Rating Rationale

December 27, 2023 | Mumbai

Varun Beverages Limited

Rated amount enhanced for Bank Debt

Rating Action

Total Bank Loan Facilities Rated	**Rs.3667.71 Crore (Enhanced from Rs.3122.8 Crore)**
Long Term Rating	**CRISIL AA+/Stable (Reaffirmed)**

Note: None of the Directors on CRISIL Ratings Limited's Board are members of rating committee and thus do not participate in discussion or assignment of any ratings. The Board of Directors also does not discuss any ratings at its meetings.
1 crore = 10 million
Refer to Annexure for Details of Instruments & Bank Facilities

Detailed Rationale

CRISIL Ratings has reaffirmed its 'CRISIL AA+/Stable' rating on the long-term bank facilities of Varun Beverages Limited (VBL; part of the Varun Beverages group).

CRISIL Ratings has taken note of the corporate announcement by VBL on December 19, 2023, regarding acquisition of 100% stake in the business conducted by The Beverage Company Ltd, South Africa, and its wholly owned subsidiaries, collectively known as Bevco, with an option to accept minority co-investment from a large equity fund. Bevco is engaged in manufacturing and distribution of licensed (PepsiCo Inc) and own-branded non-alcoholic beverages. It holds franchise rights from PepsiCo Inc for South Africa, Lesotho and Eswatini, along with distribution rights for Namibia and Botswana. The proposed transaction is valued at Enterprise Value of Rs 1,320 crore and will be in the form of cash consideration. VBL is in process of finalising the means of funding the proposed acquisition. This acquisition will bolster the geographic reach of the company in Africa. Despite the acquisition and moderate capital expenditure (capex) plans, financial risk profile should remain strong with debt to EBITDA expected to remain below 1.2 times. CRISIL Ratings will continue to monitor the developments on the acquisition, which is subject to approvals from Competition Commission South Africa and PepsiCo Inc.

The reaffirmation factors in healthy revenue growth of 22% year-on-year for the nine months ended September 30, 2023 (9M CY2023), driven by strategic expansion in lower penetrated territories, scaling up of the non-carbonated drinks portfolio and growing international presence. CRISIL Ratings expects revenue growth to remain strong in CY2023 despite unfavourable weather conditions in the second quarter, supported by healthy growth in demand in the carbonated soft drink (CSD) segment and scaling up of the non-CSD portfolio.

Operating margin rose to 23.9% in 9M CY2023, driven by operating leverage and focus on backward integration and cost optimisation. CRISIL Ratings expects the margin to remain around 21.5% over the medium term, as the company will benefit from moderation in raw material prices, especially packaging cost, with correction in prices of Pet chips.

The financial risk profile remains strong, marked by a comfortable capital structure and gearing of less than one time as on December 31, 2022. Debt to operating earnings before interest, depreciation, taxes and amortisation (EBIDTA) ratio improved to around 1.3 time in CY2022, from around 1.9 times in the previous year supported by higher profitability. The company has net capitalisation of Rs 2,000 crore in CY2023, of which cash outflow wasRs 800 crore. The balance Rs 1,200 crore was incurred in the previous year. The company has also invested Rs 1,600 crore towards domestic and international greenfield expansion during the first nine months of CY2023. While the financial risk profile is expected to remain strong, any further debt-funded capex and its impact on the financial risk profile remains a monitorable. Financial flexibility is aided by sufficient cushion in the bank limit and expected healthy cash accrual in CY2023.

The ratings also reflect the leadership position of the group in managing franchisee operations of PepsiCo, its diversified geographic reach and robust operating efficiency. These strengths are partially offset by the debt-funded expansion plans and susceptibility of business to changes in customer preferences and regulations.

Analytical Approach

CRISIL Ratings has combined the business and financial risk profiles of VBL and all its subsidiaries, including Varun Beverages Lanka (Pvt) Ltd, Varun Beverages Morocco SA, Varun Beverages (Nepal) Pvt Ltd, Varun Beverages (Zambia) Ltd, Varun Beverages (Zimbabwe) (Pvt) Ltd and Lunarmech Technologies Pvt Ltd. All these entities, collectively referred to as the Varun Beverages group, have business and financial linkages.

