BODHI CAPITAL

An Initiative of ABC | INVESTMENTS

VST Industries Ltd.

By Amaan Andicot and Maria Ben

VST Industries Ltd.

CMP: Rs. 2,853

Market Cap: Rs. 4,405 cr

Analyst Take: Buy

Holding period: 5 years

Date: 23/03/20

INDEX

Investment Thesis for VST Industries Ltd.

A fundamentally strong fast grower reasonably priced

- Strong Capital Structure
- Strong Cash Position (Steady Cash Flows + historically increasing fcfs)
- Consistent Dividend Payment
- Consistently growing EPS
- Strong Revenues
- Shrinking p/e multiples
- Gaining market share from the industry leader
- Efficient and competent Management

Company Overview

The Vazir Sultan Tobacco Company Limited was incorporated on 10th November, 1930, under the Hyderabad Companies Act No. IV of 1320 Fasli and now governed under the Companies Act, 1956/2013.

The name of the Company was subsequently changed to VST Industries Limited on 30th April, 1983. The Company has its Registered Office at Azamabad, Hyderabad.

VST Industries Ltd. deals in the production of cigarettes and unmanufactured tobacco.

It is the third largest player in the tobacco industry in terms of Market Cap.

Key Business Segments

The Company has a manufacturing facility at Hyderabad and Toopran (Telangana) and its principal activities are manufacture & sale of cigarettes and unmanufactured tobacco.

VST Industries ltd. sells the following cigarette brands (along with minor variations):

Below Rs. 5 price points	Rs. 5-6 price points	Rs. 10 price points
Charminar	Total	Edition
Moments	Charms	

Management

Name	Designation
Anish Gupta	Chief Financial Officer
Devraj Lahiri	CEO
Devraj Lahiri	Managing Director
Naresh Kumar Sethi	Non Executive Chairman
Phani K Mangipudi	Co. Secretary & Compl. Officer
Phani K Mangipudi	Secretary
Rajiv Gulati	Independent Director
Rama Bijapurkar	Independent Director
S Thirumalai	Non Exe.Non Ind.Director
Sudip Bandyopadhyay	Independent Director

- Average tenure of the board is less than 3 years, which highlights a new board.
- Devraj Lahiri however has been working for VST Industries Ltd. for over 7.5 years.
- His compensation is akin to industry averages and the size of the business. It has also grown in accordance to the performance of the business, both are up ~20%.

Management Analysis

VST Industries Ltd. has consistently had a historically high ROCE% and ROE%, this shows that the management is utilising shareholder funds efficiently.

Key Financials	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY19-22E)
Net Sales	946.4	1097.6	1254.9	1367.6	1491.4	10.8%
EBITDA	294.0	353.1	417.6	470.9	518.7	13.7%
EBITDA Margin %	31.1	32.2	33.3	34.4	34.8	
Net Profit	181.9	226.8	306.4	337.3	366.2	17.3%
EPS (₹)	117.81	146.90	198.44	218.43	237.19	
P/E	38.2	30.6	22.7	20.6	19.0	
RoNW %	31.3	34.2	38.8	37.0	35.8	
RoCE (%)	46.9	51.4	53.6	50.2	48.4	

Source: Company, ICICI Direct Research

These metrics are projected to increase and stay consistently high over the next 3 years.

Management Analysis Contd.

- VST Industries Ltd. has a debtor days of 5 as on 31st March 2019, which is a decrease from 11 days as on March 2018, this coupled with an increase in it's inventory turnover ratio (4.11 from 3.26) shows a positive signal in terms of managerial efficiency.

- Quarterly revenues (Quarter ended 31st December 2019) have gone up 13.9% while Changes in Inventories of finished goods and Work in Progress is (76) from (481) which shows a propensity towards pile up of inventories as inventory turnover is slowing. However it should be noted that a decrease in inventories, and an increase in sales is a sign of efficient inventory management.

Management Analysis Contd.

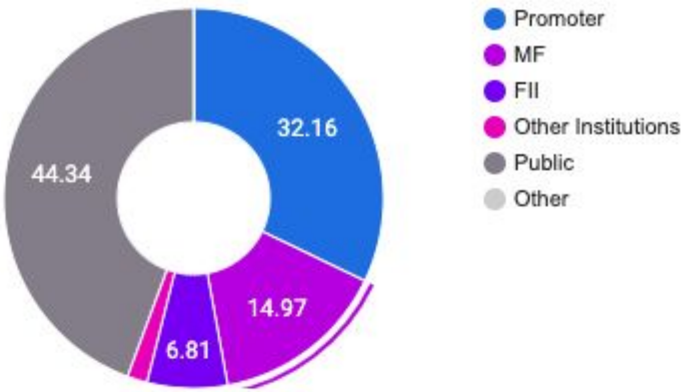
Q1 ended 30th June 2019 - revenue up by 11.9% and Inventory up by 522 (closing stock > opening stock), business was expecting further growth in sales next quarter and not because of high demand due to an increase in inventories as on 31st March 2019.

Q2 ended 30th Sep 2019 - revenue down by -1.8% and Inventory down by 481, closing stock < opening stock

Q3 ended 31st December 2019 - revenue up by 13.9% and inventory down by 74 closing stock < opening stock

This shows that the management is adaptable in how it manages inventory and can readily meet a rise in sales while being prudent as depicted by inventory management during bad quarters without any major pile up.

Shareholding Pattern



Promoters stake has remained constant for the past few years.

FIIs have reduced their stake in the business.

Public shareholding has marginally increased.

Qualitative Analysis

Why is VST industries Ltd. a fast grower?

Over the past 10 years it has a historic growth rate of earnings of 13.8%

Performance 2010-2019

	2010	2011	2012	2013	2014	2015	2016	2017#	2018#	2019#
EARNINGS PER SHARE (Rs.)	40.2	61.5	92.3	81.8	97.2	98.6	99.2	98.1	117.8	146.9
DIVIDEND ^	5402	8076	11666	11291	12646	13010	13010	13939	14427	17685
DIVIDEND PER SHARE (Rs.)	30.0	45.0	65.0	62.5	70.0	70.0	70.0	75.0	77.5	95.0
RETURN ON CAPITAL EMPLOYED (%)	25.1	35.9	49.1	41.5	45.7	43.9	41.3	27.9	31.4	34.1

- The company has successfully managed to duplicate its success in numerous cities, which validates legitimate expansion.
- VST Industries Ltd. has a strong presence in West Bengal, Uttar Pradesh, Andhra Pradesh and Telangana.
- Expansion of the business has started speeding up, this is can be ascertained by the robust volume growth VST Industries enjoys and the rapid growth of earnings past it’s slump from 2016-18.
- The business has a relatively low level of institutional ownership.
- The main products of VST (unmanufactured tobacco and cigarettes) forms a considerable proportion of the companies earnings.

