

October 23, 2024

REINITIATING & RESULT REPORT Q3 CY24 | Sector: Consumer Staples

Varun Beverages Ltd.

Sustaining growth through new levers

We reinitiate coverage on Varun Beverages Ltd. (VBL) with BUY rating and target price (TP) of Rs705. Our view is pinned on the following arguments: (1) Per capita consumption remains low. (2) Capacity and distribution expansion will continue to support growth. (3) While Sting, stabilizes, growth expected to improve in Juices and Value-Added Dairy Products (VADP). (4) Africa offers potential for long-term growth.

Per capita consumption remains low

With a population of ~1.5bn and India predominantly being a tropical country, the non-alcoholic beverages (NAB) industry has grown at ~14.5% CAGR in volume terms and ~13.7% CAGR in value terms over the past decade as per the Indian Council for Research on International Economic Relations (ICRIER) report. Per capita beverage consumption of India is still mere ~21 ltrs as compared to ~359 ltrs in the US, ~198 ltrs in Saudi Arabia and ~102 ltrs in South Africa. Carbonated soft drinks (CSD) has the highest share within NAB followed by packaged water in value terms. Energy and sports drink remain the fastest growing sub segment in this space with a 45% CAGR over CY2010 to 2019. Despite CSD's economic potential, the industry is limited by a tax structure that hinders growth & innovation. Currently, India imposes 40% tax on CSDs (28% GST + 12% compensation cess). It will be interesting to see the tax structure once compensation cess ends before Mar'26.

Expanding capacities and growing distribution network will continue to support growth

VBL has consistently build scale by adding capacities as well as acquiring new territories to capture growth. This is demonstrated by the rapid scale up of manufacturing facilities from 21 in CY16 to 48 as on 2QCY24. Moreover, the company now commands ~90% share of Pepsi volumes from 45% in CY17. The capacities are backed by strong distribution reach of ~4mn outlets (adding 0.3-0.4mn outlets every year) with installations of ~1.02mn visicoolers. VBL believes there is enough room for growth and new competition as there are 12mn potential outlets to be reached.

While Sting's stabilizes, growth is expected to improve in juices and value-added dairy

VBL introduced 'Sting' in CY17 at Rs50 in a 250ml can, but it couldn't disrupt the energy drink market. However, in CY20, after relaunching at Rs 20/- 250ml PET bottle which (at par with a normal CSD bottle), the volumes of Sting skyrocketed and has now become >15% of the overall portfolio. While there is still a lot of headroom for Sting to grow as it reaches just >10% outlets out of VBL's reach of ~4mn outlets but we expect growth rates to stabilize on high base. While on the other hand Juices, Gatorade and value-added dairy products are just a miniscule part of the company's portfolio. With increased production capacity, we believe growth rates to pick-up in these businesses which are also margin accretive due to higher realization than the CSD.

Africa offers potential for long-term growth

International business has grown almost at the same rate in the last 5 years in volumes (21.5% CAGR) through addition of new regions and capacities. Through recent commissioning of numerous greenfield and brownfield facilities across strategic geographies, VBL plans to strategically diversify its operations geographically owing to seasonality of the core CSD business. In addition to existing portfolios, VBL has announced further snacking partnerships in the African market which complements their existing PepsiCo distribution.

View and Valuation

Company is on track to deliver healthy double-digit growth in CY24 as well. Pro-active capacity additions in domestic as well as international businesses along with long runway for distribution expansion, gives us good visibility on medium-to-long term growth. Over CY24E-CY26E, we build 25% earnings CAGR driven by 18% revenue CAGR and 40bps EBITDA margin improvement (led by scale & efficiencies). Re-initiate coverage on VBL with BUY rating and a TP of Rs705, as we assign a target multiple of ~54x on March'27E EPS.

Things to monitor

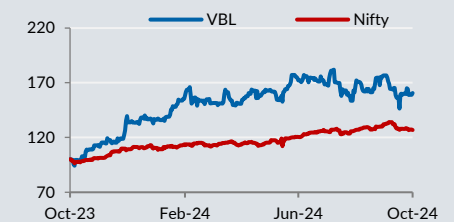
Competitive intensity and Outcome by GoM on compensation cess merger.

Reco	: BUY
CMP	: Rs 595
Target Price	: Rs 705
Potential Return	: +18.5%

Stock data (as on Oct 22, 2024)

Nifty	24,472
52 Week h/l (Rs)	681 / 331
Market cap (Rs/USD mn)	1879198 / 22356
Outstanding Shares (mn)	3,249
6m Avg t/o (Rs mn):	3,317
Div yield (%):	0.2
Bloomberg code:	VBL IN
NSE code:	VBL

Stock performance



	1M	3M	1Y
Absolute return	-9.2%	-4.9%	60.5%

Shareholding pattern (As of Sep'24 end)

Promoter	62.7%
FII+DII	29.2%
Others	8.2%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	NA
Target Price (Rs)	705	NA

Δ in earnings estimates

	CY24e	CY25e	CY26e
EPS (New)	8.0	10.0	12.4
EPS (Old)	NA	NA	NA
% change	NA	NA	NA

Financial Summary

(Rs bn)	CY24E	CY25E	CY26E
Net sales	199	236	277
YoY growth (%)	24.0	18.8	17.0
EBITDA	47	56	66
EBITDA margin (%)	23.6	23.8	24.0
PAT	26	33	40
EPS	8.0	10.0	12.4
YoY change (%)	23.5	25.5	23.7
Pre-tax ROCE (%)	27.5	29.8	33.7
ROE (%)	34.2	36.0	37.0
P/E (x)	72.1	57.4	46.5
P/B (x)	22.7	19.0	15.7

