

**Date - 20-December-2017**



# Varun Beverages Ltd.

Strong Investment Picks - “Accumulate” - Horizon of  
3-4 Years with potential upside of 70-80%



# VBL Background

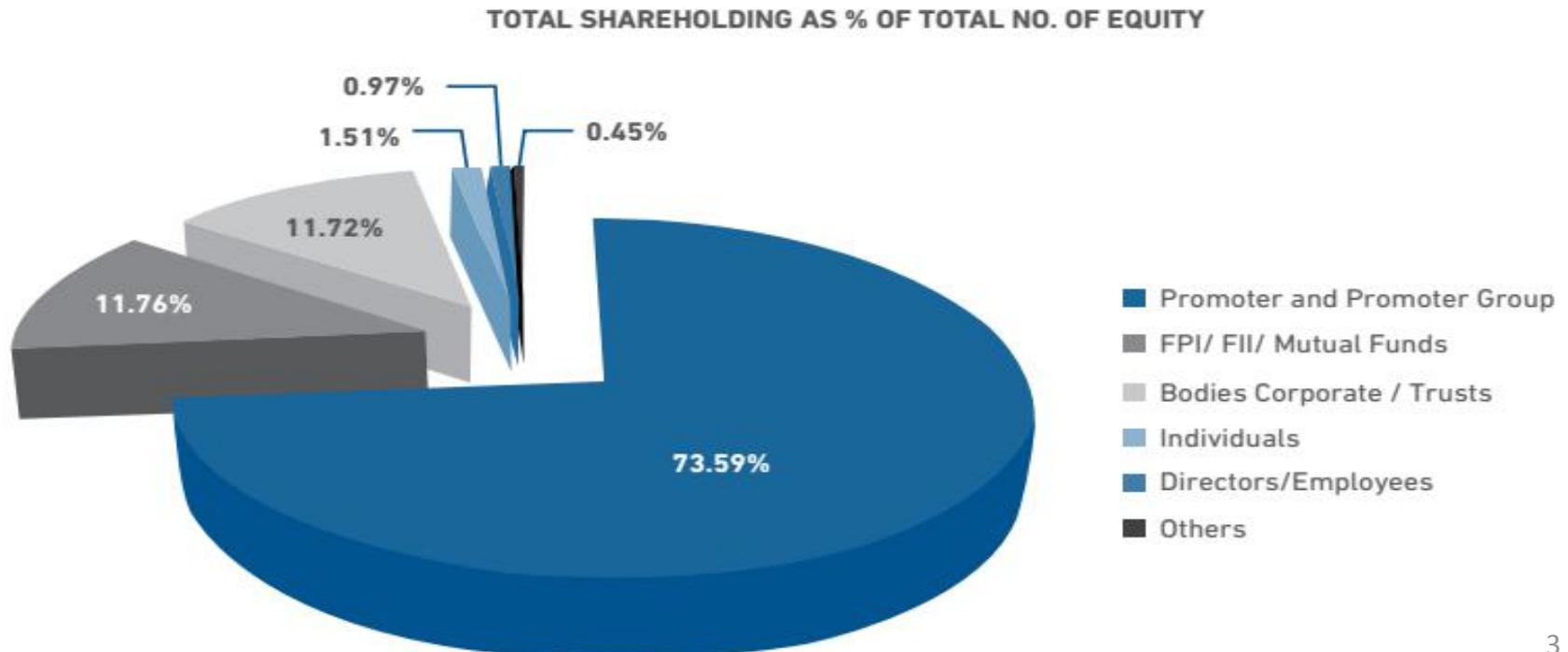
- **Incorporation Year: 1995**
- **Sector: FMCG**
- **Main Business: Manufacturer of Soft Drinks.**
- **Chairman: Ravi Kant Jaipuria**
- **Group: RJ Corp. Group**
- **Financial Year End: December.**
- **IPO Listing Date: 8th November, 2016.**

# VBL Background

**Key player** in the beverage industry

Operations spanning across **5 countries** – 3 in the Indian Subcontinent (India, Sri Lanka, Nepal) contribute ~**90%** to revenues; 2 in Africa (Morocco and Zambia) contribute ~10%

Over **25** years strategic association with PepsiCo – accounting for ~**47%** of PepsiCo's beverage sales volume in India



# VBL Snapshot

Latest Date	20-Dec-2017
Latest Price (Rs)	535.15
Previous Close (Rs)	516.45
1 Day Price Var%	3.62
1 Year Price Var%	32.05
52 Week High (Rs)	573.30
52 Week Low (Rs)	341.25
Beta	0.1946
Face Value (Rs)	10.00
Industry PE	47.87
TTM Period	201709
TTM EPS(Rs)	10.56
TTM CEPS(Rs)	30.04
Price/TTM CEPS(x)	17.82
TTM PE (x)	50.69
Price/BV(x)	5.17
EV/TTM EBIDTA(x)	13.33
EV/TTM Sales(x)	2.58
Dividend Yield%	0.00
MCap/TTM Sales(x)	2.23
Latest Book Value (Rs)	103.59
Market Cap (Rs. In Crores)	9751.66
EV (Rs. In Crores)	11310.62
Latest no. of shares (In Crores)	18.22

Price Vs Sensex Chart

Period: 21-12-2016 - 20-12-2017



# VBL History

- Varun Beverages is one of the **largest franchisee** in the world (outside USA) of **carbonated soft drinks (CSDs)** and **non-carbonated beverages (NCBs)** sold under trademarks owned by PepsiCo. It produces and distributes a wide range of CSDs, as well as a large selection of NCBs, including packaged drinking water.
- PepsiCo CSD brands produced and sold by VBL includes, Pepsi, Diet Pepsi, Seven-Up, Mirinda Orange, Mirinda Lemon, Mountain Dew, Mountain Dew Game Fuel, Seven-Up Nimbooz Masala Soda, Seven-Up Revive and Evervess. PepsiCo NCB brands produced and sold by it include Tropicana Slice, Tropicana Frutz (Lychee, Apple and Mango), Nimbooz as well as packaged drinking water under the brand Aquafina. In addition, the company has also been granted the franchise for Ole brand of PepsiCo products in Sri Lanka.
- The company has been associated with PepsiCo since the 1990s and has over two and half decades consolidated its business association with PepsiCo, increasing the number of licensed territories and sub-territories covered by it, producing and distributing a wider range of PepsiCo beverages, introducing various SKUs in its portfolio, and expanding its distribution network. The company has also been granted the franchise for various PepsiCo products for the territories of Nepal, Sri Lanka, Morocco, Mozambique and Zambia.

