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Company update and
target price change

Beverages

Target price: Rs930

Target price revision

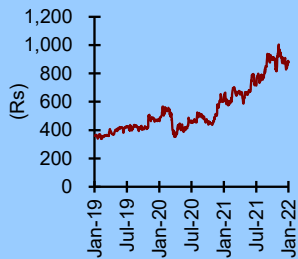
Rs930 from Rs920

Shareholding pattern

	Mar '21	Jun '21	Sep '21
Promoters	66.4	65.8	64.9
Institutional investors			
MFs and others	26.2	26.6	28.5
Banks/FIs	5.5	5.5	5.9
FIs	0.1	0.1	0.6
FIs	20.6	21.0	22.0
Others	7.4	7.6	6.6

Source: BSE

Price chart



INDIA

Varun Beverages

ADD

Maintained

Rs879

Likely limited impact of lockdown (if any)

Based on our channel checks, we believe Varun Beverages is likely to maintain strong double-digit volume growth, in line with earlier quarters. It has not yet raised prices of its products in spite of inflation in key raw materials such as sugar and PET (packaging material). It plans to focus on Eastern states and is on track to set up a new plant in Bihar. We also believe lockdown (if any) would likely have a negligible impact on the company's sales as the lockdown is likely to be in Q1CY22 (non-season). We model the company to maintain EBITDA margins of ~19.5% over CY22-23E via judicious price hikes and cost-saving initiatives. We expect Varun to report a PAT CAGR of 44.8% over CY20-23 with improving RoE. **Maintain ADD with a DCF based TP of Rs930 (35x CY23E EPS; earlier TP: Rs920).**

- **Volume growth to remain strong:** Varun is likely to maintain strong double-digit volume growth even in Q4CY21 due to (1) distribution expansion, (2) market share gains and (3) increase in in-home consumption. As some of the smaller / unorganised brands have been impacted due to covid-led lockdowns, Varun has gained share from these smaller brands.
- **Focus on Eastern markets:** Varun plans to set up a new plant in Bihar and the work is largely on track. It plans to cater to Bihar and neighboring states from the Bihar unit. Considering low per capita consumption in Bihar, there is healthy growth potential for the company in the Eastern states, in our view.
- **Lockdown (if any) will have a limited impact in non-season:** The company suffered significantly as lockdown -1 (Q2CY20) and lockdown -2 (Q2CY21) happened in its key season of summer. However, lockdown -3 (if any) is likely to be in Q1CY22 i.e. before the summer season commences. Hence, we believe there will not be any material impact on the company's volumes due to the lockdown.
- **No material impact of higher input prices:** While input prices of sugar and PET (packaging material) have increased YoY, the company has not yet raised prices of its products. It has taken some cost-saving initiatives and made changes to its packaging material which may help it maintain margins going ahead.
- **PLI benefits on juices are negligible but incrementally positive:** Varun is entitled to PLI benefit on incremental sales of juices. However, as juices contribute ~7% of annual sales, we believe the benefit at the company level will not be material.
- **Maintain ADD:** We model Varun to report revenue and PAT CAGRs of 20.2% and 44.8%, respectively, over CY20-CY23E. It continues to benefit from its relationship with PepsiCo, pan-India distribution, backward integration, and increase in in-home consumption. **Maintain ADD with a DCF-based target price of Rs930 (35x CY23E EPS; prior: Rs920).**

Market Cap	Rs380bn/US\$5.1bn	Year to December	CY20	CY21E	CY22E	CY23E
Reuters/Bloomberg	VARB.BO / VBL IN	Revenue (Rs mn)	64,501	90,289	1,00,504	1,11,877
Shares Outstanding (mn)	433.0	Adj. Net Profit (Rs mn)	2,665	7,280	9,346	11,547
52-week Range (Rs)	1020/570	Dil. Rec. EPS (Rs)	8.8	16.8	21.6	26.7
Free Float (%)	35.1	% Chg YoY	(18.9)	91.3	28.4	23.5
FII (%)	22.0	P/E (x)	100.0	52.3	40.7	33.0
Daily Volume (US\$'000)	6,356	CEPS (Rs)	21.6	30.1	35.3	40.7
Absolute Return 3m (%)	(3.3)	EV/EBITDA (x)	34.1	23.3	20.9	18.8
Absolute Return 12m (%)	45.4	Dividend Yield (%)	0.2	0.3	0.3	0.3
Sensex Return 3m (%)	0.9	RoCE (%)	9.5	16.6	19.1	21.3
Sensex Return 12m (%)	24.9	RoE (%)	7.3	18.0	19.7	20.4

