



Varun Beverages

7th NOVEMBER, 2022



India's Best Performing and Most Customer Centric PMS

Varun Beverages Ltd. (VBL) a near monopoly of PepsiCo, is a solid player in the emerging beverage market in India. VBL's focus towards PAN India expansion [reached 85% of Indian PepsiCo volume in CY21 as compared to 26% in CY11 after acquiring South and West region, CAPEX for its backward integrated facilities (Pathankot and Jammu & Kashmir), improving product mix, huge scope to capture Indian soft drinks market (44 bottles per capita consumption in India v/s 1,496 bottles in USA) and debt reduction will promote further growth.

Company Update

Rating Matrix & Stock Info

CMP	1155
52 week H/L	544
Face value	Rs.10
Market Cap.	Rs.737401 Mn
BSE	540180
NSE	VBL
Routers	VBL.BO
Bloomberg	VBL.IN
Sector	FMCG

Shareholding Pattern (%)

Particular	June 22
Promoters	63.9%
Public & Others.	36.1%

Consolidated Financials in Mn

Particulars	CY18	CY19	CY20	CY21
Revenue	51052	71295	64501	88232
EBIDTA	10168	14623	12145	16769
EBITDA Margin (%)	19.8%	17.4%	16.3%	18.7%
AdjPAT	2928	4689	3290	6940
NPM (%)	5.7%	5.4%	4.6%	8.0%
ROE (%)	15.7%	17.5%	10.4%	19.6%
EPS (Rs)	7.1	10.8	7.6	16.0
P/E (x)	222.5	159.9	105.1	149.3
P/BV (x)	41.7	36.9	22.2	20.9

Stock Performance (%)	3m	6m.	1 Yr
VBL	37.2%	77.2%	87.8%
Nifty50	7.3%	-1.8%	-2.6%

Investment Rationale

- **Reducing seasonality (summer season) by focusing on International territories/acquiring South & West region/entry into food products** – VBL recently acquired South and West regions in CY19 having volume growth of 45% where it has lower than avg. market share, thus there is huge scope of growth. Moreover, VBL's International market (19% of total volume) with higher realization than India, having clocked CAGR volumes of 24% compared to 14% growth in India over CY15-21. Production of "Kurkure Puffcorn" (started in Q3CY22) will reduce seasonality in the business.
- **Improving Product mix to attract diverse market** – Aggressive expansion into higher realization SKUs like Juices (Tropicana), energy drink (Sting, which posted massive growth in CY21) and dairy products (Cream bell) to capture diverse market.
- **Backward Integration facilities & in house production of Tropicana will boost production** In-house plant of "Tropicana" with backward integration at "Pathankot" (2019) and 2 new plants in J&K and Bihar will be the key growth drivers.
- **Extension of franchise agreement for another 20 years exhibits strong relationship of VBL with PepsiCo** – VBL's franchise agreement with PepsiCo extended till April 2039, the first time ever for 20 years. Earlier, it used to have contract only for a 10 year period, this makes VBL the only franchisee to have such long term contract.

Valuation & Outlook

At CMP of Rs 1135 VBL is trading at a P/E multiple of 70.9(x) to its FY22 EBIDTA. We are positive on the company as we believe long summers and higher spend on packaged products will fuel the growth. VBL has lower susceptibility to changes in concentrate prices as the company is able to pass on the price increase to distributors. With synergies from adjacent territories and presence in underpenetrated markets along with full year operations of the integrated territories, the company is expected to show healthy growth in CY22. The improvement in return ratios over the past decade has settled the argument related to the nature of VBL's business prevailing into pure manufacturing. EBITDA margins would remain stable but PAT margins have a huge scope to grow. Gains are expected on the back of rising out-of-home consumption after two years of sluggish performance. Thus we suggest investors to Buy the stock from long term prospective.

Jan 04, 2018

Company Overview

VBL has been associated with PepsiCo since 1991 and single-handedly accounted for more than 85% of PepsiCo India's business. It is a part of the RJ Corp group, which is the largest franchisee for Pizza Hut, KFC, Cream Bell, and Costa Coffee in India. With this distinguished track record and expertise in the QSR (Quick service restaurants). VBL was started by Ravi Kant Jaipuria (Chairman). It initially started as a business associate of PepsiCo in select territories and has slowly expanded itself. Now, it has a presence across India through its 37 state-of-the-art production facilities, along with over 100 depots, 2,500 owned vehicles more than 2,000+ primary distributors, 2 mn+ outlets and 8,40,000 visi-coolers installed. It's product portfolio includes carbonated soft drinks (CSD), non-carbonated juice-based drinks, energy drinks and packaged bottled water (PDW).