Please refer Annexure - List of entities consolidated, which captures the list of entities considered and their analytical treatment of consolidation.

Key Rating Drivers & Detailed Description

Strengths:

Market leadership and geographical diversity in domestic and global markets

The Varun Beverages group is the second largest franchisee for PepsiCo outside the US, and the largest in India. Following the acquisition of the southern and western territories of PepsiCo in 2019, VBL is present in 27 states and 7 union territories (except Andhra Pradesh, Jammu and Kashmir, and Ladakh), and accounts for over 90% of beverage sales of PepsiCo in India. It also has sole franchisee operations in Nepal, Sri Lanka, Morocco, Zambia and Zimbabwe. Furthermore, VBL continues to expand its overseas presence, having set up subsidiaries in the Democratic Republic of Congo (DRC), Mozambique and in South Africa over last two years. Consistent ramp-up in operations via organic and inorganic routes, has helped strengthen the overall market position and geographical reach. VBL has over 15 brands across CSD, non-carbonated beverages and packaged drinking water segments, with CSD accounting for nearly 72.6% of sale volume during the first nine months of CY2023. The non-carbonated drink portfolio, comprising juice-based drinks and ambient temperature, value-added dairy beverages, primarily caters to north India. VBL is also focused on expanding its manufacturing facilities for value-added dairy beverages and juice-based drinks across India.

The dominant position of VBL in PepsiCo's franchisee operations in India, and its vast distribution network in the domestic and overseas markets will continue to aid the business risk profile.

Strong operating efficiency

The group continues to derive efficiency from backward integration of operations, with facilities to manufacture crown corks, PET pre-forms, corrugated boxes, shrink wrap sheets, and plastic cap closures and shells. Furthermore, presence in contiguous territories helps manage logistic cost and other operating costs efficiently and maintain economies of scale. Operating margin improved to 20.9% in 2022, supported by better operating leverage, cost optimisation measures and higher realisations in few products. Operating margin is likely to remain healthy around 21.5% in the medium term, with decrease in cost of raw materials such as PET chips. Moreover, few territories remain relatively underpenetrated, but their contribution to sales volume and profitability should improve over the medium term. This remains a key monitorable.

Strong financial profile

Financial risk profile remains healthy, aided by an improvement in debt coverage metrics. Debt to operating EBIDTA ratio reduced to around 1.3 times as on December 31, 2022, from around 1.9 times as on December 31, 2021, mainly due to higher profitability. CRISIL Ratings expects the debt to operating EBITDA ratio to sustain below 1.2 times over the medium term, despite the capex and acquisition. The ratio will be supported by accretive cash flow, owing to better penetration in existing territories, product diversification and expansion in geographic reach. However, any large debt-funded capex remains a key monitorable.

Weaknesses:

Susceptibility of business to changes in regulations and customer preferences

The domestic beverage industry remains susceptible to changes in regulations related to content in soft drinks, and environmental issues such as ground water depletion and discharge of effluents by bottling plants in India. Further, concerns over disposal of plastic bottles and use of single-use plastic straws in ready-to-drink beverages may continue to impact the industry. The company has expanded from the CSD to non-CSD category, through juice-based drinks and value-added dairy beverages, so as to cater to customers across categories. This too may involve expenditure towards market research, advertising and promotions and cause variations in return expectations over medium term.

Debt-funded expansion plans

VBL plans to incur a large capex towards scaling up its operations and improving its reach in existing markets. The company is likely to undertake capex of Rs 2,500 crore in CY2023, towards expansions in the CSD segment as well as juice-based drinks and value-added dairy beverages, and further to support the strong demand and widen its reach in the domestic as well as international markets. It has a strong track record of improving its capital structure and coverage metrics. However, any large debt-funded capex plans remains a key monitorable.

