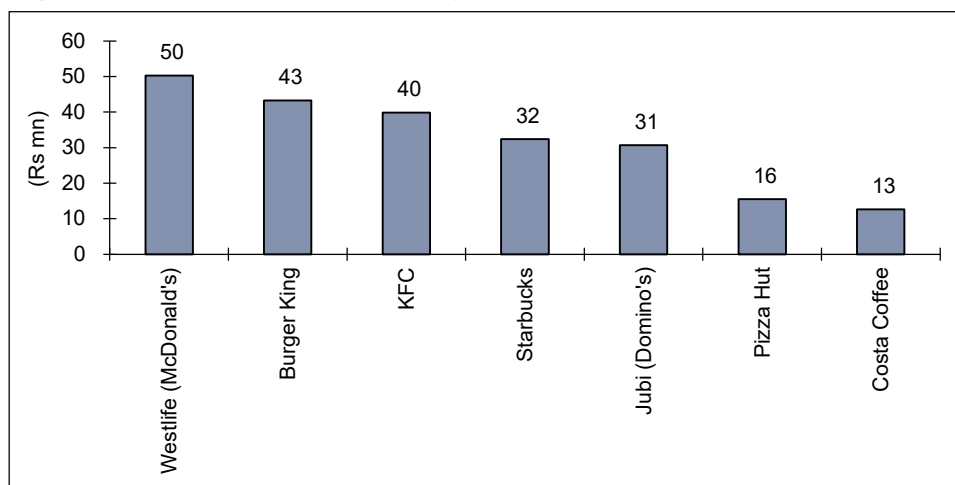
(Rs mn)	KFC (2020)	WLDL (2014)	BKIL (2019)	WLDL (2020)	BKIL (2020)
Number of stores (year end)	172	184	187	319	260
Number of stores (year beginning)	134	161	88	296	129
Average number of stores	153	173	138	308	195
Revenue	6,091	7,403	6,327	15,473	8,412
Gross profit	3,950	4,252	4,027	10,091	5,397
Staff cost	454	702	759	1,690	1,117
Royalty	453	232	236	706	343
A&P	365	406	535	745	487
Rent & other expenses	1,704	1,994	2,020	4,686	2,860
Store-level EBITDA	973	918	476	2,264	591
Gross margin (%)	64.8	57.4	63.6	65.2	64.2
Store-level EBITDA margin (%)	16.0	12.4	7.5	14.6	7.0
Staff cost (% of sales)	7.5	9.5	12.0	10.9	13.3
Royalty (% of sales)	7.4	3.1	3.7	4.6	4.1
A&P (% of sales)	6.0	5.5	8.5	4.8	5.8
Rent & opex (% of sales)	28.0	26.9	31.9	30.3	34.0
Store economics (Rs mn / store)					
Revenue	39.8	42.9	46.0	50.3	43.3
Gross profit	25.8	24.6	29.3	32.8	27.8
Staff cost	3.0	4.1	5.5	5.5	5.7
Royalty	3.0	1.3	1.7	2.3	1.8
A&P	2.4	2.4	3.9	2.4	2.5
Rent and other expenses	11.1	11.6	14.7	15.2	14.7
Store-level EBITDA	6.4	5.3	3.5	7.4	3.0

Source: Devyani International DRHP, Company data, I-Sec research

Figure 2: Comparison of Pizza Hut and JUBI when they were of similar size in terms of store network

(Rs mn)	Pizza Hut (2020)	JUBI (2010)	JUBI (2020)
Number of stores (year end)	269	306	1,335
Number of stores (year beginning)	268	241	1,227
Average number of stores	269	274	1,281
Revenue	4,174	4,239	39,273
Gross profit	3,126	3,190	29,438
Staff cost	514	287	6,764
Royalty	310	140	1,367
A&P	250	171	2,500
Rent & other expenses	1,612	1,185	11,536
Store-level EBITDA	439	1,406	7,270
Gross margin (%)	74.9	75.2	75.0
Store-level EBITDA margin (%)	10.5	29.9	18.5
Staff cost (% of sales)	12.3	9.1	17.2
Royalty (% of sales)	7.4	3.3	3.5
A&P (% of sales)	6.0	4.0	6.4
Rent & opex (% of sales)	38.6	29.0	29.4
Store economics (Rs mn / store)			
Revenue	15.5	15.5	30.7
Gross profit	11.6	11.7	23.0
Staff cost	1.9	1.4	5.3
Royalty	1.2	0.5	1.1
A&P	0.9	0.6	2.0
Rent and other expenses	6.0	4.5	9.0
Store-level EBITDA	1.6	4.6	5.7