Company's Brand

PepsiCo CSD brands produced and sold by VBL includes Pepsi, Diet Pepsi, Seven-Up, Mirinda Orange, Mountain Dew, Mountain Dew Ice, Seven-Up, Nimbooz Masala Soda, Evervess, Sting, Gatorade and Slice Fizzy Drinks. PepsiCo NCB brands includes Tropicana Slice, Tropicana Juices (100%, Delight, Essentials), Nimbooz, as well as packaged drinking water under the brand Aquafina

Brands Licensed to VBL



* Note: "CreamBell" trademark, an established brand, has been licensed to be used by VBL for ambient temperature value added dairy based beverages.

Source : Investor presentation & Company research

Business Model

The production process of CSDs involves mixing concentrate (formula), sugar and treated water. The mixture is carbonated and filled in containers such as bottles (PET and glass) or cans on automated filling lines. The production process for NCB products involves a similar process, except that the beverage is pasteurized. Packaged drinking water (PDW) is processed using the water filtration process specified by PepsiCo.

The concentrate is supplied by PepsiCo and its price is decided after considering the selling price, taxation, input cost, market, and other conditions. VBL is engaged in local marketing and promotional activities; e.g. through investment in chilling equipment such as visi-coolers, ice chests, bottle coolers, delivery vehicles, etc.; and distributes PepsiCo products to retailers, which include traditional and modern retail outlets, either directly or indirectly, through distributors and wholesalers.

Comprehensive Investment Rationale

Reducing seasonality by targeting International territories/acquiring south & West region/ entry into food products

Geographically, the international market (19% of total volumes) has clocked an amazing 24% CAGR volume growth, while the Indian business saw a 14% growth over CY15-21 and has doubled its market share in most of its international geographies over the past five years, due to higher realization and expansion into newer geographies. In December 21, it has expanded into a new international region (Democratic Republic of Congo) by incorporating a new entity 'Varun Beverages RDC SAS' in the Democratic Republic of Congo. Varun Beverages is looking to expand its operations by setting up outlets in rural Zimbabwe powered by solar energy. It has already invested some over US\$ 85 million so far.

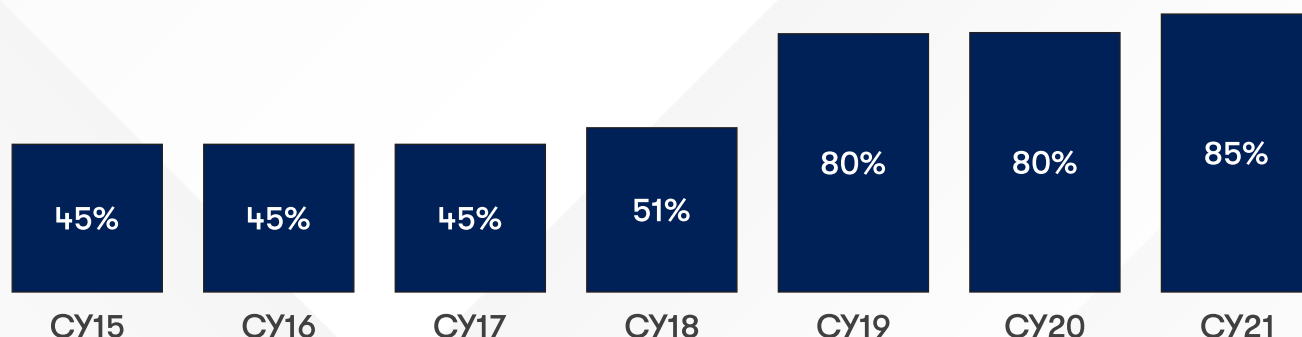
Year	Sales Volume India (Mn Unit case)	Sales Volume International (Mn unit cas)
2018	274	66
2019	404	89
2020	337	88
2021	454	115

VBL has achieved a monopoly in India, in terms of selling PepsiCo's products, by expanding its operations and relentless acquisition of new territories in the past few years. These were either franchised to other bottlers of PepsiCo or operated by PepsiCo directly. VBL's contribution to PepsiCo India's volume increased from 27% in CY11 to 45% in CY16 and gradually to 85% + in CY21.

The very recent acquisitions of West and South regions have been completed in H1CY19, resulting in 47% increase in the domestic volumes. While VBL is expected to benefit from the economies of scale in these adjacent territories, the ability to successfully integrate and increase profitability will be a key factor. We expect a strong execution in these under-served territories.

