Initiating Coverage

Your success is our success

Varun Beverages

Refer to important disclosures at the end of this report

Sunny day arrives, Initiate at BUY

CMP	Target Price
Rs 510 as of (June 9, 2017)	Rs 674 12 months
Rating	**Upside**
BUY	32.1 %

A bet on PepsiCo India

- We initiate coverage of Varun Beverages (VBL) with a BUY rating and a price target of Rs674, implying 32% upside from here. VBL is the leading Indian soft drinks player and controls 45% of PepsiCo India's volume through franchise model.
- PepsiCo's rising focus on non-carbonates and plans to launch new products on the health platform will help VBL capture market share from competition. We view VBL's long-term track record as impressive; largely driven by regular acquisitions of territories, which have delivered scale benefits and synergies.
- Strong growth outlook (EPS CAGR 35% in CY16-19E), solid FCF generation of Rs11bn in CY17-19E, low D/E of 0.4x by CY19E, and trading at 11.7x CY18E EV/EBITDA, VBL's financial profile and valuation look attractive.
- We value VBL on DCF model due to strong cash flow visibility. VBL should be compared to pure franchise owners like JUBI, PAG and WLDL. These are trading at 16.9x EV/EBITDA CY18E. Catalysts from new product launches and acquisition of new territories.

- **A strong proxy play:** VBL is a solid proxy play on the long-term growth story of the soft drinks category in India. With end-to-end execution capabilities and presence across the entire beverage value chain, the company's profile is not restricted to being just a bottler. Soft drinks pose a good opportunity in India given low per-capita consumption and underpenetrated rural market.
- **Growth drivers ahead:** 1) Organic volume growth of 10% translates into revenue and EPS CAGR of 13% and 35% respectively over CY16-19E, 2) Acquisition of additional production and distribution rights from PepsiCo India (PepsiCo) and its franchises to expand its presence and drive volumes, 3) Solid cash flow generation of Rs11bn over CY17-19E could be used to repay debt and this in turn will result in a more comfortable balance sheet position.
- **Increasing focus on non-carbonates:** India too is catching up with developed markets in terms of changing consumer preferences towards healthy/non-carbonates. PepsiCo has a strong portfolio in this segment and is in the process of expanding the same. Non-carbonates volumes are expected to grow ~3x faster than carbonates volumes. Further, even carbonates offer an annual 9% growth opportunity due to underpenetrated market in India. Given PepsiCo's innovation initiatives and VBL's strong distribution capabilities, we believe VBL can capture market share faster than the competitors.
- **Valuations and risks:** We expect significant ROE/ROCE improvement of 600/500bps to 14.6/16.3% by CY19E. Current valuation on EV/EBITDA basis of 11.7x is not expensive given the strong EPS growth prospects. We have valued VBL on DCF basis due to strong cash flow visibility. Seasonality and growing competition in non-carbonates segments pose as key risks to our recommendation

Financial Snapshot (Consolidated)

(Rs mn)	CY15	CY16	CY17E	CY18E	CY19E
Net Sales	33,941	38,520	43,068	48,742	55,301
EBITDA	6,341	7,952	8,483	9,353	10,543
EBITDA Margin (%)	18.7	20.6	19.7	19.2	19.1
APAT	870	1,513	2,093	2,743	3,744
EPS (Rs)	6.5	8.3	11.5	15.0	20.5
EPS (% chg)	0.0	27.5	38.2	31.1	36.5
ROE (%)	47.6	14.3	10.5	12.2	14.6
P/E (x)	78.4	61.5	44.5	34.0	24.9
EV/EBITDA (x)	16.2	14.5	13.2	11.7	10.0
P/BV (x)	30.7	4.9	4.4	3.9	3.4

Source: Company, Emkay Research

Change in Estimates	
EPS Chg CY17E/CY18E (%)	NA
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	NA

Emkay vs Consensus		
EPS Estimates		
	CY17E	**CY18E**
Emkay	11.5	15.0
Consensus	10.9	13.6
Mean Consensus TP (12M)		Rs 575

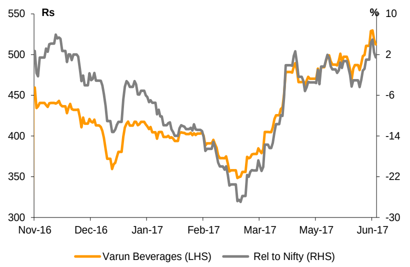
Stock Details	
Bloomberg Code	VBL IN
Face Value (Rs)	10
Shares outstanding (mn)	183
52 Week H/L	539 / 340
M Cap (Rs bn/USD bn)	93 / 1.45
Daily Avg Volume (nos.)	1,59,873
Daily Avg Turnover (US$ mn)	1.1

Shareholding Pattern [Mar'16]	
Promoters	73.7 %
FIIs	17.9 %
DIIs	1.2 %
Public and Others	7.2 %

Price Performance

(%)	1M	3M	6M	12M
Absolute	4	39	21	-
Rel. to Nifty	(1)	29	3	-

Relative price chart



Source: Bloomberg

This report is solely produced by Emkay Global. The following person(s) are responsible for the production of the recommendation:

Anubhav Gupta
anubhav.gupta@emkayglobal.com
+91-022-66121336

Nikhar Jain
nikhar.jain@emkayglobal.com
+91-022- 66242490

1.0 Investment thesis: VBL is 2nd largest franchiser of PepsiCo globally (excluding USA)

1.1 Benefiting from strong relationship with PepsiCo

Presence across soft drink segments

Soft drinks offer a good opportunity in India given the low per-capita consumption and under penetration in the rural market. Market research firm Euromonitor expects carbonated beverages (carbonates) to grow 6.8% in volume and 9.6% in value for the next five years in India. Carbonates form 81% of VBL's volumes. Non-carbonated beverages (non carbonates) like packaged water and juices are relatively small but are likely to grow faster than carbonates. Euromonitor expects non-carbonates (water & juices) to post a 22.5% CAGR over CY16-21E in value. VBL plays a critical role in manufacture and distribution of PepsiCo's beverages. The company also has a presence in other South Asian and African markets which form 24% of VBL's overall revenue.

1.2 Building a solid and sustainable track record with a focused strategy

Impressive long term track record

VBL is a key player in the soft drinks industry operating in six countries with end-to-end execution capabilities and presence across a large part of the beverage value chain. VBL's strong relations with PepsiCo has benefitted it in multiple ways including access to modern technology, marketing leverage, operational know-how, industry best practices, access to raw materials and equipment at competitive prices as well as access to experienced personnel. VBL's long-term track record is impressive; largely driven by regular acquisitions of territories from PepsiCo/other franchises, which has delivered scale benefits and synergies.

1.3 Huge potential for soft drinks category; Upside from non-carbonates

Low penetration of soft drinks in India

India is a largely under-tapped market with per capita consumption of soft drinks of 9.4 liters/year as compared to the global average of 91.9 liters/year. Current market size is 13.6bn liters which is expected to grow at 15% CAGR over CY16-21E (market has grown at 16% CAGR in last 5 years). The non-carbonates segment is growing 3x faster than carbonates. PepsiCo has a strong portfolio in non-carbonates and is expected to launch more products in the next 1 year. Currently, non-carbonates account for 19% of VBL's volumes but their contribution is expected to rise to 28% by CY19.

1.4 Expect 35% EPS CAGR over CY16-19E

Strong earnings growth

We forecast organic volumes to rise at 10% CAGR CY16-19E, driving a 13% revenue CAGR over the same period. We expect VBL's EPS to increase at 35% CAGR on the back of lower interest and depreciation costs. We factor in a 160bps EBITDA margin contraction to 19.1% by CY19E.

1.5 Significant improvement in return ratios and solid cash flow generation

ROE/ROCE to improve significantly

We forecast ROE/ROCE to rise 600/500bps to 14.6/16.3% by CY19. We also expect VBL to generate FCF of Rs11bn in next 3 years on steady state basis. This will help VBL look for potential acquisition of more territories from PepsiCo. VBL's balance sheet will then be comfortably placed with net D/E declining to 0.4x in CY19 from 1.2x in CY16.

2.0 Steady state cash flows; Attractively valued

Value VBL using discounted cash flow methodology

Value stock using DCF methodology, given strong CF visibility

VBL has strong cash flow visibility due to its sound business model. We expect VBL to generate large cash flows on steady state basis. Hence, we think it is appropriate to value VBL on discounted CF methodology. Our DCF-based TP of Rs674 is based on 11.25% WACC and 4.5% terminal growth.

Exhibit 1: DCF Methodology

Particulars	CY17E	CY18E	CY19E	CY20E	CY21E	CY22E	CY23E	CY24E	CY25E	CY26E	CY27E	CY28E	CY29E	CY30E	CY31E
Cash flow from operations (Rs bn)	**8.4**	**8.9**	**10.1**	**11.4**	**13.0**	**14.7**	**16.6**	**18.8**	**21.3**	**24.0**	**27.0**	**30.4**	**34.1**	**38.2**	42.8
Interest	-1.8	-1.7	-1.5	-1.0	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TAX	-0.8	-1.1	-1.4	-1.8	-2.7	-3.2	-3.7	-4.2	-4.8	-5.5	-6.3	-7.1	-8.1	-9.1	-10.3
Residual cash flow	**5.8**	**6.2**	**7.2**	**8.6**	**10.0**	**11.5**	**13.0**	**14.6**	**16.4**	**18.5**	**20.7**	**23.2**	**26.0**	**29.1**	**32.5**
Capex	-4.0	-3.0	-2.5	-2.0	-4.1	-4.5	-4.9	-5.3	-5.7	-6.1	-6.6	-7.1	-7.6	-8.1	-8.7
Free Cash Flow	**1.8**	**3.2**	**4.7**	**6.6**	**5.8**	**7.0**	**8.1**	**9.3**	**10.7**	**12.3**	**14.1**	**16.1**	**18.4**	**21.0**	**23.8**
PV Factor or Discount Rate	1.00	0.90	0.81	0.73	0.65	0.59	0.53	0.47	0.43	0.38	0.34	0.31	0.28	0.25	0.22
PV of Free Cash Flow	**1.8**	**2.8**	**3.8**	**4.8**	**3.8**	**4.1**	**4.3**	**4.4**	**4.6**	**4.7**	**4.9**	**5.0**	**5.1**	**5.2**	**5.4**
Cumulative Cash Flow	1.8	4.6	8.4	13.2	17.0	21.1	25.4	29.8	34.4	39.1	44.0	49.0	54.1	59.3	64.7
Assumed Terminal Year (n)															
Cash Flow at 2031	23.8														
Terminal Growth Rate	4.5%														
WACC	11.25%														
Terminal Value	345.4														
Discounted Terminal Value	77.6														
Present Value of Firm till Terminal Year	64.7														
Total Discounted Value of Firm	**142**														
Add: Cash Balance	1.1														
Less: Current Debt	20.3														
Present Value of Equity	**123.1**														
Fair Value	674														

Source: Emkay Research

Should be valued in line with JUBI, PAG and WLDL

Our fair value implies EV/EBITDA of 15.4x CY18E. This is at a premium to global bottling peers but in line with other Indian franchisees of global brands like JUBI, PAG and WLDL. We believe the premium to global bottling peers is justified given superior growth opportunities for VBL's key markets - India and Africa. VBL is currently trading at 11.7x EV/EBITDA and 34x PER CY18E.

Exhibit 2: Global Peer Bottlers

Global Bottlers	Mcap	EPS Growth (%)			PER (x)			EV/EBITDA (x)			P/BV (x)			ROE(%)		
Companies	(USD m)	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E
Arca Continental SAB	12,663		18.2	10.9	22.1	18.7	16.9	10.5	9.0	8.1	2.8	2.6	2.2	14.2	15.3	15.0
Coca-Cola Amatil	5,307		2.4		16.9	16.5		8.8	8.5					21.6		
Coca-Cola Bottlers Japan Inc	6,572	173.0	15.3	20.5	27.8	24.1	20.0	8.4	7.2	6.7	27.8	24.1	20.0	7.3	5.2	5.9
Coca-Cola European Partners	19,884	9.6	12.1	10.1	17.4	15.5	14.1	12.1	11.2	10.6	2.5	2.4	2.2	14.1	16.6	17.0
Coca-Cola Femsa	16,739		9.4	5.7	22.2	20.3	19.2	10.2	9.4	8.7	2.1	2.0	1.6	10.5	11.8	10.5
Coca-Cola Hbc	10,772	14.6	13.3	12.8	23.7	20.9	18.5	11.7	10.8	9.9	3.1	2.9	2.6	13.4	14.1	14.9
EmbotelladoraAndina	3,549		13.4	12.7	22.5	19.9	17.6	8.8	8.1	7.5	2.8	2.7	2.5	13.0	14.1	15.2
Massimo Zanetti Beverage	310		12.3	18.7	13.5	12.1	10.2	6.8	6.6	6.1	0.9	0.8	0.8	6.4	6.8	7.0
Average		**65.7**	**12.0**	**13.1**	**20.7**	**18.5**	**16.6**	**9.7**	**8.8**	**8.2**	**6.0**	**5.3**	**4.5**	**12.6**	**12.0**	**12.2**
Varun Beverages		**38.2**	**31.1**	**36.5**	**44.5**	**34.0**	**24.9**	**13.2**	**11.7**	**10.0**	**4.4**	**3.9**	**3.4**	**10.5**	**12.2**	**14.6**

Source: Emkay Research, Bloomberg

No direct Indian peer

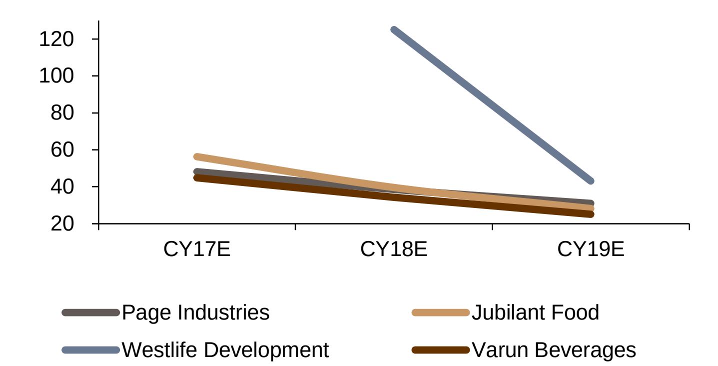
VBL trading much below peers like JUBI, PAG, WLDL

In our view, VBL is more comparable to Jubilant Foodworks (JUBI), Page Industries (PAG), and Westlife Development (WLDL) which are franchisees of leading international brands. These are trading at 30.7x EV/EBITDA and 52x PER CY18E. VBL is trading much cheaper than these valuations.