What Makes VST Industries Ltd. a good business?

Strong Barriers to entry: Due to the crackdown on the tobacco industry by the government, through heavy excise duties, GST implementation and barring of advertisements there is a high entry barrier for new players. This is advantageous to the big players in the tobacco industry.

Limited Capital Requirements: VST industries Ltd. focuses solely on production of unmanufactured tobacco and a variety of cigarettes. Due to the nature of the business, low capital expenditures are incurred and capital requirements are minimal. This is an explanation for VST industries' high price/book ratio.

Reliable Customers: Due to tobacco being a highly addictive substance. VST industries ltd. enjoys a highly reliable customer base out of which it possesses high negotiating power. VST industries also caters to smokers from low income groups with brands like Charminar, Moments, etc. while also selling some of the more premium variants such as Charms, Total and Edition.

Low risk of technological obsolescence: The tobacco industry isn't majorly impacted by technological changes, hence obsolescence of the business or the technology it utilises in production is unlikely. Coupled with strong barriers to entry, there is no influx of competitors and as a result no rapid form of technological evolution.

Abundant Growth Possibilities: According to the Growth-Share Matrix, VST industries is a star, this is due to it's growing market share, high growth rate and high cash generation along with low cash usage. A large part of VST's income is free cash flows, this leaves VST with the opportunity to diversify, pay higher dividends to its shareholders or to plough its earnings right back into the business through retained earnings. So far, VST Industries has opted for a mix of higher dividends and retained earnings.

Threats and Challenges

The effects of COVID-19: Due to a fall in overall demand and an impending economic slowdown, The premium brands that have driven profitability for VST Industries Ltd. in strong probability would observe a slump in sales. In addition to this suspension of business operations will hamper the fundamentals of the business in the short to medium term.

Regulatory Restrictions: The company operates under increasingly stringent regulatory regimes. Namely, The COTPA guidelines on packaging and labelling and advertising and promotion.

Taxation changes: Could have an impact on the short-term revenues of the company. The company's business is subjected to GST, excise and other cesses as may be made applicable, which could require the Company to take up product prices.In addition to this, a change in macroeconomic variables such as a reduction in disposable income can impact the business.

Regional Disruptions: Through state level restriction on trade or through terrorism and political violence including bandhs, strikes etc. Have the potential to disrupt the Company's business operations. Such disruptions result in potential loss of assets and increased costs due to more complex supply chain arrangements and/or maintaining inefficient facilities.

Illegal Cigarettes: The market for illegal cigarettes have been growing steadily and has led to a dent in revenues for tobacco companies due to its lower prices. This is indicative of the low amount of growth the tobacco industry has observed (~ 4%)

Solutions to challenges faced

The effects of COVID-19: along with impending economic downturn which would inevitably lead to a fall in demand and a reduction in income of the consumer (which would result in down-trading) isn’t that big of an issue due to down-trading playing into VST’s favour. A large chunk of VSTs revenue comes from its middle and lower cost variants such as Charminar and Moments. Hence down-trading would work to the company’s benefit.

In addition to this, in order to mitigate complex supply chain arrangements and inefficient facilities, The company focuses on securing multiple sourcing/delivery strategies and relies on insurance covers and business continuity planning.

Solutions to challenges faced contd.

Regulatory restrictions: The company addresses this risk by engaging in continuous social dialogue with stakeholders and the regulatory community through industry bodies. At the same time, it works on developing strategies and capabilities to effectively launch competitive and consumer acceptable brands within the changing regulatory environment.

Taxation Policy: Such risks are addressed through:

- Engagement with tax authorities wherever appropriate.
- Regular management review in order to build a well laddered brand portfolio across new segments
- Investments in distribution infrastructure in order to increase geographical spread.

Illegal Cigarette Market: The company has been and will continue to focus on R&D by way of developing blends with innovative variants for new brands, which have been well accepted by consumers in the marketplace.

The company also continues to give a competitive edge to its products by laying emphasis for plants to enhance capital efficiencies and cost optimization. The company has also continued to lay a large emphasis in it's tobacco leaf plantations. This has reaped great benefit for the company as indicative of its strong revenue growth of unmanufactured tobacco.


RIVALRY AMONG EXISTING COMPETITORS:
Number of competitors
Diversity of competitors
Industry concentration
Industry growth
Quality differences
Brand loyalty
Barriers to exit
Switching costs
THREAT OF NEW ENTRANTS
THREAT OF NEW ENTRANTS:
Barriers to entry
Economies of scale
Brand loyalty
Capital requirements
Cumulative experience
Government policies
Access to distribution channels
Switching costs
BARGAINING POWER OF SUPPLIERS
RIVALRY AMONG EXISTING COMPETITORS
BARGAINING POWER OF BUYERS
BARGAINING POWER OF SUPPLIERS:
Number and size of suppliers
Uniqueness of each supplier's product
Focal company's ability to substitute
BARGAINING POWER OF BUYERS:
Number of customers
Size of each customer order
Differences between competitors
Price sensitivity
Buyer's ability to substitute
Buyer's information availability
Switching costs
THREAT OF SUBSTITUTE PRODUCTS:
Number of substitute products available
Buyer propensity to substitute
Relative price performance of substitute
Perceived level of product differentiation
Switching costs
THREAT OF SUBSTITUTE PRODUCTS

Quantitative Analysis

Revenue Analysis and Breakdown

PRINCIPAL BUSINESS ACTIVITIES OF THE COMPANY

(All the business activities contributing 10% or more of the total turnover of the Company shall be stated)

Sl.No.	Name and Description of main products/services	NIC Code of the Product/service	% to total turnover of the Company
1	Cigarettes containing tobacco	12003	79.80%
2	Unmanufactured Tobacco	46202	20.20%

- VST sells ~55% of their cigarettes (Total, Charms) at rs. 5-6 price points.
- The premium variant Edition at a rs. 10 price point contributes ~5% of revenues
- Cheap variants, Moments and Charminar at below rs. 5 price points contributes the remaining 40% of cigarette sales.

