Varun Beverages Ltd - BUY

Stock Analysis Report | NSE Ticker: BRIT.NS| Recommendation **Sept. 22, 2023**

CMP: INR 909.35
Target Price : INR 1209.43
Target Return: ~33%
Target Period: 09-12 months

Overview

Business Overview

The company was incorporated in 1995 as a subsidiary of RJ Corp, and named after founder Ravi Jaipuria's son. **Varun Beverages Limited** (**VBL**) is an Indian company that produces, bottles and distributes beverages. It is the second largest bottling company of PepsiCo's beverages in the world outside the United States.

Key events

With India growth on a strong footing, Varun Beverages is exploring international opportunities, and the incorporation of a wholly-owned subsidiary in South Africa is on those lines, it could drive meaningful value creation in the medium term for the company. VBL is setting up two plants in Maharashtra and Uttar Pradesh, with a third unit scheduled for construction in Orissa in the near future. |Market expansion in sports drinks segment: Bottlers of Gatorade, Sting. The company recently did a stock split in the ratio of 2-for-1.

Investment Rationale

As per the analysts, VBL is shifting its focus to new performers such as value-added dairy, sports drinks, and juices segments to sustain its growth trajectory. These untapped markets have the potential to become significant drivers of growth for the company in the long run. VBL recognizes the rising demand for dairy-based beverages, as health-conscious consumers are increasingly opting for these healthier alternatives over carbonated drinks.

On the cost front, VBL continues to display strong improvement in EBITDA margins year after year which is expected to improve as more production moves in-house as well as consumption of soft drinks and dairy products increases. This will further support the earnings outlook. For 2022, the company reported a more than 2-fold rise in net profit to Rs 1,270 crore, on the back of a sharp 60% jump in revenue to Rs 10,596 crores. The strategy to enter unpenetrated territories has helped it in gaining significant market share, the recently commissioned manufacturing unit in Bihar is one such effort.

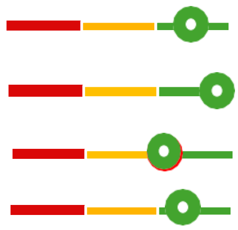
Indicators & Analysts View

Financial Trend

Quality

Valuation

Street sentiment



Position	Strong Buy	Buy	Hold	Sell
Count	13	14	3	1

Source: Kotak Securities

Fundamental Analysis

Dominance in Beverage sales

VBL is the 2nd largest bottling company of PepsiCo's beverages in the world outside the United States. In carbonated soft drinks (CSDs), as well as a large selection of non-carbonated beverages (NCBs) segment it stands with 85% market share of Pepsico's business. In this segment there are hardly any peers of VBL (only one being "Orient Beverage") due to majority of market share with VBL, which makes the market favorable for stable and growing margins. Moreover, Indian sports and energy drinks market is expected to record a CAGR of 14 percent until CY28, reaching a value of $5.8 billion.

Deep distribution Channels

VBL has recovered faster than other companies in this segment because of deep distribution channels. It granted franchisees for various PepsiCo products spread across 27 States and 7 Union Territories (except Jammu & Kashmir and Andhra Pradesh) in India . It supplies to 33 lakh outlets and as part of the renewed post covid strategy of expanding distribution channel with rural focus.

Opportunity in Dairy segment

the flavored milk market in India is projected to see a compounded annual growth rate (CAGR) of 25 percent to Rs 15,860 crore between CY23 and CY28. VBL recognizes the rising demand for dairy-based beverages, as health-conscious consumers are increasingly opting for these healthier alternatives over carbonated drinks. VBL's foray into the value-added dairy segment, operating under the brand name 'Cream Bell', has also been well-received by consumers. As a result, the company plans to triple its capacity in this segment by CY23-end and aims to roll out its value-added dairy-based beverages nationwide by CY24.

9 Months Highlights

9 Highlights (INR Cr)

Particulars	Dec-21	Dec-22	YoY
Revenue	8891	13211	*48.5%*
EBDITA	1,006	2,023	*101%*
EBIDTA Margin	*11.3%*	*15.3%*	*400 bps*
PAT	746	1550	*107%*
PAT Margin	*8.3%*	*11.7%*	*340 bps*

Source – Company Reports

- **Robust Q4 Sales Growth:** VBL reported a robust revenue growth mainly on account of volume growth in consumption as more people in rural areas shifted to CSD and energy drink as instant energy booster. VBL also managed to improved its market share and increase its distribution despite the constraints brought about by the WHO tax increment.
- **Strong EBITDA Margins:** Despite sharp inflation in raw material prices, EBITDA Margins improved significantly mainly on account of improvement in sales mix as well as the benefits of the long term cost rationalization projects taken by the company
- **Demand Scenario:** During the period, VBL managed to grow above the market growth rate and its rural sales (especially lower labour class) growth is much ahead of its urban sales growth, as energy drinks such as Sting have turned out to be the cheapest energy drink option during the previous quarters. Company will also look to ramp up it international business further aiding volumes.