Exhibit 3: Indian Peers

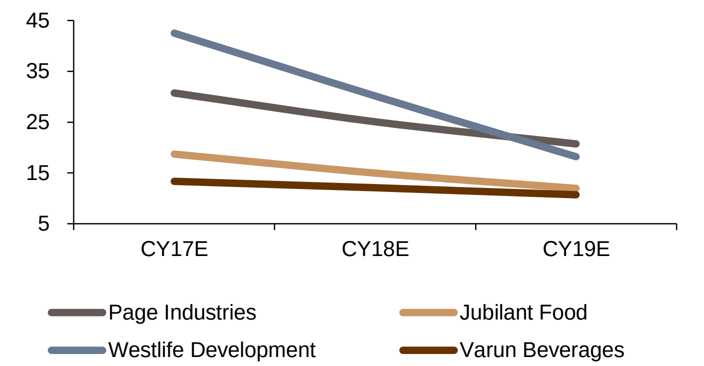
Franchise Companies	Mcap	EPS Growth (%)			PER (x)			EV/EBITDA (x)			P/BV (x)			ROE(%)		
	(USD m)	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E	CY17E	CY18E	CY19E
Page Industries*	2,470	24.1	24.8	24.7	48.2	38.6	30.9	30.7	25.1	20.7	20.3	15.9	12.6	47.8	44.8	45.6
Jubilant Food*	934	95.6	39.2	30.7	56.2	39.6	28.2	18.7	15.0	12.0	6.7	39.6	28.2	12.4	15.7	19.6
Westlife Development*	507		257.5	189.9	446.8	125.0	43.1	42.5	30.2	18.2	6.1	5.7	5.1	4.8	6.4	9.8
Average		**59.8**	**107.2**	**81.8**	**183.7**	**67.7**	**34.1**	**30.7**	**23.4**	**16.9**	**11.0**	**20.4**	**15.3**	**21.7**	**22.3**	**25.0**
Varun Beverages		**38.2**	**31.1**	**36.5**	**44.5**	**34.0**	**24.9**	**13.2**	**11.7**	**10.0**	**4.4**	**3.9**	**3.4**	**10.5**	**12.2**	**14.6**

Source: Emkay Research, Bloomberg *For CYF17, year ending is March 2018



Source: Emkay Research, Bloomberg

Exhibit 5: VBL's EV/EBITDA(x) vs Indian peers



Source: Emkay Research, Bloomberg

Upside to our TP on acquisition of new territories

New acquisitions will increase NAV

VBL plans to add more territories of PepsiCo which are still operated by it and other franchise operators. Currently, PepsiCo itself manages 32% and other franchises manage 23% of India volume. We believe VBL will be the preferred partner to acquire these territories given its size and capabilities.

Strong BUY, 32% potential upside

BUY recommendation

We initiate coverage on VBL with a BUY rating and target price of Rs674. VBL is a key player in the soft drinks industry with end-to-end execution capabilities and presence across the entire beverage value chain—while PepsiCo owns the brands and is primarily engaged in demand creation, VBL is responsible for demand delivery. We believe VBL is well-positioned to leverage PepsiCo's brand strength to increase market penetration in its licensed territories through its strong distribution infrastructure, demonstrated end-to-end execution capabilities and proven track record of more than two decades.

3.0 VBL – Not just a bottler but a key player in Indian soft drink industry

Strategic franchise partner of PepsiCo

VBL is a strategic franchisee partner of PepsiCo in India and has over the past 25 years developed a significant and mutually beneficial business association. VBL's strong relationship with PepsiCo is reflected in the large number of franchisee territories and sub-territories granted/ acquired by it over the years.

PepsiCo owns the brands, provides the concentrate for beverages, undertakes investment in R&D (both product and packaging innovations) and is responsible for consumer-level marketing/advertising support.

Presence across the entire value chain

VBL undertakes all critical activities including manufacturing and distribution, supply chain management, in-market execution, local-level promotions, merchandising, in-store activations and driving market share gains. It has also made investments in setting up backward integration facilities for production of preforms, crowns, corrugated boxes and pads, plastic crates and shrink-wrap films to ensure operational efficiencies.

Exhibit 6: Strong Relationship with PepsiCo

Source: Company

VBL is crucial to PepsiCo in value chain

Strong relationship with PepsiCo

PepsiCo owns the brands and is primarily engaged in demand creation while VBL is responsible for demand delivery. VBL has benefitted from strong relations with PepsiCo: access to modern technology, marketing leverage, operational know-how, industry best practices, access to raw materials and equipment at competitive prices as well as access to experienced personnel.

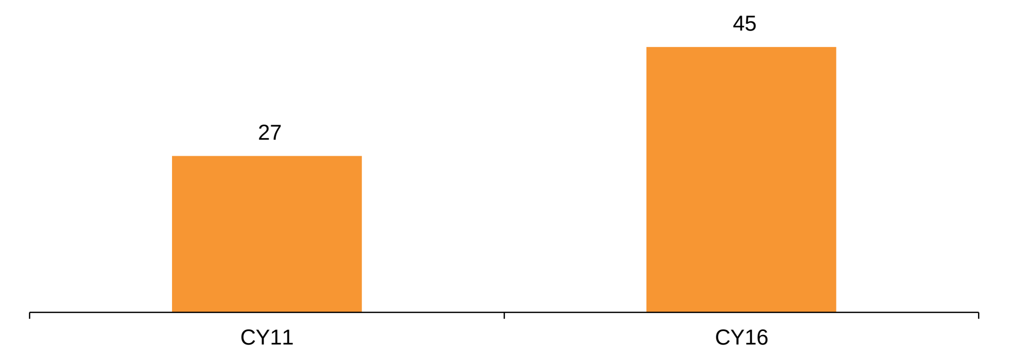
VBL has strong sales teams to develop and implement local advertising and marketing strategies. VBL, as a franchisee, primarily focuses on customer-level marketing including managing distributor and retailer relationships, special occasion-based marketing at points of sale, and implementing promotional activities to strengthen a strong distribution network.

VBL's share in PepsiCo India sales volume increased to 45% from 27% in last 5 years

Constant increase in PepsiCo's share by VBL

VBL has acquired licenses for additional territories and sub-territories from PepsiCo continuously. This was possible as VBL demonstrated ability to grow PepsiCo product sales in its territories. These were either earlier operated by PepsiCo directly or other franchises.

Exhibit 7: VBL's share in PepsiCo's India sales volume (%)



Source: Company, Emkay Research

PepsiCo's key brands in VBL's portfolio

VBL's share in PepsiCo soft drinks India volumes increased to 45% in CY16 from 27% in CY11. VBL competed following transactions since CY11:

- Goa and North East sub-territories and Nepal, Sri Lanka and Morocco merged CY12
- Delhi sub-territory acquired in CY13
- Punjab, Himachal Pradesh, Chandigarh as well as remaining parts of sub-territories of Haryana, Uttarakhand and Uttar Pradesh acquired in CY15
- Zambia and Mozambique territories consolidated in CY16
- Two co-packing facilities in UP and Punjab acquired in CY16
- Increased stake in Zambia to 90% from 60% and reduced stake in Mozambique to 10% from 51% in CY17

Exhibit 8: Brands

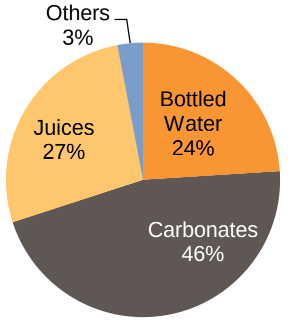
Source: Company

4.0 Huge potential in underpenetrated Indian soft drink market

Indian market to rise 15% pa for next 5 years

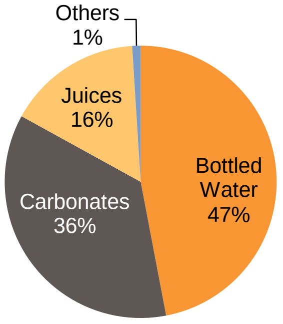
India is an underpenetrated market with per capita consumption of 9.4 liters/year as compared to the global average of 91.9 liters/year. The market has grown at 16.4% volume CAGR over CY10-15 and is expected to grow at 15.1% volume CAGR over CY16-21E. Non-carbonates would grow faster than carbonates due to rising health consciousness among consumers. From a products perspective, juices and bottled water are expected to grow the fastest at a CAGR of 16.9% and 19.8% over CY16-21 (in volume terms).

Exhibit 9: Industry Value break up in CY16 (Rs603bn)



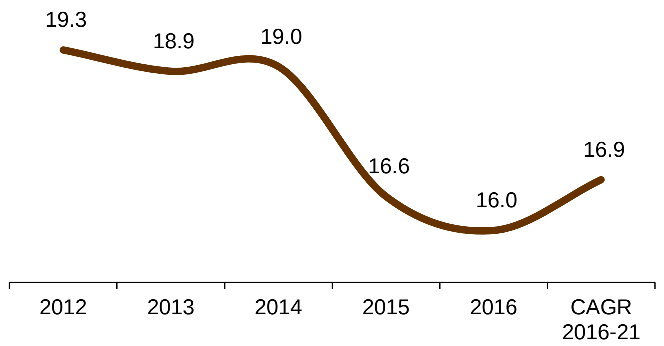
Source: Euromonitor

Exhibit 10: Industry Volume break up in CY16 (13.6bn ltrs)



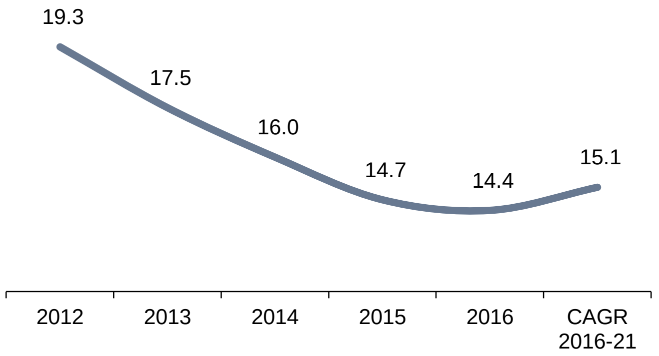
Source: Euromonitor

Exhibit 11: Overall industry value growth (%)



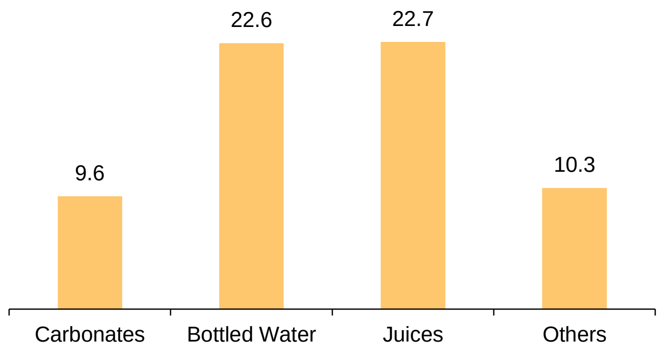
Source: Euromonitor

Exhibit 12: Overall industry volume growth (%)



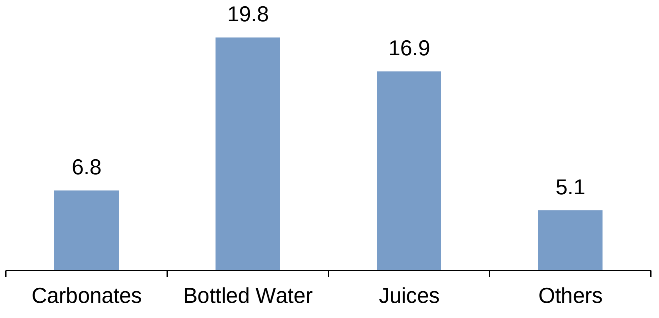
Source: Euromonitor

Exhibit 13: Segment wise industry value growth CAGR CY16-21E (%)



Source: Euromonitor

Exhibit 14: Segment wise industry volume growth CAGR CY16-21E (%)



