SMART SYNC SERVICES

VBL Mar CY20

Brief Company Introduction

VBL are the second largest franchisee in the world (outside US) of carbonated soft drinks ("CSDs") and non-carbonated beverages ("NCBs") sold under trademarks owned by PepsiCo and a key player in the beverage industry. They produce and distribute a wide range of CSDs, as well as a large selection of NCBs, including packaged drinking water. PepsiCo CSD brands sold include Pepsi, Diet Pepsi, Seven-Up, Mirinda Orange, Mirinda Lemon, Mountain Dew, Seven-Up Nimbooz Masala Soda, Evervess Soda, Sting and Gatorade. PepsiCo NCB brands sold by the company include Tropicana (100%, Essentials & Delight), Tropicana Slice, Tropicana Frutz, Seven-Up Nimbooz and Quaker Oat Milk as well as packaged drinking water under the brand Aquafina.

Standalone Financials (In Crs)					
	Mar CY21	Mar CY21	YoY %	Dec CY20	QoQ %
Sales	1805	1344	34.30%	868	107.95%
PBT	175	5***	143.06%	-66	-365.15%
PAT	125	77**	62.34%	-52	-340.38%
Consolidated Financials (In Crs)					
	Mar CY21	Mar CY21	YoY %	Dec CY20	QoQ %
Sales	2276	1725	31.94%	1357	67.72%
PBT	195	8	2338%	-19	-1126.3%
PAT	137	60*	128%	-7	-2057.14%

*contains negative tax expense of Rs 52 Cr

**Contains negative tax expense of Rs 72 Cr

***contains exceptional item of Rs 66.5 Cr for impairment of certain plant & equipment

Detailed Results:

1. The current quarter was up for the company with a 32% YoY rise in consolidated revenues & a PAT of Rs 137 Cr.
2. The company saw an EBITDA rise of 40.7% YoY and a volume rise of 32.8% YoY in the quarter. CY20 EBITDA fell 17% YoY.
3. Other income in Q1 fell 77.3% YoY.
4. Organic sales volumes grew 24.7% YoY. Realization per case was flat at Rs 148.
5. CSD constituted 70%, Juice 7.2%, and Packaged Drinking water 22.8% of total sales volumes in Q1 CY21.
6. EBITDA margin improved by 86 bps YoY in Q1 CY21.
7. Gross margins fell by 294 bps YoY to 55.8% in Q1 due to change in product mix and lower realization in international operations.
8. Finance costs for the company declined 33.4% YoY due to the repayment of some debt and a lower average cost of borrowing.
9. The company announced a bonus share issue of 1 share for every 2 existing shares.

Investor Conference Call Highlights:

1. The management maintains that VBL has adequately stocked its supply chain and has not seen any issues from the local lockdowns so far. The situation is much better than last year as VBL has some stores to supply rather than no supply like last year.
2. The rural segment is doing much better than the urban segment according to the management as the lockdowns are less severe. It has grown >50% in 1 year.
3. The company is not facing any input price pressures. Sugar prices are running normally. PET resin prices have gone up in the last 2 months, but the company is adequately stocked beforehand to last till Sept or Oct and this price increase is expected to normalize by then.
4. The expected tax rate for CY21 is expected to be 25%.
5. The 3 categories that are doing very well currently for the company are the energy drink Sting (which has grown almost 10 times in volumes in 2 years), the newly launched Mountain Dew Ice (as a competitor to Limca), and Tropicana (which is the only juice in the country available in PET format).
6. The company has reduced Rs 600 Cr of debt in the last 1 year.
7. The North is the best performing zone for VBL. It had invested a lot for expansion in the South and the East but the improvements have been slow since the start of the pandemic.
8. The company will stick to its existing capex plans and will keep it lower than the depreciation for the year.
9. The management admits that there isn't clear evidence of VBL outpacing the market as the entire industry has done well in the past 1 year.
10. The peak season for the industry has again been affected due to the pandemic although not as severe as last year according to the management.
11. Sting has grown 2.5 times in the past 1 year for VBL.
12. The management clarifies that although out of home consumption has gone down a lot, once the situation normalizes, it will not be adding too much to organic growth as it will just be substituting the current in-home consumption to some extent since all of this growth has come from the same outlets and visi-coolers that are present in the market.
13. The management has stated that it has already put all the planned visi-coolers for the year before the peak season and will not be adding any more for the year.
14. The management has stated that the rise in standalone other expenses is mainly variable expenses which have risen with volume growth. Other contributing factors to it are asset write-offs that the company has done like for a glass line in Bazpur of Rs 15 Cr.
15. The management hopes to see the start of the currency reserve reversal in Zimbabwe soon.
16. There should not be any raw material factors weighing down the margin for CY21 according to the management. But the exact margins ultimately will depend on volumes sold and product mix.
17. The North and East Zones have grown 38% in the past year.
18. Tropicana is still small for the company, accounting for 3-4% of volumes.
19. The biggest competitor for Tropicana is Real by Dabur. But the distribution reach of VBL is much bigger than the competition especially in the rural regions and thus the management is confident of high growth in this product category.
20. The management feels that it will take 2 or more years for the South & West zones to start showing performance because of the addition of visi-coolers and other measures done by the company.
21. The management states that the penetration in the rural areas in the East zone remains low due to the low power situation and the penetration should improve as the power situation improves.

22. Although the energy drink Sting is assumed to be part of the urban portfolio, its pricing helps it sell well in all regions according to the management.
23. There isn't any significant demand impact from the local lockdowns since in-home consumption is steady and procurement has not stopped totally.
24. The Tropicana production capacity is running at close to full utilization.
25. There isn't any price differential as compared to the competitor Coca-Cola in soft drinks right now.
26. In terms of pricing action, the company is seeing good demand for the 1.25L pack which is sold for Rs 50 as home consumers are showing more interest in this compared to the 2L pack.

Analyst Views:

Varun Beverages have been one of the biggest bottlers in India and has been quite proactive in international expansion for some time now. The company has seen a good YoY recovery in the quarter with sustained margins. Although the local lockdowns have dampened out of home consumption, the broad demand looks to be steady at the moment. VBL has also seen good growth in 3 key categories of Tropicana, Sting and Mountain Dew Ice, which are expected to be big growth drivers once they scale up in the future. The company has also done well to shield itself from commodity price pressures by procuring PET resin earlier on and stocking enough requirement to last till Oct. It remains to be seen whether there is a further economic disruption in the future from the resurgence of COVID-19 cases in the peak season of April to June which may have severe second-order effects on the company's performance and. Nonetheless, given the resilient sales network, the rising demand for the company's products, and the arrival of the peak season for the beverages industry, Varun Beverages is a good consumption stock to watch out for at present. However, as it is a capital-intensive business, the current pandemic can put a strain on the Balance Sheet which is already laden with debt. The valuation at current levels does not provide any margin of safety.