Round 1 - Sales Growth and Stability Check (fig in Cr.)									
2018-19	2017-18	2016-17	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10
1,184.11	1,358.64	2,261.30	2062.99	1723.08	789.17	666.68	684.43	581.54	1125.42
-12.84%	-39.91%	9.60%	19.70%	118%	18.30%	-2.59%	17.69%	-48%	12.01%
Jun-19	Sep-19	Dec-19							
304.45	299.14	343.12							

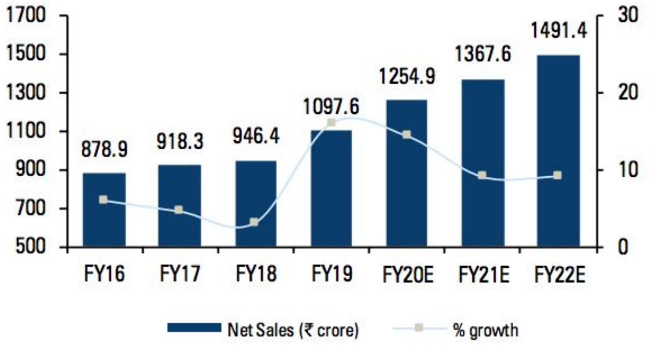
- Historic sales growth over the past 10 years have clocked in at 9.1%

- Revenue (net of GST) for the quarter increased 17.3% YoY to Rs. 343.8 crore. Cigarette sales increased 9% to Rs. 268 crore led by ~8% YoY volume growth along with a change in the product mix. Tobacco sales witnessed splendid growth of 43% to Rs. 100 crore. The company has been able to maintain double digit volume growth (~10%) YoY in The quarter ended Dec 31st 2019.

(note: the company’s products are now subjected to GST, compensation cess in addition to excise. Due to such restructuring of indirect taxes, the figures from “revenue from operations” are not comparable with previous periods.)

Revenue Analysis and Breakdown

Exhibit 4: Net revenue to grow at 10.8% CAGR over FY19-22E



Source: ICICI Direct Research, Company

- Despite the observations in Sales degrowth (gross) over the past 3 years, net sales have been consistently increasing due to a decrease in sales returns, allowances and discounts.
- This could also be an attributor to better quality of products and less discounting taking place.

As of these past three quarters, the company has been able to benefit from double digit sales growth due to:

1) Stable Tax environment post GST implementation
2) Further emphasis on the Rs. 5-6 price points. Which contribute to 55% of the business' revenues.

In addition to this, VST Industries Ltd. is capturing market share from the industry leader as reflected in its volume growth, which is over and above industry average growth of 4%.

Earnings Trend and analysis

Round 2 - Earnings Growth and Stability Check (fig in Cr.)									
2018-19	2017-18	2016-17	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10
22,621	18,251	15,024	15,311	15,221	15,015	12,624.00	14,250	9,070	8,378
146.9	117.8	98.1	99.2	98.6	97.2	81.8	92.3	61.5	40.2
EPS-GR	(146.9/40.2)^1/10 = 1.1383 - 1 = 0.1383 * 100 = 13.83%								
Jun-19	Sep-19	Dec-19							
49.01	49.42	52.77							

- Historic Earnings Per Share Growth rate = 13.83%
- Q3 has observed a 47% increase in earnings YoY this is attributed to corporate tax cuts
- Growth in earnings have been organic due to the absence of leverage effect.
- Strong and consistent growth in “other income” ~57% due to high amounts of investment in debt funds, gains in foreign exchange, other non-operating income and sale of investments. Other income contributes to ~3.1% of total income.

Income Statement Analysis

IV Expenses			
Cost of Materials Consumed	21	55964.19	46324.43
Changes in Inventories of Finished Goods and Work-in-Progress	22	(947.49)	705.19
Excise Duty (Refer Note 33)		8509.61	41106.43
Employee Benefits Expense	23	9226.12	8919.52
Depreciation and Amortisation Expense		4134.53	3916.41
Other Expenses	24	10346.19	9408.58
Total Expenses		87233.15	110380.56

- Profit after tax has primarily increased due to a reduction in expenses (~26%). Despite an overall increase in Cost of raw materials, purchases, employee benefits and depreciation. The lowering of costs have been primarily due to a reduction in change of inventories and excise duty.

Let's talk about inventories

22. CHANGES IN INVENTORIES OF FINISHED GOODS AND WORK-IN-PROGRESS		
(a) (Increase)/Decrease in Finished Goods		
Opening Stock	1742.51	10426.56
Closing Stock	2641.62	1742.51
	(899.11)	8684.05
(b) Increase/(Decrease) in Excise Duties on Finished Goods (Refer Note 33)	126.01	(8373.58)
(c) (Increase)/Decrease in Work-in-Progress		
Opening Stock	666.84	1061.56
Closing Stock	841.23	666.84
	(174.39)	394.72
TOTAL	(947.49)	705.19

- As on March 31st 2019, Closing stock (841.23) has been higher than (666.84) which indicated an inventory pileup. As indicative of an increase in overall inventory listed on the balance sheet.

	As at 31st March, 2019	As at 31st March, 2018
8. INVENTORIES		
(At lower of cost and net realisable value)		
Raw Materials including packing materials	24549.36	22767.59
Work-in-Progress	841.23	666.84
Finished Goods	2641.62	1742.51
Stores and Spares	152.75	110.54
TOTAL	28184.96	25287.48
The above includes goods in transit	-	-
The cost of inventories recognised as an expense in respect of write- down of inventory to net realisable value.	4.93	95.61

- Inventory's as on March 31st 2019, have increased
- Raw materials and packing materials, Work-in-Progress, Finished Goods and Store and Spares have increased across the board.