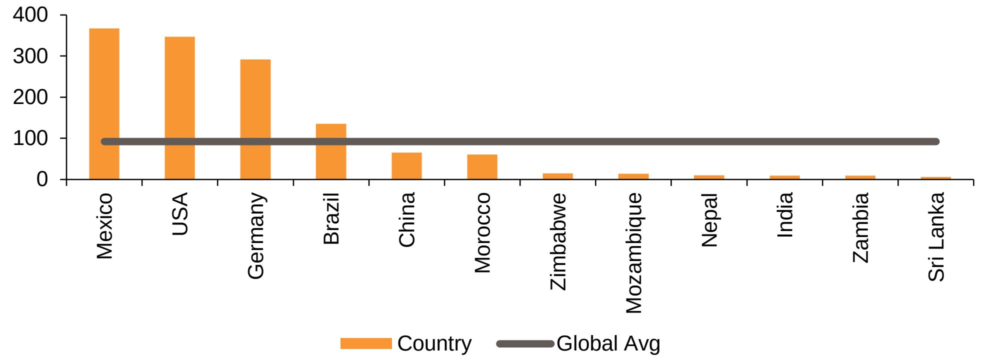
Source: Euromonitor

India is an important market for PepsiCo as it offers superior growth

India is among lowest penetrated markets

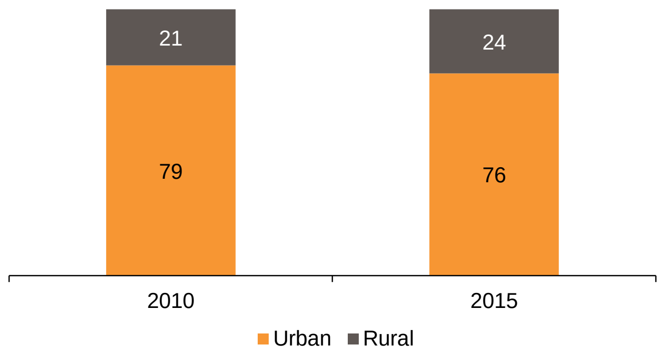
The global soft drinks market is mature and highly penetrated. The global soft drinks market, comprising bottled water, carbonates, packaged juices and RTD tea and coffee grew at a CAGR of 3.4% by volume and 1.3% CAGR by value during CY10-15. Euromonitor expects the market to grow at a volume CAGR of 3.4% by CY20 and at a value CAGR of 4.5% by CY20.

Exhibit 15: Global Per-capita Consumption (ltr)



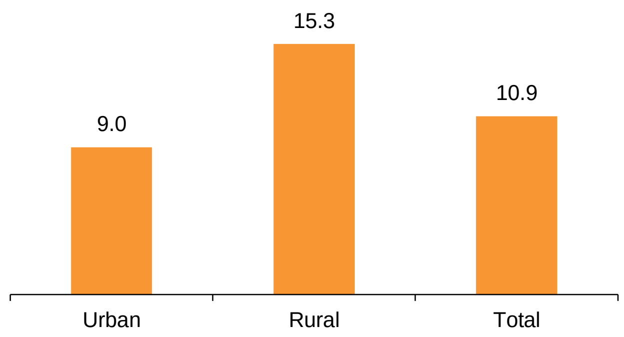
Source: Euromonitor

Exhibit 16: Rural/Urban Volume Mix in CY15 (%)



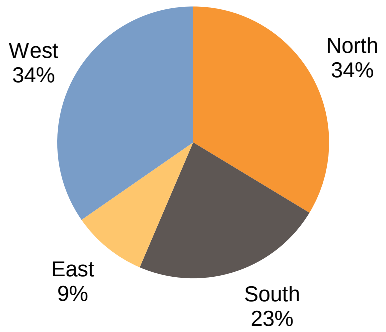
Source: Euromonitor

Exhibit 17: Growth of carbonates in Rural/Urban in CY10-15 (%)



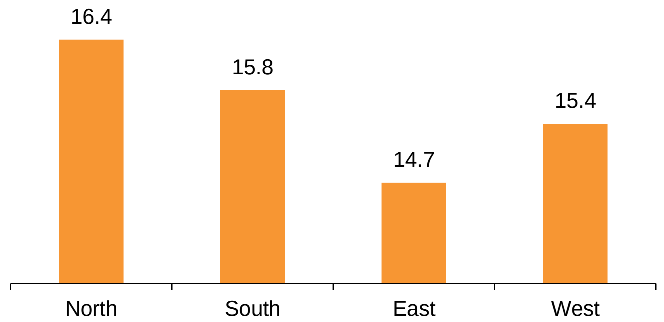
Source: Euromonitor

Exhibit 18: Geographical volume split for soft drinks in CY15 (%)



Source: Euromonitor

Exhibit 19: Growth of soft drinks region-wise in CY10-15 (%)



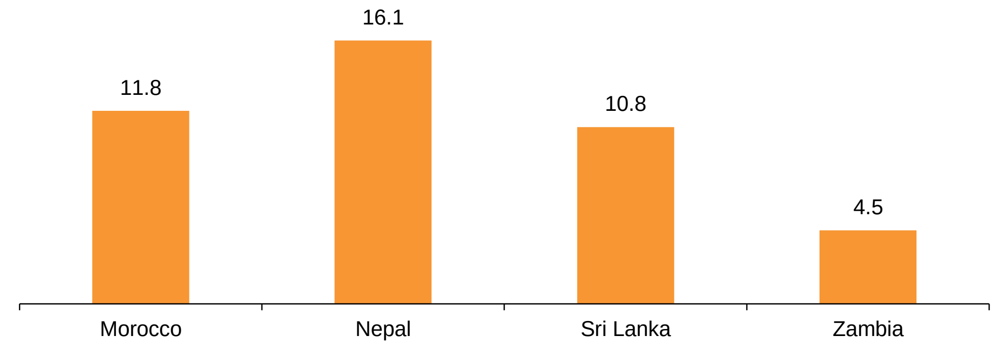
Source: Euromonitor

Exhibit 20: Indian Carbonates Market

Volumes (mn ltrs)	CY11	CY12	CY13	CY14	CY15	CY16	CY21E	CAGR CY16-21E
Cola Carbonates	1,317	1,462	1,609	1,735	1,863	1,986	2,628	5.8
Growth(%)		***11.0***	***10.1***	***7.8***	***7.4***	***6.6***		
Low Calorie Cola Carbonates	17	19	21	23	25	27	38	6.9
Regular Cola Carbonates	1,300	1,443	1,588	1,712	1,838	1,959	2,590	5.7
Non-Cola Carbonates	1,797	2,024	2,245	2,483	2,715	2,942	4,215	7.5
Growth(%)		***12.6***	***10.9***	***10.6***	***9.3***	***8.4***		
Lemonade/Lime	954	1,125	1,287	1,465	1,635	1,804	2,787	9.1
Mixers	211	220	228	237	246	254	289	2.7
Orange Carbonates	453	469	486	500	514	526	568	1.6
Other Non-Cola Carbonates	179	210	244	281	320	358	571	9.8
Total Carbonates	3,114	3,486	3,854	4,218	4,578	4,928	6,843	6.8
Growth(%)		***11.9***	***10.6***	***9.4***	***8.5***	***7.6***		

Source: Euromonitor

Exhibit 21: Overseas market growth forecast CY16-20E CAGR (%)



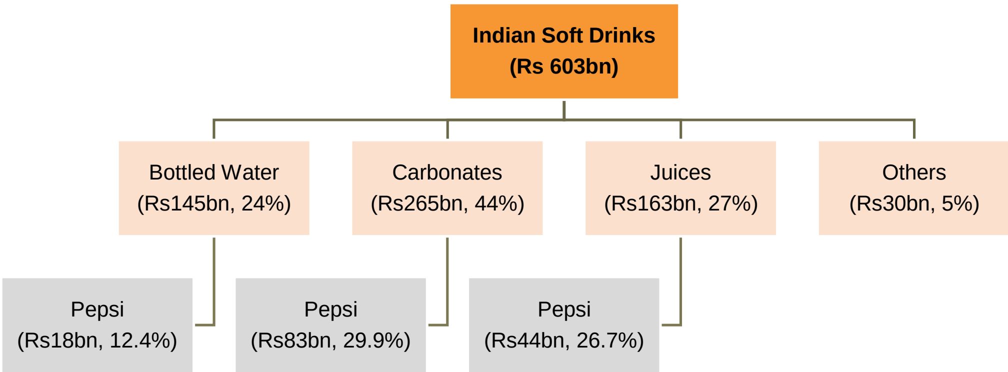
Source: Euromonitor

4.0 VBL has strong portfolio in 'Rs600bn' soft drink market

Present in all categories

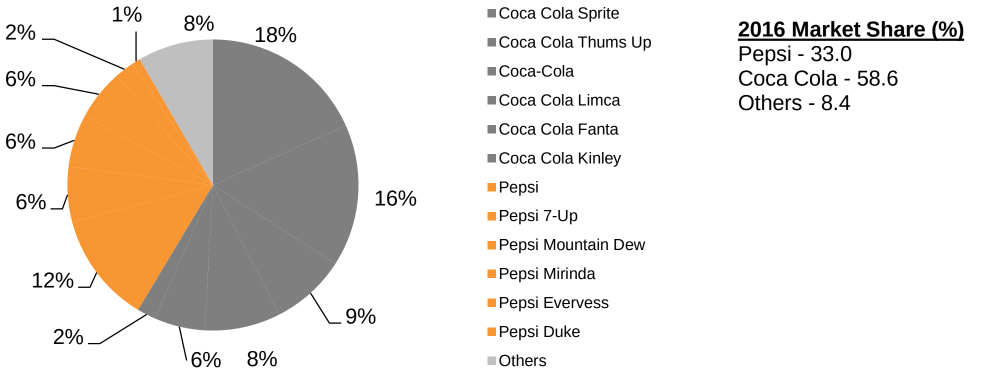
VBL scales 95% of soft drinks market through its presence in carbonates (44%, Rs265bn), juices (27%, Rs163bn) and bottled water (24%, Rs145bn). The total addressable market size is Rs570bn.

Exhibit 22: VBL's addressable market size -> Size in Rs bn and Market Share in %



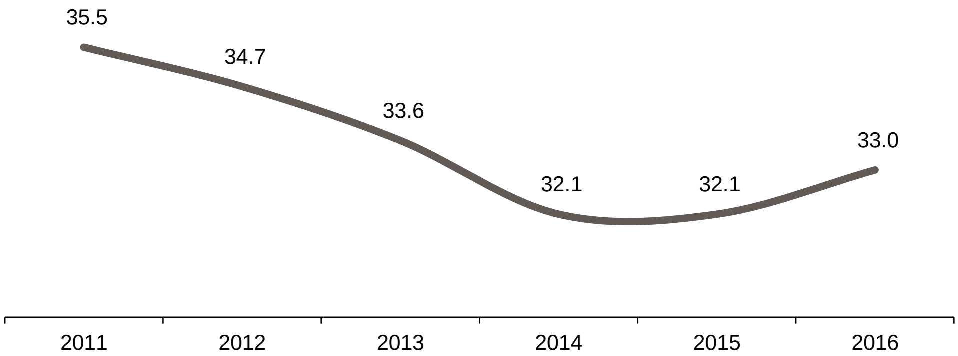
Source: Euromonitor

Exhibit 23: Pepsi's Market Share in Carbonates volume in CY16 (%)



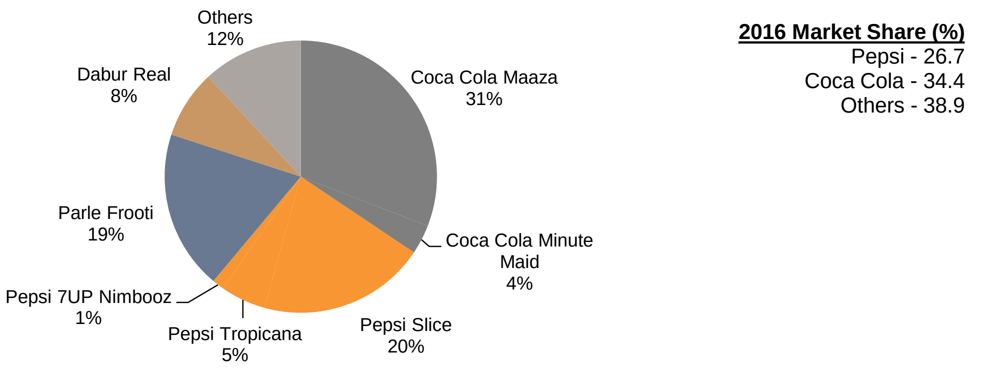
Source: Euromonitor

Exhibit 24: Pepsi's Market Share Trend in Carbonates volume (%)



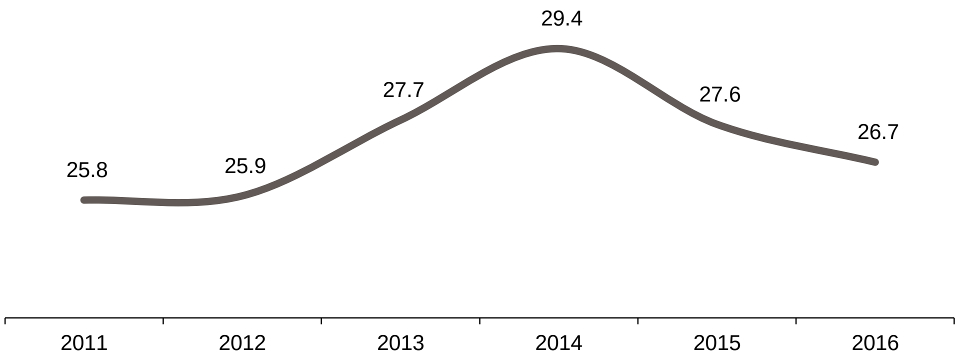
Source: Euromonitor

Exhibit 25: Pepsi's Market Share in Juices (volume) in CY16 (%)