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MANAS RASTOGI, Associate

STORY IN CHARTS

Exhibit 1: List of brands licensed & owned

Brands licensed by PepsiCo:				Own Brands [^] :	
Carbonated Soft Drinks				Carbonated Soft Drinks	
Fruit Pulp / Juice Based Drinks				Energy Drink	
Sports Drink		Carbonated Juice Based Drinks		Packaged Water	
Ice Tea				Dairy Based Beverages*	
Snacks#					

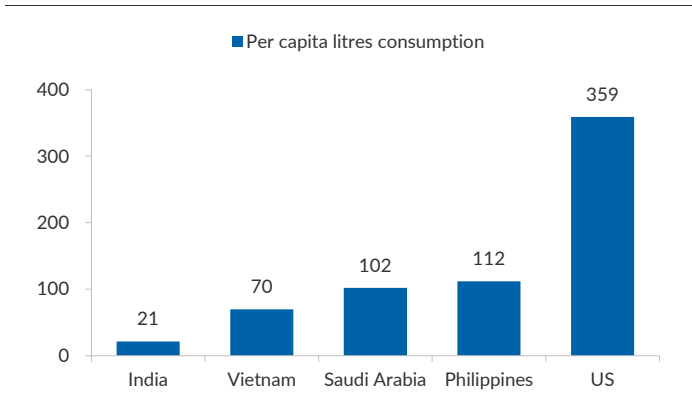
Source: Company, YES Sec

Manufacturing of Cheetos (underway) & Distribution of Frito Lay, Doritos and Cheetos in Morocco; Manufacturing & Distribution of Simba Munchiez (underway) in Zambia and Zimbabwe; Co-manufacturing of Kurkure Puffcorn in India.

[^] Manufacturing & Distribution of own brands is restricted in select territories.

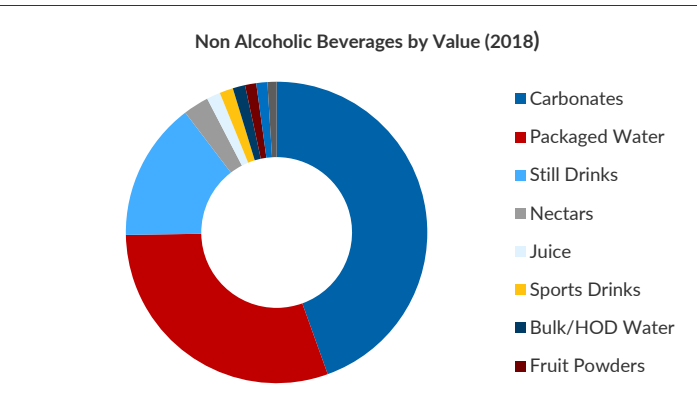
* "CreamBell" trademark has been licensed to be used by VBL for ambient temperature value added dairy based beverages.

Exhibit 2: India has the lowest per capita consumption of ~21 liters



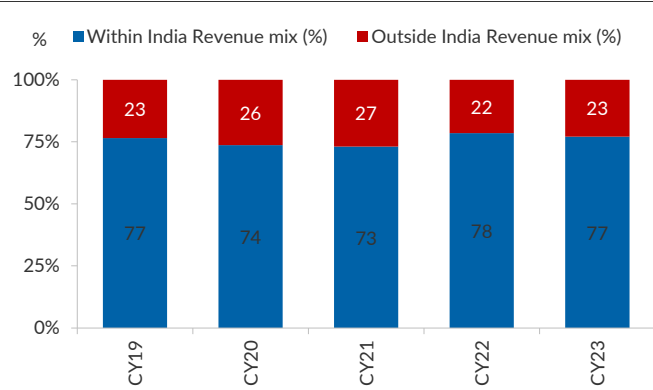
Source: ICRIER, YES Sec

Exhibit 3: CSD constitutes the highest share in Non-Alcoholic beverages in value terms