Balance Sheet Analysis

		Note		As at 31st March, 2019		As at 31st March, 2018
I	**ASSETS**					
	1 Non-Current Assets					
	(a) Property, Plant and Equipment	2A		21333.73		19506.23
	(b) Capital Work-in-Progress	2B		29.85		3422.11
	(c) Intangible Assets	2C		7.24		1.22
	(d) Financial Assets					
	(i) Investments	3	225.98		202.61	
	(ii) Loans	4	13.38		14.85	
	(iii) Other Financial Assets	5	1.77	241.13	1.77	219.23
	(e) Deferred Tax Assets (Net)	6		3101.46		2481.65
	(f) Other Non-Current Assets	7		111.80		297.80

	Gross Block						
	Balance as at 31.03.2017	Additions	Disposals	Balance as at 31.03.2018	Additions	Disposals	Balance as at 31.03.2019
2A. PROPERTY PLANT AND EQUIPMENT							
Land	1724.80	-	-	1724.80	556.42	-	2281.22
Buildings on Freehold Land (including roads)	2539.69	40.52	-	2580.21	3048.58	-	5628.79
Buildings on Leasehold Land	34.41	8.40		42.81	8.73	-	51.54
Plant & Equipment	20014.30	1342.86	17.08	21340.08	1897.95		23238.03
Electrical Installation & Equipment	779.98	-	-	779.98	330.61	-	1110.59
Furniture & Fixtures	129.62	77.21		206.83	63.73	0.55	270.01
Motor Vehicles	241.83	7.81	128.84	120.80	4.63	8.16	117.27
Office Equipment	206.67	-		206.67	50.45	2.45	254.67

- No major CapEx made this year. Though there is an incremental increase in Property, Plant and Equipment from last year.
- The bulk of Capital Expenditure over the past 3 financial years is attributed to Plant and Equipment and Buildings on Free Hold Land which equal to ~1.6% of this years revenues alone.
- Depreciation on assets is charged as per industry and accounting norms.

Balance Sheet Analysis Contd.

		Note				
2	**Current Assets**					
	(a) Inventories	8		28184.96		25287.48
	(b) Financial Assets					
	(i) Investments	9	57305.88		41409.57	
	(ii) Trade Receivables	10	1431.74		2733.09	
	(iii) Cash and Cash Equivalents	11	2638.60		2852.11	
	(iv) Other Bank Balances	12	1047.21		906.71	
	(v) Loans	4	1.46		1.69	
	(vi) Other Financial Assets	5	121.21	62546.10	0.12	47903.29
	(c) Current Tax Assets (Net)	13		192.77		261.72
	(d) Other Current Assets	7		4935.84		7032.60
TOTAL				120684.88		106413.33

- Trade receivables have decreased by ~47.6% this coupled with a reduction in debtor days by ~54% is a positive signal.
- Notable increase in short term investments ~38%
- Cash balances have decreased by ~7.48%

Balance Sheet Analysis Contd.

II EQUITY AND LIABILITIES						
1 Equity						
(a) Equity Share Capital	14	1544.19		1544.19	
(b) Other Equity		64858.86	66403.05	56664.88	58209.07
2 Liabilities					
Non-Current Liabilities					
(a) Provisions	15		1849.74		1415.15
Current Liabilities					
(a) Financial Liabilities					
(i) Trade Payables	16				
- Total outstanding dues of micro enterprises and small enterprises		30.01		32.28	
- Total outstanding dues of creditors other than micro enterprises and small enterprises		8271.35		5776.67	
(ii) Other Financial Liabilities	17	1270.37	9571.73	1308.70	7117.65
(b) Other Current Liabilities	18		42860.36		39671.46
TOTAL			120684.88		106413.33

- Equity share capital has remained constant at Rs. 1544.19 consistently over the past 10 years.
- Other Equity has increased by ~14.5%

Balance Sheet Analysis Contd.

B OTHER EQUITY

	Reserve and Surplus			Other Comprehensive Income (OCI)			Total
	Capital Redemption Reserve	General Reserve	Retained Earnings	Equity Instru-ments	Cash Flow Hedge	Remeasurement of defined benefit plans (net)	
Balance as at 31st March, 2017	1000.25	22402.15	29007.96	36.53	9.53	(103.50)	52352.92
Profit for the year			18189.31				18189.31
Other Comprehensive Income (net of tax)				26.09	(13.92)	49.63	61.80
Dividend on							
Ordinary Shares-Final (₹75/- per share)			(11581.44)				(11581.44)
Dividend tax thereon			(2357.71)				(2357.71)
Transfer to General Reserve		900.00	(900.00)				-
Balance as at 31st March, 2018	1000.25	23302.15	32358.12	62.62	(4.39)	(53.87)	56664.88
Profit for the year			22684.43				22684.43
Other Comprehensive Income (net of tax)				22.75	82.88	(168.64)	(63.01)
Dividend on							
Ordinary Shares-Final (₹77.5/- per share)			(11967.49)				(11967.49)
Dividend tax thereon			(2459.95)				(2459.95)
Transfer to General Reserve		2250.00	(2250.00)				-
Balance as at 31st March, 2019	1000.25	25552.15	38365.11	85.37	78.49	(222.51)	64858.86

Balance Sheet Analysis Contd.

- The increase in other equity is primarily attributed to an increase in amounts transferred to the General Reserve, Retained Earnings and other comprehensive income which includes an increase in income from Cash Flow Hedges and Equity Instruments.

Balance Sheet Analysis contd.

II	**EQUITY AND LIABILITIES**					
	1 Equity					
	(a) Equity Share Capital	14	1544.19		1544.19	
	(b) Other Equity		64858.86	66403.05	56664.88	58209.07
	2 Liabilities					
	Non-Current Liabilities					
	(a) Provisions	15		1849.74		1415.15
	Current Liabilities					
	(a) Financial Liabilities					
	(i) Trade Payables	16				
	- Total outstanding dues of micro enterprises and small enterprises		30.01		32.28	
	- Total outstanding dues of creditors other than micro enterprises and small enterprises		8271.35		5776.67	
	(ii) Other Financial Liabilities	17	1270.37	9571.73	1308.70	7117.65
	(b) Other Current Liabilities	18		42860.36		39671.46
	TOTAL			120684.88		106413.33

- Absence of any form of long term debt
- There is a ~42.9% increase in trade payables
- Other current liabilities involve - Advances from customers which have increased by ~160% and Statutory Liabilities which have decreased by around ~4%

Balance Sheet Analysis Contd.

- Trade Payables (creditors) has increased at a rate faster than purchases (~42.9% in comparison to ~ 20.9%)
- This means that old creditors haven’t been paid yet.
- This isn’t alarming as current liabilities (minus statutory liabilities) form a very small fraction of the overall sources of funds ~8%

Balance Sheet Analysis Contd.