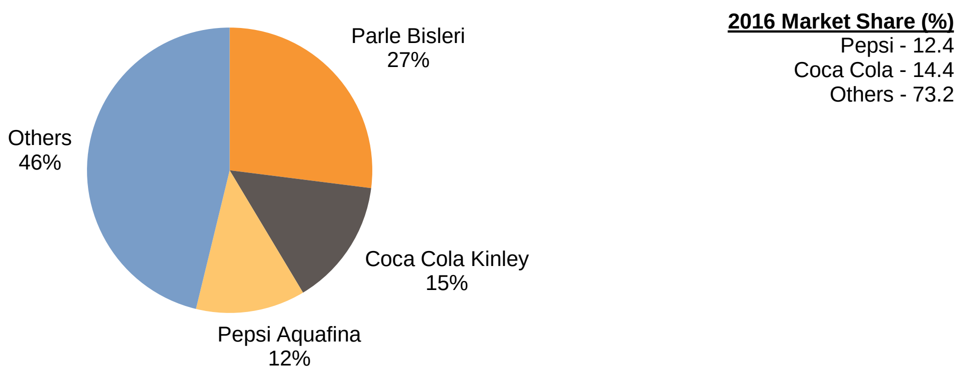
Source: Euromonitor

Exhibit 26: Pepsi's Market Share Trend in Juices volume (%)



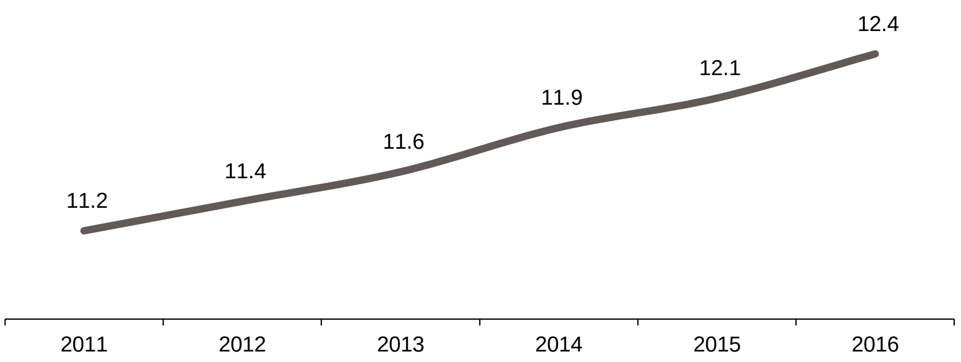
Source: Euromonitor

Exhibit 27: Pepsi's Market Share in Water volume in CY16 (%)



Source: Euromonitor

Exhibit 28: Pepsi's Market Share Trend in Water volume (%)



Source: Euromonitor

5.0 PepsiCo's increased thrust on non-carbonates

Focus on non-carbonates to tap into changing consumer preferences

Ready for changing consumer preferences

PepsiCo plans to capitalize on the changing consumer sentiment from regular cola-carbonates to non-cola carbonates by focusing on products like 7UP Nimbooz Masala Soda. VBL is working closely with PepsiCo to launch new products and diversify its product portfolio. It has introduced a number of non-carbonates' brands in India like Tropicana Slice, Tropicana Frutz (Lychee, Apple and Mango) and 7UP Nimbooz. VBL is also actively evaluating growth opportunities in new product segments.

PepsiCo is investing to reduce sugars in global beverages in line with its 'portfolio with purpose 2025' goal. They are looking forward to bringing more variants of existing products in zero calories or no-sugar category. They plan to keep rolling out products every 2-3 months.

Exhibit 29: Focus on non-cola carbonates

Product	Comments
Mountain Dew	Mountain Dew was the fastest growing carbonates' brand with a CAGR of 19.2% in CY11-15
	Mountain Dew became VBL's largest selling carbonates' brand in CY14
	Relative under-penetration of Mountain Dew in certain markets and distribution channels presents significant growth opportunities
Nimbooz Masala Soda and Revive	There is a large segment of consumers switching from regular carbonates to non-cola carbonates
	VBL launched Nimbooz Masala Soda in CY13 and intends to grow by expanding distribution and increasing production volumes

Source: Company

Exhibit 30: PepsiCo brand portfolio in India (non-cola carbonated soft drinks)

Source: Company, Emkay Research

Exhibit 31: Increased thrust beyond carbonates (Juices and Water)

Product	Countries	Description
Tropicana Slice	India, Nepal	Mango-based
Nimbooz	India	Lemon-based
Tropicana Frutz	India, Sri Lanka	Lychee, Apple, Mango, Mixed Fruit & Orange flavours
Aquafina	India, Sri Lanka	Packaged Drinking Water

Source: Company

Exhibit 32: PepsiCo brand portfolio in India (Juices and Water)

Source: Company, Emkay Research

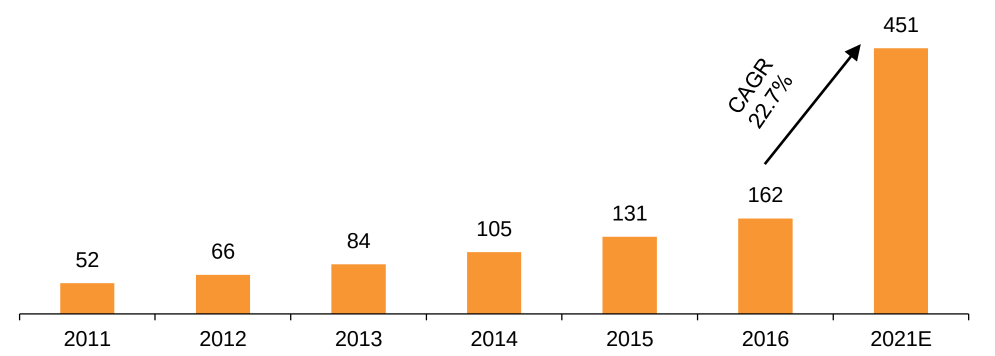
Water is fastest growing category

Over the past five years, packaged water has seen a 22% CAGR in volume. The key growth drivers include increasing consumer awareness and growing consciousness about water borne diseases. The trend is likely to continue led by continued rise in awareness over health concerns along with drinking water shortages especially in urban areas, making consumers opting for bulk packaged drinking water.

Juices have enormous scope for strong growth

The juice market in India is estimated at Rs160bn in CY16 which has seen a 20% volume CAGR over CY11-16. The market is divided into three categories: a) Juice drinks: Contains up to 24% juice and has seen a 21% CAGR - forms 83% of total juice market in volumes; b) Nectars: Juice content is between 25-99% and has seen a 16% CAGR; c) 100% juice: Fastest growing segment with a 23% CAGR.

Exhibit 33: Juice market size (Rs bn)



Source: Euromonitor

Pepsi and Coca Cola should dominate non-carbonates also

In our view, Pepsi and Coca Cola will also dominate the non-carbonates market as they have been dominating the carbonates space. The distribution and reach are far superior to new home grown local players like Manpasand, Parle Agro, Hectar Beverages etc. We think once the overall volume picks up for the category, large players including PepsiCo will capture market share. VBL will be a direct beneficiary of such growth as PepsiCo will require a credible and large franchises to manufacture and distribute its products.

6.0 VBL has solid infrastructure – manufacturing and distribution

Manufacturing capabilities

Strong manufacturing capabilities

VBL has 59 production lines across its 16 production facilities in India catering to different products. VBL also has 4 international production facilities. The facilities are strategically located closer to various target markets. This enables VBL save on transportation and distribution expenses and leverage economies of scale.

A few state-of-the-art and modern production techniques used by VBL are:

- Continuous sugar syrup production process
- UV filters/reverse osmosis facilities for water treatment
- Mechanized or industrial robotic packing systems

Exhibit 34: Key player in PepsiCo's Value chain

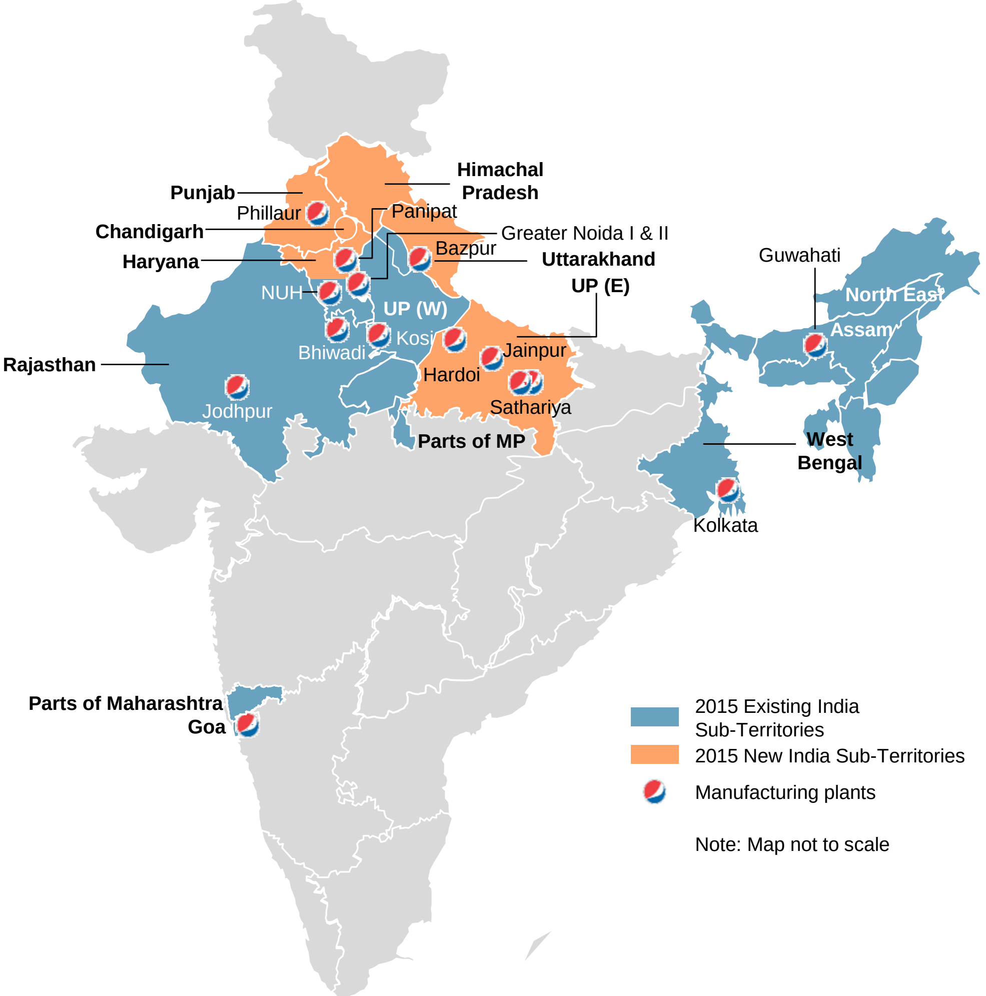
Source: Company

Distribution capabilities

Strong distribution capabilities

VBL has 537 primary distributors in India. It also has 57 depots, 1,421 delivery vehicles and more than 1,300 sales and distribution personnel. VBL has also developed an extensive distribution network in international markets which included 14 depots, 603 delivery vehicles and 649 distributors, as of December 31, 2016.

Exhibit 35: VBL's Indian Territories



Source: Company

Exhibit 36: Overseas Territories

Source: Company

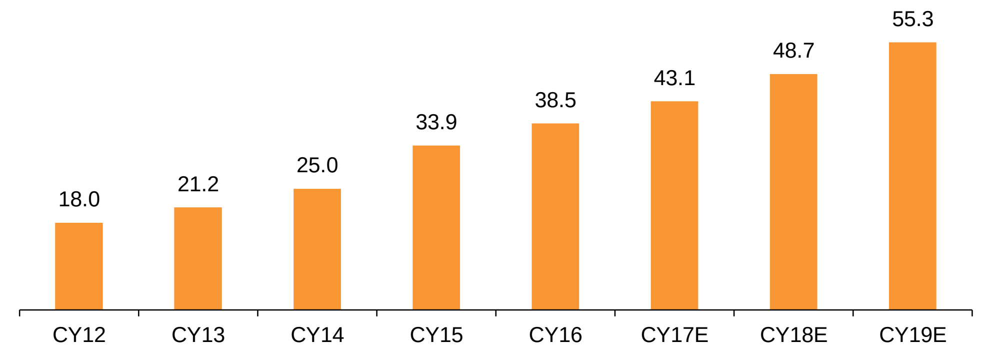
7.0 Financial Performance: Solid earnings growth

Revenue CAGR of 13% CY16-19E

Revenue growth driven by volumes

Over CY16-19, we expect VBL to grow its consolidated revenues at 13% CAGR (lower versus overall soft drinks industry growth given higher salience of carbonates in VBL's portfolio) supported by 10.1% volume CAGR.