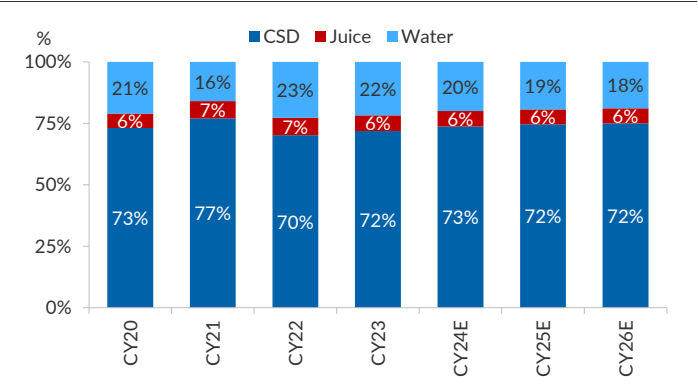
Source: ICRIER, YES Sec

Exhibit 4: Revenue within India stood at ~23% in CY23



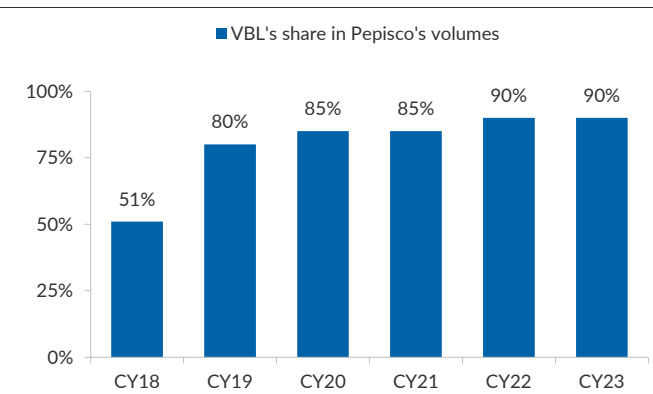
Source: Company, YES Sec

Exhibit 5: CSD mix expected to remain stable at 72% by CY26E



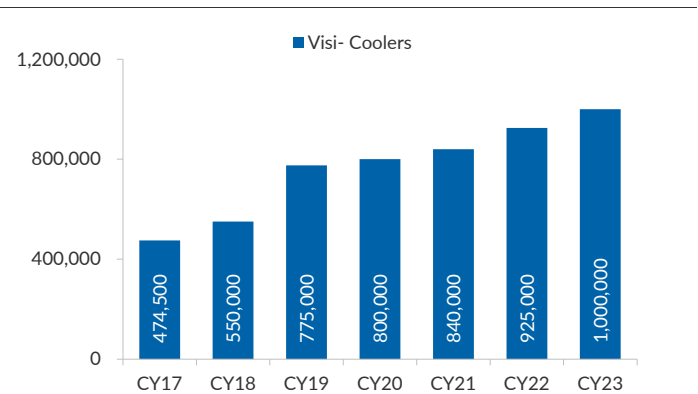
Source: Company, YES Sec

Exhibit 6: VBL's has successfully expanded its operations to gain overall share in PepsiCo's volumes



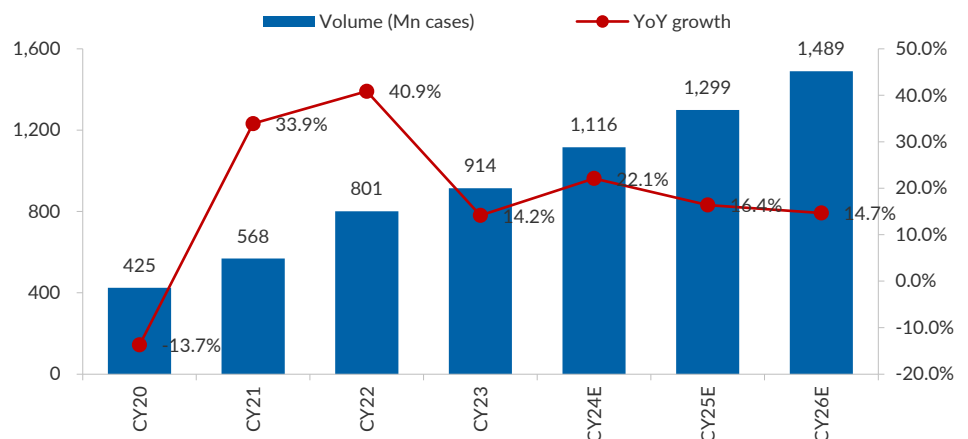
Source: Company, YES Sec

Exhibit 7: Steady rise in Visi-coolers (1.02mn currently) aided VBL's volume growth and has helped reaching ~4mn+ outlets



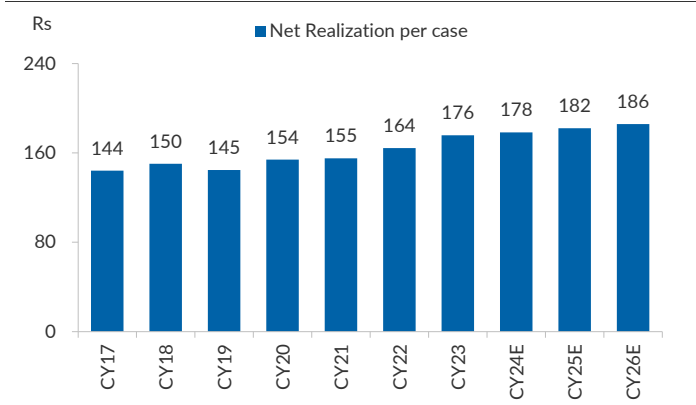
Source: Company, YES Sec

Exhibit 8: Overall volumes are expected to grow at 15.5% CAGR over CY24E-26E to 1,489mn cases



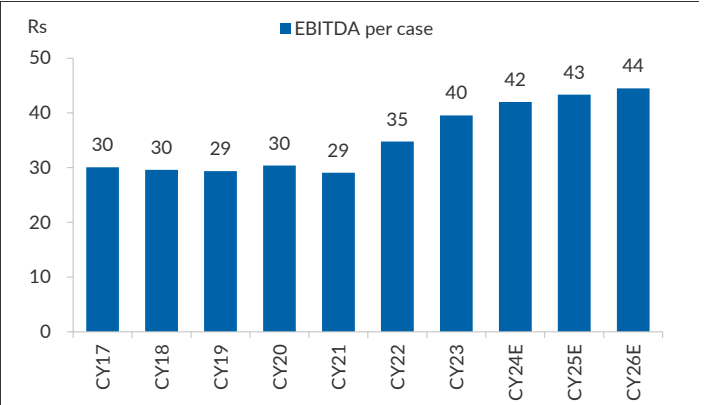
Source: Company, Yes Sec

Exhibit 9: Net realization per case expected to improve slightly given lower realizations from Africa business



