

Varun Beverages | BUY

Strong revenue performance; profit impacted by one-off items

Varun Beverages reported a strong domestic performance with 21% volume growth driven by a revival in underlying demand and a softer base. It reported an operating profit of INR70mn in the parent business vs loss of INR70mn in 4QLY. International business performance was more subdued though with volumes growing mere 1.5% while operating profit halved on one-time translation losses of c.INR110mn in Zambia. The acquisitions of new territories in the domestic market is expected to add incremental 10-11% to volumes next year and the company remains confident of market share gains in these territories (around 10-15% at present vs PepsiCo's national market share of c.40%). With domestic underlying volume growth trajectory showing signs of recovery, a favourable base (volume grew mere 1% in CY17 on GST related disruption) and incremental volumes from acquisitions, we expect the company to report a healthy performance in CY18. We remain positive on VBL given its attractive product portfolio which would help capture growth opportunities in Indian beverage segment, its capability in driving cost efficiencies across value-chain and inorganic growth opportunities available. Maintain BUY with DCF based price target of INR710/share.

- **Strength in domestic business negated by a weak international performance:** VBL's 4QCY17 consolidated net sales grew 21.4% to INR5.4bn but EBITDA declined 14.2% to INR225mn (on translation related losses in International business). It reported a net loss of INR725mn which declined 39.5% YoY. Consolidated volume grew 14% to 33mn cases led by a 21% growth in domestic volumes (vs 2% decline in 9MCY17) aided by some recovery in underlying demand and a favourable base (impacted by demonetization) as per management. Domestic revenues grew by 29% aided by some phasing of promotions. On product basis, carbonated soft drinks and packaged water grew 14.3% while juices reported a 10% growth at a consolidated level. Aided by recovery in underlying demand, new launches and acquisitions of under-penetrated geographies, management expects volume growth trajectory to remain healthy in near future. VBL has incurred a capex of INR6.6bn in CY17 including INR2.7bn on acquisition of incremental territories and setting-up greenfield plant in Nepal and Zimbabwe. This has led to an increase in net debt to c.INR25bn.
- **Sharp GPM expansion on phasing of promotions negated by higher SG&A:** VBL's 4QCY17 consolidated GPM expanded by a sharp 679bps which management attributed to moderation in input costs including sugar prices (4% lower sequentially in 4QCY17) as well as some phasing of promotions between 3Q and 4Q (GPM contraction was 20bps for CY17). EBITDA margin, though, contracted 177bps to 4.3% on sharp increase in other expenses (+52.9%) partially led by INR110mn translation losses in Zambia. This led to 14.2% decline in EBITDA – improvement in domestic EBITDA (INR70mn in 3QCY vs loss of INR70mn in 3QLY) negated by a sharp 53.4% fall in International EBITDA to INR155mn. For CY17, EBITDA margin was 30bps higher, though, aided by controls on other expenses (grew a mere 1.3%).



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Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	BUY
Current Price Target (12M)	710
Upside/(Downside)	8.9%
Previous Price Target	635
Change	11.8%

Key Data – VBL IN

Current Market Price	INR652
Market cap (bn)	INR119.1/US\$1.9
Free Float	18%
Shares in issue (mn)	182.3
Diluted share (mn)	182.3
3-mon avg daily val (mn)	INR213.5/US\$3.3
52-week range	762/340
Sensex/Nifty	34,011/10,452
INR/US\$	64.2