# VBL Products



# VBL's Journey

## Journey Over the Years

1991-99

- Bottling & Trademark License Agreement with PepsiCo through a group Company in 1991
- Varun Beverages Limited incorporated as public limited company in 1995
- Commenced operations in Greater Noida in 1995 and Jaipur in 1996
- Acquired existing operations at Nepal in 1998
- Commenced operations in Alwar, Jodhpur and Kosi in 1999.

2000-13

- Expansion into international territories – Sri Lanka and Morocco
- Investment by Standard Chartered PE (2011 & 2012)
- Consolidation of territories held by various companies into Varun Beverages Limited (includes Goa, North East, Sri Lanka, Nepal and Morocco territories)
- Acquired the business of manufacturing and marketing of soft drink beverages in Delhi, India in 2013
- Presence in 15 states and a union territory sales volume increased to 153.5 million cases

2014-15

- Investment of ₹ 4,500 million by promoter group during 2014 and 2015
- Acquired PepsiCo's India sub-territories in Uttar Pradesh\*, Uttarakhand\*, Himachal Pradesh, Haryana\*, Punjab and the Union Territory of Chandigarh in 2015
- Investment by AION Capital in 2015
- Incorporated Varun Beverages (Zimbabwe) Private Limited
- Sales volume increased to 239.7 million cases

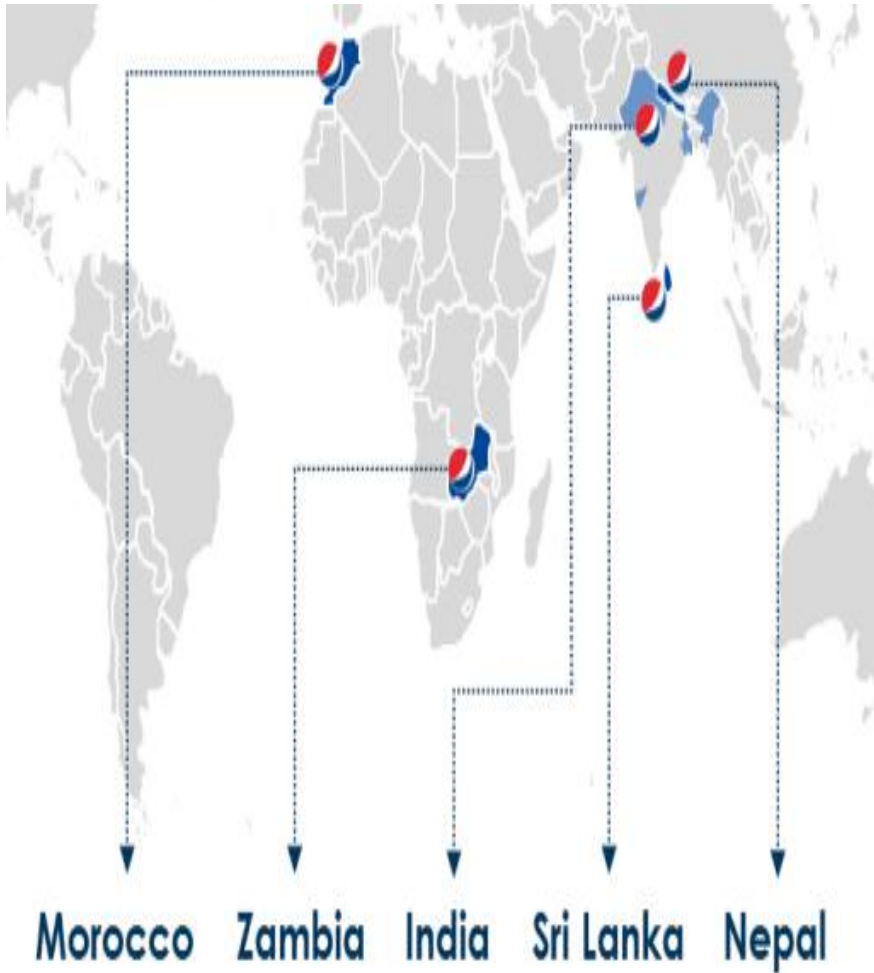
2016

- Acquired shareholding from Arctic International Private Limited in:
  - Varun Beverages (Zambia) Limited (60%)
  - Varun Beverages Mozambique Limitada (51%)
- The Company's shares got listed in NSE and BSE
- Acquired two co-packing facilities located at Phillaur (Punjab) and Satharia (Uttar Pradesh) for operational efficiencies
- Established new production facility in Goa
- Sales volume increased to 275.8 million cases