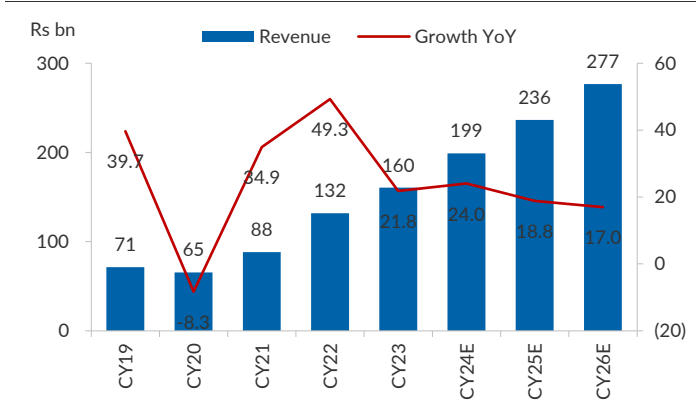
Source: Company, YES Sec

Exhibit 10: EBITDA per case also expected to improve steadily to Rs44 by CY26



Source: Company, YES Sec

Exhibit 11: VBL's revenues expected to grow by 18% over CY24E-26E to Rs 277bn



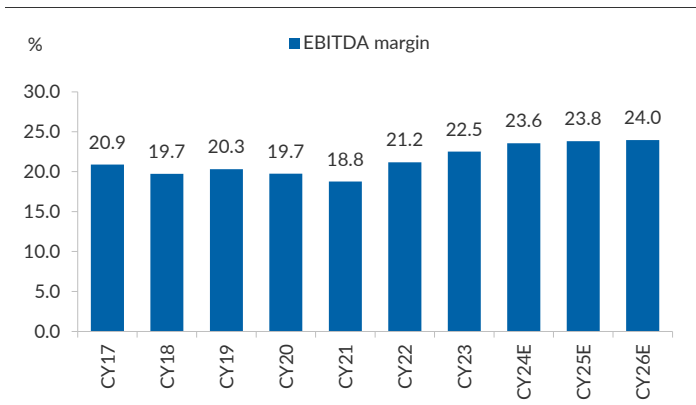
Source: Company, YES Sec

Exhibit 12: Gross margin expected to improve to 55.9% by CY26E



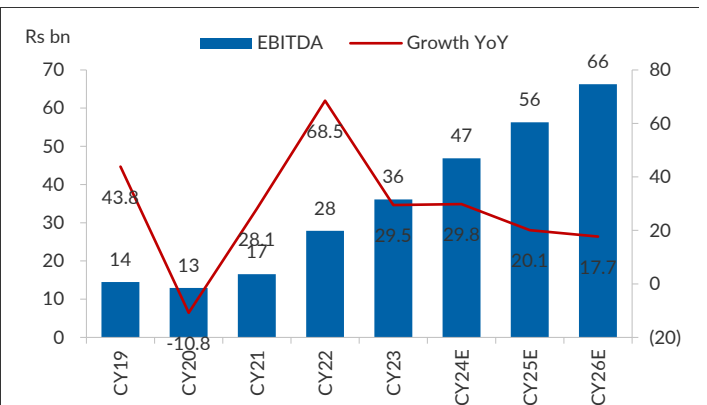
Source: Company, YES Sec

Exhibit 13: EBITDA margin expected to improve to ~24% by CY26E largely driven by scale and efficiencies



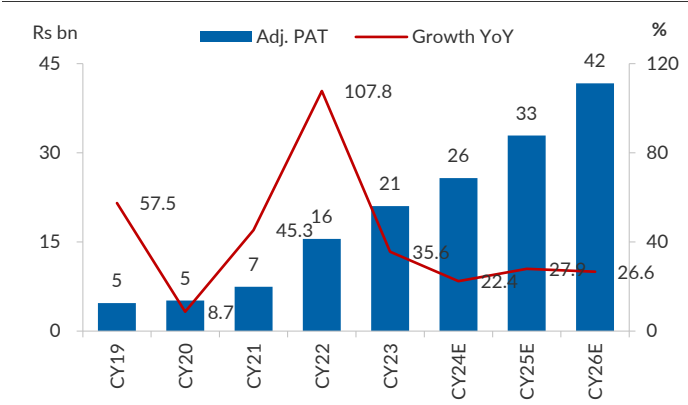
Source: Company, YES Sec

Exhibit 14: EBITDA is expected to rise by 19% CAGR over CY24E-26E



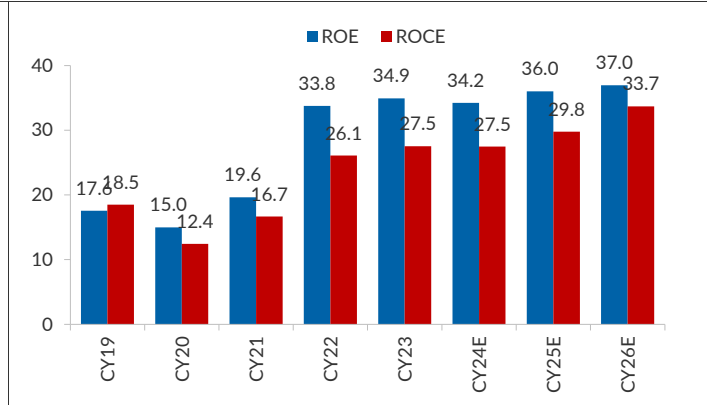
Source: Company, YES Sec

Exhibit 15: Adj PAT is expected to grow at 25% CAGR over CY24E-26E



Source: Company, YES Sec

Exhibit 16: Post completion of capacity additions, return ratios to revert back to improving trend