Price Performance

%	1M	6M	12M
Absolute	1.1	25.1	62.5
Relative*	3.4	16.8	35.2

* To the BSE Sensex

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Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Financial Summary					(INR mn)
Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E
Net Sales	33,941	38,520	40,041	49,200	55,383
Sales growth (%)	35.6%	13.5%	3.9%	22.9%	12.6%
EBITDA	6,371	7,952	8,360	10,484	11,920
EBITDA (%)	18.8%	20.6%	20.9%	21.3%	21.5%
Adjusted net profit	1,003	1,510	2,106	2,874	3,632
EPS (INR)	7.5	8.3	11.6	15.8	19.9
EPS growth (%)	-597.5%	10.5%	39.5%	36.5%	26.4%
ROIC (%)	7.3%	9.1%	9.6%	10.5%	11.2%
ROE (%)	19.7%	11.8%	10.7%	13.5%	15.6%
PE (x)	87.0	78.7	56.4	41.4	32.7
Price/Book Value (x)	12.9	6.3	5.9	5.4	4.8
EV/EBITDA (x)	16.9	16.9	16.6	13.7	12.0
Dividend Yield (%)	0.0%	0.0%	0.5%	0.7%	0.9%

Source: Company data, JM Financial. Note: Valuations as of 16/Feb/2018

Exhibit 1. 4Q & CY17 result snapshot

	(INR mn)							
	4QCY17	4QCY16	YoY growth	4QCY17E	% Var	CY17	CY16	YoY growth
Sales (ex-excise)	5,274	4,342	21.4%	4,764	10.7%	40,034	38,612	3.7%
Gross Profit	3,356	2,588	29.7%	2,740	22.5%	21,933	21,233	3.3%
Gross Profit Margin %	63.6%	59.6%	405 bps	57.5%	614 bps	54.8%	55.0%	-20 bps
Staff Cost	1,158	1,035	11.9%	1,163	-0.4%	4,628	4,210	9.9%
Other Expenses	1,973	1,291	52.9%	1,286	53.4%	8,947	9,063	-1.3%
EBITDA	225	262	-14.2%	339	-33.8%	8,358	7,960	5.0%
EBITDA margin %	4.3%	6.0%	-177 bps	7.1%	-286 bps	20.9%	20.6%	26 bps
Depreciation	880	800	10.0%	977	-9.9%	3,466	3,222	7.6%
EBIT	-655	-538	21.7%	-637	2.8%	4,891	4,738	3.2%
Interest Expense	526	1,009	-47.8%	500	5.2%	2,122	4,325	-50.9%
Financial Other Income	17	17	-0.1%	38	-55.8%	127	357	-64.6%
PBT pre-exceptionals	-1,165	-1,530	-23.9%	-1,099	5.9%	2,896	770	276.3%
Taxes	-439	-408	7.6%	-242	81.4%	769	313	145.7%
Reported Net Profit	-728	-1,192	-38.9%	-833	-12.5%	2,102	424	395.9%

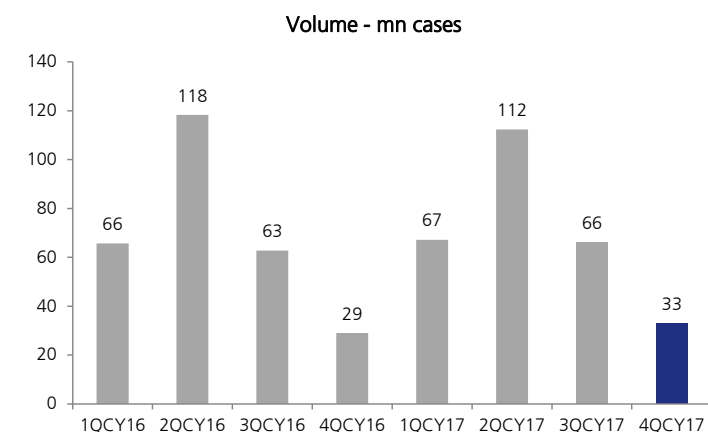
Source: Company, JM Financial

Exhibit 2. Costs breakdown

	(%)				
% of net sales	4QCY17	4QCY16	4QCY17E	CY17	CY16
Cost of Goods Sold	36.4%	40.4%	42.5%	45.2%	45.0%
Staff Cost	22.0%	23.8%	24.4%	11.6%	10.9%
Other Expenses	37.4%	29.7%	27.0%	22.3%	23.5%
Depreciation	16.7%	18.4%	20.5%	8.7%	8.3%