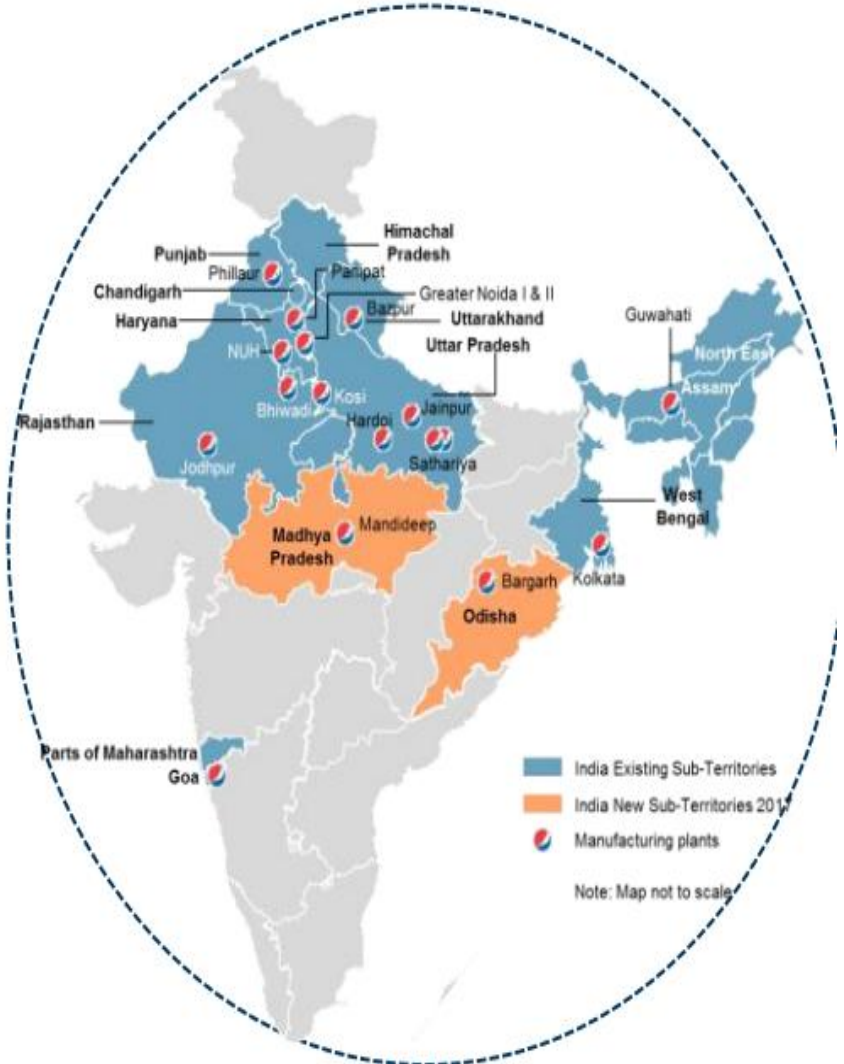
\*Remaining parts of these sub-territories

# VBL Presence

## Global Presence



## India Presence



Source: VBL investor presentation



# VBL Plants

## ANCILLARY PRODUCTION FACILITIES



**CHOPANKI PLANT**



**KOSI PLANT**



**GREATER NOIDA PLANT**

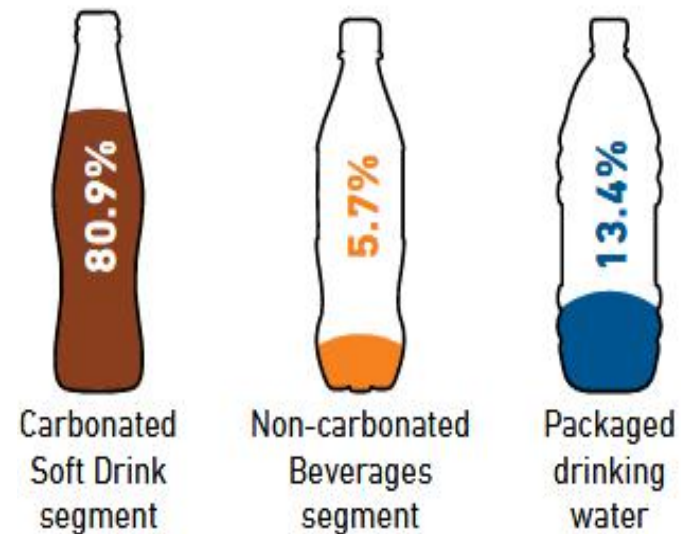
*Source: Co. Website*

# VBL's Business Segment

- **CSD**: Pepsi, Seven-Up, Mountain Dew, Mirinda & Everess.
- **NCB**: Tropicana Slice, Seven-Up Nimbooz, Tropicana Frutz.
- **PDW**: Aquafina.