Source: Company, YES Sec

Q3 CY24 QUARTERLY RESULTS HIGHLIGHTS

- **Headline performance:** Headline performance: Consolidated net sales grew 24.1% YoY to Rs48bn in 3QCY24. EBITDA grew by 30.5% YoY to Rs11.5bn. Adjusted PAT (APAT) grew by 22.3% to Rs6.3bn.
- **Volumes:** Overall volumes for the quarter grew by ~21.5% YoY to 267mn cases (including 34mn cases from BevCo. And DRC). Heavy rains throughout Sep'24 quarter led to India volumes growing by 5.7% and international volumes grew by 7.9% organically.
- CSD (Carbonated Soft Drink; constituted 75%) volumes grew by ~26% YoY to 200mn cases.
- Water volumes grew 12% YoY to 56mn cases.
- Juice volumes grew ~2.7% YoY to 11mn cases.
- **Net revenue per case** for the quarter was up 2.2%YoY at Rs180 in 3QCY24 (it was Rs179 in 2QCY24).
- **Margins:** Overall gross margin up ~20bps to 55.5% (up ~80bps QoQ) in 3QCY24. EBITDA margins improved by ~120bps YoY to 24% in 3QCY24.
- **EBITDA per case** stood at Rs43 in 3QCY24 vs Rs40 in 3QCY23.
- **9M performance:** Consolidated net sales grew 22% YoY to Rs163.1bn in 9MCY24. EBITDA grew by 29.5% YoY to Rs41.3bn. Adjusted PAT (APAT) grew by 24.5% to Rs24.4bn.

Exhibit 17: Quarterly result snapshot

Particulars (Rs. Mn)	3QCY23	2QCY24	3QCY24	YoY (%)	QoQ (%)	9MCY23	9MCY24	YoY (%)
Net Sales	38,705	71,969	48,046	24.1	-33.2	133,749	163,188	22.0
COGS	17,297	32,606	21,364	23.5	-34.5	62,479	72,845	16.6
% of sales	44.7	45.3	44.5	-0.2	-0.8	46.7	44.6	-2.1
Gross margin %	55.3	54.7	55.5	0.2	0.8	53.3	55.4	3.9
Employee costs	3,716	4,993	5,130	38.1	2.8	10,753	14,060	30.8
% of sales	9.6	6.9	10.7	1.1	3.7	8.0	8.6	0.6
Other expenses	8,872	14,458	10,041	13.2	-30.5	28,605	34,972	22.3
% of sales	22.9	20.1	20.9	-2.0	0.8	21.4	21.4	0.0
EBITDA	8,821	19,912	11,511	30.5	-42.2	31,912	41,310	29.5
EBITDA margin %	22.8	27.7	24.0	1.2	-3.7	23.9	25.3	1.5
Depreciation	1,708	2,425	2,566	50.2	5.8	5,149	6,866	33.3
EBIT	7,113	17,487	8,945	25.7	-48.9	26,762	34,444	28.7
EBIT margin %	18.4	24.3	18.6	0.2	-5.7	20.0	21.1	1.1
Interest expense	625	1,292	1,185	89.7	-8.2	1,944	3,414	75.6
Other income	185	440	243	31.0	-44.9	702	766	9.1
PBT	6,673	16,636	8,002	19.9	-51.9	25,520	31,797	24.6
Tax	1,529	4,012	1,713	12.1	-57.3	5,933	7,403	24.8
Effective tax rate %	22.9	24.1	21.4	-1.5	-2.7	23.2	23.3	0.1
Adj.PAT after Share of Assc & JV	5,140	12,618	6,288	22.3	-50.2	19,587	24,394	24.5
PAT margin %	13.3	17.5	13.1	-0.2	-4.4	14.6	14.9	0.3

Source: Company, YES Sec

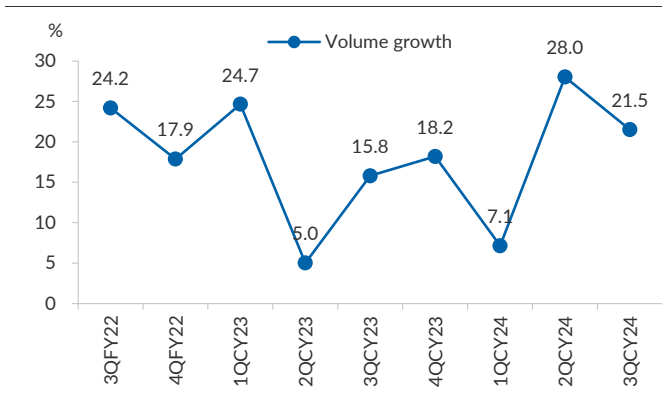
VBL 3QCY24 CON CALL HIGHLIGHTS

- **Margins:** The company expects margin expansion in the future owing to backward integration in bigger plants due to low freight and more advanced capacities. 17 of the company's plants are backward integrated. 4 new large upcoming plants can produce 800-900 bottles a minute which was 100-200 bottles a minute earlier with the same manpower. International margins will improve in future given the benefits of bulk buying and operating leverage.
- Heavy rains usually disturbs rural markets more hence 3Q was subdued for rural but it had grown ahead of urban in Q2.
- **QIP proceeds** will be used for debt reduction, M&A, expanding snacks business in Africa and increasing capacity in India.
- **Competition:** Management believes Campa is a formidable competition. However, it has not affected VBL as of now. Only 4mn outlets are serviced by the company out of the total 12mn outlets. The company adds 300k-400k outlets every year and it will take some time for Campa to increase distribution. If there is a need in the future it might be taking pricing actions to fight with Campa. Concentrate charge is not large so does not affect pricing difference. The management believes there is room for everyone to grow given the huge market size.
- **DRC:** The first six months were used to correct backend operations to reduce inefficiencies. Expect reasonable growth due to the upcoming summer season. Capacity in DRC would be more than 70mn cases in the next year same time from current levels of 35mn cases. DRC volumes for the quarter stood at 5mn cases and rest 29mn cases was for BevCo.
- **South Africa:** Pepsi is scaling faster than Non-Pepsi portfolio in BevCo business. The company has ramped up the capacity. Last quarter growth was 12% and this quarter it grew by 20%. September month was particularly good. The company is optimistic of reasonable growth in South African market. Seasonality is 60% and 40% in SA business.
- **Inventory correction:** The company doesn't have much inventory and can correct inventory anytime.
- **Other carbonated beverages:** The company will be relaunching Nimbu Masala Soda early next year and also in talks with Pepsi to launch a variant with Jeera given the huge surge in demand. Jeera variant is taking time for approval from parent given the high sodium content.
- **Sting's** volume contribution is slightly more than 15% of domestic CSD volumes.
- **Capital structure:** Debt-equity can go maximum up to 1:1. Proceeds of QIP could be used to create war chest, if there are any opportunities available.
- **Snacks business:** The business model in Morocco and Zambia for the snacks business will be same as India beverages business, the company will pay for seasonings like it pays for concentrates in beverages. Zimbabwe, Zambia and Morocco plants coming up next year for the snacks business. Potential of USD100mn revenue from these three plants. Snacks is less capex and more turnover hence better return ratios.
- **Capex:** Rs24bn for the implementation of the facilities at Kangra in Himachal Pradesh, Pradesh, Buxar in Bihar and in Meghalaya. 3 plants in Zimbabwe, Zambia and Morocco will be commercialized next year.
- **Accounting change:** India gross margins were down owing to shift of water head cost from SG&A to Cost of goods sold.
- **Distribution:** Expanding distribution across the country specially in those states (especially South and East) where the penetration was lower. Penetration-led growth should last at least 4-5 years.