Liquidity: Strong
Cash accrual was healthy at Rs 1,957 crore for CY2022 (Rs 1,169 crore in the previous year). With ramp up of capacities and scaling up of non-carbonated beverages, CRISIL Ratings expects cash accrual to remain healthy in CY2023, however against sizeable repayments. Furthermore, given the seasonal nature of the beverage business, working capital requirement is moderate. Cash and bank balance was around Rs 228 crore as on December 31, 2022. Utilisation of bank lines (sanctioned limit of Rs 570 crore) averaged 36% over the 12 months through May 2023.

Environment, social and governance (ESG) profile
The ESG profile of VBL supports its strong credit risk profile. The fast-moving consumer goods sector has a moderate environmental and social impact, primarily driven by plastic waste generation, intensive water usage and direct impact of the products on health and well-being of consumers.

Key highlights
- VBL has implemented phase-wise recycling of used PET bottles and has recycled 80% of its used PET bottles sold over CY2022. It targets to recycle 100% of used PET bottles by 2025.
- By 2030, VBL aims to reduce carbon emissions per litre of beverage produced, by 50% over the base year, 2020. It has achieved 36% reduction in carbon emissions in 2022 over the base year.
- VBL aims to reduce the water usage ratio to 1.60 time by 2025 from 1.92 time in 2020 (1.7 time in 2022) and has implemented several measures towards water conservation.
- In order to sustain the water recharge at 2.0 times of total consumption, VBL has adopted 116 ponds and check dams, rejuvenated ponds in water stressed zones. The entire water discharged from its manufacturing facilities goes to the effluent treatment plant to ensure sufficient quality of discharged water.
- VBL has implemented the prevention of sexual harassment and corporate social responsibility policies. It has a 100% resolution rate of sexual harassment cases, in line with peer average.
- The company's governance structure is characterised by 60% of its board comprising independent directors, split between the chairman and CEO positions, dedicated investor grievance redressal system and extensive disclosures.

There is growing importance of ESG among investors and lenders. The commitment of VBL to the ESG principle will play a key role in enhancing stakeholder confidence given shareholding by foreign portfolio investors and access to both domestic and foreign capital markets.

Outlook: Stable
CRISIL Ratings believes VBL will sustain its healthy business risk profile, supported by strong cash accrual, with growth in new territories and integration benefits. Financial risk profile should also be aided by gradual reduction in debt.

Rating Sensitivity Factors
Upward Factors
- Debt to EBITDA ratio sustaining below one time in the absence of any large, debt-funded capex
- Significant and sustained improvement in operating performance, leading to higher-than-estimated cash accrual

Downward Factors
- Large, debt-funded capex or acquisition, leading to debt to EBITDA ratio of over 1.5 times on a sustained basis and weakening the financial risk profile
- Weaker-than-expected operating performance, leading to a significant fall in cash accrual

About the Company
VBL was established in 1995, by the promoter, Mr Ravi Kant Jaipuria, to cater to beverage operations of PepsiCo in India. The company manufactures and distributes sweetened aerated water (soft drinks), non-sweetened aerated water (soda), packaged drinking water and juice-based drinks. It is the largest franchisee for PepsiCo in India, with 33 manufacturing units. In 2019, VBL acquired the franchise rights for the southern and western sub-territories from PepsiCo India and third-party bottlers, and expanded its presence to 27 states and seven union territories.

Operations outside India includes franchise operations in Nepal, Sri Lanka, Morocco, Zambia and Zimbabwe. VBL has incorporated new subsidiaries in the Democratic Republic of Congo (DRC), Mozambique and in South Africa over the last two years but is yet to commence operations in these regions.

Key Financial Indicators

For the 12 months ended December 31	Unit	2022	2021
Operating income	Rs crore	13555	8952
PAT	Rs crore	1550	746
PAT margin	%	11.2	8.3
Adjusted debt/adjusted networth	Times	0.80	0.92
Adjusted interest coverage	Times	13.96	8.44

Any other information: Not Applicable

Note on complexity levels of the rated instrument:
CRISIL Ratings` complexity levels are assigned to various types of financial instruments and are included (where applicable) in the 'Annexure - Details of Instrument' in this Rating Rationale.