## Snapshot of Business Segment

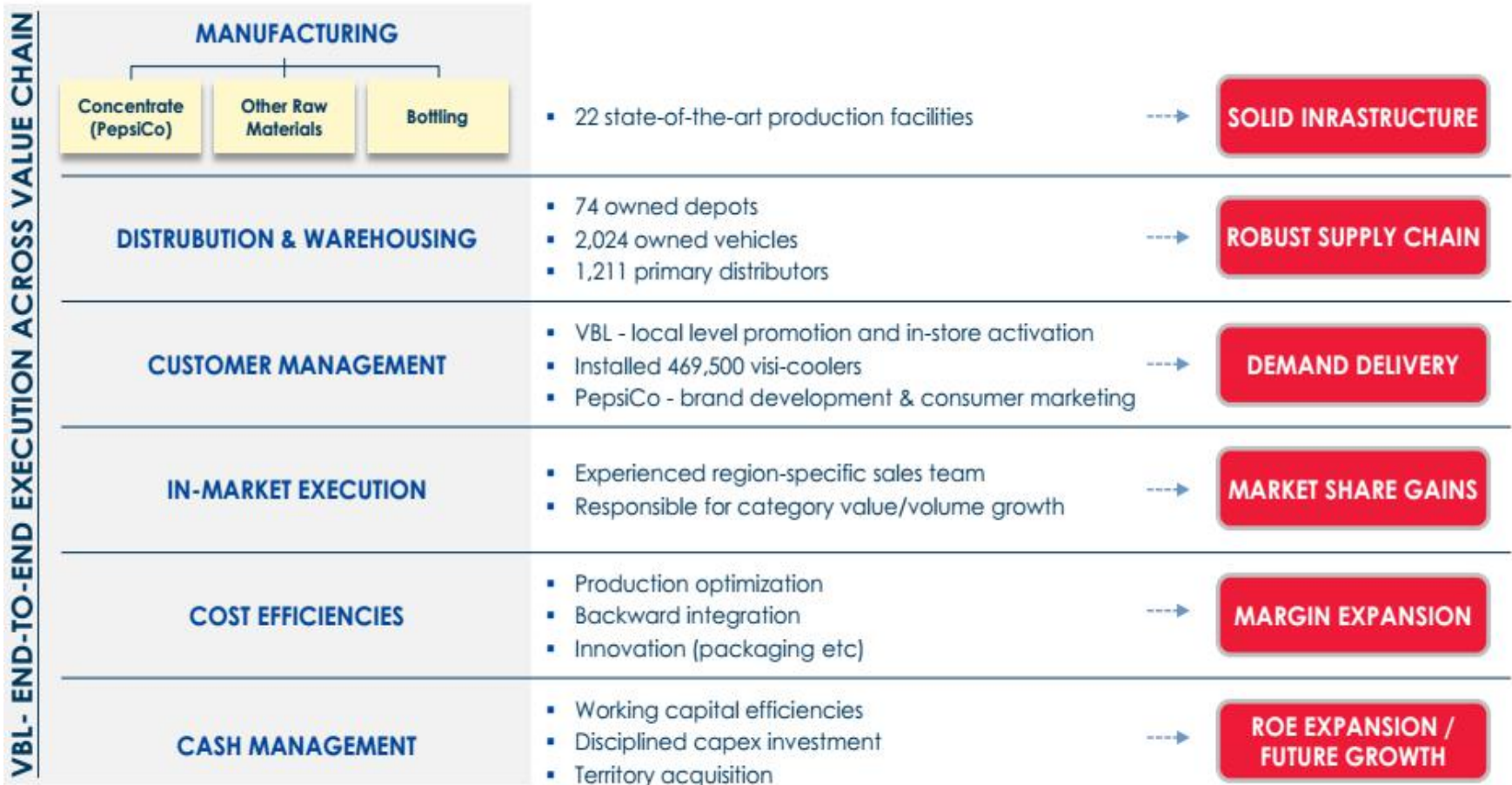
Segmental sales volume break-up, 2016



Source: Co. Annual Report

# VBL's Profile

## Key Player in the Beverage Industry – Business Model



# Symbiotic Relationship with PepsiCo

## VBL – Demand Delivery

- Investment in Production Facilities – manufacturing plants
- Sales & Distribution – Vehicles
- In-outlet Management – Visi-Coolers
- Market Share Gains – Consumer Push Management

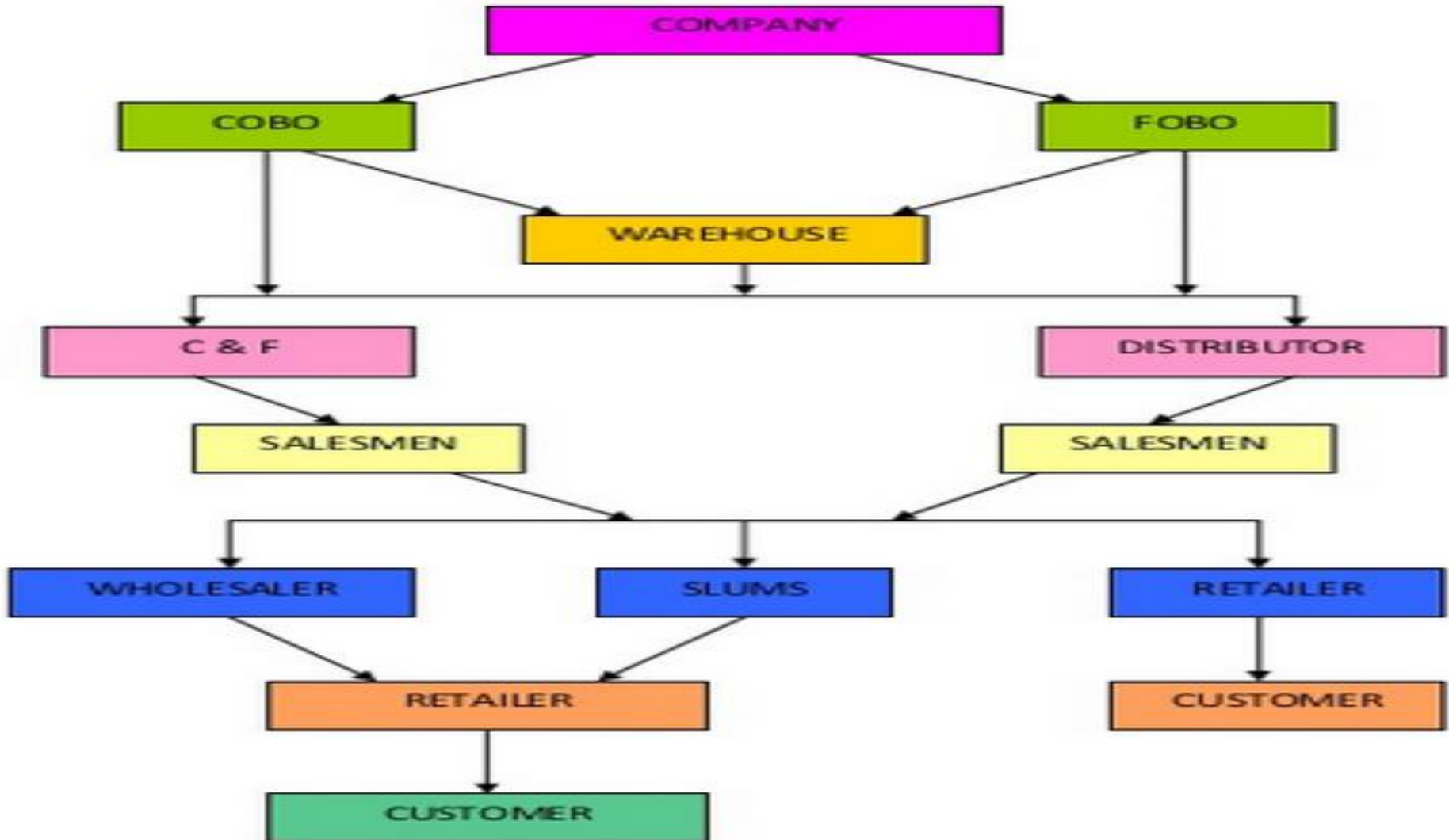


## PepsiCo – Demand Creation

- Owner of Trademarks
- Investment in R&D – Product & Packaging innovation
- Concentrate Supply
- Brand Development – Consumer Pull Management