Source: Devyani International DRHP, Company data, I-Sec research

Figure 3: Revenue per store of key QSR brands in India

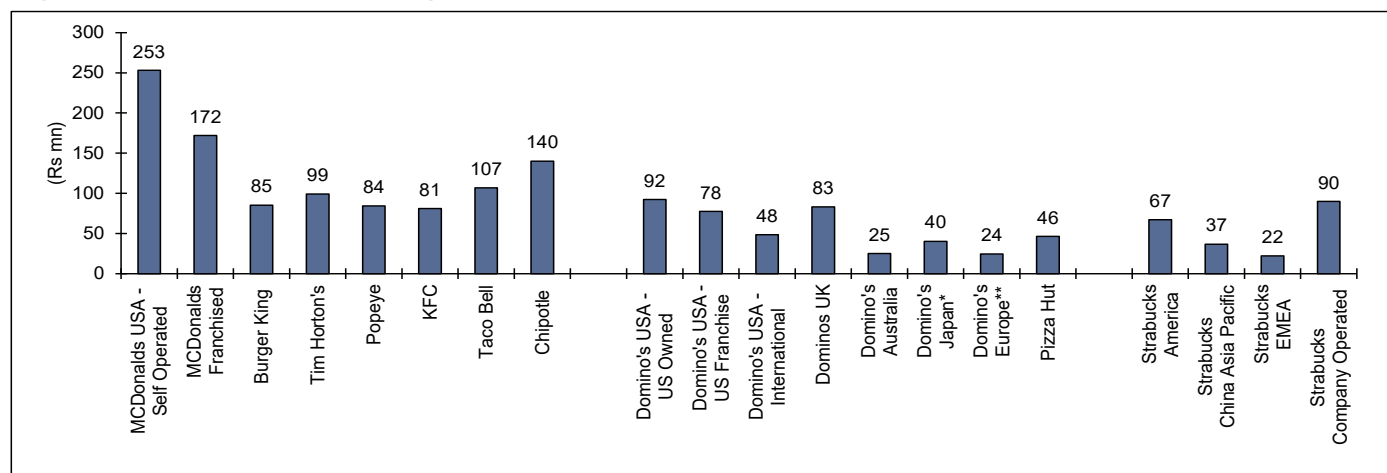
Source: Devyani International DRHP, Company data, I-Sec research

Figure 4: Comparison of Costa Coffee and Tata Starbucks when they were of similar size in terms of store network

(Rs mn)	Costa Coffee (2020)	Tata Starbucks (2016)	Tata Starbucks (2020)
Number of stores (year end)	63	82	185
Number of stores (year beginning)	67	72	146
Average number of stores	65	77	166
Revenue	820	2,348	5,367
Gross profit	634	1,434	3,600
Staff cost	61	329	661
Royalty	58	157	358
A&P	16	78	136
Rent & other expenses	325	786	2,147
Store-level EBITDA	174	84	297
Gross margin (%)	77.3	61.1	67.1
Store-level EBITDA margin (%)	21.2	3.6	5.5
Staff cost (% of sales)	7.4	14.0	12.3
Royalty (% of sales)	7.1	6.7	6.7
A&P (% of sales)	2.0	3.3	2.5
Rent & opex (% of sales)	39.6	33.5	40.0
Store economics (Rs mn / store)			
Revenue	12.6	30.5	32.4
Gross profit	9.8	18.6	21.8
Staff cost	0.9	4.3	4.0
Royalty	0.9	2.0	2.2
A&P	0.3	1.0	0.8
Rent and other expenses	5.0	10.2	13.0
Store-level EBITDA	2.7	1.1	1.8

Source: Devyani International DRHP, Company data, I-Sec research

- In our analysis of global QSR players also, burger and snack players are able to deliver a much higher store throughput vs pizza.