Research Analysts:

Aniruddha Joshi

aniruddha.joshi@icicisecurities.com
+91 22 6807 7249

Manoj Menon

manoj.menon@icicisecurities.com
+91 22 6807 7209

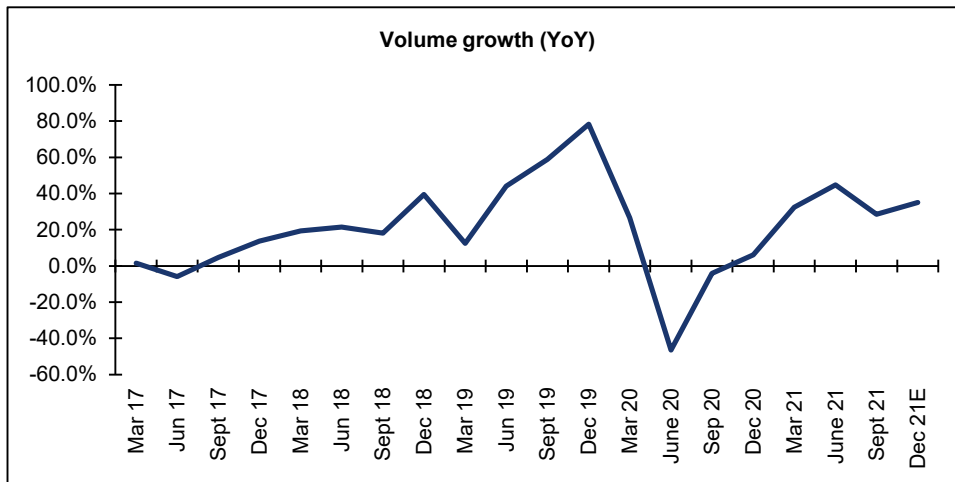
Karan Bhuwania

karan.bhuwania@icicisecurities.com
+91 22 6807 7351

Likely limited impact of lockdown (if any)

Volume growth remains strong: Varun has been posting strong volume growth over the past 2-3 quarters due to (1) distribution expansion, (2) market share gains and (3) increase in in-home consumption. As some of the smaller / unorganised brands have been impacted due to covid-led lockdowns, Varun has gained share from these smaller brands. We expect Varun to continue to maintain strong volume growth even in Q4CY21.

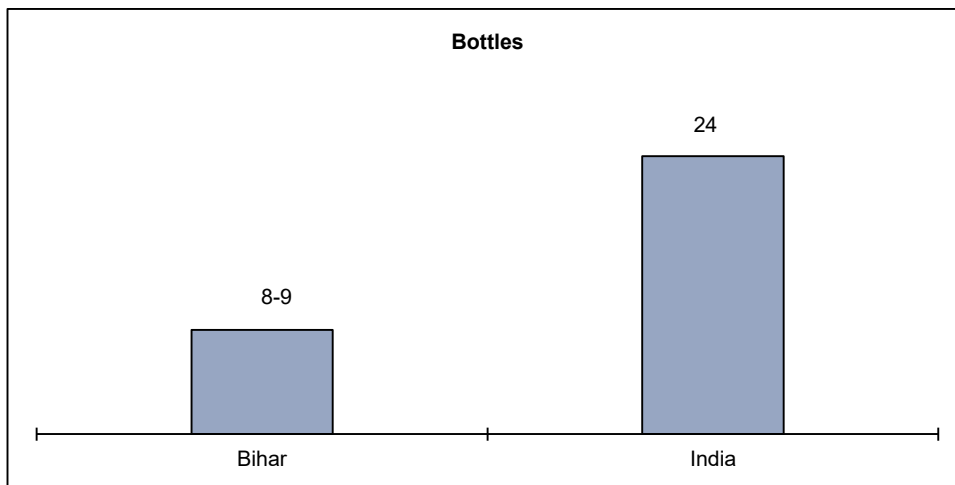
Chart 1: Volume growth to remain strong



Source: Company, I-Sec research

Focus on Eastern markets: The company’s work on setting up a new plant in Bihar is on track. It plans to cater to Bihar and neighbouring states from the Bihar unit. Considering low per capita consumption in Bihar, we see healthy growth potential for the company in Eastern states.