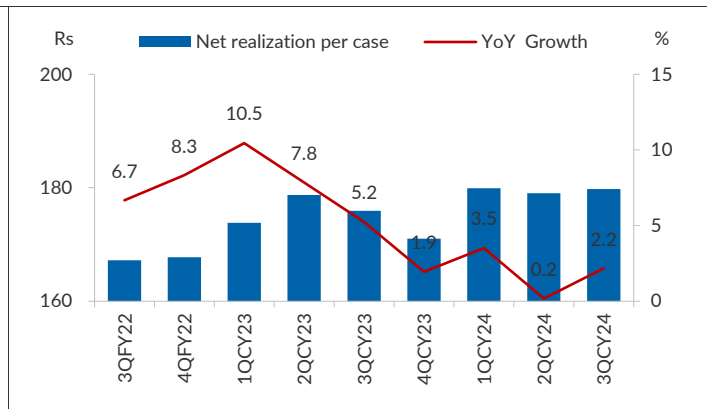
- Other income of Rs310mn received as maiden dividend from Sri Lanka subsidiary and is non-taxable as per income tax act.
- CWIP is currently Rs4bn, and all the assets have been capitalized already.
- The first r-PET plant will be introduced in the 2nd half of next year as part of the government mandate.
- The company does not sell anything at INR10 except the glass bottles. Glass bottles are sold in restaurants and eateries while PET bottles are used on the go. VBL pet bottle is priced at Rs20.

QUARTERLY CHARTS

Exhibit 18: Overall volume growth was 21.5% in 3QCY24 **Exhibit 19: Net realization per case was up 2.2% YoY to ~Rs180 in 3QCY24**