CRISIL Ratings will disclose complexity level for all securities - including those that are yet to be placed - based on available information. The complexity level for instruments may be updated, where required, in the rating rationale published subsequent to the issuance of the instrument when details on such features are available.

For more details on the CRISIL Ratings` complexity levels please visit www.crisilratings.com. Users may also call the Customer Service Helpdesk with queries on specific instruments.

Annexure - Details of Instrument(s)

ISIN	Name of instrument	Date of allotment	Coupon rate (%)	Maturity date	Issue size (Rs.Crore)	Complexity level	Rating assigned with outlook
NA	Term Loan	NA	NA	Jun-24	24	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-26	110	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-26	200	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	500	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	350	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jul-25	58.33	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-24	80	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	210	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jul-27	165	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-25	40	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	143	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	300	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-25	100	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-25	40	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-25	75	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-24	16.67	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-27	200	NA	CRISIL AA+/Stable
NA	Term Loan	NA	NA	Jun-26	300	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	80	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	90	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	100	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	40	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	30	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	60	NA	CRISIL AA+/Stable
NA	Overdraft Facility	NA	NA	NA	20	NA	CRISIL AA+/Stable
NA	Cash Credit	NA	NA	NA	50	NA	CRISIL AA+/Stable
NA	Overdraft Facility	NA	NA	NA	50	NA	CRISIL AA+/Stable
NA	Overdraft Facility	NA	NA	NA	50	NA	CRISIL AA+/Stable
NA	Overdraft Facility	NA	NA	NA	50	NA	CRISIL AA+/Stable
NA	Bank Guarantee*	NA	NA	NA	85.6	NA	CRISIL AA+/Stable
NA	Bank Guarantee*	NA	NA	NA	50	NA	CRISIL AA+/Stable
NA	Proposed Long Term Bank Loan Facility	NA	NA	NA	0.11	NA	CRISIL AA+/Stable

**Long-term bank guarantee*

Annexure - List of Entities Consolidated

Names of entities consolidated	Extent of consolidation	Rationale for consolidation
Varun Beverages (Nepal) Pvt Ltd	Full	Strong operational and financial linkages
Varun Beverages Morocco SA	Full	Strong operational and financial linkages
Varun Beverages Lanka (Pvt) Ltd	Full	Strong operational and financial linkages
Ole Springs Bottlers (Pvt) Ltd	Full	Strong operational and financial linkages
Varun Beverages (Zambia) Ltd	Full	Strong operational and financial linkages
Varun Beverages (Zimbabwe) (Pvt) Ltd	Full	Strong operational and financial linkages
Lunarmech Technologies Pvt Ltd	Full	Strong operational and financial linkages
Varun Beverages RDC SAS	Full	Strong operational and financial linkages
Varun Beverages International DMCC	Full	Strong operational and financial linkages
Varun Beverages South Africa (PTY) Ltd	Full	Strong operational and financial linkages

Annexure - Rating History for last 3 Years

	Current			2023 (History)		2022		2021		2020		Start of 2020
Instrument	**Type**	**Outstanding Amount**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Date**	**Rating**	**Rating**
Fund Based Facilities	LT	3532.11	CRISIL AA+/Stable	29-09-23	CRISIL AA+/Stable	01-07-22	CRISIL AA+/Stable	14-10-21	CRISIL AA/Positive	13-01-20	CRISIL AA/Stable	CRISIL A1+ / CRISIL AA/Stable
			--		--	26-05-22	CRISIL AA+/Stable	21-01-21	CRISIL AA/Stable		--	--
Non-Fund Based Facilities	LT	135.6	CRISIL AA+/Stable	29-09-23	CRISIL AA+/Stable	01-07-22	CRISIL AA+/Stable		--		--	CRISIL A1+
Commercial Paper	ST		--		--	01-07-22	Withdrawn	14-10-21	CRISIL A1+	13-01-20	CRISIL A1+	CRISIL A1+
			--		--	26-05-22	CRISIL A1+	21-01-21	CRISIL A1+		--	--
Non Convertible Debentures	LT		--		--		--		--	13-01-20	Withdrawn	CRISIL AA/Stable

All amounts are in Rs.Cr.