Exhibit 37: VBL's Revenue (Rs bn)

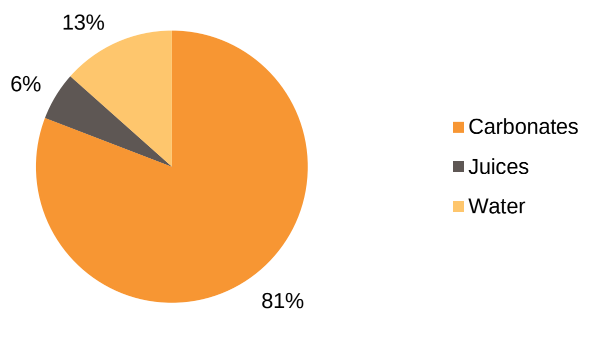


Source: Company, Emkay Research

Realization to grow at an avg 2.5%

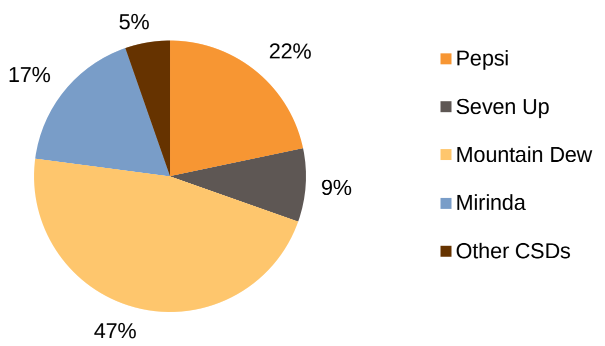
Over CY16-19, we expect VBL's revenue to increase at 13% CAGR backed by 10.1% volume CAGR and 2.6% realization CAGR during the period. India business (76% of revenues in CY16) would grow at 12.4% CAGR backed by 9.7% volume CAGR and 2.5% realization CAGR; we note over CY12-16 realization growth in India business has been muted at 0.6% CAGR due to sustained increase in excise rates.

Exhibit 38: VBL's category-wise volume mix (%)



Source: Company, Emkay Research

Exhibit 39: VBL's brand-wise volume mix (%)



Source: Company, Emkay Research

International business has huge potential

VBL's international business is likely to grow faster at 14.9% CAGR (aided by ~12% volume CAGR) due to relatively lower scale of business, faster growth in respective international markets and market share gains. We note VBL has divested its stake in Mozambique business from 51% to 10% in CY17 and hence we have not consolidated Mozambique revenues in our estimates.

Acquisitions led to increase in revenue

VBL's revenues have increased at 21% CAGR over CY12-16. This was on the back of a strong 19.4% volume CAGR. We cite that the revenue growth was also supported by new acquisitions in India (acquired part of Delhi sub-territory in CY13 and acquired large size of contiguous sub-territories in CY15 from PepsiCo) and international markets (acquired Mozambique and Zambia in CY16). Organic volume growth in India business in CY13-16 was 7% (CAGR). We have not built in any upside from inorganic growth opportunities.

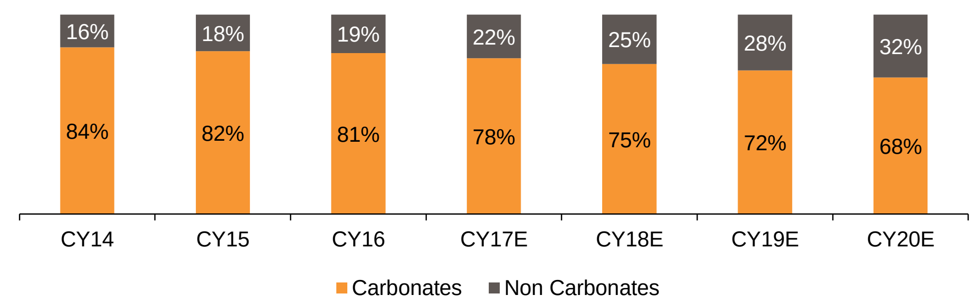
GST is neutral for VBL

The new GST rates for water, juices and carbonates are in line with the previous tax rates which VBL was already paying. As per our estimates, GST implementation will have neutral impact on VBL.

Changing revenue mix in favour of non carbonates

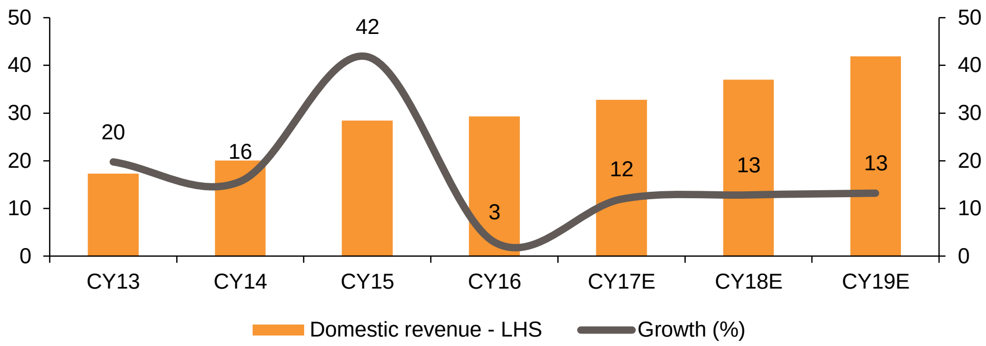
We expect contribution from non carbonates (in VBL's revenue) to rise to 32% in CY20E from current 19%. This will be on the back of PepsiCo's increased thrust on new products which are in line with changing consumer preferences (shift towards healthy drinks).

Exhibit 40: VBL's Revenue Mix (%)



Source: Company, Emkay Research

Exhibit 41: VBL's Domestic Revenue (Rs bn) and Growth (%)

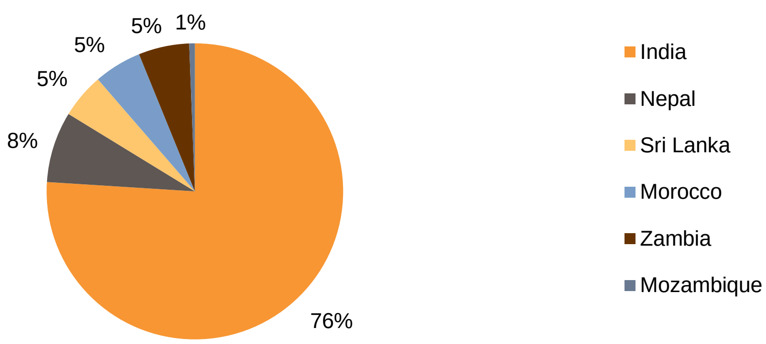


Source: Company, Emkay Research

Seasonality an important factor in annual sales

Seasonality plays a very important role in beverage business as the sales are highly skewed towards Apr-Jun. This quarter contributes 50% to the company's annual revenue. The company loses out on the sales opportunity in the event of a weaker than usual summer. This cannot be compensated in the subsequent months, in the same year. This also has implications on profitability as the company derives most of its profits in Apr-Jun while winters have a negative implication on the Oct-Dec'16 quarter when the company actually reports losses.

Exhibit 42: VBL's Geographical revenue mix



Source: Company, Emkay Research

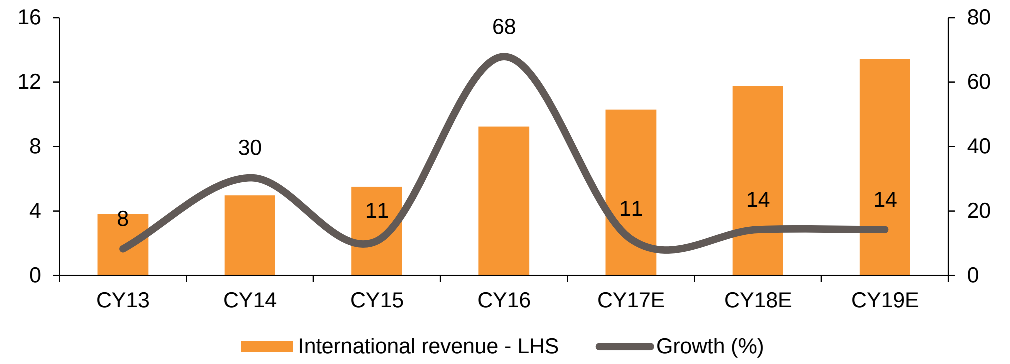
This can change if the company is able to acquire territories from PepiCo in South India where the weather remains warm through the year in comparison to North India.

Higher growth in international business

International business boosting overall revenue

In CY16, international sales contributed 24% to revenue. The volume will increase faster than India due to lower penetration levels. International business is estimated to post 11% volume CAGR and 13% revenue CAGR over CY16-19E.

Exhibit 43: VBL's International Revenue (Rs bn) and Growth (%)



Source: Company, Emkay Research

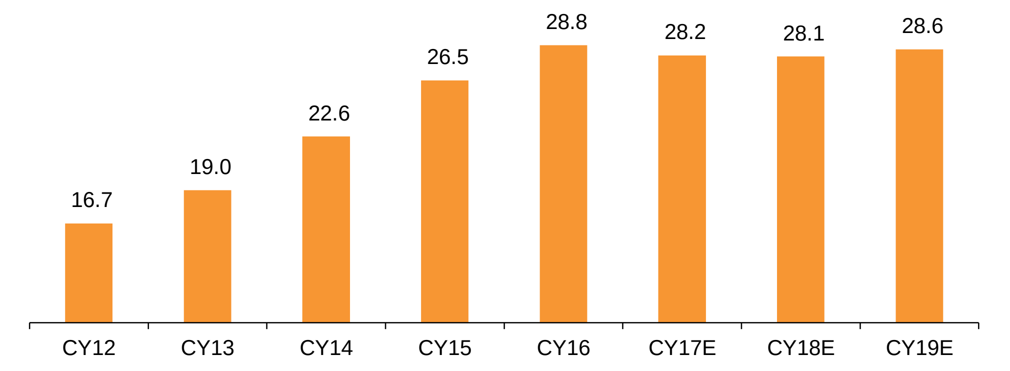
Higher concentrate and sugar costs

Slight reduction in EBITDA margins

We have factored reduction of 160bps in EBITDA margin over CY16-19 due to higher concentrate cost and inflation in sugar. However this would be partially negated by: 1) 2% increase in selling price, (2) lower freight cost due to commencement of new PET line in Goa, and (3) higher profitability in international operations (improved scale of operations and divestment of loss making Mozambique business).

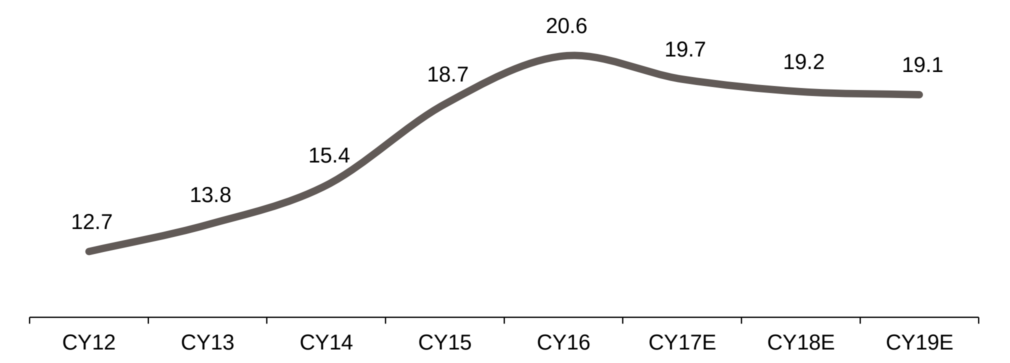
VBL's EBITDA margin improved significantly to 20.6% from 12.7% in last 5 years. VBL has taken several initiatives to drive cost efficiency.

Exhibit 44: VBL's EBITDA/Case (Rs/Case)



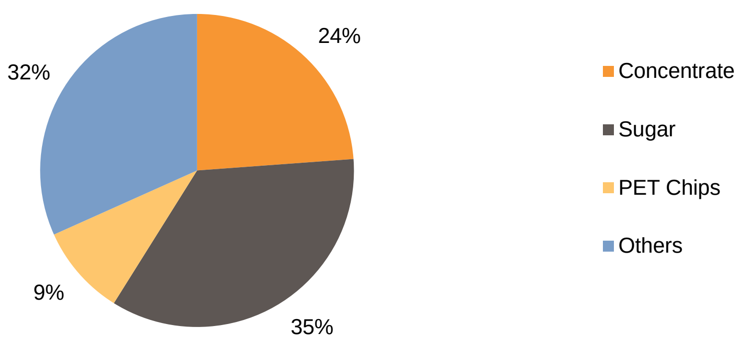
Source: Company, Emkay Research

Exhibit 45: VBL's EBITDA margin (%)



Source: Company, Emkay Research

Exhibit 46: VBL's Raw Material Cost breakup (%)



Source: Company, Emkay Research

Key costs:

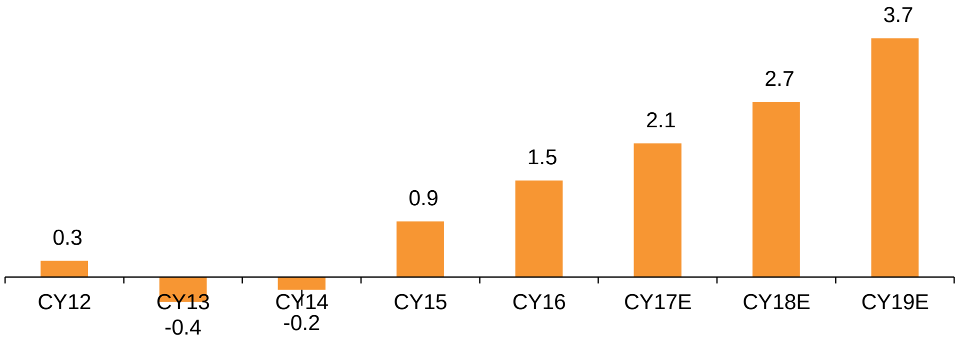
- Concentrate: This is 24% of total RM cost as of CY16. VBL buys concentrate from PepsiCo which is a source of revenue for latter. As per franchise agreement, PepsiCo is entitled to unilaterally determine concentrate price. However, the same is mutually decided at the start of each year and is linked to net realization to VBL. The stability in concentrate price is must for VBL to sustain its EBITDA margins.
- A&P spends: The bulk of A&P Spends are borne by PepsiCo. VBL takes care of the local marketing cost which is 1% of India revenue.
- Royalty. VBL pays PepsiCo some royalty on use of the trademark 'LEHAR' for 2 products: Aquafina Water and Evervess Soda. PepsiCo can revise the royalty rates from time to time.