Figure 5: Revenue per store of global QSR brands

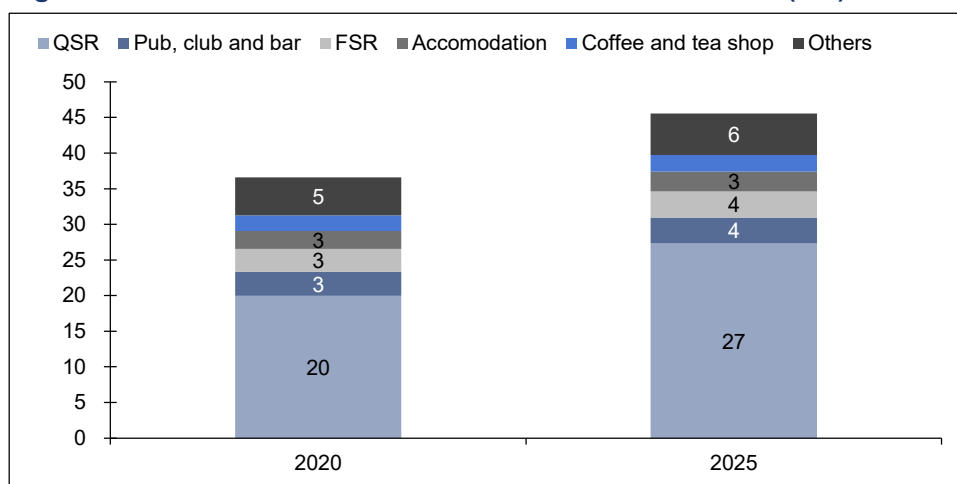
Source: Bloomberg, Company data, I-Sec research

Industry dynamics

QSR is likely to be the fastest growing and dominant format

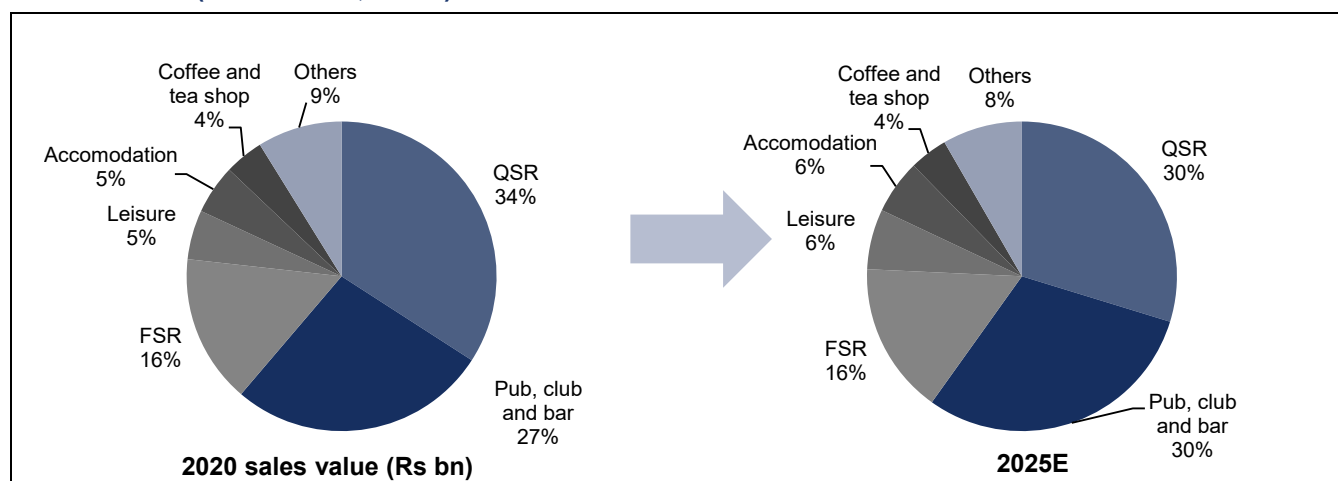
- The Indian food services sector generated total revenues of Rs8.4trn in 2020. Over the past five years, the food services business has grown at a CAGR of 1.9% (including covid impact in 2020) on the back of: 1) 2.4% CAGR in the number of transactions led by higher deliveries, increased demand for eating out and urbanisation; and 2) 1.4% CAGR in the number of outlets.
- QSR continues to remain the dominant channel, constituting 54% of the total outlets and 34% of the total food services sector. Over 2020-2025, the number of outlets (for the industry) is expected to grow at a CAGR of 4.5%, in which QSR outlets will grow at 6.5% CAGR.