Source: VBL Investor presentation

# Sales & Distribution Channel of PepsiCo



# Sales & Distribution Channel of PepsiCo (Contd.....)

- ❑ **Company:** PepsiCo India provides concentrates to all the bottling plants in the Country.
- ❑ **COBO:** Company owned bottling operations, operating directly under the company. Out of 32 bottling plants, PepsiCo owns 15.
- ❑ **FOBO:** Franchisee owned bottling operations. VBL has 17 bottling plants in the country.
- ❑ **Warehouses:** Company or Franchisee owned warehouses spread over various locations. Stocks are sent from the bottling plants to these warehouses, from where they are sent to the C&F centres and distributors.
- ❑ **C&F Centre:** Biggest centre in the distribution network and receive proper assistance from the company (either FOBO or COBO). The C&F centre is owned by a private player and not by the company. The delivery vans are owned by the company and the salesman at the C&F points are on the company payroll.
- ❑ **Distributors:** Everything at the distributor point owned and managed by the distributors, even the salesperson are on the distributors payroll.

# VBL and PepsiCo Agreement

- ❑ PepsiCo provides trademarks and bottling rights to VBL. They collectively fall under the term '*PepsiCo Agreements*'.
- ❑ PepsiCo reserves the rights to terminate the agreement with a written 2 month's notice.
- ❑ PepsiCo India / PepsiCo Inc. and / or the PepsiCo International Entities reserve the rights for themselves and authorized third parties to undertake the production, sale and distribution of beverage products for the relevant territories and sub-territories. Historically, VBL has been the sole franchisee and licensee with respect to its licensed territories and sub-territories.

# Key Points of the Agreement

- ❑ **Concentrates:** As per the agreement, VBL purchases concentrates from PepsiCo or PepsiCo approved manufacturers at a price and terms & conditions set by PepsiCo from time to time. However, to encourage promotion PepsiCo India allows price discount from time to time.
- ❑ **Royalty:** VBL only pays royalty to PepsiCo for use of trademarks for Aquafina and Everess. Licenses for other products falls under the PepsiCo agreement and hence no royalty is needed to pay.
- ❑ **Immediate termination:** Certain ground rules are in place by PepsiCo, which if not followed by VBL may result in immediate termination. Some of the conditions are as follows: 1) if promoters cease to be in control of the company. 2) production is closed for consecutive 30 days without the approval of PepsiCo etc.

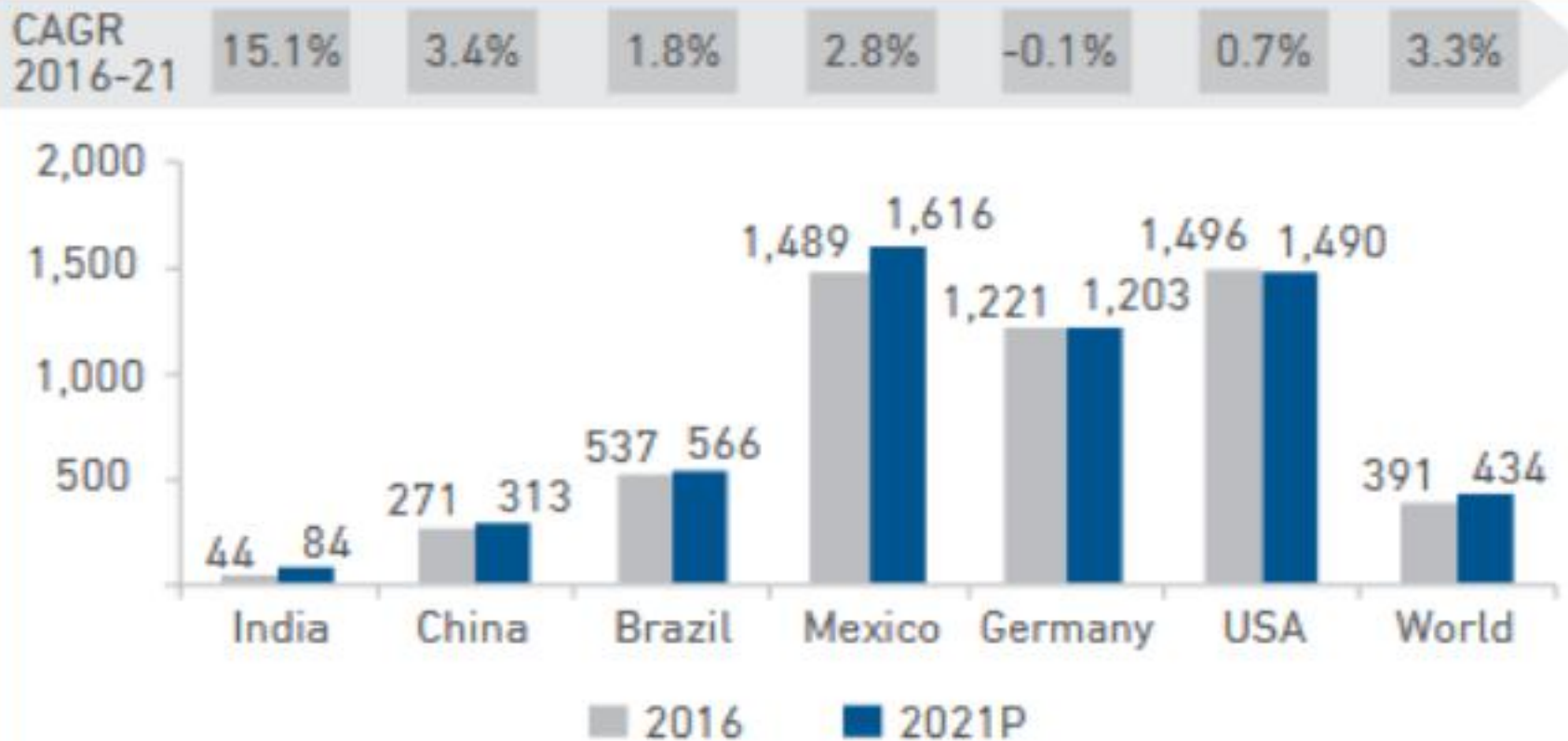


# Soft Drink Industry - Global

- ❑ The soft drink market majorly comprises of bottled water, carbonates, packaged juices, ready to drink tea and coffee.
- ❑ In terms of per capita consumption of soft drinks, Asian and African economies are well behind mature markets like US and Germany. The per capita consumption in US and Germany is expected to go down in the next five years. Both US and Germany show a largely downward trend while in Asian and African economies per capita consumption of soft drinks is expected to grow substantially.
- ❑ Bottled water, carbonates and juices consumption are largely expected to follow a similar trend in the Asian and African markets as the overall soft drink consumption.
- ❑ Per Capita Consumption of USA is 1496 bottles and 391 bottles worldwide. Worldwide per capita consumption is expected to reach 434 bottles by 2021.