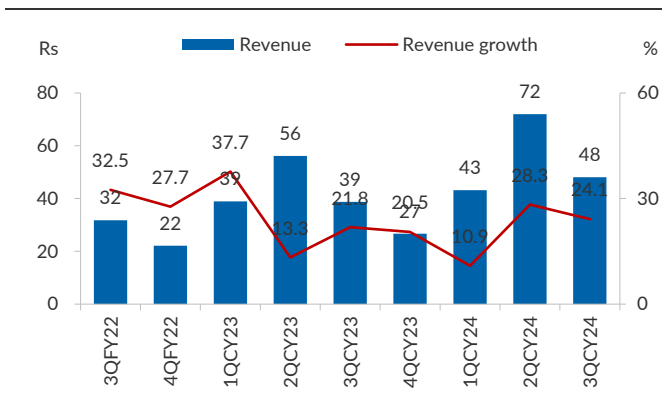


Source: Company, YES Sec



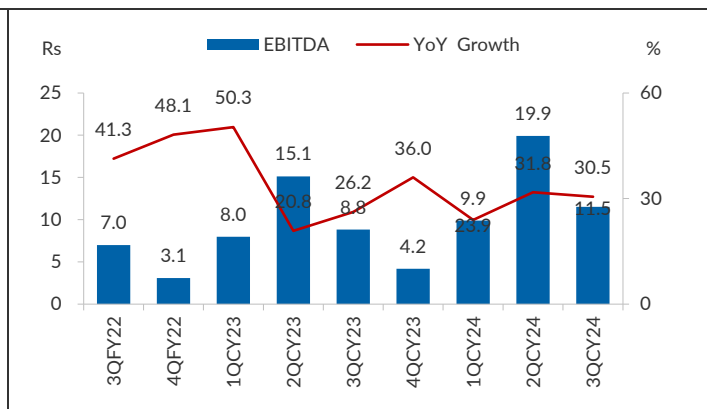
Source: Company, YES Sec

Exhibit 20: Revenue grew by 24.1% YoY to Rs48bn in 3QCY24



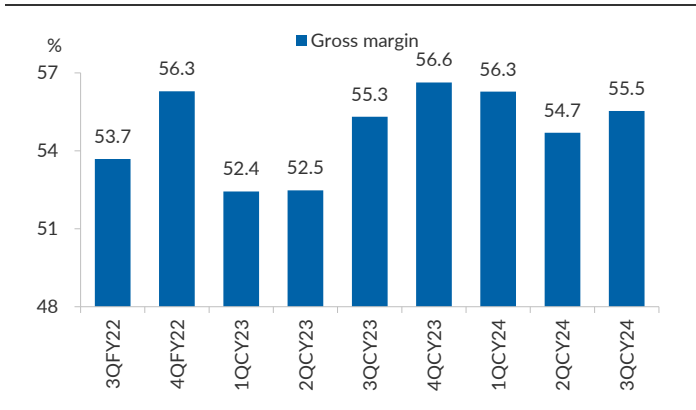
Source: Company, YES Sec

Exhibit 21: EBITDA grew by 30.5% YoY to 11.5bn in 3QCY24



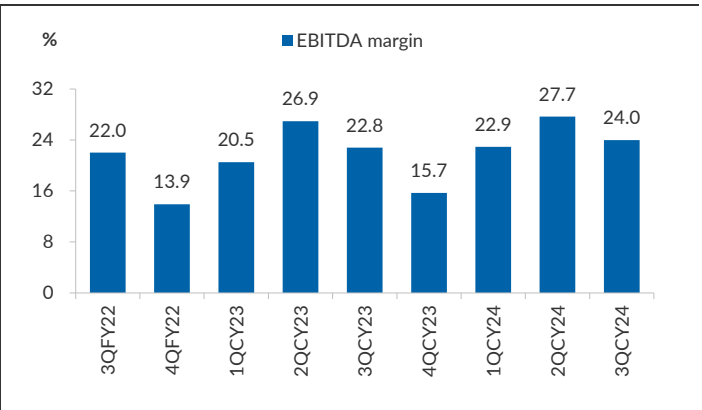
Source: Company, YES Sec

Exhibit 22: Gross margin improved by 20bps YoY to 55.5%



Source: Company, YES Sec

Exhibit 23: EBITDA margins improved by 120bps YoY to 24%

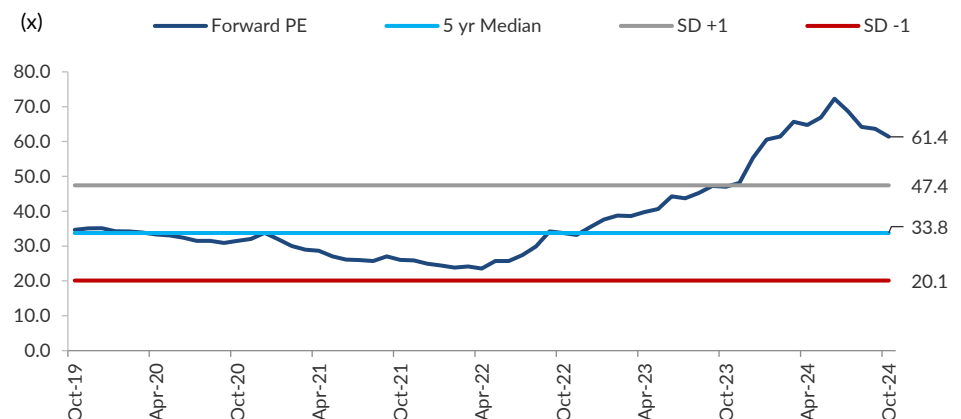


Source: Company, YES Sec

VIEW & VALUATION

- We expect VBL’s revenue to grow at ~18% CAGR over CY24E-CY26E led by (1) Indian beverages industry on a secular growth trend. (2) Capacity and distribution expansion. (3) While Sting, stabilizes, growth expected to improve in Juices and Value-Added Dairy Products (VADP). (4) Africa offers potential for long-term growth.
- We expect gross margins to improve by ~50bps over CY24E-CY26E leading to EBITDA margin improvement of ~40bps largely driven by scale and efficiencies.
- Company is on track to deliver healthy double-digit growth in CY24 as well. Pro-active capacity additions in domestic as well as international businesses along with long runway for distribution expansion, gives us good visibility on medium-to-long term growth. VBL is currently trading at ~59x/48x CY25E/CY26E EPS. We have not yet baked-in Africa’s new announced snacking business in our earnings. Over CY24E-CY26E, we build 25% earnings CAGR driven by 18% revenue CAGR. Re-initiate coverage on VBL with BUY rating and a TP of Rs705, as we assign a target multiple of ~54x on March’27E EPS.
- Things to monitor: Competitive intensity and Outcome by GoM on compensation cess merger.

Exhibit 24: Currently trading at ~61x 1-yr forward earnings



Source: Company, YES Sec

FINANCIALS

Exhibit 25: Income statement

(Rs mn)	CY21	CY22	CY23	CY24E	CY25E	CY26E
Net Sales	88,232	131,731	160,426	198,996	236,473	276,583
% growth	34.9	49.3	21.8	24.0	18.8	17.0
COGS	40,346	62,612	74,049	88,752	104,994	121,973
Gross Profits	47,886	69,120	86,377	110,244	131,479	154,610
Staff costs	10,077	12,166	14,466	19,303	22,465	25,722
Selling & Admin costs	1,249	1,398	1,964	2,487	3,074	3,734
Other expenses	20,013	27,675	33,852	41,590	49,659	58,912
Total Expenses	71,686	103,850	124,330	152,133	180,192	210,341
EBITDA	16,547	27,881	36,096	46,864	56,281	66,242
% growth	40.8	68.5	29.5	29.8	20.1	17.7
EBITDA margin	18.8	21.2	22.5	23.6	23.8	24.0
Depreciation	5,313	6,172	6,809	9,535	11,095	11,695
Other income	679	388	794	873	960	1,056
Interest cost	1,847	1,861	2,681	4,596	3,812	3,252
Profit before tax	10,066	20,236	27,399	33,605	42,334	52,351
Tax	2,606	4,735	6,375	7,635	9,737	12,041
Tax Rate	25.9	23.4	23.3	22.7	23.0	23.0
PAT	7,461	15,501	21,019	25,963	32,586	40,294
Adj. PAT	7,461	15,501	21,024	25,970	32,597	40,310
% growth	87.9	107.8	35.6	23.5	25.5	23.7
Adj PAT margin	8.5	11.8	13.1	13.1	13.8	14.6