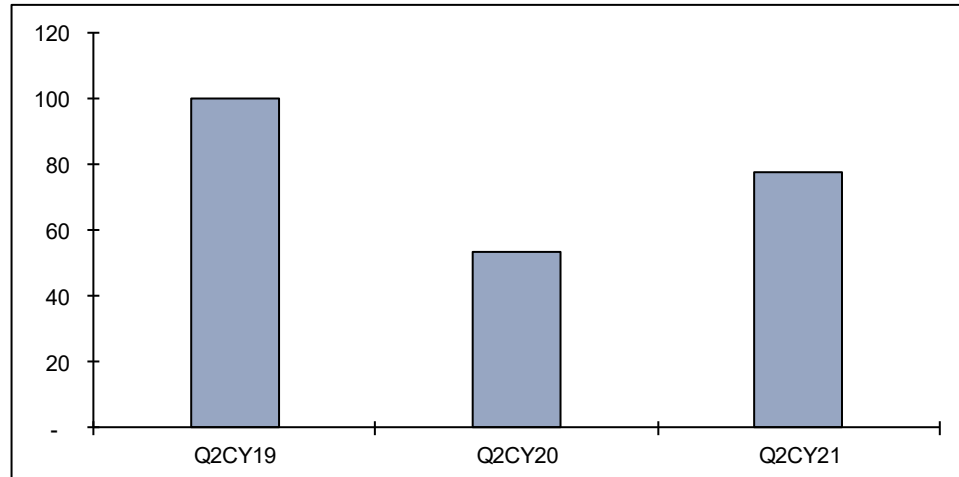
Chart 2: Per capita consumption in Bihar vs India



Source: Company, I-Sec research

Lockdown (if any) will have limited impact in off-season: The company suffered significantly as lockdown -1 and lockdown -2 happened in its key season of summer. However, lockdown -3 (if any) is likely to be in Q1CY22 i.e. before the summer season commences. Hence, we believe there will not be any material impact on company's volumes due to the lockdown.

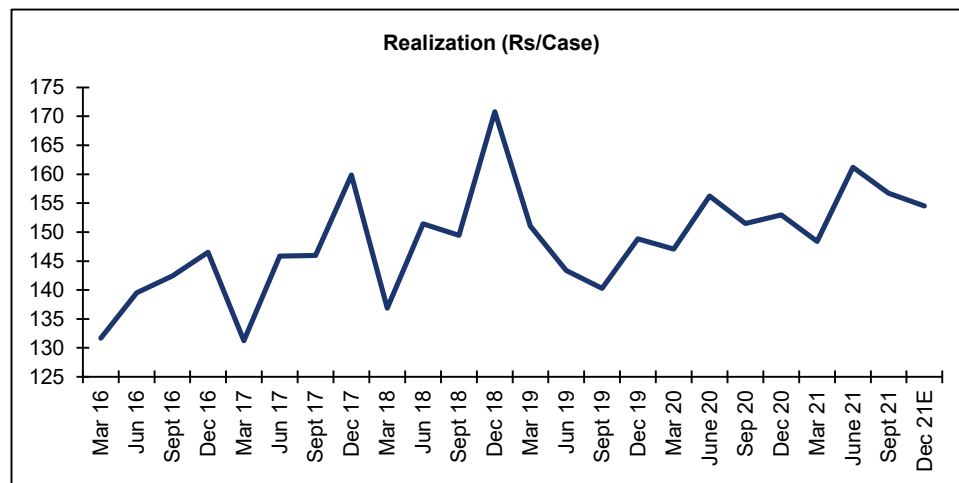
Chart 3: Volumes in previous lockdowns with Q2CY19 volumes indexed at 100



Source: Company, I-Sec research

No material impact of higher input prices: While input prices of sugar and PET (packaging material) have increased YoY, the company has not yet raised prices of its products. It has taken some cost-saving initiatives and made changes to its packaging material which may help it maintain margins going ahead.