# Soft Drink Industry - Global

## Global Markets - Per Capital Soft Drink Consumption (Per Capita bottles)



Source: VBL Investor Presentation

# Soft Drink Industry - Global

## Soft Drinks Consumption CAGR

Country	CAGR (2020) (per capita in litres)
India	14.4%
Sri Lanka	10.8%
Zambia	4.5%
Zimbabwe	4.3%
Morocco	11.8%
Mozambique	4.4%
Nepal	16.1%

## Carbonates Consumption CAGR

Country	CAGR (2020) (per capita in litres)
India	6.4%
Sri Lanka	5.4%
Zambia	3.6%
Zimbabwe	3.5%
Morocco	2.6%
Mozambique	3.4%
Nepal	5.0%

## Juices Consumption CAGR

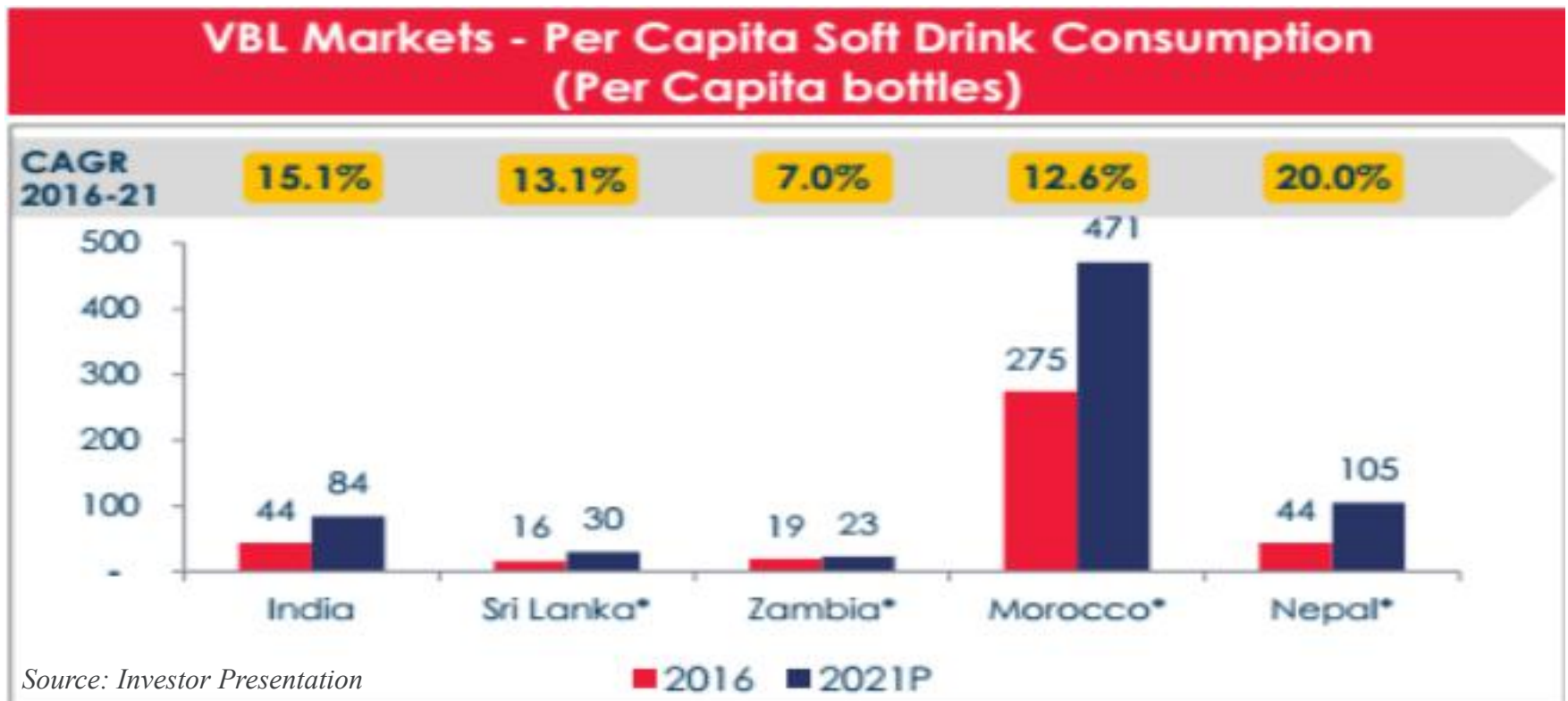
Country	CAGR (2020) (per capita in litres)
India	20.1%
Sri Lanka	20.7%
Zambia	5.2%
Zimbabwe	4.6%
Morocco	6.8%
Mozambique	5.2%
Nepal	22.4%

## Bottled Water Consumption CAGR

Country	CAGR (2020) (per capita in litres)
India	17.6%
Sri Lanka	14.9%
Zambia	5.9%
Zimbabwe	7.0%
Morocco	17.1%
Mozambique	5.0%
Nepal	17.8%

# Soft Drink Industry - India

- Per Capita Consumption of India is 44 bottles.
- Per litre consumption is expected to reach 18.4 litres by 2020.
- The industry is growing at a CAGR of 16% from 2011 to 2016.