Long term sources of Funds include:

- Share Capital = Rs. 1544.91 lakhs
- Reserves and Surplus = Rs. 64,858.86 lakhs

Short term sources of Funds include:

- Current Liabilities = Rs. 52,432.09 lakhs

Long term Uses include:

- Fixed Assets = Rs. 21,333.73 lakhs

Short term Uses include:

- Current Assets = Rs. 67,(lakhs

Balance Sheet Summary

- This organisation has the most ideal type of balance sheet. It’s long term sources of funds are ~32% greater than it’s long term uses.

- It’s short term sources fall short of it’s short term uses by ~ 29.07% hence long term sources of funds are also being used for short term uses. Which highlights good financial management as funds are invested in such a way that the assets will generate an inflow of funds before the liabilities demand an outflow.

Cash Flow Analysis

Indicator	Graph	Mar-2019	Mar-2018	Mar-2017	Mar-2016	Mar-2015	Mar-2014	Mar-2013	Mar-2012	Mar-2011	Mar-2010	Mar-2009
Cash from Operating Activity Annual Cr		290.2	420.1	145.7	132.1	117.1	129.8	118.4	151.2	84.8	52.6	20.8
Cash from Investing Activity Annual Cr		-148	-264.1	-17.8	-24	3.5	-18.3	8.7	-63.4	-8.2	-5.3	25.1
Cash from Financing Annual Activity Cr		-144.3	-139.4	-130.1	-130.1	-126.5	-112.9	-116.7	-80.8	-54	-54.5	-36.8
Net Cash Flow Annual Cr		-2.1	16.6	-2.2	-21.9	-5.9	-1.4	10.4	7	22.6	-7.3	9.1

- Cash Flow from Operating Activity has been consistently increasing over the past 11 years.
- Cash flow from Operating Activities have declined from March ‘18 due to a decrease in trade receivables, advances and other assets along with an increase in Trade Payables.
- Cash flow from Investing activities has been negative barring, March ‘15 and March ‘09.

Cash Flow Analysis

- VST Industries Ltd. constantly experiences cash flows used in investing activities due to Purchase of Property, Plant and Equipment, Intangibles etc. and Current Investments.
- The company holds a variety of current investments in savings funds, liquid funds, growth plans, growth funds, low duration funds and debt funds.
- Cash flow used in financing activities consist solely of paying dividends. This has been the case for the past 10 years.

Cash Flow Analysis

Round 3 - Free Cash Flow Analysis (fig in Lakhs.)									
2018-19	2017-18	2016-17	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10
23,054.28	40,586.58	6,020.79	12,483.81	9,662.56	6,933.08	8,409.45	11,531.15	1,976.03	763.76
FCF-GR	(23,054.28/763.76)^1/10 = 1.40598 - 1 = 0.40598 * 100 = 40.59%								

- Free Cash Flow = Cash flow generated From Operating Activities - Capital Expenditure
- VST Industries Ltd. has a FCF of Rs. 23,054.28 lakhs, it has a FCFR of 79.4% for the year ended 31st March 2019
- FCF has been increasing at an average rate of 40.59% over the past 10 years.
- The decrease in fcf isn't alarming as Cash flows were propped up due to a large inflow of funds on account of an increase in trade payables.

Cash Flow Analysis

	31st March 2019	31st March 2018	31st March 2017
A Cash Flow from Operating Activities			
Profit Before Tax Expense	35067.45	27945.39	23089.65
Adjustments:			
Depreciation and Amortisation Expense	4134.53	3916.41	3691.79
Profit on sale of Property, Plant and Equipment (Net)	(9.86)	(165.16)	(2.16)
Unrealised (Gain)/Loss on Exchange (Net)	56.02	(55.27)	8.75
Interest on Loans and Deposits, etc.	(5.80)	(8.13)	(5.84)
Dividend Income from Non-Current Investments	(4.35)	(4.47)	(3.77)
Net gain arising on Current Investments measured at FVTPL	(3661.34)	(2121.16)	(1733.11)
			(181.93)
Operating Profit before Working Capital Changes	35576.65	29507.61	24863.38
Adjustments for Movement in Working Capital:			
Trade Receivables, Advances and Other Assets	3342.65	(7145.12)	(54.00)
Inventories	(2897.48)	7643.55	4772.63
Trade Payables, Other Liabilities and Provisions	5860.81	22108.49	(7176.41)
Cash generated from Operations	41882.63	52114.53	22405.60
Income Taxes Paid (Net)	(12866.32)	(10102.23)	(7836.85)
Net cash from Operating Activities	29016.31	42012.30	14568.75

Cash Flow Analysis

- In isolation, Inventories have risen due to an outflow of cash, however this hasn’t been the case over prolonged periods.
- Over the course of these 3 years customers delaying payments have fallen drastically.
- Vendors have asked for payments at a slower rate as compared to prior years as indicative of a negative trade payable balance turning positive.
- Combined with a rise in free cash flows. There is no major fundamental weakness in the business detected.

Ratio Analysis

Round 4 - Ratio Analysis Profitability ratios					
Year	2018-19	2017-18	2016-17	2015-16	2014-15
OPM%	32.13%	31.02%	26.85%	26.88%	29.00%
CAGR	(32.13/29)^1/5 = (- 1)*100 = 2.07%				
NPM %	20.64%	19.19%	16.42%	17.33%	18.20%
CAGR	(20.64/18.20)^1/5 = (1.0254 - 1)*100 = 2.5%				

- Operating Profit Margins have been steadily increasing over the past 5 years and have grown at a CAGR of ~2.07%
- Net Profit Margins have also seen an increase over the past 5 years and have grown at a CAGR of ~2.5%

Ratio Analysis

Managerial Efficiency ratios					
Year	2018-19	2017-18	2016-17	2015-16	2014-15
ROE%	34.16%	31.24%	28.11%	41.33%	43.90%
ROCE%	34.10%	31.40%	27.90%	41.30%	43.90%
ROA%	18.79%	17.09%	18.99%	18.51%	18.42%

- ROE (%) and ROCE (%) have been consistently high and have mirrored each other due to an absence of long term debt. Despite seeing a fall from 41.33% to 28.11% (~13.22%) due to a fall in operating profit and net income respectively this is due to a switch in accounting policies from GAAP to (IND AS)
- Brokerage reports have estimated to see an upward increase in return ratios.
- The ROA% has been constant albeit high over the past 5 years which is a positive signal.