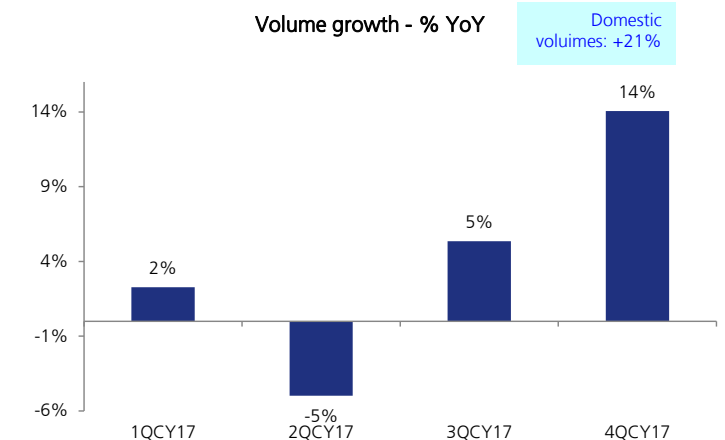
Source: Company, JM Financial

Exhibit 3. Volume growth trend (mn cases)



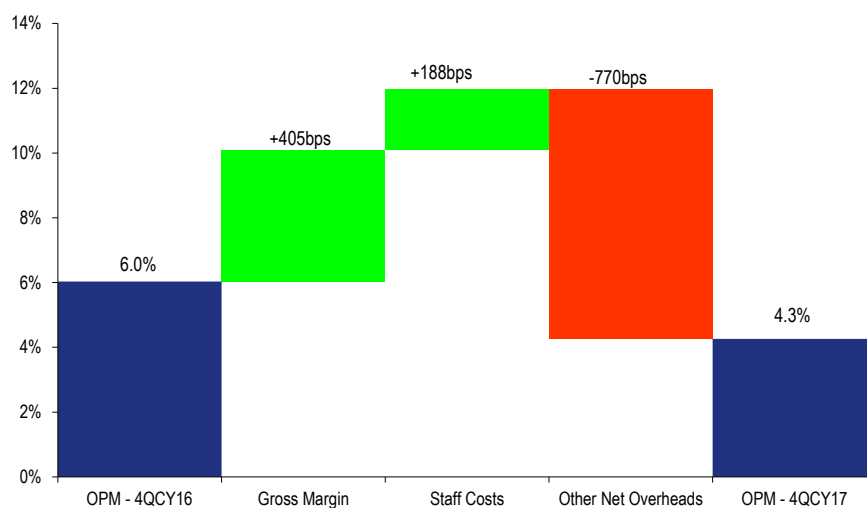
Source: Company, JM Financial

Exhibit 4. Sales growth: Domestic vs International



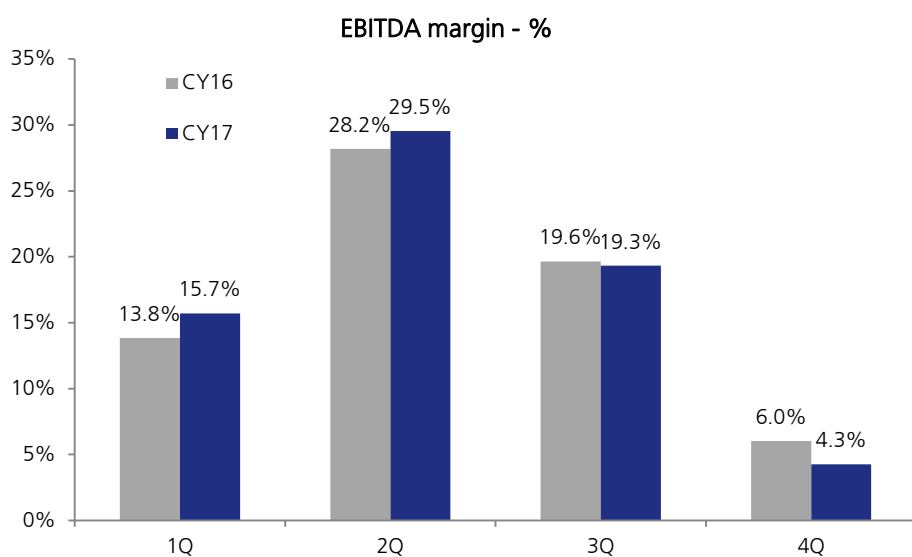
Source: Company, JM Financial

Exhibit 5. Operating margin movement – 4QCY17



Source: Company, JM Financial

Exhibit 6. EBITDA margin trends



Source: Company, JM Financial

Exhibit 7. With estimates of 12% NOPAT CAGR over CY18-CY30, we arrive at a DCF based price target of INR710

	CY16	CY17E	CY18E	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E	CY26E	CY27E	CY28E	CY29E	CY30E	CAGR
Explicit Forecast																
EBIT	4,228	4,888	6,669	7,807	8,985	10,227	11,584	13,117	14,795	16,632	18,452	20,460	22,665	24,850	27,197	
Tax Rate	34.1%	26.6%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	31.1%	
NOPAT	2,786	3,588	4,598	5,383	6,195	7,052	7,987	9,044	10,201	11,468	12,722	14,107	15,628	17,134	18,753	12.4%
Depreciation	3,724	3,471	3,815	4,114	4,447	4,783	5,125	5,481	5,850	6,229	6,632	7,076	7,564	8,099	8,683	
Change in net working capital	3,664	-2,050	-4,573	-393	-407	-427	-458	-509	-552	-597	-599	-659	-723	-729	-786	
Capex	-55,525	-6,567	-6,465	-5,500	-5,572	-5,551	-5,792	-6,015	-6,216	-6,371	-7,009	-7,710	-8,481	-9,261	-10,114	