Earnings CAGR of 35% over CY16-19E

Strong earnings growth through CY19E

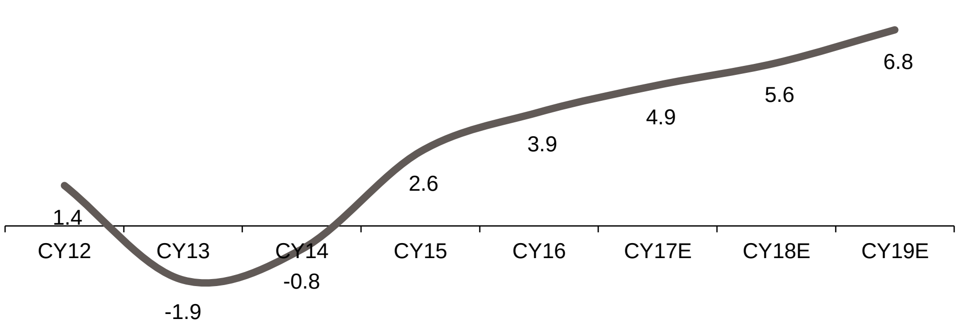
We forecast VBL's earnings to rise at 35% CAGR over CY16-19 backed by: 1) 13% revenue CAGR, 2) lower depreciation costs (VBL depreciates its plants & machinery within 10 years), 3) lower interest costs (debt repayment from FCF generation), 4) reduction in losses in international markets, 5) low tax rate as international business has lower taxation and its contribution to earnings is rising.

Exhibit 47: VBL's Net profit (Rs bn)



Source: Company, Emkay Research

Exhibit 48: VBL's Net margin (%)



Source: Company, Emkay Research

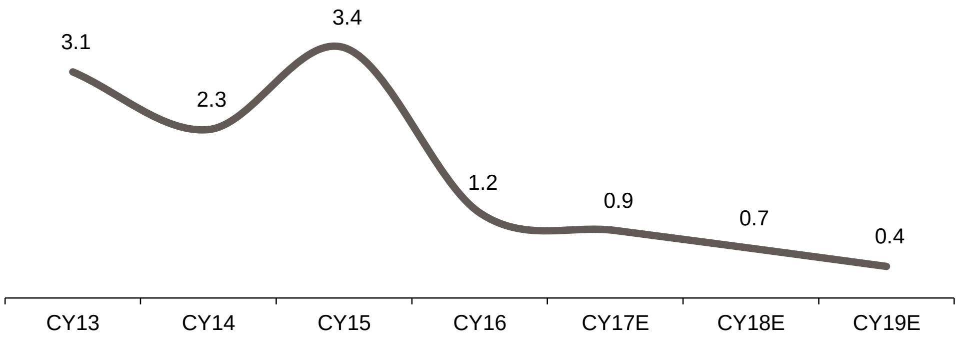
8.0 Solid FCF generation and debt repayment

D/E to decline to 0.4x by CY19E

Debt profile to improve

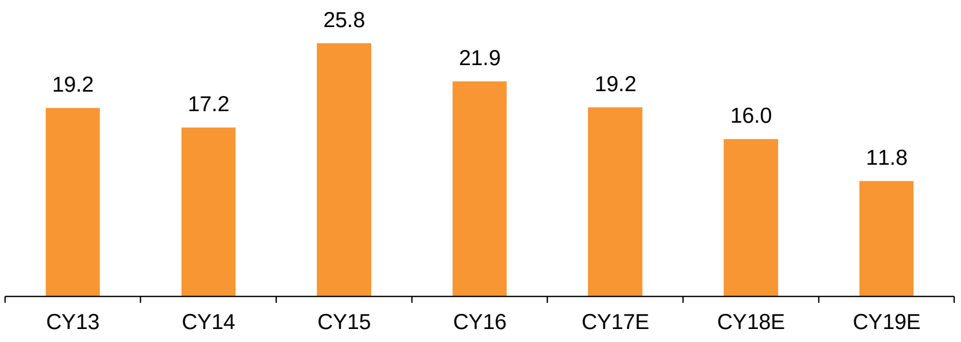
VBL has net debt of Rs21.9bn as at Dec-16. We expect this to reduce to Rs11.8bn by CY19E. There will be debt repayment of Rs6.2bn to PepsiCo (deferred payment) and other lenders. Last year's IPO proceeds of Rs6.7bn were also used to repay debt.

Exhibit 49: VBL's D/E (x)



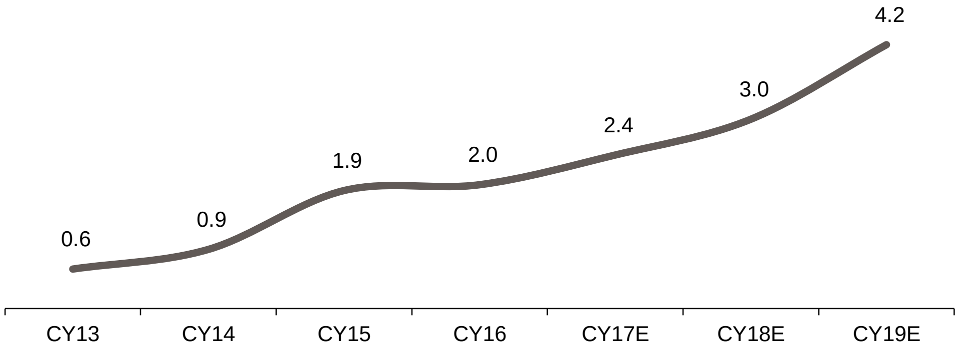
*Source: Company, Emkay Research *Adjusted debt for CCD of Rs4.1bn in CY13, Pref Cap of Rs2bn in CY14 and Rs2.5bn in CY15. This was all converted into equity in CY16*

Exhibit 50: VBL's Net debt (Rs bn)



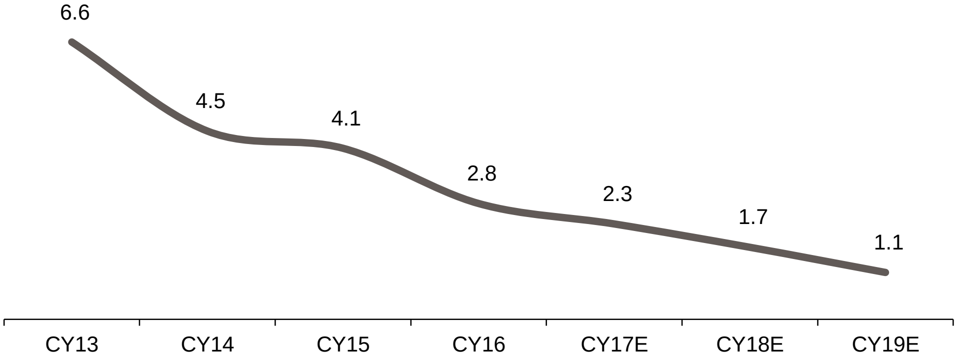
*Source: Company, Emkay Research *Adjusted debt for CCD of Rs4.1bn in CY13, Pref Cap of Rs2bn in CY14 and Rs2.5bn in CY15. This was all converted into equity in CY16*

Exhibit 51: VBL's Interest coverage (x)



Source: Company, Emkay Research

Exhibit 52: VBL's Net debt/Ebitda (x)



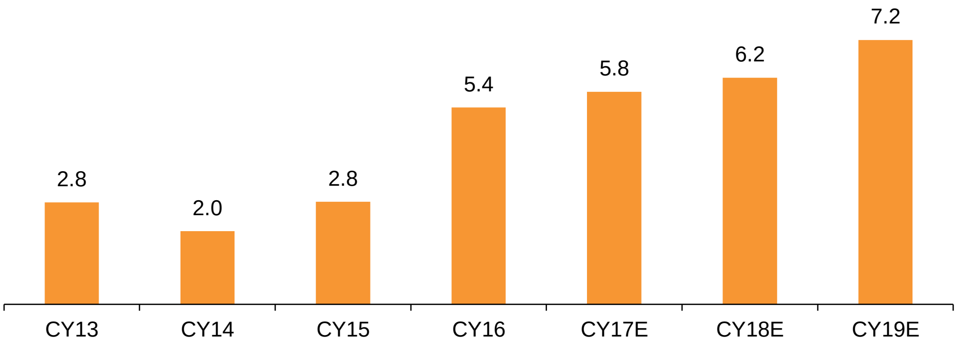
*Source: Company, Emkay Research *Adjusted debt for CCD of Rs4.1bn in CY13, Pref Cap of Rs2bn in CY14 and Rs2.5bn in CY15. This was all converted into equity in CY16*

FCF generation of Rs11bn by CY19E

Solid FCF generation

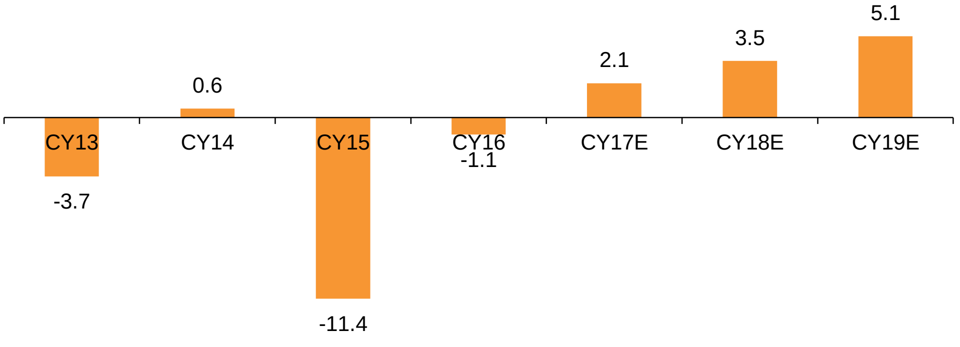
We expect VBL to be FCF positive from CY17E onwards. This will be on the back of strong operating cash flows and low capex spends. We expect OPCF to rise to Rs7.2bn in CY19E from Rs5.4bn in CY16. This will translate into FCF of Rs11bn in CY17-19E.

Exhibit 53: VBL's Operating cash flows (Rs bn)



Source: Company, Emkay Research

Exhibit 54: VBL's free cash flows (Rs bn)



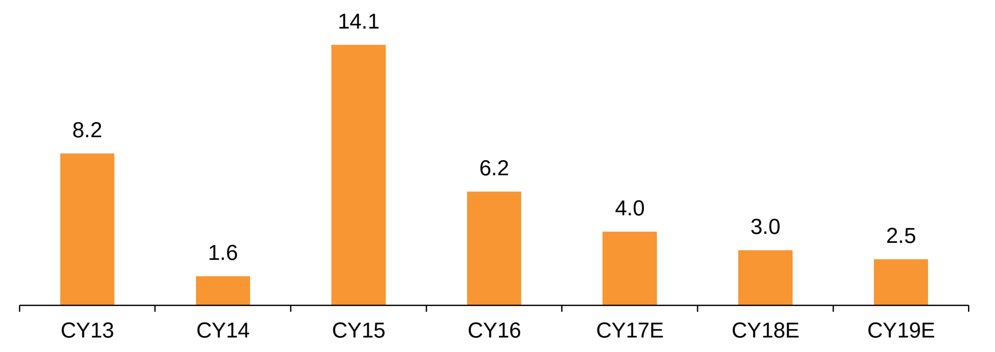
Source: Company, Emkay Research

Capex

Capex spends to slow down going forward

VBL has incurred a cumulative capex of Rs24.5bn including expenses towards acquisition of new territories. We have assumed an average annual maintenance capex of Rs3.1bn for the next 3 years. Post CY19E, we expect VBL to spend Rs90/case on incremental volume. All new capex will be funded from internal cash flows.

Exhibit 55: VBL's Capex (Rs bn)



Source: Company, Emkay Research

Working capital

Working capital improvement

VBL's working capital cycle has improved to 29 days in CY16 from 45days in CY13. We expect this to further improve to 27days by CY18E. This will be supported by operational efficiency and production optimization.