Ratio Analysis

Turnover Ratios and Debtor Days					
Year	2018-19	2017-18	2016-17	2015-16	2014-15
ITR	3.9	3.75	2.8	2.34	2.28
ATR (%)	91.60%	89.04%	115.63%	106.78%	101.22%
Debtor Days	5	11			

- The business has been experiencing consistently increasing Inventory Turnover Ratios.
- The consistently high Asset Turnover Ratio shows a high efficiency in the company's ability to generate sales from it's assets.
- Debtor Days have seen a decrease ~54.5%, which highlights more efficient management in terms of collecting debt.

Ratio Analysis

Liquidity ratios					
Year	2018-19	2017-18	2016-17	2015-16	2014-15
Current Ratic	1.83	1.72	2.21	1.31	1.29
Quick Ratio	1.29	1.18	0.88	0.46	0.52

- The company has been in a position to fulfill all it’s short term obligations comfortably for the past 4 years.

- The company over the past 2 years have also been able to fulfill all short term debt obligations using it’s quick assets.

Ratio Analysis

Solvency ratios					
Year	2018-19	2017-18	2016-17	2015-16	2014-15
D/E ratio	0	0	0	0	0
ICR	0	0	0	0	0

- VST Industries Ltd. has consistently been debt free as indicative of it's long term D/E ratio of 0 over the past 5 years.
- VST Industries Ltd. thus has no interest coverage ratio.
- The absence of interest payments thus shows organic growth due to the absence of the leveraging effect.
- These ratios show that the business is conservative in it's outlook towards debt and is thus unlikely to borrow long term funds in the future from creditors.

Ratio Analysis

Valuation Ratios										
Year	2018-19	2017-18	2016-17	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11	2009-10
EPS	146.9	117.8	98.1	99.2	98.6	97.2	81.8	92.3	61.5	40.2
EPS-GR	(146.9/40.2)^1/10 = 1.1383 - 1 = 0.1383 * 100 = 13.83%									
P/E(TTM)	2,853/185.54 = 15.37									
P/E(historic)	17.78									
PEG(current)	15.37/26.30 = 0.58				using Q3 EPS GR					
PEG(historic	15.37 / 13.8 = 1.1				(TTM / historic growth rate)					
P/B ratio	6.46									
FCF	23,054.28 lakhs									
FCF ratio	79.4%%									
FCF yield (%)	5.20%									
Earnings yield %		6.38%								

- PEG (using current figures) is 0.5 which indicates an undervalued stock
- PEG(using historic EPS growth rate) is 1.1 which depicts that company's share price at current levels mirrors earnings growth
- FCFs form 79.4% of cash flow from operating activities, which shows the company's strong ability to generate cash

Ratio Analysis Contd.

- VST Industries Ltd.s' P/B ratio of 6.46 is alarming when looked at in isolation, however upon looking at it in conjunction with the relatively low amount of fixed assets which generate high earnings (thus showing a reasonably high degree of efficiency), this P/B is not a negative signal or an anomaly, rather an indicator of the above mentioned. This is due to the relatively low book value per share (due to less fixed assets) in relation to the business' share price (which has seen a constant surge due to a strong and consistent rise in it's EPS.)
- In addition to this, despite the business having a high P/B ratio it is by no means overvalued at current prices as the business enjoys high ROE % and ROA %

Ratio Analysis Contd.

- FCF Yield (%) = ~5.20%
- Earnings Yield (%) = ~6.38%

When looking at alternatives such as fixed deposits which have interest rates ranging from 3.50%-6.5% p.a or 91-Day Treasury Bills which have a primary yield of 5.28% or alternatively 364-Day Treasury Bills which have a primary yield of 5.99%, VST Industries Ltd. is a superior investment across asset classes by virtue of not just it's higher earnings yield of ~6.38% but also due to its generous and increasing dividend.

Ratio Analysis

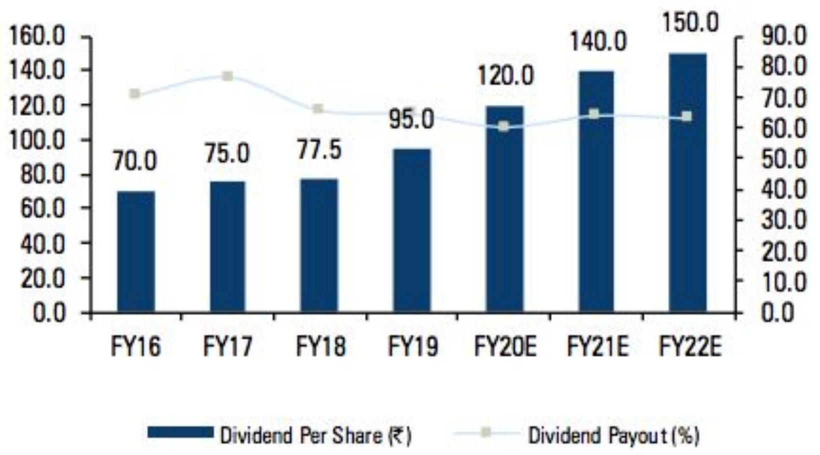
Historic P/E calculation (using closing prices of each month)															
Financial Year	April	May	June	July	August	September	October	November	December	January	February	March	Avg. Price	EPS	P/E
2009-10	324	343.75	391.15	418.85	423.95	446.35	480.5	504.6	528.75	502.5	484.9	628.65	448.16	40.2	11.14
2010-11	540.2	544.95	590.6	505	532.1	578.25	614.05	635.25	629	653.25	631.25	634.95	590.73	61.5	9.6
2011-12	853.25	871.5	1,003.85	1,216.05	1,222.65	1,317.50	1,281.50	1,100.30	1,083.25	1,205.10	1,275.45	1,455.15	1,157.12	92.3	12.53
2012-13	1,959.45	1,877.05	1,763.75	1,658.15	1,688.30	1,763.60	1,762.95	1,845.85	1,950.05	1,786.15	1,600.20	1,515.95	1,764.28	81.8	21.56
2013-14	1,552.40	1,580.85	1,595.40	1,590.55	1,475	1,501.40	1,458.05	1,655.15	1,738.10	1,601.80	1,600	1,645.95	1,582.88	97.2	16.28
2014-15	1,960.25	1,815.50	1,797.90	1,530.15	1,530.50	1,628.25	1,815.35	1,845.55	1,901.85	1,874.95	1,680.55	1,571.40	1,746.01	98.6	17.7
2015-16	1,621.10	1,665.45	1,630.65	1,728.75	1,494.35	1,604.60	1,603.20	1,678.35	1,698.30	1,697.30	1,519	1,608.20	1,629.10	99.2	16.42
2016-17	1,633.70	1,668.10	1,700.15	1,928.55	2,351.30	2,269.15	2,372.65	2,198.30	2,405.20	2,400.55	2,690.40	2,868.50	2,207.21	98.1	22.49
2017-18	3,059.50	3,102.85	3,290.20	3,100.50	2,721.95	2,851.30	3,110.80	3,392.70	3,207.05	3,299.45	3,205.10	2,935.80	3,106.43	117.8	26.37
2018-19	3,050.40	3,176.75	2,902.50	2,712.15	3,298.00	2,799.45	3,172.15	3,190.40	3,272.85	3,214.30	3,216.40	3,455.00	3,121.69	146.9	21.25
2019-20	3,425.40	3,616.05	3,440.80	3,348	3,414.25	3,774.50	3,856.75	4,333.50	4,214.45	4,448.45	4,077.20	2,771.95	3,726.78	185.54 (TTM)	20.06