Figure 6: Number of outlets of Indian food services sector (mn)



Source: Devyani International DRHP, Company data, I-Sec research

Figure 7: Market share of segments of the Indian food services market in 2020 and the expected market share in 2025 (Sales value; Rsbn)

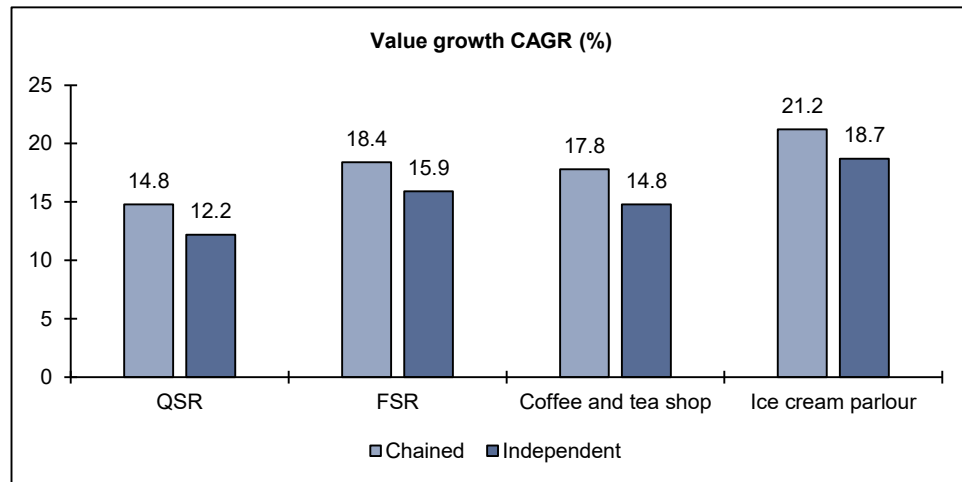


Source: Devyani International DRHP, Company data, I-Sec research

Chained operators to expand at a faster pace

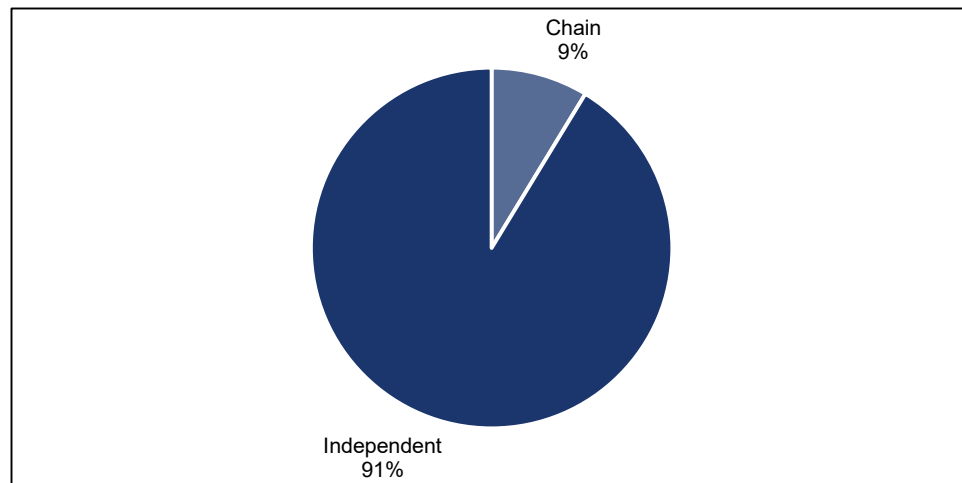
- Going forward, all the restaurant formats are expected to witness faster growth in chain operator segment than independent operators. This will be driven by some consolidation in the sector and increased requirement of economies of scale. Independent chains comprise >90% of the total QSR industry in India.
- Chained players have been able to bounce back better from the covid-induced disruption on the back of: 1) superior technological capabilities, 2) ability to drive demand through promotions, and 3) adoption of standardised hygiene protocols.