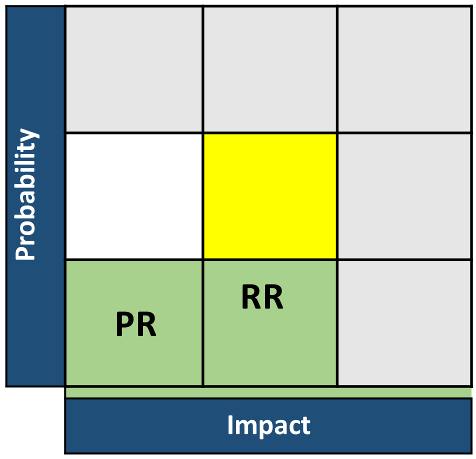
Risk Matrix

PR

Portfolio Risk | Concentration of CSDs Portfolio
Upto 87% of the revenues of Varun Beverages is contributed by CSDs portfolio which is significantly different from Dairy portfolio. Concentration in CSDs segment makes the organisation vulnerable to high impact on the revenues in case of one-off events.

RR

Regulatory Risk | Carbonated beverages Regulations
Carbonated beverage industry in India is subject to WHO regulations, which leads to calls on countries to tax sugar-sweetened beverages to save lives. Indian govt. putting the main product that is CSDs under sin tax of 28%.



Source: Team Analysis

Valuation Metrics

- On a headline level the stock's valuation look moderately rich. However, Varun Beverages's average forward PE is 42x and therefore at 11.53x FY23 EPS, the stock is currently trading around its market price.

We expect EBITDA margins to settle at 26.5% given the cost optimization drives and improvement in product mix. Given the strong growth and earnings outlook we expect the stock to be re-rated upwards. We have arrived at a target price of INR 1209.43 at 42x FY23 EPS (upside ~26.5%) and expect it to be achieved over the next 12-15 months

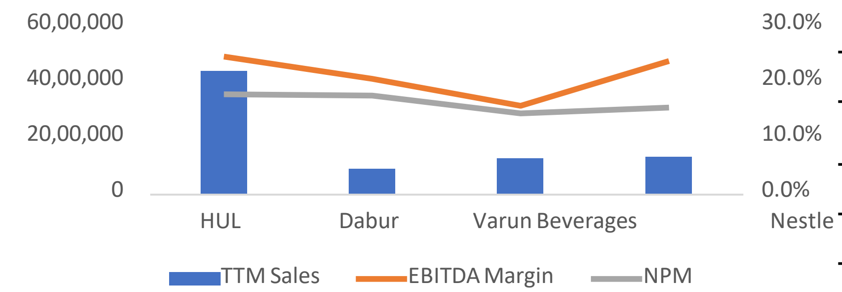
Metrics	FY20	FY21	FY22
PE	53.57	36.95	57.37
PEG	-1.80	0.33	1.31
EV/EBITDA	16.32	16.22	31.65
P/B	5	6.29	16.47
Div. Yield (%)	*0.15*	*0.16*	*0.17*

Financial Highlights (INR Cr)

Particulars	FY18	FY19	FY20	FY21	FY22
Revenue	5127	7172	6487	8891	13211
% Growth	-	*39.8%*	*-10.4%*	*37%*	*48.5%*
EBITDA	1023	1485.4	1238.2	1722.8	2826.2
EBITDA %	*19%*	*20.7%*	*19%*	*19.3%*	*21.3%*
PAT	332.1	448.4	226	489.2	1277.1
PAT %	*6.4%*	*6.2%*	*3.4%*	*5.4%*	*9.6%*
EPS	10.69	16.83	11.40	16.03	23.05
Total Debt	3240	3417	3240	3386	3883
Fixed Assets	4737	6518	6451	6783	7516

- FY20 turned out to be subdued for the company with a sharp decline in growth due to a slowdown in volume growth and adverse product mix. However, FY21-FY22 turn out to be a strong year for the company on account of strong forecasted volume growth due to market share gains and strong value growth on account of forecasted price hikes
- We estimate strong performance on the operational front with EBITDA Margins spiking to 25-26% mainly on account of strong cost rationalizations, debt figures are also increasing because of renewed capex plans in all segments

Peer Analysis



Company	TTM P/E	TTM P/B	Net D/E	ROE (5yr)	Rev CAGR 3yr	PAT CAGR 3yr	Mcap (Bn)
Nestle India	79.1	81.6	0.1	*125.8%*	*5.7%*	*9.0%*	1,650.0
Dabur	59.8	13.4	0.1	*54.35%*	*3.9%*	*2.2%*	952.0
HUL	75.6	12.0	0.1	*38.65%*	*3.2%*	*9.0%*	5,640.0

Shareholding Pattern

Particulars	Sep-23
Promoter	63%
Of which pledged	*0%*
Institutions	31%
Individuals	06%
Total	**100%**

Summary

Overall, we are bullish on Varun Beverages Industries and forecast an upside of ~33% on a 12-15 months horizon

Analyst
Deepak Dalal
SIES College Of Management Studies