Free Cash Flow	-45,352	-1,558	-2,625	3,604	4,664	5,857	6,862	8,001	9,282	10,728	11,748	12,815	13,988	15,243	16,536	
Discount Factor				0.90	0.81	0.73	0.66	0.59	0.53	0.48	0.43	0.39	0.35	0.32	0.29	
Discounted FCFF				3,247	3,784	4,280	4,517	4,744	4,958	5,161	5,090	5,002	4,918	4,827	4,717	
Fade Period																
FCFF	17,970	19,475	21,048	22,686	24,383	26,136	27,937	29,779	31,654	33,553						
% growth	8.7%	8.4%	8.1%	7.8%	7.5%	7.2%	6.9%	6.6%	6.3%	6.0%						
Discount factor	0.26	0.23	0.21	0.19	0.17	0.15	0.14	0.12	0.11	0.10						
Discounted FCFF	4,617	4,507	4,388	4,260	4,124	3,982	3,833	3,681	3,524	3,365						
Valuation																
PV of explicit forecast	55,244															
PV of Fade period	40,279															
PV of terminal value	59,201															
Enterprise Value	154,724															
Less:																
Net Debt	25,220															
Minority interest	1															
Value attributable to equity shareholders	129,504															
No. of shares - mn	182															
Share price - Rs	710															
WACC																
Terminal growth rate	5.0%															
EPS - 1 yr fwd																
P/E	35.7															
EBITDA - 1 yr fwd																
EV/EBITDA	13.0															

Source: Company, JM Financial

Financial Tables (Consolidated)