Figure 8: Restaurant owner types value growth (%CAGR; 2020-2025)



Source: Devyani International DRHP, I-Sec research

Figure 9: Share of chained and independent QSR revenues (2020)

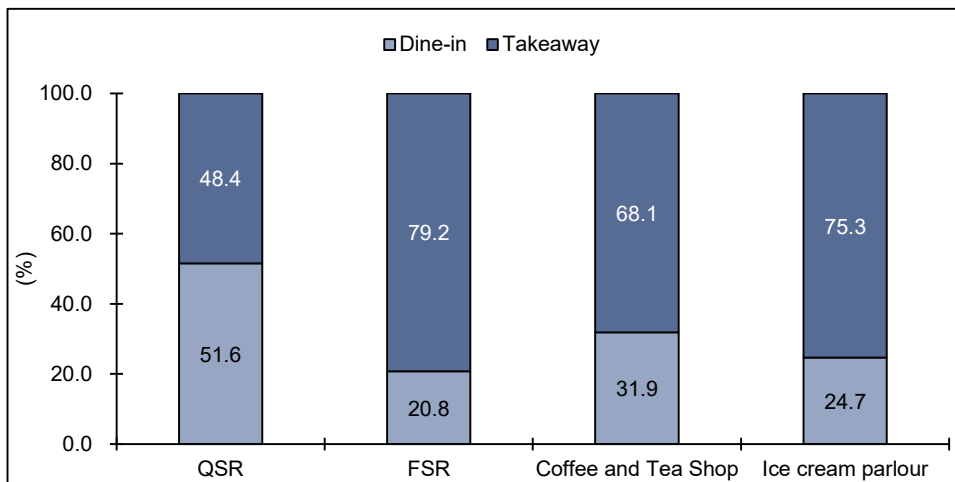


Source: Devyani International DRHP, I-Sec research

Other highlights

- QSRs have adapted well to the disruption.** With lockdown-led restrictions impacting the food service business in a big way last year, QSRs were relatively less impacted. This was due to better adoption of takeaway channel given: 1) its convenience-based format, and 2) focused investments and initiatives by several organised players on developing the delivery channel. Furthermore, given the better delivery capabilities of the QSR format, growth in the overall food delivery ecosystem augurs well for them.

Figure 10: Share of delivery and dine-in for food service formats (%)



Source: Devyani International DRHP, I-Sec research

- Pizza Hut adopts the EDV offering.** Pizza Hut launched *Wow Everyday Value* in April 2019 on the lines of a similar offering by JUBI (launched in April 2017). We note that besides multiple other initiatives, EDV has been important for driving growth for JUBI as it helped: 1) improve perception of value in the minds of the consumer; and 2) spread out consumption evenly amongst all days (rather than special offers on a particular day), which also enhances consumer experience. As highlighted in the foregoing, improving store throughput is extremely essential to enhance store economics (given the gap with JUBI). However, we believe, media intensity around the same has been relatively weak.

About the company

Devyani International is one of the two franchisees of Yum Brands in India. It has a footprint of 655 stores across 155 cities in India. Besides franchisees of KFC and Pizza Hut, 1) it also operates Costa Coffee stores, 2) operates KFC and Pizza Hut stores in Nepal and Nigeria, and 3) has a network of its own brands such as *Vaango* and *Food Street*. Company began its relationship with Yum in 1997 with its first Pizza Hut outlet. Its current network comprises 264 KFC stores, 297 Pizza Hut stores and 44 Costa Coffee outlets.

Key highlights of the franchise agreement:

- **Store opening charges.** Devyani is required to pay initial store opening fees of US\$53,400 and US\$26,700 for each KFC and Pizza Hut store opened, respectively. The amount paid for each Costa Coffee store is negligible.
- **Royalty.** The royalty (continuation) charge for both Pizza Hut and KFC stores is 6.3% of revenues while it is 6.0% of revenues for Costa Coffee.
- **Adspends.** For both KFC and Pizza Hut stores, Devyani is required to spend 6.0% of gross revenues for advertising. Of this, 5.0% is contributed to Yum and the rest 1.0% is spent for localised store-based promotions and marketing activities.