- Historic P/E is calculated on the basis of the average P/E ratios of VST Industries Ltd. over the past 11 years.
- Due to EPS figures for the year ended 31st March 2020 not being announced yet, TTM figures are used.
- Historic P/E comes out to 17.78 which is more than current P/E of 15.37 which is a sign that the business is undervalued.

Ratio Analysis

Dividend ratios	
Dividend Payout Ratio %	44.62%
DPR % NP	64.66%
Dividend Yield (%)	3.49

Exhibit 8: High dividend payout to continue



- The company has relatively high dividend payout ratios in terms of both CP and NP %
- The business enjoys a relatively high dividend yield of 3.49%, ideal dividend stocks are considered to have a yield ranging from 4-6%
- Brokerage firm ICICI Direct expects high dividend payouts to continue over the next 3 years.

A fast growing company and dividend?

- This business has been observing a growth in retained earnings and increasing dividends, at first glance this seems improbable. However, upon taking a deeper look, one can ascertain that this is likely due to the security and stability of funds (through a variety of current investments like debt funds) the business enjoys along with robust free cash flows and no major capex plans.

Comparables

Comparables									
Company	P/E	P/B	D/E	ROE%	ROCE%	EV/EBITDA	EV/Sales	OPM %	FCF yield %
Godfrey Phillips India Ltd.	13.11	2.51	0.02	12.77%	18.01%	12.57	2.31	19.30%	4.10%
VST Industries Ltd.	15.37	6.46	0	34.16%	34.10%	13.6	4.85	32.13%	5.20%

- On the grounds of ITC, having a very different and heavily diversified business, comparison would not yield any significant takeaways.
- Despite having a higher P/E ratio than Godfrey Phillips, VST Industries Ltd. enjoys higher OPM %, ROE %, ROCE% along with a higher fcf yield %.
- It should be noted that VST Industries limited has a high price to book ratio when compared to Godfrey Phillips.
- Godfrey Phillips has a low d/e of 0.02, while VST Industries is virtually debt free.

Comparables

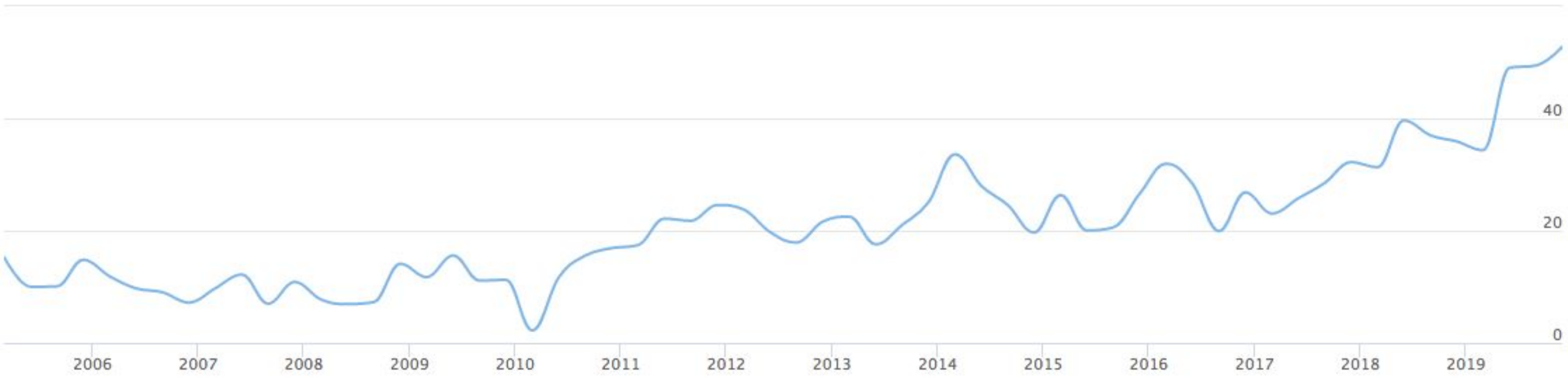
Comparables									
Company	P/E	P/B	D/E	ROE%	ROCE%	EV/EBITDA	EV/Sales	OPM %	FCF yield %
Godfrey Phillips India Ltd.	13.11	2.51	0.02	12.77%	18.01%	12.57	2.31	19.30%	4.10%
VST Industries Ltd.	15.37	6.46	0	34.16%	34.10%	13.6	4.85	32.13%	5.20%

- It should be noted that Godfrey Phillips does have a lower EV/EBITDA as compared to VST Industries Ltd. Which implies that the stock may be potentially undervalued. Though both EV/EBITDAs are on the higher side.
- EV/sales for Godfrey Phillips is much lower than VST Industries Ltd. it falls between the usual range of 2-3 however VST Industries is much higher at 4.85 which indicates a potentially overvalued stock as it’s above the usual threshold of 2-3.