Exhibit 56: VBL's Working capital cycle (days)

Working capital days	CY13	CY14	CY15	CY16	CY17E	CY18E	CY19E
Inventory	43	42	46	46	46	46	46
Debtor	11	14	11	12	12	12	12
Loans & advances	34	23	25	32	30	30	30
Other current assets	2	2	1	1	1	1	1
Current liabilities	41	40	37	52	52	52	52
Provision	4	6	9	10	10	10	10
Working capital days	**45**	**34**	**37**	**29**	**27**	**27**	**27**

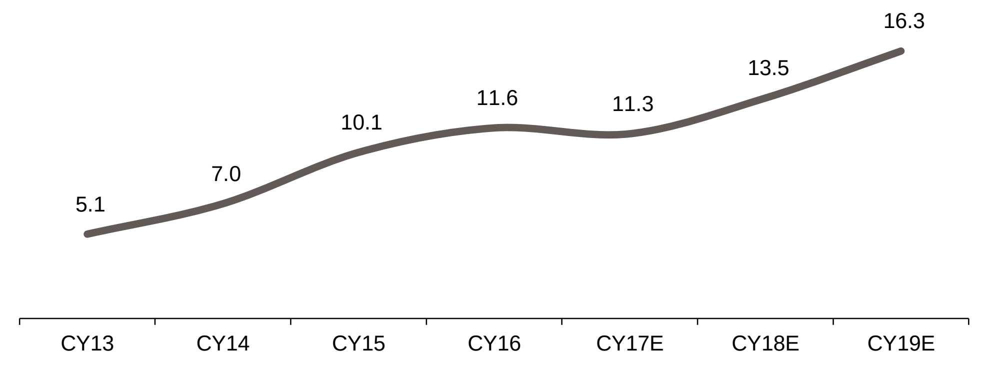
Source: Company, Emkay Research

9.0 Steady increase in return ratios

Improvement in ROE/ROCE

We expect VBL's ROCE to improve to 16.3% in CY19E from 11.6% in CY16. This will be on the back of lower capex spends, debt reduction, better asset turnover and improvement in working capital management. VBL's ROCE was 6-11% over CY12-16 due to high capex intensity.

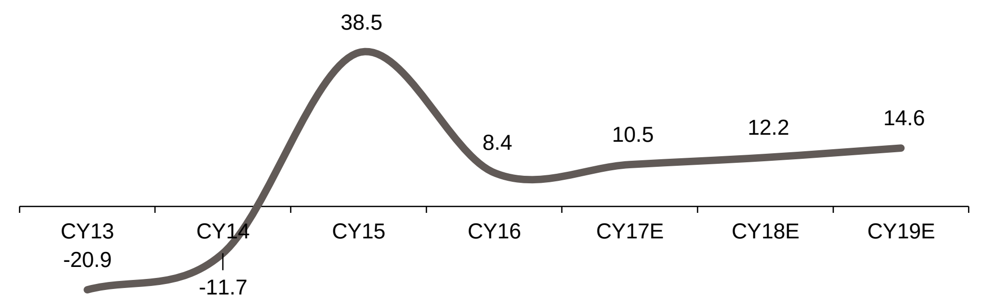
Exhibit 57: VBL's ROCE (%)



Source: Company, Emkay Research

Similarly, we expect VBL's ROE to rise to 14.6% in CY19E from 8.4% in CY16. This will be supported by increase in earnings and improvement in cash flows.

Exhibit 58: VBL's ROE (%)



Source: Company, Emkay Research

10.0 Risks

The key risks to our recommendation are:

- **Seasonality:** 45% of VBL's sales come in Apr-Jun due to heat and warm weather. Bad weather conditions, including disturbed summers or untimely rains during peak sales season of summer, may adversely affect its sales.
- **Agreement with PepsiCo:** VBL carries risk of cancellation or non-renewal of franchisee agreement from PepsiCo. VBL's relationship with PepsiCo is governed by agreements for different geographies. PepsiCo however is entitled to unilaterally terminate these by giving written notice of 12 months.
- **Concentrate:** PepsiCo determines concentrate price that VBL requires for its products. VBL's margins could be at risk in case PepsiCo decides to increase prices. However, in practice, concentrate prices are mutually agreed upon at the start of each year and are linked to selling price of VBL.
- **Change in customer preference:** Currently, 81% of VBL volume comes from carbonates. However there is a visible shift in consumer preferences globally as people are getting more heath consciousness. The future sales volume growth depends on new product launches by Pepsi in non-carbonated category and franchisee to VBL for these products.

11.0 Profile

Part of RJ Corp group

VBL is part of the RJ Corp group, a diversified business conglomerate with interests in beverages, quick-service restaurants, dairy and healthcare. RJ Corp was incorporated in 1980 as Cheers Beverages Private Ltd. VBL's Promoter and Chairman, Mr. Ravi Kant Jaipuria, has an established reputation as an entrepreneur and business leader and is the only Indian to receive PepsiCo's International Bottler of the Year award, which was awarded in 1997.

Strong relationship with PepsiCo

VBL is currently PepsiCo's one of the largest franchisees in the world outside of the US for carbonates and non-carbonates. It has been associated with PepsiCo since its entry into the Indian market in 1991, when it was appointed as an exclusive bottler and distributor for the territory of Agra. VBL holds franchises for PepsiCo products across 17 States and two Union Territories in India. Apart from India, the company has been granted franchises in Nepal, Sri Lanka, Morocco and Zambia.

The relationship between the two in India is based on three franchisee agreements in place for a 10-year period until 2 October 2022. PepsiCo has the right to renew agreements for an additional five years. Similar agreements are in place for each of the overseas territories.

PepsiCo agreement details

VBL has entered into three franchisee agreements with PepsiCo for a 10-year period until 2 October 2022. PepsiCo has the right to renew agreements thereafter in normal course. Similar agreements are in place for each of the overseas territories. Details are:

- Licensing of following PepsiCo owned trademarks: Diet Pepsi, 7UP, Mirinda Orange, Mirinda Lemon, Mountain Dew, 7UP Nimbooz Masala Soda, 7UP Revive, Lehar Evervess Soda, Tropicana Slice, 7UP Nimbooz, and Aquafina.
- VBL pays a royalty for the use of the trademark "LEHAR" for Aquafina and Evervess Soda.
- VBL purchases concentrate for all PepsiCo products produced by PepsiCo at a price and at terms and conditions determined by PepsiCo. However the price of concentrate has been agreed by PepsiCo after consulting with VBL to encourage promotion of new products and penetration into new markets.
- VBL needs to install and maintain adequate production and distribution capacity to ensure that it is able to match the demand of PepsiCo products at any time.
- VBL discusses an indicative annual operating plan with PepsiCo which relates to Sales Volume targets for the year based on which VBL determines capex requirements, volume capacity, distribution capacity, etc.
- VBL is prohibited from manufacturing, distributing or selling non-PepsiCo products that would compete with the PepsiCo products. Any non-compliance provides PepsiCo the option to terminate these agreements.
- PepsiCo is entitled to terminate franchise agreements in the event of: 1) if promoters cease to be in control of the company, 2) if any competitors of PepsiCo acquires any shareholding in any entity of promoter group or acquires any shareholding in VBL in excess of 15%, 3) if VBL discontinues production of PepsiCo for a period of 30 consecutive days 4) if D/E ratio of VBL (on a standalone basis) exceeds 2:1

Key Financials (Consolidated)

Income Statement

Y/E Dec (Rs mn)	CY15	CY16	CY17E	CY18E	CY19E
Net Sales	**33,941**	**38,520**	**43,068**	**48,742**	**55,301**
Expenditure	**27,601**	**30,568**	**34,584**	**39,389**	**44,758**
EBITDA	**6,341**	**7,952**	**8,483**	**9,353**	**10,543**
Depreciation	3,174	3,724	4,177	4,221	4,336
EBIT	**3,167**	**4,228**	**4,306**	**5,132**	**6,207**
Other Income	143	348	365	383	403
Interest expenses	1,688	2,148	1,765	1,706	1,481
PBT	**1,621**	**2,428**	**2,907**	**3,810**	**5,129**
Tax	766	829	814	1,067	1,385
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	15	(87)	0	0	0
Reported Net Income	**870**	**1,513**	**2,093**	**2,743**	**3,744**
Adjusted PAT	**870**	**1,513**	**2,093**	**2,743**	**3,744**

Balance Sheet

Y/E Dec (Rs mn)	CY15	CY16	CY17E	CY18E	CY19E
Equity share capital	1,338	1,823	1,825	1,825	1,825
Reserves & surplus	885	17,116	19,208	21,951	25,696
Net worth	**2,223**	**18,939**	**21,033**	**23,776**	**27,521**
Minority Interest	**0**	**1**	**1**	**1**	**1**
Loan Funds	**34,950**	**22,542**	**20,307**	**16,807**	**12,807**
Net deferred tax liability	1,484	2,158	2,154	2,217	2,297
Total Liabilities	**38,657**	**43,639**	**43,495**	**42,801**	**42,625**
Net block	**34,991**	**39,633**	**39,874**	**39,076**	**38,107**
Investment	**33**	**56**	**59**	**62**	**65**
Current Assets	**8,944**	**11,578**	**13,022**	**14,196**	**16,214**
Cash & bank balance	581	657	1,071	786	1,051
Other Current Assets	785	1,385	1,525	1,610	1,775
Current liabilities & Provision	**5,690**	**8,585**	**9,460**	**10,533**	**11,761**
Net current assets	**3,254**	**2,993**	**3,562**	**3,664**	**4,453**
Misc. exp	0	0	0	0	0
Total Assets	**38,657**	**43,639**	**43,495**	**42,801**	**42,625**

Cash Flow

Y/E Dec (Rs mn)	CY15	CY16	CY17E	CY18E	CY19E
PBT (Ex-Other income) (NI+Dep)	**1,479**	**2,081**	**2,542**	**3,426**	**4,726**
Other Non-Cash items	0	0	0	0	0
Chg in working cap	(273)	1,010	(158)	(323)	(445)
Operating Cashflow	**5,301**	**8,134**	**7,511**	**7,963**	**8,713**
Capital expenditure	(14,749)	(8,942)	(3,462)	(3,422)	(3,367)
Free Cash Flow	**(9,447)**	**(809)**	**4,049**	**4,541**	**5,346**
Investments	(15)	(23)	(3)	(3)	(3)
Other Investing Cash Flow	(63)	(543)	0	0	0
Investing Cashflow	**(14,684)**	**(9,161)**	**(3,100)**	**(3,042)**	**(2,968)**
Equity Capital Raised	0	485	2	0	0
Loans Taken / (Repaid)	8,287	(12,408)	(2,235)	(3,500)	(4,000)
Dividend paid (incl tax)	0	0	0	0	0
Other Financing Cash Flow	0	15,174	0	0	0
Financing Cashflow	**6,599**	**1,104**	**(3,998)**	**(5,206)**	**(5,481)**
Net chg in cash	**(2,783)**	**76**	**414**	**(284)**	**264**
Opening cash position	3,364	581	657	1,071	786
Closing cash position	**581**	**657**	**1,071**	**786**	**1,051**

Source: Company, Emkay Research

Key Ratios

Profitability (%)	CY15	CY16	CY17E	CY18E	CY19E
EBITDA Margin	18.7	20.6	19.7	19.2	19.1
EBIT Margin	9.3	11.0	10.0	10.5	11.2
Effective Tax Rate	47.3	34.1	28.0	28.0	27.0
Net Margin	2.5	4.2	4.9	5.6	6.8
ROCE	9.8	11.1	10.7	12.8	15.5
ROE	47.6	14.3	10.5	12.2	14.6
RoIC	10.1	10.6	10.2	12.2	14.9

Per Share Data (Rs)	CY15	CY16	CY17E	CY18E	CY19E
EPS	6.5	8.3	11.5	15.0	20.5
CEPS	30.2	28.7	34.4	38.2	44.3
BVPS	16.6	103.9	115.3	130.3	150.8
DPS	0.0	0.0	0.0	0.0	0.0

Valuations (x)	CY15	CY16	CY17E	CY18E	CY19E
PER	78.4	61.5	44.5	34.0	24.9
P/CEPS	16.9	17.8	14.9	13.4	11.5
P/BV	30.7	4.9	4.4	3.9	3.4
EV / Sales	3.0	3.0	2.6	2.2	1.9
EV / EBITDA	16.2	14.5	13.2	11.7	10.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0

Gearing Ratio (x)	CY15	CY16	CY17E	CY18E	CY19E
Net Debt/ Equity	15.5	1.2	0.9	0.7	0.4
Net Debt/EBIDTA	5.4	2.8	2.3	1.7	1.1
Working Cap Cycle (days)	28.7	22.1	21.1	21.5	22.5

Growth (%)	CY15	CY16	CY17E	CY18E	CY19E
Revenue	35.6	13.5	11.8	13.2	13.5
EBITDA	64.9	25.4	6.7	10.3	12.7
EBIT	81.5	33.5	1.8	19.2	20.9
PAT	0.0	73.8	38.4	31.1	36.5

Quarterly (Rs mn)	Q1CY16	Q2CY16	Q3CY16	Q4CY16	Q1CY17
Revenue	8,690	16,606	8,975	4,249	8,792
EBITDA	1,195	4,847	1,711	200	1,372
EBITDA Margin (%)	**13.7**	**29.2**	**19.1**	**4.7**	**15.6**
PAT	(541)	2,567	369	(906)	30
EPS (Rs)	**(4.0)**	**19.2**	**2.7**	**(5.0)**	**0.2**

Source: Company, Emkay Research

Shareholding Pattern (%)	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Promoters	-	-	-	73.6	73.7
FIIs	-	-	-	11.1	17.9
DIIs	-	-	-	1.0	1.2
Public and Others	-	-	-	14.3	7.2

Source: Emkay Research

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

Emkay Global Financial Services Ltd.
CIN - L67120MH1995PLC084899
7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India
Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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AXIS DIRECT

18 MAY 2017 Quarterly Update

VARUN BEVERAGES

FMCG

BUY

Target Price: Rs 545

Good beginning to the summer

Consolidated net sales grew 1% YoY, aided by ~2% volume growth. Volume in CSD declined 4% YoY, was flat in juices and grew 36% in water. EBITDA margin expanded 198 bps YoY to 15.2% as gross margin expanded 313 bps YoY to 54.3%. Aided by reduced interest costs, the company has achieved an adj. PAT of Rs45mn, compared to PAT loss of Rs518mn in Q1CY16. As per management, the all critical summer season has begun well with healthy growth in April.