Figure 11: Key highlights of Devyani International's core brands business in India

	KFC			Pizza Hut			Costa Coffee		
	FY2019	FY2020	FY2021	FY2019	FY2020	FY2021	FY2019	FY2020	FY2021
Stores (#)	134	172	264	268	269	297	67	63	44
Cities (#)	57	76	97	83	82	100	16	18	17
SSSG (%)	4.7	3.1	(33.7)	4.7	(3.7)	(30.3)	2.7	(4.4)	(61.6)
Revenue (Rs mn)	4,641	6,091	6,443	4,233	4,174	2,879	902	820	214
Average daily sales per store (Rs)	113,852	116,740	100,270	44,679	43,918	34,900	37,458	37,414	18,510
Average daily transactions per store (Rs)	284	286	197	94	94	66	123	117	58
Average Transaction size (Rs)	401	409	508	476	467	530	304	319	320
Brand contribution (Rs mn)	854	973	1,182	655	439	372	182	174	33
Brand margin (%)	18.4	16.0	18.3	15.5	10.5	12.9	20.2	21.2	15.5

Source: Devyani International DRHP, Company data, I-Sec research

Valuation and risks

We value stocks on DCF (WACC and TG ranging from 10-13%, 3- 6% respectively) except Godrej Cons. and Tata Cons. which we value on SoTP basis. Key upside risk is better-than-expected gross margins due to correction in input prices. Key downside risk is unexpected irrational competition due to deceleration in general consumption demand. Please refer Figure 12 for our estimates, target prices and ratings.

Figure 12: Valuation summary

Company	CMP* (Rs)	TP (Rs)	Upside (%)	Rating	PE (x)		EV/EBITDA (x)		ADTV (US\$ mn)	Market Cap	
					FY22E	FY23E	FY22E	FY23E		(Rs bn)	(US\$ bn)
Staples											
Bajaj Consumer	279	400	44	BUY	17	16	14	12	5.5	40	0.5
Britannia	3,436	3,200	(7)	REDUCE	43	38	32	28	36.4	874	11.9
Colgate	1,633	1,750	7	ADD	43	38	28	25	14.1	425	5.8
Dabur	537	580	8	ADD	51	43	44	38	27.8	950	12.9
Emami	504	550	9	ADD	30	26	26	24	5.7	217	2.9
GCPL	818	850	4	BUY	44	37	33	29	17.8	742	10.1
HUL	2,362	2,600	10	ADD	59	50	41	36	74.7	5,643	76.8
ITC	209	240	15	ADD	17	16	13	12	117.4	2,708	36.9
Jyothy Labs	147	190	29	BUY	21	18	16	14	1.5	53	0.7
Marico	460	500	9	BUY	46	38	35	29	15.0	525	7.1
Mrs. Bector's Foods	399	400	0	ADD	33	27	16	13	34.1	20	0.3
Nestle	17,497	16,800	(4)	HOLD	67	55	44	37	31.8	1,647	22.4
Tata Consumer	650	770	19	BUY	54	44	31	27	36.3	600	8.2
Varun Beverages	992	1,100	11	ADD	41	31	18	16	5.3	291	4.0
Zyklus Wellness	2,110	2,500	18	BUY	36	29	30	26	1.4	127	1.7
Discretionary											
Avenue Supermarts	3,034	2,600	(14)	REDUCE	109	77	75	53	27.4	1,882	25.6
Bata	1,485	1,300	(12)	REDUCE	51	43	22	19	16.8	183	2.5
Jubilant Foodworks	3,020	3,200	6	ADD	71	61	31	28	44.9	388	5.3
Page Industries	29,280	32,000	9	ADD	58	46	39	32	22.8	335	4.6
Sheela Foam	2,024	2,500	24	BUY	30	24	21	18	0.7	97	1.3
Titan	1,538	1,700	11	ADD	65	47	42	32	47.5	1,385	18.9
United Spirits	572	650	14	ADD	41	33	27	22	22.0	395	5.4
Westlife Development	482	450	(7)	ADD	128	68	27	21	2.0	71	1.0
Paints											
Akzo Nobel	2,267	2,800	23	BUY	38	32	24	21	0.8	99	1.4
Asian Paints	2,833	2,800	(1)	ADD	69	61	47	41	89.2	2,452	33.4
Berger Paints	791	750	(5)	HOLD	87	74	56	49	14.3	713	9.7
Indigo Paints	2,536	2,750	8	ADD	91	67	61	44	NA	115	1.6
Kansai Nerolac	559	625	12	ADD	48	43	31	27	3.3	302	4.1