Also, given the climatic difference between the North & East and South & West regions in India, PAN-India operations will likely smoothen-out the business seasonality. The increase in operations is expected to kick in the economies of scale, thus, providing VBL with better negotiating power with its suppliers.

% of PepsiCo's Volumes supplied in India by VBL



Cold beverages are a high volume-low value business that requires the distribution and manufacturing units to be closer to the point of consumption. VBL has been consistently improving its distribution network and launching manufacturing units PAN India.

We believe that increasing the distribution network along with newly acquired territories should drive volume growth for VBL in the long run.

Jan 04, 2018

March 20, 2018

Diversified Product Mix

CSD carbonated soft drink

VBL is focusing on diversifying its product portfolio, which is in line with its long-term strategy. The CSDs are considered to be noxious goods, and attract 40% GST, which is quite high. The company has responded well to the market's need for healthier alternatives by introducing new products in low/zero calorie segments including Diet Pepsi and Pepsi Black. It has also introduced smaller SKUs (150ml) of the full-sugar carbonate version of Pepsi. The CSD market clocked a decent 6% CAGR over the last 5 years; however, the growth is witnessing a slowdown, as people are shifting their preferences to sugarless and nutrition-rich drinks especially fruit drinks. High growth in NCB and water will set off any downside.

NCB : Non Carborated Beverages

NCBs segment has recorded a robust volume CAGR of 16% over CY18-21, although the average volume share stood at a decent ~6-7% for the same period. The margins in the NCB business are expected to improve, as juices (which were previously outsourced) are now manufactured in-house at VBL's new Pathankot plant. Further, increased awareness of the health benefits of juices and other NCBs in Metros and Tier-1 cities is a good indicator of their growth potential going forward. Realization and margins are also highest in the juices segment compared to blended realizations for VBL. Portfolio expansion into lemon-based drinks (40% of industry) and continued traction in 'Sting' should boost growth.

Water

The PDW (packaged drinking water) market has substantial potential to grow due to increasing health consciousness and awareness among the populace regarding the quality of water and the spread of water-borne diseases. Further, the pick-up in domestic tourism after COVID should also boost the sale of PDW as travellers usually prefer packaged water (v/s tap water) due to health and safety concerns. The improving footprint in the African region has led to higher growth in the water segment.

Segment wise volume breakup trend

Year	CSD	NCB	water
2019	348	33	112
2020	308	27	90
2021	399	36	132

Diversified Product Mix

Building backward integrated facilities & in-house production of "Tropicana" will boost production VBL continues to derive efficiencies from backward integration of operations with facilities to manufacture crown corks, polyethylene terephthalate (PET) pre-forms (bottles), corrugated boxes, shrink wrap sheets, plastic cap closures, and plastic shells, which are the key raw materials for VBL. VBL invested ~₹ 5500 mn to setup an in-house facility in Pathankot, Punjab where it has started manufacturing of juices (Tropicana) in March-2019. Before this facility, Tropicana manufacturing was outsourced, where margins were pretty low. This fully backward integrated facility has scope for margin improvement for VBL and boost production volumes of Tropicana juices, preforms and CSD products.

CAPEX plan

During CY 2021, VBL made a sizable investment of a total of ~RS 3,500 million. Out of this, Rs 1,300 million primarily for the brownfield expansion at certain plants in India (including Tirunelveli and Pathankot), glass bottles and pallets, and Rs 2,200 million is primarily for the brownfield expansion in Morocco and Zimbabwe .

Cost cutting initiatives

The concentrate and sugar constitute a significant chunk of VBL's raw material (in the range of 57-60%). VBL has lower susceptibility to changes in concentrate prices as the company is easily able to pass on the price increase to distributors. PET is a dominant packaging material in the soft drinks space, with ~85% of products sold in PET bottles, ~12% in glass and aluminium cans and tetra packs making up ~2-3%. VBL is undertaking measures to make light weight PET preforms (bottles) and closures (caps) which will help further to reduce the cost. Through light weighting, the Company intends to reduce the usage of plastic. During the last 10 years, the Company has reduced the weights of preforms and plastic closures by 10% to 20% in different SKUs. During CY21, 70% of plastic waste was recycled, which was sold in the form of finished products, as compared 66% during CY20. Plastic waste includes PET, shrink film, plastic closures and labels & laminates post consumption. Due to these initiatives, the EBITDA margins have improved from 13% in CY12 to 19% in CY21.