# Soft Drink Industry - India

## Segmental share of constituents in Indian soft drinks markets

Segment	2016	2021
Carbonates	36.3%	24.9%
Bottled water	47.3%	57.8%
Juice	15.6%	16.9%
Others	0.7%	0.5%

## Soft Drinks Industry - India

Million Cases	2016	2021P	CAGR
Carbonates	868	1205	6.8%
Bottled water	373	816	16.9%
Juice	1,132	2,795	19.8%
Others	18	23	5.1%
<b>Total</b>	<b>2,391</b>	<b>4,839</b>	<b>15.1%</b>

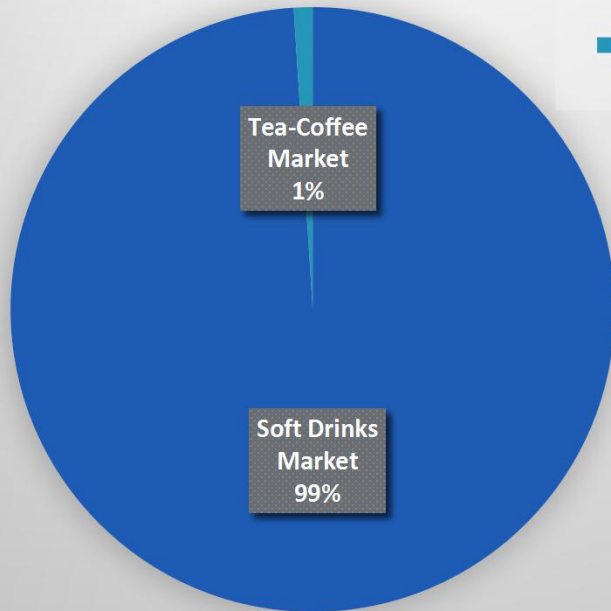


Source: Annual Report

# Soft Drink Industry - India

## Beverages Market

- Soft Drinks Market
- Tea-Coffee Market



SEGMENT-WISE FORECAST OF COMPOUNDED GROWTH IN SOFT DRINK SALES VOLUMES IN INDIA DURING 2016-21



Source: Annual Report

# Soft Drinks Industry - India

## Distribution Channel

- ❑ **Off-Trade Channel:** includes bars, restaurants. It is very easy for company to penetrate the market with this channel.
- ❑ **On-Trade Channel:** includes grocery shops, supermarkets etc.

## Territorial Trends

- ❑ **North India:** It has been the second largest market in terms of total volume of sales. However, in the off-trade channel North India took the lead in total sales volume.
- ❑ **East & Northeast India:** It has the lowest level per capita consumption within the soft drinks drink industry. The reason for this is that leading soft drink players give it less priority due to difficult terrain, as it makes transportation difficult.

# Soft Drinks Industry - India

- West India:** Largest overall market for stock market in India. It ranks first in terms of total volume of sales. In off-trade channel, the share of West India is substantially higher.
- South India:** People of South India are more inclined towards juice due to rising health consciousness. Also, IT hubs of the country i.e. cities like Hyderabad, Bangalore, Chennai, have long erratic working hours hence, the consumers are leaning more towards energy drink consumption.

## *Region-wise Forecast of the Indian soft drinks market for the period for 2015 to 2020*

*Total (Off-trade + On-trade) sales of soft drinks in terms of volume and value:*

*Source: DRHP of VBL*

Region	By volume (in million litres)			By value* (₹ in millions)		
	2015	2020	CAGR (2015-20)	2015	2020	CAGR (2015-20)
East and Northeast India	1,048.5	2,081.8	14.7%	42,799.7	93,300.7	16.9%
North India	4,104.1	8,760.3	16.4%	1,82,004.2	4,19,657.7	18.2%
South India	2,744.3	5,709.0	15.8%	1,18,641.1	2,56,479.6	16.7%
West India	4,184.0	8,579.9	15.4%	1,80,885.2	4,06,883.2	17.6%
<b>Total</b>	<b>12,081.0</b>	<b>25,131.0</b>	<b>15.8%</b>	<b>5,24,330.3</b>	<b>11,76,321.2</b>	<b>17.5%</b>



# Soft Drink Industry - India

- ❑ The industry is seasonal.
- ❑ Their main period is from April to June. This is also reflected in their sales.
- ❑ In the below figure, it shows that maximum sales is during Quarter-2. *(the co. follows the calender year, hence, Q2 as per calender year i.e. from April to June)*



**Bargaining Power of Suppliers:**

- few suppliers for entire industry, but the end product is comprised of few ingredients, which are largely commodities.
- it is important for the supplier contain whatever bargaining power they have.

**Threat of New entrants:**

- Biggest deterrent is the BRAND NAME.
- Heavy start-up costs.
- Access to distribution channel as both coke & Pepsi maintain good relations with their channel partners.

**Threat of Competitors:**

Intense rivalry b/w Pepsi and Coke and hence there will be a downward pressure on prices.

**Threat of Substitutes:**

- many substitutes to products.
- challenge lies in creating brand loyalty in substitute markets.
- negligible switching costs.
- In India, local beverages like tea & nimbu-pani also pose a threat.

**Bargaining Power of buyers:**

- bottlers, retailers & distributors have greater bargaining power than the consumer.
- Large retailers such as Reliance, Big Bazaar extract profits from the company through incentives such as volume-based purchases and so on.
- Bargaining power of consumer is low, as no one individual can effect the profit of the manufacturer.

# VBL - Investment Rationale

- ❑ **Ease of obtaining Raw Material:** The main key component i.e. the 'concentrate' is provided by PepsiCo or PepsiCo approved manufacturers, at a fixed cost determined by PepsiCo itself.
- ❑ **Backward Integration:** The company is doing backward integration of facilities for production of preforms, crowns, corrugated boxes & pads, plastic crates and shrink-wrap films to ensure optimal quality standards.
- ❑ **Latest Acquisition:** The company recently completed acquisition of franchisee states of Odisha and parts of Madhya Pradesh along with 2 manufacturing units at Bargarh(Odisha) & Bhopal (Madhya Pradesh). With this, the company has expanded its footprint to 18 states and 2 union territories.
- ❑ **Growth Opportunities:** Bottled water expected CAGR 19.8% by year 2021, provides significant growth opportunities. Non-carbonated beverages (NCB) is also expected to grow at CAGR of 16.9% by year 2021, as people become more health conscious. Since, lemonade and soda are used as mixer in drinks (alcoholic or non-alcoholic), its' use is expected to grow over a period of time as people working in metropolitan cities have erratic working hours and their use of drinks (energy or otherwise) increases.
- ❑ **Regional:** The company has maximum presence in North India and is slowly moving towards other regions. With the company increasing its footprint across India, the growth opportunities are tremendous.