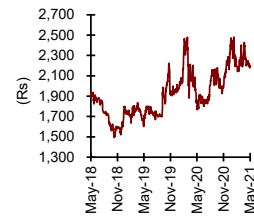
Source: Bloomberg, Company data, I-Sec research

Company	EV/ sales (x)		P/B (x)		P/CEPS (x)		RoE (%)		RoCE (%)		CAGR (FY21-23E) (%)		
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	Revenues	EBITDA	PAT
Staples													
Bajaj Consumer	3.6	3.2	5	4	17	16	28	27	29	30	10	9	7
Britannia	5.9	5.3	21	16	39	34	49	41	29	27	10	9	8
Colgate	8.5	7.7	33	31	36	32	87	94	103	111	9	7	7
Dabur	9.0	8.0	11	10	45	39	23	24	17	18	12	14	14
Emami	7.5	6.8	10	8	29	24	36	36	35	34	8	4	15
GCPL	7.3	6.6	8	7	39	34	20	21	19	20	10	12	13
HUL	10.7	9.5	12	11	52	45	20	23	16	18	13	17	16
ITC	4.8	4.4	4	4	15	14	25	26	27	28	13	12	12
Jyothy Labs	2.6	2.4	4	3	17	15	18	20	17	20	10	12	17
Marico	6.5	5.8	17	15	41	35	38	41	33	37	13	13	16
Mrs. Bector's Foods	2.3	2.0	5	4	18	16	15	15	16	18	19	15	17
Nestle	10.9	9.4	62	48	58	48	107	97	39	39	15	19	21
Tata Consumer	4.3	3.9	4	4	43	36	7	9	9	10	13	17	25
Varun Beverages	3.5	3.1	7	6	22	19	17	19	16	19	26	28	55
Zyklus Wellness	6.0	5.4	3	3	34	28	8	9	8	9	11	19	36
Discretionary													
Avenue Supermarts	6.0	4.6	14	12	87	64	14	17	17	21	35	47	48
Bata	6.0	5.2	9	8	28	24	19	19	26	26	38	84	NM
Jubilant Foodworks	8.7	7.7	23	17	42	37	38	33	28	27	25	33	69
Page Industries	8.7	7.5	29	24	51	41	55	56	43	44	27	43	51
Sheela Foam	3.1	2.7	7	5	24	20	24	24	23	23	21	19	29
Titan	4.8	3.9	15	12	53	40	26	29	29	33	27	58	72
United Spirits	4.4	4.0	8	7	32	27	22	22	25	27	16	39	65
Westlife Development	4.7	3.9	14	12	37	28	12	19	21	33	40	145	NM
Paints													
Akzo Nobel	3.5	3.0	7	6	29	25	19	19	19	19	16	21	21
Asian Paints	10.3	9.1	18	16	57	50	29	28	26	25	17	16	19
Berger Paints	10.0	8.7	21	17	69	60	26	26	22	22	17	18	22
Indigo Paints	73.2	53.0	61	44	17	14	22	25	19	20	30	47	59
Kansai Nerolac	5.0	4.4	7	6	38	34	15	15	14	14	15	13	16

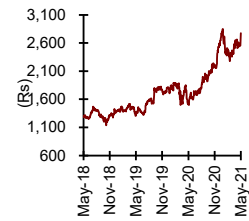
Source: Bloomberg, Company data, I-Sec research

Price charts

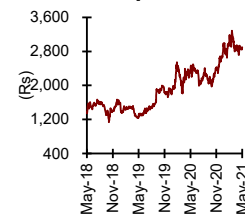
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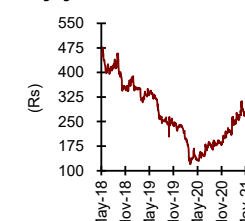
Asian Paints