Chart 4: Realisation per case to remain stable



Source: Company, I-Sec research

PLI benefits on juices are negligible but incrementally positive: Varun Beverages is entitled to PLI benefit on incremental sales of juices. However, as juices contribute just ~7% of annual sales, we believe the benefit at the company level will be limited.

Valuation

We have valued Varun Beverages (Varun) as per the DCF methodology. Our DCF valuation indicates a value of Rs930 per share. The implied P/E multiple at our target price and CY23E EPS works out to 35x. We maintain ADD rating on the stock.

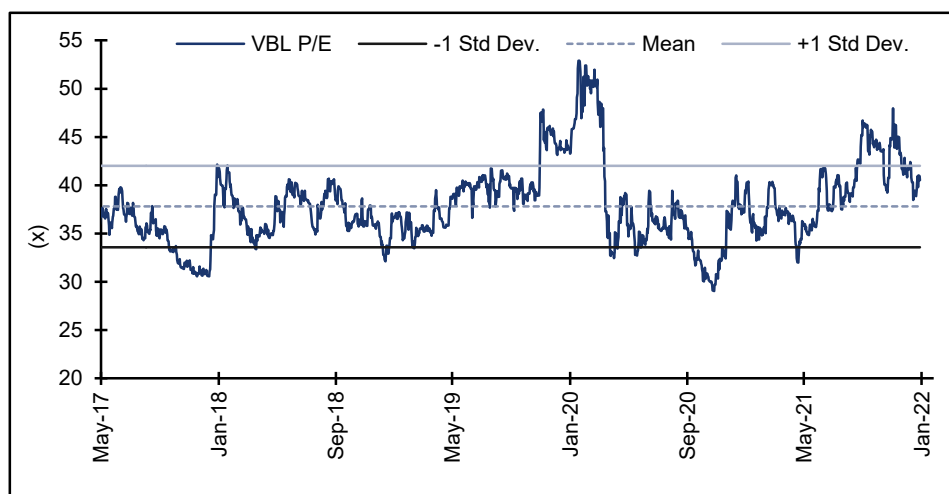
Table 1: DCF valuation

Particulars	Amt (Rs)
Cost of equity (%)	11.3%
Terminal growth rate (%)	5.0%
Discounted interim cash flows (Rsmn)	1,43,045
Discounted terminal value (Rsmn)	2,59,676
Total equity value (Rsmn)	4,02,721
Value per share (Rs)	930

Source: Company, I-Sec research

Mean P/E and standard deviations

Chart 5: 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 could 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 2: Profit & loss statement
(Rs mn, year ending December 31)

	CY20	CY21E	CY22E	CY23E
Net Sales	64,501	90,289	1,00,504	1,11,877
Operating Expenses	52,356	72,557	80,658	89,820
EBITDA	12,145	17,732	19,846	22,057
<i>% margins</i>	18.8	19.6	19.7	19.7
Depreciation & Amortisation	5,287	5,729	5,914	6,086
Gross Interest	2,937	2,674	2,122	1,527
Other Income	370	490	747	1,066
Recurring PBT	4,290	9,818	12,557	15,511
Less: Taxes	202	2,504	3,202	3,955
Less: Minority Interest	-	-	-	-
Net Income (Reported)	3,805	7,280	9,346	11,547
Extraordinaries (Net)	(1,140)	-	-	-
Recurring Net Income	2,665	7,280	9,346	11,547

Source: Company data, I-Sec research

Table 3: Balance sheet
(Rs mn, year ending December 31)