Robust Financials

VBL has delivered a healthy Volume/Revenue/EBITDA/PAT growth during CY17-21. Sharp rise in its return ratios (ROCE of 17% in CY21 vs. 12% in CY17) is due to strong volume growth and measures taken to increase the cost-efficiency. We expect further improvement in the return ratios by CY24E.

Industry overview

The FMCG industry has evolved and exhibiting resilience to evolve in ways that create more value in the future for the entire chain after it bounced back from the second wave of Covid-19. The revenue growth of the FMCG sector is expected to double the increase in the coming fiscal year, owing to factors such as recovery in urban demand and discretionary segments, as well as price rises implemented to counter the impact of rising raw material prices. The pandemic has had a big impact on the FMCG sector where it not only changed consumer behaviour but also made FMCG companies to re-invent their strategies for customer acquisition, retention and value propositions. The consumption basket has transformed during this period and some of these changes are likely to be permanent. Consumers are rapidly adapting the usage of technology and with the increase in the usage of smartphone and internet penetration will further help people in rural areas easily access online shopping on various e-commerce websites. Consumers of today can interact easily with other people who have bought the same product. As a result, brands are devising marketing strategies to build a brand community where they target consumers who are interested in their products. With the new government regulation regarding investments in FMCG companies and accepting foreign-directed investments, the sector has seen a sudden influx of funds.

Key Risk

Termination & Non-renewal of PepsiCo agreement - VBL's entire business is solely dependent on its relationship with PepsiCo. Though the franchise agreement was recently extended to 2039, any future changes in the contractual agreement will have major repercussions on VBL's business dynamics. Apart from that, VBL has to set aside 20% of net revenues, of which, 14% is paid to PepsiCo and the remaining 6% has to be spent by VBL on below-the-line (BTL) marketing. Any major change in this arrangement will have a huge impact on VBL's profitability.

Seasonality factor - The April-June quarter is the peak season for VBL, where around 40% of the sales are recorded. This is due to the seasonal nature of its business as consumption takes place largely in May (summer season). We can expect the seasonality to reduce, as they expand more into international territories and enter into the food business going forward.

Awareness towards healthy beverages - Increasing awareness with respect to high sugar content in CSDs is gradually leading to a reduction in its consumption, and thus, affecting volumes. Failure of not being able to expand its NCB business has caused VBL to take a back step among its competitors.

Peer Comparison

Particulars (Rs in Mn.)	Varun Beverages Limited	Marico Limited	Tata consumer Limited
CMP (as on 07-10-2022)	1135	521	781
Revenue	88232	80480	124254
EBIDTA	16769	15880	17188
PAT	6941	11720	9358
Margins			
EBITDA Margin%	18.7	19.0	15.0
PAT Margin%	8.0	13.6	8.7
Return Ratios			
ROE (%)	19.6	38.7	7.3
ROCE (%)	17.1	44.9	9.6
Leverage			
Debt- Equity (x)	0.8	0.1	0.0
Valuation			
EPS	16	9.8	10.1
P/E	70.9	54.8	77.3

*Financials are as on FY22

*Varun Beverages follow calendar year

Consolidated Income Statement

Y/E March (Rs Mn)	CY17	CY18	CY19	CY20	CY21
Revenues	40035	51052	71295	64501	88232
Total operating Expense	31652	40884	56672	52356	71463
EBITDA	8383	10168	14623	12145	16769
Other Income	125	218	425	369	683
Depreciation	3466	3850	4886	5287	5312
Interest	2145	2228	3243	2937	2073
PBT	2896	4307	6919	3625	10066
Tax	769	1339	2240	52	2605
Rate (%)	26.5	31.0%	32.3%	1.4%	25.8%
PAT	2127	2968	4678	3572	7460
Minority int	-39	-70	-32	-282	-520
Adj PAT	2101	2928	4689	3290	6940

Source: Company Financials

Consolidated Balance Sheet

Y/E March (Rs Mn)	CY17	CY18	CY19	CY20	CY21
Sources of Funds					
Share Capital	1830	1830	2890	2890	4330
Reserves & Surplus	15870	18160	30400	32350	36470
Net Worth	17700	19990	33290	35240	40800
Long term debt	26540	28080	34170	32160	33560
Other Liabilities & Provisions	8520	11920	16300	17070	21440
Capital Employed	52760	59980	83760	84470	95790
Application of Funds					
Fixed Asset	39810	43870	64790	64090	63110
Capital WIP	1450	3520	640	670	4970
Investment	80	110	-	-	-
Other Asset	11410	12470	18330	19720	27720
Total Assets	52760	59980	83760	84470	95790