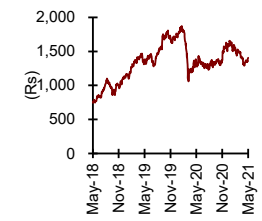
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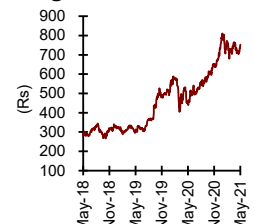
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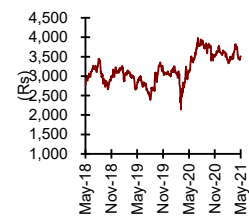
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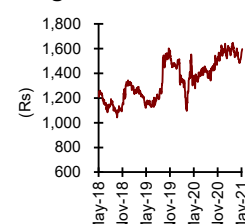
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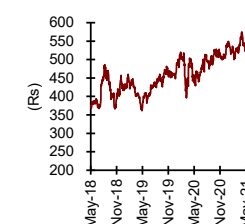
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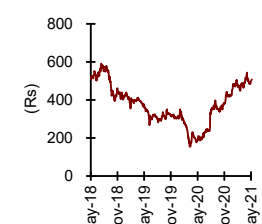
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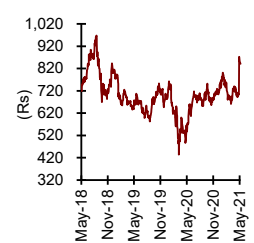
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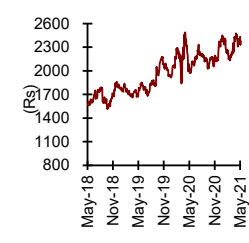
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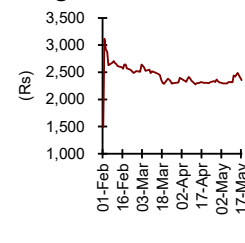
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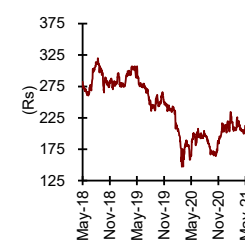
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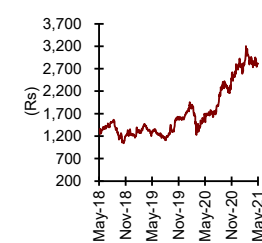
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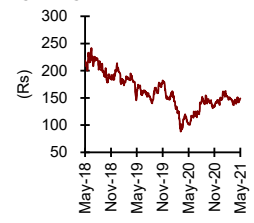
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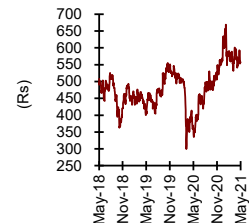
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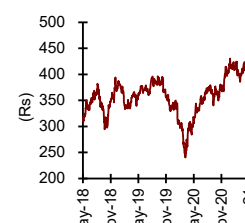
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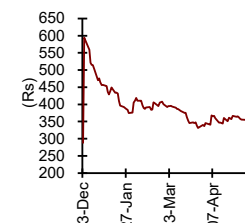
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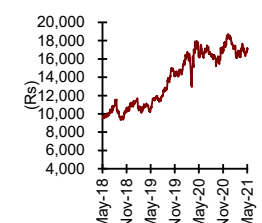
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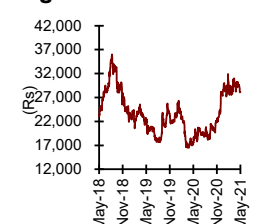
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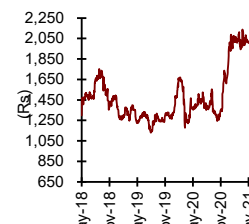
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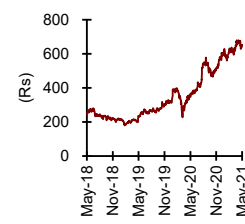
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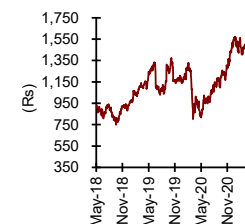
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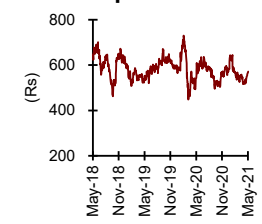
Tata Consumer



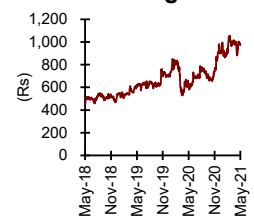
Titan



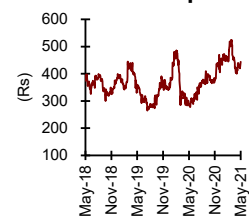
United Spirits



Varun Beverages



Westlife Development



Zydus Wellness



Source: Bloomberg

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