VBL Sep 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)								
	Sep-20	Sep-19	YoY %	Jun-20	QoQ %	9MSep20	9MSep19	YoY
Sales	1315	1350	-2.59%	1421	-7.46%	4081	4819	-15.31%
PBT	104	99	5.05%	159	-34.59%	335	713	-53.02%
PAT	79	65	21.54%	122	-35.25%	278	503	-44.73%
Consolidated Financials (In Crs)								
	Sep-20	Sep-19	YoY %	Jun-20	QoQ %	9MSep20	9MSep19	YoY
Sales	1843	1779	3.60%	1668	10.49%	5236	6015	-12.95%
PBT	192	116	65.52%	182*	5.49%	381*	760	-49.87%
PAT	161	81	98.77%	143	12.59%	365	526	-30.61%

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

Detailed Results:

1. The current quarter was mixed for the company with a 3.6% YoY rise in consolidated revenues.
2. Consolidated Profits were up with over 98% YoY rise.
3. 9M numbers were dismal with 13% YoY revenue decline and 31% YoY PAT decline.
4. The company saw an EBITDA rise of 17% YoY and a volume decline of 4% YoY in the quarter. 9-Month EBITDA fell 22.7% YoY.
5. Other income in Q3 grew 93% YoY.
6. Sales volumes in India fell 6.7% YoY while in international territories it grew 5.8% YoY.
7. CSD constituted 74%, Juice 6%, and Packaged Drinking water 20% of total sales volumes in Q3 2020.
8. Gross margins declined by 149 bps during Q3 2020 primarily due to an increase in the mix of promotional packs like Pepsi PET1, 250ml, Sting PET 250ml, etc.

9. Finance costs for the company declined 33.2% YoY due to the repayment of some debt from the funds from the QIP.

Investor Conference Call Highlights:

1. A rise in demand is expected for the company with the reopening of theatres, restaurants, mass transportation, and outdoor facilities.
2. The major factor in the big jump in PAT YoY is the big reduction in finance expenses.
3. The management has stated that margins near about 21% are healthy margins for the company in the long term.
4. The key focus for the company has remained in-home consumption. The company's launch of the 1.25 ltr pack at Rs 50 has been very well received. Although go-to-market is expected to rise going forward, the in-home consumption seems to be sustainable.
5. In-home consumption has gone up by 20% to 25% YoY.
6. Large PET bottle consumption has grown more than 10% YoY.
7. The present inventory level is at Rs 848 Cr. It is elevated due to the offseason currently.
8. In terms of monthly YoY recovery, the company finally saw positive growth in September with 12% YoY growth.
9. The management has stated that it is difficult to provide any specific guidance on margins and RM costs going forward.
10. The management expects the company to maintain its pace of adding visi-coolers of less 40,000 units each year.
11. The current debt is at Rs 2830-2840 Cr.
12. Institutional sales have been very low at only 2-3% of sales.
13. Rural & semi-urban sales were at almost 30% each.
14. The company has spent around Rs 400 Cr in Capex in the year and this figure represents the majority Capex for the year.
15. The management has stated that VBL is among the most profitable soft drink companies in the world. It also stated that the main commodities that affect the company are oil and sugar.
16. The company is indeed looking for ways to reduce seasonality in the beverages business but the management acknowledges that this is a deeply embedded and structural characteristic of this industry everywhere. The company sees main newcomer additions in peak summer season and it is looking to reduce seasonality by increasing volumes for these same customers in the rest of the year.
17. The management is aiming to maintain >10% growth in the next 3-5 years.

18. The company saw a good response to its dairy-based products but had to almost withdraw these products due to the pandemic. The company is now looking to relaunch this segment in Jan or Feb next year.
19. The company has stopped making the fizzy Slice juice-based product as it didn't get a good response in its pilot locations.
20. The company is indeed looking at much larger plants and scaling down the smaller plants as operating these smaller plants is much costlier and it is more feasible to either convert into a large plant or shut it down.
21. The company has enough plants in South & West and is not looking to add any plants in these zones.
22. Tropicana is the only space where the company is running out of capacity and is looking to open a new plant. The Capex required would be at least Rs 200 Cr but this will not happen in the next at least.
23. The juice business has grown by 19% in Q3. The main advantages of Tropicana over market rivals is VBL's distribution reach which is much larger than rivals and the huge volume number of Visi-coolers in the market which the big competitors like Real & B-Natural do not have.
24. The compensate pricing with Pepsi has been fixed for 20 years and will not be renegotiated.

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 recovery in the quarter with a big rise in margins. Post lockdown demand seems to have stayed resilient as in-home consumption has risen along with juice consumption as on-the-go consumption slowly comes back to normalcy. It remains to be seen whether there is a further economic disruption in the future from COVID-19 which may have severe second-order effects on the company's performance. 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.