Annexure - Details of Bank Lenders & Facilities

Facility	Amount (Rs.Crore)	Name of Lender	Rating
Bank Guarantee*	44.8	RBL Bank Limited	CRISIL AA+/Stable
Bank Guarantee*	85.6	IndusInd Bank Limited	CRISIL AA+/Stable
Bank Guarantee*	5.2	RBL Bank Limited	CRISIL AA+/Stable
Cash Credit	30	Kotak Mahindra Bank Limited	CRISIL AA+/Stable
Cash Credit	90	HDFC Bank Limited	CRISIL AA+/Stable
Cash Credit	100	IndusInd Bank Limited	CRISIL AA+/Stable
Cash Credit	40	YES Bank Limited	CRISIL AA+/Stable
Cash Credit	60	ICICI Bank Limited	CRISIL AA+/Stable
Cash Credit	50	RBL Bank Limited	CRISIL AA+/Stable
Cash Credit	80	Axis Bank Limited	CRISIL AA+/Stable
Overdraft Facility	50	The Federal Bank Limited	CRISIL AA+/Stable
Overdraft Facility	50	JP Morgan Chase Bank N.A.	CRISIL AA+/Stable
Overdraft Facility	20	DBS Bank India Limited	CRISIL AA+/Stable
Overdraft Facility	50	The Hongkong and Shanghai Banking Corporation Limited	CRISIL AA+/Stable
Proposed Long Term Bank Loan Facility	0.11	Not Applicable	CRISIL AA+/Stable
Term Loan	50	The Hongkong and Shanghai Banking Corporation Limited	CRISIL AA+/Stable
Term Loan	350	Axis Bank Limited	CRISIL AA+/Stable
Term Loan	100	ICICI Bank Limited	CRISIL AA+/Stable
Term Loan	40	Kotak Mahindra Bank Limited	CRISIL AA+/Stable
Term Loan	16.67	Kotak Mahindra Bank Limited	CRISIL AA+/Stable
Term Loan	24	Axis Bank Limited	CRISIL AA+/Stable
Term Loan	110	Axis Bank Limited	CRISIL AA+/Stable
Term Loan	200	Axis Bank Limited	CRISIL AA+/Stable
Term Loan	500	Axis Bank Limited	CRISIL AA+/Stable
Term Loan	58.33	HDFC Bank Limited	CRISIL AA+/Stable
Term Loan	80	HDFC Bank Limited	CRISIL AA+/Stable
Term Loan	210	HDFC Bank Limited	CRISIL AA+/Stable
Term Loan	165	HDFC Bank Limited	CRISIL AA+/Stable
Term Loan	40	IndusInd Bank Limited	CRISIL AA+/Stable
Term Loan	143	IndusInd Bank Limited	CRISIL AA+/Stable
Term Loan	300	IndusInd Bank Limited	CRISIL AA+/Stable
Term Loan	75	Kotak Mahindra Bank Limited	CRISIL AA+/Stable
Term Loan	150	The Hongkong and Shanghai Banking Corporation Limited	CRISIL AA+/Stable
Term Loan	300	JP Morgan Chase Bank N.A.	CRISIL AA+/Stable

**Long-term bank guarantee*

Criteria Details

Links to related criteria
CRISILs Approach to Financial Ratios
Rating criteria for manufaturing and service sector companies
CRISILs Bank Loan Ratings - process, scale and default recognition
Rating Criteria for Fast Moving Consumer Goods Industry
CRISILs Criteria for Consolidation

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