# VBL - Investment Rationale

- ❑ **Major Player in the Industry:** VBL is the sole distributor of Pepsi in India. So, the company doesn't face any competition from other franchisees'.
- ❑ **IPO:** The company is repaying its debt from the funds gained in the public issue. This can have a positive effect on the PAT margins.
- ❑ **Launched New Products:** The company has launched 2 new products:
  - 1) Pepsi Black:** a zero calorie flavor CSD product currently available in 250ml cans and 250ml glass bottles.
  - 2) Sting:** It is a carbonated energy drink available in 250ml cans and bottles. The drink is said to be in competition with Red Bull. Where a 250ml can of Red bull is available at Rs. 110, a **Sting** energy drink can of 250ml is available at only Rs. 50.
- ❑ **Franchisee Model:** The company promoters are in the franchisee business, so they are well versed with the needs of this type of business model.
- ❑ **Competition:** As there are no other distributors of PepsiCo besides VBL, the company doesn't face competition for manufacturing and distribution of Pepsi.

# VBL - Risks

- ❑ **Seasonality & Cyclicity:** The business of the company is highly seasonal as the major business period is between April to June. Also, a cyclical downturn can lead to slowdown in the markets. If the company offers lower price, then it affects the revenues.
- ❑ **Business Agreement Risk:** VBL solely relies on its agreement with PepsiCo. Termination of the said agreement can adversely affect the company.
- ❑ **Regulatory Risk:** Regulations on consumer health and the risk of negatively targeting of VBL products for packaging waste recovery may adversely affect their business.
- ❑ **'Concentrate' Pricing Risk:** PepsiCo determines the price of the concentrates sold to VBL. So, if this right is negatively exercised by PepsiCo then it would affect the business interest.
- ❑ **Consumer Preference Risk:** This risk is inherent in this business. Also, with high competition from Coca-Cola, the company has to be on point with its selling & distribution strategy but in the end it is the consumer's preference which becomes the deciding sales factor.

# VBL - Risks

- ❑ **Raw Material:** Sugar accounts for nearly 33% of the raw material needed to manufacture the final product. If the prices of sugar increase or decrease then the PAT margin is affected accordingly.
- ❑ **New Product Preference:** As discussed earlier, consumer preference is key to capturing the market. VBL has a lot of new products lined up for the coming year, so if these products manage to entice the consumers then the company stands to gain market share as well as rise in revenues and EBITDA margins.

# VBL - Valuations

## Financial Highlights (2012-16)

Source: Annual Report



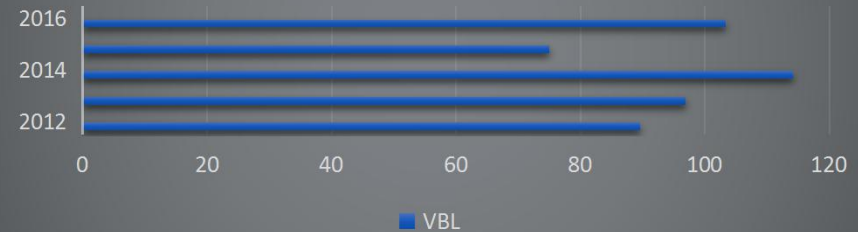
Note: Historically, till 2015, in debt equity ratio calculation, CCD's issued to Private Equity Investors were considered as Equity and deferred acquisition consideration to PepsiCo was excluded from the debt. From the year 2016, CCDs of private equity investors are converted into equity and interest free deferred acquisition consideration to PepsiCo has been considered in total debt.

# VBL - Valuations

Cash Conversion Cycle  
(days)



S&D Expense  
(in crore)



Description	2016	2015	2014	2013	2012
PATM(%)	3.54	2.86	-0.75	-1.72	1.26
Sales/Total Asset	0.94	1.01	0.9	0.85	0.78
Asset/Equity	4.56	21.02	19.71	15.96	14.88
ROE(%)	15.11	60.84	-13.21	-23.27	14.63

- ❑ Company's cash conversion cycle is getting shorter which is good for the company, as the company is collecting its accounts receivable faster.
- ❑ Company's Debt/Equity ratio is steadily decreasing as the company is paying of its debt and is expected to go down even further with more debt repayment. Current D/E is 0.86x
- ❑ Company's ROCE is steadily increasing for the past 5 years at a CAGR of 17.7% (approx.)
- ❑ ROE is volatile but the PAT margins are clearly increasing and along with the decrease in leverage.



# VBL - Final View

- At the current market price of Rs. 535.15, the stock is trading at a TTM P/E of 50.69, Price/Book Value of 5.17 and EV/TTM EBITDA of 13.33, we strongly recommend our investors to *accumulate at every dips*. On valuations parameters VBL may seem high but the company has a franchisee business model and its promoters are experienced in the franchisee business. VBL commands a premium as it is the sole distributor of Pepsi beverages product in India. The company also has a new energy drink product lined up called '**Sting**' which has a pricing advantage over its competitors. We also believe that the company may acquire some new franchisee rights in the near future and possible renewal of existing franchisee rights, indicating high growth potential. We believe the upside potential of this stock is 70% - 80% with a long-term horizon of 3-4 years.

# Disclosure

- Name: Jainam Wealth      Email id: jainamwealth@gmail.com      Ph. No.: 0261- 6725555
  
- Analyst ownership of the stock: No
  
- Analyst Certification: The Analyst certifies that the views expressed herein accurately reflect his (their) personal view(s) about the subject security and issuer(s) and that no part of his (their) compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report.
  
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