	CY20	CY21E	CY22E	CY23E
Assets				
Total Current Assets	17,997	18,767	20,623	25,038
<i>of which cash & cash eqv.</i>	1,901	619	608	2,983
Total Current Liabilities & Provisions	11,976	14,536	16,181	18,012
Net Current Assets	6,020	4,230	4,442	7,025
Investments	1,723	1,723	1,723	1,723
Net Fixed Assets	63,844	61,283	58,118	54,782
Capital Work-in-Progress	668	-	-	-
Total Assets	72,497	72,478	73,525	76,772
Liabilities				
Borrowings	34,460	28,460	21,460	14,460
Deferred Tax Liability	2,149	2,149	2,149	2,149
Minority Interest	648	648	648	648
Equity Share Capital	2,887	2,887	2,887	2,887
<i>Face Value per share (Rs)</i>	10	10	10	10
Reserves & Surplus*	32,353	38,334	46,381	56,628
Less: Misc. Exp. n.w.o.	-	-	-	-
Net Worth	35,240	41,221	49,267	59,515
Total Liabilities	72,497	72,478	73,525	76,772

Source: Company data, I-Sec research

Table 4: Quarterly trend
(Rs mn, year ending December 31)

	Dec 20	Mar 21	June 21	Sept 21
Net sales	13,309	22,409	24,498	23,982
% growth (YoY)	9.1	33.7	49.4	33.0
EBITDA	1,722	3,816	5,708	4,947
Margin (%)	12.9	17.0	23.3	20.6
Other income	56	57	244	369
Extraordinaries (Net)	(20)	(99)	101	(71)
Adjusted Net profit	(217)	1,193	3,183	2,331

Source: Company data, I-Sec research

Table 5: Cashflow statement
(Rs mn, year ending December 31)

	CY20	CY21E	CY22E	CY23E
Operating Cashflow	8,536	13,009	15,260	17,633
Working Capital	(1,108)	508	(222)	(208)
Changes				
Capital Commitments	(4,282)	(2,500)	(2,750)	(2,750)
Free Cashflow	3,146	11,017	12,288	14,675
Cashflow from Investing Activities	(516)	(5,000)	(4,000)	(4,000)
Issue of Share Capital	-	-	-	-
Inc (Dec) in Borrowings	(2,242)	(6,000)	(7,000)	(7,000)
Dividend paid	(722)	(1,299)	(1,299)	(1,299)
Change in Deferred Tax Liability	(547)	-	-	-
Chg. in Cash & Bank balance	(334)	(1,282)	(11)	2,376

Source: Company data, I-Sec research

Table 6: Key ratios
(Year ending December 31)

	CY20	CY21E	CY22E	CY23E
Per Share Data (Rs)				
EPS	8.8	16.8	21.6	26.7
Cash EPS	21.0	30.0	35.2	40.7
Dividend per share (DPS)	1.7	3.0	3.0	3.0
Book Value per share (BV)	86.3	100.2	118.7	142.4
Growth (%)				
Net Sales	(9.5)	40.0	11.3	11.3
EBITDA	(16.9)	46.0	11.9	11.1
PAT	(18.9)	91.3	28.4	23.5
DPS	-	80.0	-	-
Valuation Ratios (x)				
P/E	100.0	52.3	40.7	33.0
P/CEPS	41.9	29.3	24.9	21.6
P/BV	10.2	8.8	7.4	6.2
EV / EBITDA	34.1	23.3	20.9	18.8
EV / Sales	6.4	4.6	4.1	3.7
Operating Ratios				
Raw Material / Sales (%)	42.9	42.7	42.5	42.5
Employee cost / Sales (%)	13.8	13.0	13.0	13.0
SG&A / Sales (%)	1.8	1.7	1.7	1.7
Other Income / PBT (%)	8.6	5.0	6.0	6.9
Effective Tax Rate (%)	4.7	25.5	25.5	25.5
Working Capital (days)	23.3	14.6	13.9	13.2
Inventory Turnover (days)	52.6	45.1	45.1	45.1
Receivables (days)	13.7	9.1	9.1	9.1
Payables (days)	65.9	57.3	57.3	57.3
Net D/E (x)	0.9	0.5	0.2	(0.0)
Profitability Ratios (%)				
Net Income Margins	6.3	8.1	9.3	10.3
RoACE	9.5	16.6	19.1	21.3
RoAE	7.3	18.0	19.7	20.4
Dividend Payout	19.0	17.8	13.9	11.3
Dividend Yield	0.2	0.3	0.3	0.3
EBITDA Margins	18.8	19.6	19.7	19.7

Source: Company data, I-Sec research

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