Source: Company Financials

Consolidated Cash Flow Statement

Y/E March (Rs Mn)	CY17	CY18	CY19	CY20	CY21
Cash Flow from operating Activity	6200	10000	13080	10120	12310
Cash Flow from Investing Activity	-7450	-8730	-23190	-4710	-10100
Cash Flow from Investing Activity	1590	-840	11070	-5740	-1780
Net Cash Flow	330	419	956	-328	430
Add Op Balance	330	650	430	1380	1050
Closing Balance	650	430	1380	1050	1510

Key Ratios

Jan 04, 2018

Y/E March (Rs Mn)	CY17	CY18	CY19	CY20	CY21
Per share (Rs)					
EPS	5.1	7,,1	10.8	7.6	16.0
BVPS	27.2	30.8	51.2	54.3	62.8
DPS	0.7	0.7	1.1	1.1	1.7
Valuation (x)					
P/E	222.5	159.9	105.1	149.3	70.9
P/BV	41.7	36.9	22.2	20.9	18.1
Return Ratios (%)					
EBIDTA Margin	18.8%	19.8%	17.4%	16.3%	18.7%
PAT Margin	4.7%	5.7%	5.4%	4.6%	8.0%
ROE	12.2%	15.7%	17.5%	10.4%	19.6%
ROCE	12.1%	14.1%	17.6%	9.7%	17,,1%
Leverage Ratio (%)					
Total D/E	1.5	1.4	1.0	0.9	0.8
Turnover Ratios					
Inventory Days	37.5	35.5	30.8	45.1	46.5
Receivable Days	11.3	9.7	6.3	9.8	9.0
Payable days	46.9	41.2	45.0	65.3	55.3

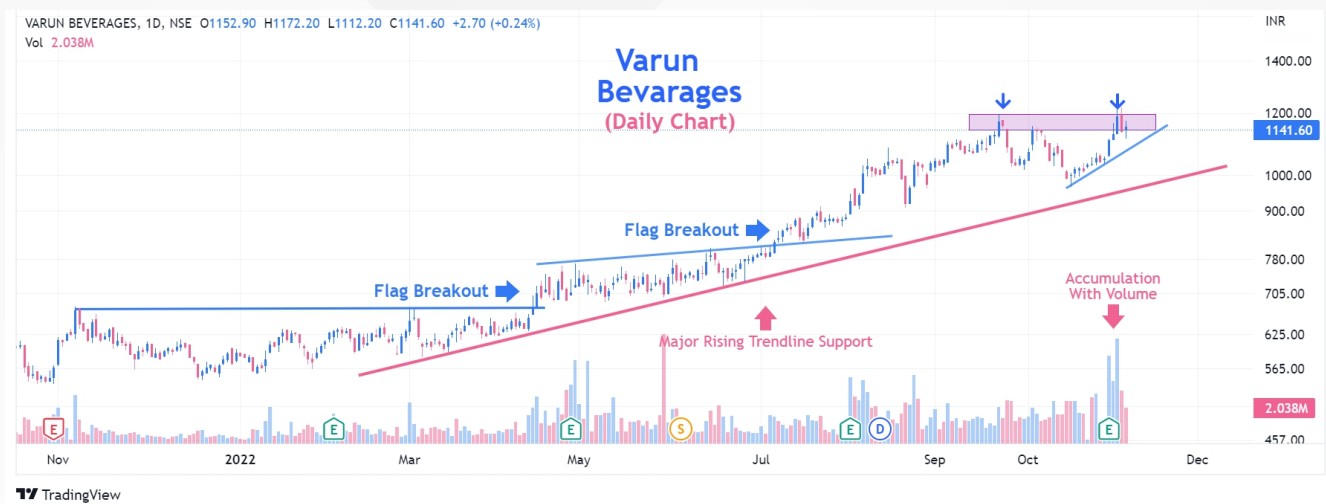
Source: Company Financials

Technical Outlook

Varun Beverages made a new high and tested it twice after posting a stellar results with volume accumulation. It has given multiple breakout from the flags after consolidation indicating an overall bullish trend.

On the upper side the resistance is placed at 1230 which was the new all time high. Once 1230 is broken on closing basis doors open to 1500 & 2000 level.

On the lower side the immediate support is placed at 1092 followed by a major rising trendline support at 960 level.



**This research has been done by the
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