Source: Company, YES Sec

Exhibit 26: Balance sheet

(Rs mn)	CY21	CY22	CY23	CY24E	CY25E	CY26E
Equity capital	4,330	6,496	6,496	6,497	6,497	6,497
Reserves and surplus	36,469	44,528	62,869	75,837	92,180	112,983
Net worth	40,799	51,024	69,364	82,334	98,678	119,480
Minority Interest	1,168	1,131	1,482	1,482	1,482	1,482
Total Debt	33,419	36,948	51,943	62,962	54,316	45,737
Other LT liabilities	2,092	2,283	2,195	2,301	2,413	2,530
Total liabilities	77,791	91,622	126,962	151,057	158,866	171,207
Gross Block	93,880	103,075	124,902	160,902	186,902	196,902
Depreciation	30,991	37,163	43,972	53,508	64,603	76,298
Net Block	62,889	65,912	80,930	107,394	122,299	120,604
Capital work-in-progress	4,966	6,066	19,222	12,000	12,000	12,000
Goodwill	242	242	242	242	242	242
Net deferred tax	(3,087)	(3,368)	(3,430)	(3,430)	(3,430)	(3,430)
Other assets	2,260	6,709	5,833	6,124	6,430	6,752
Investments	0	0	211	211	211	211
Cash	3,366	2,853	4,599	9,967	628	11,548
Inventories	14,481	19,939	21,505	26,715	31,098	36,373
Debtors	2,212	2,993	3,594	4,362	5,183	6,062
Other current assets	5,847	8,540	12,517	14,018	15,708	17,613
Current Assets	22,540	31,472	37,616	45,094	51,989	60,048
Creditors	7,118	8,243	7,582	8,997	10,931	13,033
Other CL	8,268	10,021	10,677	17,548	20,573	23,735
Current Liabilities	15,386	18,264	18,259	26,545	31,504	36,768
Net Current Assets	7,155	13,208	19,357	18,549	20,485	23,280
Total Assets	77,791	91,622	126,963	151,057	158,866	171,207

Source: Company, YES Sec

Exhibit 27: Cash flow statement

(Rs mn)	CY21	CY22	CY23	CY24E	CY25E	CY26E
PBT	10,066	20,236	27,398	33,598	42,323	52,335
Add: Depreciation	5,313	5,831	6,409	9,535	11,095	11,695
Add: Interest	1,705	1,626	2,443	4,596	3,812	3,252
Less: taxes paid	(1,242)	(3,733)	(6,679)	(7,635)	(9,737)	(12,041)
Add: other adjustments	(840)	(208)	1,072	(292)	(306)	(322)
Less: WC changes	(2,687)	(5,852)	(6,735)	808	(1,936)	(2,795)
Cash flow from operations	12,314	17,900	23,908	40,611	45,251	52,125
Capital expenditure	(8,154)	(17,499)	(31,939)	(36,000)	(26,000)	(10,000)
Net cash after capex	4,160	401	(8,031)	4,611	19,251	42,125
(Inc.)/Dec in investments	(1,953)	453	(959)	0	0	0
Cash flow from investing activities	(10,107)	(17,046)	(32,899)	(36,000)	(26,000)	(10,000)
Dividends paid	(1,083)	(1,624)	(2,273)	(12,994)	(16,243)	(19,492)
Others	(694)	1,444	12,122	(6,596)	(5,812)	(5,252)
Cash from financing activities	(1,777)	(180)	9,849	(19,591)	(22,055)	(24,743)
Opening cash balance	1,046	1,507	1,543	2,422	(12,559)	(15,363)
Closing cash balance	1,507	1,543	2,422	(12,559)	(15,363)	2,019
Change in cash balance	430	675	858	(14,980)	(2,804)	17,381

Source: Company, YES sec

Exhibit 28: Ratio analysis

	CY21	CY22	CY23	CY24E	CY25E	CY26E
Per share numbers (Rs)						
Reported earnings	17.2	23.9	16.2	8.0	10.0	12.4
Dividend	3.0	5.0	3.5	4.0	5.0	6.0
Book Value	141.3	176.7	53.4	25.3	30.4	36.8
Valuations (x)						
P/E	61.5	44.4	36.8	74.4	59.3	48.0
EV / EBITDA	29.6	25.9	22.7	42.4	35.3	29.7
P/Sales	5.2	5.2	4.8	9.7	8.2	7.0
Profitability Ratios						
Gross margin	54.3	52.5	53.8	55.4	55.6	55.9
EBITDA margin	18.8	21.2	22.5	23.6	23.8	24.0
PAT margin	8.5	11.8	13.1	13.0	13.8	14.6
Return Ratios						
ROCE (pre-tax)	16.7	26.1	27.5	27.5	29.8	33.7
RONW	19.6	33.8	34.9	34.2	36.0	37.0
Turnover ratios						
Total asset turnover ratio (x)	1.1	1.4	1.3	1.3	1.5	1.6
Fixed asset turnover ratio (x)	1.3	1.8	1.6	1.7	1.8	2.1
Debtors days	9	8	8	8	8	8
Inventory days	60	55	49	49	48	48
Payable days	64	48	37	37	38	39
NWC days	5	16	20	20	18	17

Source: Company, YES sec

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