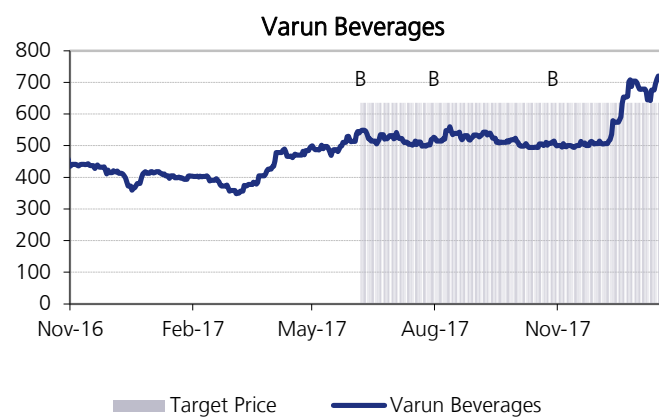
Profit & Loss Statement						Balance Sheet					
Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E	Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E
Sales	33,642	38,251	39,762	48,857	54,997	Shareholders' Fund	6,743	18,939	20,308	22,176	24,537
Sales Growth	36.0%	13.7%	3.9%	22.9%	12.6%	Share capital	1,338	1,823	1,823	1,823	1,823
Other Operating Income	299	269	279	343	386	Reserves & Surplus	5,405	17,116	18,484	20,353	22,714
Total Revenue	33,941	38,520	40,041	49,200	55,383	Preference Share Capital	0	0	0	0	0
Cost of Goods Sold/Op. Exp.	17,165	17,363	18,128	22,195	24,923	Minority Interest	0	1	1	1	1
Personnel cost	3,238	4,264	4,631	5,666	6,350	Total Loans	20,773	16,247	21,121	27,457	28,830
Other expenses	7,169	8,941	8,923	10,855	12,190	Def. Tax Liab / Assets (-)	1,429	2,158	1,352	1,527	1,747
EBITDA	6,371	7,952	8,360	10,484	11,920	Total - Equity & Liab	28,945	37,344	42,781	51,160	55,114
EBITDA margin (%)	18.9%	20.8%	21.0%	21.5%	21.7%	Net Fixed Assets	35,335	40,589	43,685	46,335	47,721
EBITDA Growth (%)	65.7%	24.8%	5.1%	25.4%	13.7%	Gross Fixed Assets	41,455	47,521	54,088	60,553	66,053
Depn & Amort	3,174	3,724	3,471	3,815	4,114	Intangible Assets	4,870	7,048	7,048	7,048	7,048
EBIT	3,197	4,228	4,888	6,669	7,807	Less: Depn. & Amort.	11,369	14,936	18,407	22,223	26,336
Other Income	143	348	124	188	309	Capital WIP	379	956	956	956	956
Finance Cost	1,688	2,148	2,111	2,550	2,674	Investments	33	56	56	56	56
PBT before Excep & Forex	1,651	2,428	2,901	4,307	5,442	Current Assets	8,945	11,578	10,815	15,120	19,008
Excep & forex Inc/Loss(-)	255	0	0	0	0	Inventories	4,247	4,899	4,357	6,291	7,082
PBT	1,906	2,428	2,901	4,307	5,442	Sundry Debtors	979	1,303	1,503	1,606	1,808
Taxes	789	829	772	1,337	1,690	Cash & Bank Balances	581	657	830	2,181	4,455
Extraordinary Inc/Loss(-)	0	0	0	0	0	Loans & Advances	2,994	4,577	3,976	4,886	5,500
Assoc. Profit/Min. Int.(-)	13	-87	-23	-95	-120	Other Current Assets	144	142	149	156	164
Reported Net profit	1,130	1,513	2,106	2,874	3,632	Current Liab. & Prov.	15,367	14,880	11,776	10,351	11,671
Adjusted Net Profit	1,003	1,510	2,106	2,874	3,632	Current Liabilities	14,552	13,826	10,812	9,016	10,121
Net Margin (%)	3.0%	3.9%	5.3%	5.9%	6.6%	Provisions & Others	815	1,053	964	1,335	1,550
Diluted share capital (mn)	133.8	182.3	182.3	182.3	182.3	Net Current Assets	-6,422	-3,302	-960	4,769	7,337
Diluted EPS (INR)	7.5	8.3	11.6	15.8	19.9	Application of Funds	28,945	37,344	42,781	51,160	55,114
Diluted EPS Growth	-597.5%	10.5%	39.5%	36.5%	26.4%	Source: Company, JM Financial					
Total Dividend + Tax	0	0	737	1,006	1,271						
Dividend Per Share (Rs)	0.0	0.0	3.4	4.6	5.8						
Source: Company, JM Financial											