VALUATION

Price to Earnings line comparison

Price Line



Earnings Line

Price to Earnings line comparison

- Historically the price line has mirrored the earnings graph for VST Industries Ltd.
- Due to the COVID-19 fallout and market crash, the company's share price has been pummeled, in addition to supply chain disruptions and the shutdown of operations due to the government enforced lockdown.
- VST Industries Ltd has enjoyed strong earnings growth for the past 3 quarters ending Dec 2019. Operations have been shut down from 27th March 2020. It should be noted that despite security of earnings through other income (such as debt funds) the earnings for the quarter at the end of 31st March could see a fall due to decreased demand from the consumer. However being conservative and presuming the company earns nothing. The annual figure for EPS would still be higher than that of last year's as the earnings for the preceding three quarters adds up to 151.2 which is ~3% higher than that of last years EPS of 146.9

Historic FCFs

Free Cash Flow= (EBITDA - D&A)(1-tax rate) + non cash adjustments +/- change in working capital - Capex													
	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	TTM
Sales +	339	380	471	578	684	669	789	836	883	922	948	1,099	1,220
Expenses +	255	313	401	439	475	488	571	594	646	675	654	746	819
Operating Profit	83	67	70	139	210	180	218	243	237	248	294	353	401
OPM %	25%	18%	15%	24%	31%	27%	28%	29%	27%	27%	31%	32%	33%
								11%	-2%	5%	19%	20%	14%
Other Income	16	35	33	20	26	26	32	18	20	20	25	39	46
Interest	0	0	0	0	0	0	0	0	0	0	0	0	0
Depreciation	14	16	18	24	25	22	27	32	31	37	39	41	40
Profit before tax	86	86	86	135	211	184	224	229	227	231	279	351	407
Tax %	32%	28%	27%	30%	32%	31%	33%	33%	32%	34%	35%	35%	
Net Profit	58	62	62	95	143	126	150	152	153	152	182	227	287
EPS in Rs	34.39	34.94	35.21	54.24	81.76	71.14	85.34	83.92	85.3	98.13	117.79	146.9	185.54
Dividend Payout %	53%	75%	75%	73%	70%	76%	72%	71%	71%	76%	66%	65%	
(EBITDA-D&A)(1-tax rate)	60.92	52.72	55.96	104.5	150.8	131.02	154.97	173.37	171.08	176.26	204.75	243.8	401
Working Capital Changes	14.74	-41.94	4.27	-17.11	8.5	-10.54	-17.88	-46.64	-41.15	-24.58	226.07	63.06	
Fixed Assets Purchased	-38.21	-25.09	-27.16	-43.78	-34.39	-38.15	-51.81	-23.78	-52.48	-44.72	-45.41	-25.89	
Fixed Assets Sold	0.08	0.02	0.11	1.17	5.23	2.75	0.3	0.07	0.81	0.2	2.19	0.1	
FCF	**37.53**	**-14.29**	**33.18**	**44.78**	**130.14**	**85.08**	**85.58**	**103.02**	**78.26**	**107.16**	**387.6**	**281.07**	

3 yr avg Operating Profit growth
17%

To methods to estimate intrinsic value using the dcf model

Conservative

Method 1			
WACC (Calculated using rates from Damodaran blogspot- using unlevered beta of 0.68 and rf at 4.97)	9.78%	g for 6-10 yrs	7%
Method 1- Very Conservative Growth rate g= Reinv rate * ROE (1-5 yrs) [One approach - use the dividend payout ratio * ROE to find growth = this way we get 36.40*0.35= 12.74.	13.00%	Terminal g	5%

Moderate

Method 2			
WACC	9.78%	g for 6-10 yı	12%
5 yr g= Calculated as avg growth in Operating Income for last 3 yrs	17.00%	Terminal g	5%

Estimation of Intrinsic Value

Method 1 (Very conservative)			**Growth rate 13%**					**Growth rate 7%**			**Growth at 5%**	***(In crores)***
					Present Value of Future Cash Flows						**PV of**	
	FY 20	**FY 21**	**FY22**	**FY23**	**FY 24**	**FY 25**	**FY 26**	**FY 27**	**FY 28**	**FY 29**	**Terminal Value**	**Sum of PVs**
DCF Calculation	**289.3025785**	**297.7762904**	**306.4981984**	**315.475572**	**324.715895**	**198.4465391**	**193.4134511**	**188.5080145**	**183.72699**	**179.0672274**	**1545.153392**	**4022.0842**

Method 2 (Moderate Estimates)			**Growth rate 17%**					**Growth rate 12%**			**Growth at 5%**	***(In crores)***
					Present Value of Future Cash Flows						**PV of**	
	FY 20	**FY 21**	**FY22**	**FY23**	**FY 24**	**FY 25**	**FY 26**	**FY 27**	**FY 28**	**FY 29**	**Terminal Value**	**Sum of PVs**
DCF Calculation	**299.5433777**	**319.2309217**	**340.212433**	**362.572958**	**386.403133**	**247.1808751**	**252.1693247**	**257.2584481**	**262.45028**	**267.7468841**	**2310.361378**	**5305.13**

Present Market Cap	**4569**	crores
No. of shares	**1.544102737**	crores
CMP	**2959**	

Intrinsic Value / Share	
Method 1	*2604.803458*
Method 2	***3435.73642***

Sensitivity Analysis

		Growth					
	2604.80346	13%	14%	15%	16%	17%	18%
WACC	7.78%	4556.76	4743.78	4937.15	5137.04	5343.60	5557.02
	8.78%	3303.53	3434.44	3569.72	3709.46	3853.77	4002.78
	9.78%	2607.17	2707.05	2810.19	2916.67	3026.56	3139.96
	10.78%	2170.78	2251.33	2334.45	2420.21	2508.66	2599.88
	11.78%	1874.37	1941.88	2011.50	2083.29	2157.29	2233.56

Summary of Investment Thesis

- VST Industries Ltd. has shown a track record of consistent performance in terms of earnings growth and net sales.
- The company has immense growth opportunities due to capturing the rural and low income markets while penetrating the market for premium variants
- It has generous and stable dividends
- It’s got strong fundamentals as indicative of a strong balance sheet and favourable ratios.
- The business is a free cash flow machine due to low capex requirements and has observed increasing cash flow from operations
- The yield (%) of the business are more favourable when compared to other asset classes
- The Cost of Capital is far less than the return on equity alone. (ROE % is 275% greater than The Cost of Capital)
- Share price has historically mirrored earnings and as of recent quarters earnings have grown more than share price.
- Due to an absence of Long term debt, growth is organic as the degree of operating leverage is low, this means that fixed costs are less prominent in the costing structure of a business hence earnings aren’t magnified/are sensitive to sales. This makes the company suitable for investment especially during these uncertain times, as businesses with high operating leverages tend to suffer due to diminished sales.