VBL is a long term structural play in the underpenetrated Indian soft beverages market. Higher growth potential (low per capita) and strong margin profile (OPM to sustain at ~20% in the medium term) are the key factors which will make it command apremium to global peers. VBL trades at CY18 EV/E of 11.3x and P/E of 32x. Maintain **BUY** with revised TP of Rs 545, based on fwd.EV/E of 11.5x (vs. Rs510 earlier).

CMP	: Rs 485
Potential Upside	: 12%

MARKET DATA

No. of Shares	: 183 mn
Free Float	: 26%
Market Cap	: Rs 89 bn
52-week High / Low	: Rs 508 / Rs 341
Avg. Daily vol. (6mth)	: 99,954 shares
Bloomberg Code	: VBL IB Equity
Promoters Holding	: 74%
FII / DII	: 11% / 1%

India – extended winter in North hurts volume growth, but Q2 looks better: Q1CY17 volumes grew a mere 2% due to weak volumes in North India. For Q2CY17 (most important quarter as it contributes to almost 60% of full year EBITDA), management highlighted good growth in April despite a high base; and, it expects the momentum to sustain in May and June as well given the subdued base. Management is looking to maintain EBITDA margin in CY17.

International volume grew 3.8%: Management highlighted that international operations in Nepal, Sri Lanka and Morocco posted double digit growth in Q1. Zambia business was hit by heavy rains and lean season (Nov and Dec are key months). In Q1CY16, the company increased its stake in Zambia subsidiary from 60% to 90% (at cost of Rs 710 mn). In CY16, Zambia unit registered sales volume of 10.7 mn case with EBITDA at Rs 467 mn. On the other hand, the company divested 41% stake in its loss-making Mozambique subsidiary in light of limited opportunity to scale-up operations to turn around the subsidiary. In CY16, the unit contributeda mere 0.6% to net sales and recorded net loss of Rs 99 mn.

Financial summary (Consolidated)

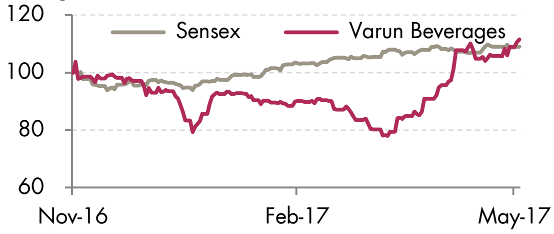
Y/E December	CY15	CY16	CY17E	CY18E
Sales (Rs mn)	33,941	38,520	42,502	48,402
Adj PAT (Rs mn)	1,130	1,513	2,311	2,792
Con. EPS* (Rs)	-	-	10.9	14.2
EPS (Rs)	8.4	8.9	12.7	15.3
Change YOY (%)	(657.1)	6.5	41.7	20.8
P/E (x)	57.8	54.3	38.3	31.7
RoE (%)	22.2	11.8	11.5	12.3
RoCE (%)	9.9	11.0	10.6	11.8
EV/E (x)	14.9	13.1	12.8	11.3
DPS (Rs)	-	-	-	-

Source: *Consensus broker estimates, Company, Axis Capital

Key drivers

	CY16	CY17E	CY18E
Domestic volume	224	247	271
International volume	52	56	63
Gross margin	54.9%	53.9%	53.0%
EBITDA margin	20.6%	20.3%	19.8%

Price performance



Conference call highlights

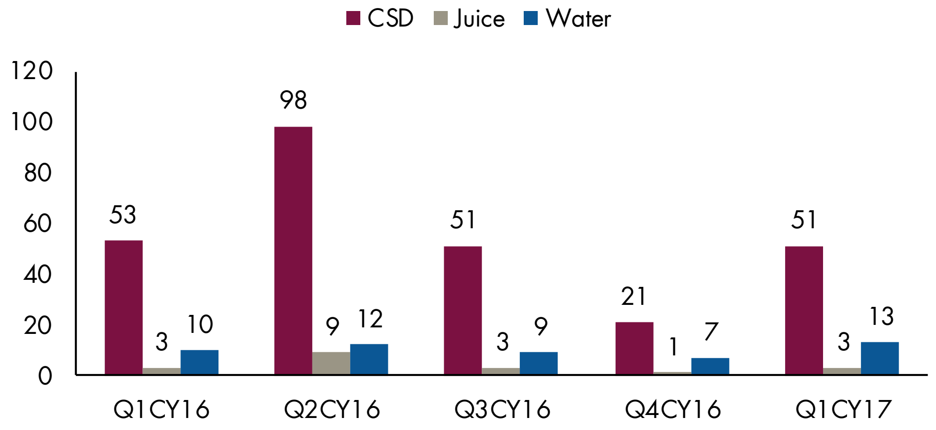
- **Capex guidance:**The company maintained its capex guidance (in line with depreciation for CY17). Going ahead,capex to reduce substantially (50-60% of depreciation). In Q2CY16, the company commenced production/ operation from its new unit at Hardoi, Uttar Pradesh.
- **Quarterly mix**
  - **Volume mix:** 18-19% in Q1, 45-46% in Q2, 22-23% in Q3 and 12-14% in Q4
  - **EBITDA mix**: 15% in Q1, 60% in Q2, 12.5% in Q3 and 12.5% in Q4
  - **PAT mix:**For the first time, the company has recorded PAT profit in first quarter. Usually the company makes 120-130% of annual PAT in Q2, 20% of annual in Q3 and balance loss in Q4
- The company has guided for interest cost of Rs 1.7 bn for CY17 (under IGAAP). Under Ind-AS, the cost will further increase by Rs 450 mn as a reflection of fair value of interest-free loan from PepsiCo and deferred benefit from the government
- Management highlighted that credit rating for long term debt has been upgraded from CRISIL A+/Positive to CRISIL AA-/Stable. The company had already secured top rating for short term debt i.e. CRISIL A1+
- The company has repaid annual installment of Rs 3,235 mn towards interest free deferred acquisition payment to PepsiCo during Q1CY17. The last installment of Rs3 bn is pending (due in Feb-18)

Exhibit 1: Result update

(Rs. mn)	Mar-17	Mar-16	% Chg	Dec-16	% Chg
Net Sales	**8,746**	**8,634**	**1.3**	**4,201**	**108.2**
Raw Material Cost	4,001	4,220	(5.2)	1,739	130.1
(% of Net Sales)	45.7	48.9	-313 bps	41.4	435 bps
Staff Expenditure	1,100	972	13.1	1,019	7.9
(% of Net Sales)	12.6	11.3	132 bps	24.3	-1168 bps
Other Expenses	2,319	2,303	0.7	1,291	79.6
(% of Net Sales)	26.5	26.7	-16 bps	30.7	-423 bps
EBITDA	**1,326**	**1,138**	**16.5**	**151**	**776.6**
EBITDA margin (%)	15.2	13.2	198 bps	3.6	1156 bps
Other income	182	104	74.0	93	96.1
PBIDT	**1,508**	**1,243**	**21.3**	**244**	**518.1**
Depreciation	801	775	3.4	926	(13.5)
Interest	566	1,090	(48.1)	499	13.5
PBT	**141**	**-622**	**nm**	**-1,181**	**nm**
Tax	74	-61	nm	-289	nm
Minority interest	22	-43	nm	15	49.7
Adjusted PAT	**45**	**-518**	**nm**	**-906**	**nm**
Reported PAT	**45**	**-518**	**nm**	**-906**	**nm**

Source: Company, Axis Capital

Exhibit 2: Category-wise sale volume (mn cases)



Source: Company, Axis Capital

AXIS DIRECT

Financial summary (Consolidated)

Profit &loss (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Net sales	**33,941**	**38,520**	**42,502**	**48,402**
Other operating income	-	-	-	-
Total operating income	**33,941**	**38,520**	**42,502**	**48,402**
Cost of goods sold	(17,165)	(17,363)	(19,584)	(22,771)
Gross profit	16,777	21,157	22,918	25,631
Gross margin (%)	*49.4*	*54.9*	*53.9*	*53.0*
Total operating expenses	(10,406)	(13,205)	(14,271)	(16,069)
EBITDA	**6,371**	**7,952**	**8,648**	**9,563**
EBITDA margin (%)	*18.8*	*20.6*	*20.3*	*19.8*
Depreciation	(3,174)	(3,724)	(3,912)	(4,231)
EBIT	**3,197**	**4,228**	**4,735**	**5,332**
Net interest	(1,688)	(2,148)	(1,652)	(1,733)
Other income	143	348	130	288
Profit before tax	**1,906**	**2,428**	**3,214**	**3,886**
Total taxation	(789)	(829)	(903)	(1,095)
Tax rate (%)	*41.4*	*34.1*	*28.1*	*28.2*
Profit after tax	1,118	1,600	2,311	2,792
Minorities	-	(111)	-	-
Profit/ Loss associate co(s)	13	23	-	-
Adjusted net profit	**1,130**	**1,513**	**2,311**	**2,792**
Adj. PAT margin (%)	*3.3*	*3.9*	*5.4*	*5.8*
Net non-recurring items	-	-	-	-
Reported net profit	**1,130**	**1,513**	**2,311**	**2,792**

Balance sheet (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Paid-up capital	5,838	1,823	1,823	1,823
Reserves & surplus	905	17,116	19,426	22,218
Net worth	6,743	18,939	21,250	24,041
Borrowing	30,008	22,482	22,794	20,694
Other non-current liabilities	2,000	3,237	3,268	3,301
Total liabilities	**38,751**	**44,657**	**47,312**	**48,036**
Gross fixed assets	46,325	52,437	59,569	63,669
Less: Depreciation	(11,369)	(14,936)	(18,848)	(23,079)
Net fixed assets	34,956	37,501	40,721	40,590
Add: Capital WIP	379	3,088	2,821	2,821
Total fixed assets	35,335	40,589	43,542	43,411
Total Investment	33	56	56	56
Inventory	4,247	4,899	5,106	5,717
Debtors	979	1,303	1,370	1,543
Cash & bank	581	657	445	1,452
Loans & advances	2,994	4,577	4,569	4,560
Current liabilities	5,561	7,566	7,919	8,845
Net current assets	3,333	3,969	3,670	4,525
Other non-current assets	50	43	43	43
Total assets	**38,751**	**44,657**	**47,312**	**48,036**

Source: Company, Axis Capital

Cash flow (Rs mn)

Y/E December	CY15	CY16	CY17E	CY18E
Profit before tax	1,906	2,428	3,214	3,886
Depreciation & Amortisation	3,174	3,724	3,912	4,231
Chg in working capital	*(419)*	*820*	*87*	*151*
Cash flow from operations	**5,548**	**8,303**	**7,994**	**8,940**
Capital expenditure	*(2,645)*	*(7,999)*	*(6,866)*	*(4,100)*
Cash flow from investing	**(2,997)**	**(10,680)**	**(6,866)**	**(4,100)**
Equity raised/ (repaid)	-	*7,014*	-	-
Debt raised/ (repaid)	*(6,652)*	*1,025*	*312*	*(2,100)*
Dividend paid	-	-	-	-
Cash flow from financing	**(2,360)**	**2,459**	**(1,340)**	**(3,833)**
Net chg in cash	191	82	(212)	1,006

Key ratios

Y/E December	CY15	CY16	CY17E	CY18E
OPERATIONAL				
FDEPS (Rs)	8.4	8.9	12.7	15.3
CEPS (Rs)	32.0	31.0	34.1	38.5
DPS (Rs)	-	-	-	-
Dividend payout ratio (%)	-	-	-	-
GROWTH				
Net sales (%)	35.6	13.5	10.3	13.9
EBITDA (%)	65.7	24.8	8.7	10.6
Adj net profit (%)	(660.8)	33.8	52.8	20.8
FDEPS (%)	(657.1)	6.5	41.7	20.8
PERFORMANCE				
RoE (%)	22.2	11.8	11.5	12.3
RoCE (%)	9.9	11.0	10.6	11.8
EFFICIENCY				
Asset turnover (x)	1.1	1.0	1.0	1.1
Sales/ total assets (x)	0.9	0.8	0.8	0.9
Working capital/ sales (x)	0.1	0.1	0.1	0.1
Receivable days	10.5	12.3	11.8	11.6
Inventory days	56.2	58.5	55.0	53.7
Payable days	24.4	32.8	32.0	30.7
FINANCIAL STABILITY				
Total debt/ equity (x)	5.9	1.8	1.1	0.9
Net debt/ equity (x)	5.8	1.7	1.1	0.8
Current ratio (x)	1.6	1.5	1.5	1.5
Interest cover (x)	1.9	2.0	2.9	3.1
VALUATION				
PE (x)	57.8	54.3	38.3	31.7
EV/ EBITDA (x)	14.9	13.1	12.8	11.3
EV/ Net sales (x)	2.8	2.7	2.6	2.2
PB (x)	9.7	4.3	4.2	3.7
Dividend yield (%)	-	-	-	-
Free cash flow yield (%)	4.4	0.4	1.3	5.5

Source: Company, Axis Capital

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Research Team

Sr. No	Name	Designation	E-mail
1	Akhand Singh	Research Analyst	akhand.singh@axissecurities.in
2	Poonam Darade	Research Associate	poonam.darade@axissecurities.in

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