Cash Flow statement						Dupont Analysis					
Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E	Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E
Profit before Tax	1,651	2,428	2,901	4,307	5,442	Net Margin	3.0%	3.9%	5.3%	5.9%	6.6%
Depn. & Amort.	3,174	3,724	3,471	3,815	4,114	Asset Turnover (x)	1.2	1.2	1.0	1.0	1.0
Net Interest Exp. / Inc. (-)	1,545	1,800	1,987	2,362	2,365	Leverage Factor (x)	5.6	2.6	2.0	2.2	2.3
Inc (-) / Dec in WCap.	-419	820	-2,050	-4,573	-393	RoE	19.7%	11.8%	10.7%	13.5%	15.6%
Others	79	112	-1,009	24	30	Key Ratios					
Taxes Paid	-483	-581	-670	-967	-1,371	Y/E March	CY15A	CY16A	CY17E	CY18E	CY19E
Operating Cash Flow	5,548	8,303	4,630	4,967	10,187	BV/Share (INR)	50.4	103.9	111.4	121.6	134.6
Capex	-6,095	-10,758	-6,567	-6,465	-5,500	ROIC (%)	7.3%	9.1%	9.6%	10.5%	11.2%
Free Cash Flow	-547	-2,455	-1,937	-1,498	4,687	ROE (%)	19.7%	11.8%	10.7%	13.5%	15.6%
-Inc/dec in investments	3,034	-1	0	0	0	Net Debt-equity ratio (x)	3.0	0.8	1.0	1.1	1.0
Others	65	79	124	188	309	PER	87.0	78.7	56.4	41.4	32.7
Investing Cash Flow	-2,997	-10,680	-6,443	-6,277	-5,191	PBV	12.9	6.3	5.9	5.4	4.8
Inc(dec) in capital	0	6,808	0	0	0	EV/EBITDA	16.9	16.9	16.6	13.7	12.0
Dividend+Tax Thereon	0	0	-737	-1,006	-1,271	EV/Net Sales	3.2	3.5	3.5	2.9	2.6
Inc/dec in loans	-952	-2,175	4,874	6,336	1,373	Debtor days	11	12	14	12	12
Others	-1,408	-2,173	-2,152	-2,669	-2,824	Inventory days	46	47	40	47	47
Financing Cash Flow	-2,360	2,459	1,985	2,661	-2,722	Creditor days	193	165	125	85	85
Inc / Dec (-) in Cash	191	82	173	1,351	2,274	Source: Company, JM Financial					
Opening cash balance	390	575	657	830	2,181						
Closing cash balance	581	657	830	2,181	4,455						
Source: Company, JM Financial											

History of Earnings Estimate and Target Price

Date	FY18E EPS (INR)	% Chg.	FY19E EPS (INR)	% Chg.	Target Price	% Chg.
15-Jun-17	10.9		14.7		635	
9-Aug-17	11.2	2.8	14.3	-2.7	635	0.0
6-Nov-17	11.2	0.0	14.3	0.0	635	0.0

Recommendation History



APPENDIX I

JM Financial Institutional Securities Limited

Corporate Identity Number: U65192MH1995PLC092522

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SEBI Registration Nos.: BSE - INZ010012532, NSE - INZ230012536 and MSEI - INZ260012539, Research Analyst – INH000000610

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Rating	Meaning
Buy	Total expected returns of more than 15%. Total expected return includes dividend yields.
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Sell	Price expected to move downwards by more than 10%

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