



VST Industries Ltd

Rs 210

... betting on cash flows and not growth

Buy

Industry	FMCG	BSE/ NSE Codes	509966/ VSTIND
Company P/E	5.5x FY09E	52 Week H/L	392 / 183
Market Cap. (Rs)	3235mn	52 Week Avg volumes	1700 / 1500
Face Value	10	Dividend (FY'08)	200%

Investment Rationale

- We recommend a BUY on VST Industries based on free cash generation, compelling valuation, positioning within the cigarette market and brand equity.
- VST known for the Charminar brand of cigarette now derives close to 20% of its annual volumes from brands like Moments and Shaan launched during the past five years and has been able to successfully withstand the body blow delivered by last year's budget in terms of excise hikes which actually threatened the viability of 60% of its annual revenues.
- Given the free cash flow generation of this debt-free company and considering the fact that it has cash and cash equivalent worth Rs150 per share we believe that even after considering all contingent liabilities of Rs1bn towards Income Tax and Excise cases pending against the company, there is a strong possibility of VST maintaining its dividend track record of 200% which it has been paying since the past two years. Even if this were not to happen if you consider the 125% dividend paid out in earlier years as a base the dividend yield works out to 6% against 9.5% if it pays 200%
- Last year's budget did not effect any change in the excise structure on filter cigarette which constitutes 70% of the industry volumes but equated micro cigarettes (length less than 60mm) to regular filter cigarettes on the excise front and also equated plain cigarettes to long size filter cigarettes and made a Charminar smoker pay the same as that of a Wills Filter smoker. The additional impact on VST was anywhere between 2.5 to 5 times on its brands. This virtually put VST in a significant competitive disadvantage compared to peers like ITC and Godfrey Phillips and contraction in EBITDA margins is here to stay from the current fiscal onwards for VST.
- VST has also to contend with competition from the un-organised market at lower price points but despite this the company has managed to report a 9% growth in volumes during the third quarter as compared to the previous quarter.
- It is also important to note that the nine monthly performance of VST should be viewed in the context of the Rs135mn foreign exchange loss included in other expenditure. VST exports cut leaf tobacco and finished cigarettes.
- We recommend a BUY on VST trading at 5.5x FY09E earnings with a one-year price target of Rs252 which is a 20% annualized return.

Company History

- VST Industries is the third most important cigarette player in India along with ITC and Godfrey Phillips and employs close to 1100 people. British American Tobacco – BAT owns 32% of the company and investors who recollect the battle in 2001 between ITC and Bright Star Investments, a finance company would know that ITC holds 10% in VST while Bright Star Investments – BSI holds 25% in VST. VST Industries has its facility in Azamabad in the state of Andhra Pradesh and is a AAA rated company.

Table 1: Profit and Loss A/c.

Year End Mar. (Rs. Mn.)	FY07	FY08	FY09E
Net Sales	3,362	3,400	3,910
% growth yoy		1.1%	15.0%
Other Income	158	158	196
Total Income	3,520	3,558	4,106
RM Consumption	1,165	1,369	1,681
% of sales	34.7%	40.3%	43.0%
Manufacturing Exps	119	120	156
% of sales	3.6%	3.5%	4.0%
SG& A Expenses	1,273	1,071	1,271
% of sales	37.9%	31.5%	32.5%
Total Expenditure	2,558	2,560	3,108
% of sales	76.1%	75.3%	79.5%
EBITDA	962	998	998
Depreciation	115	137	146
Profit Before Tax	848	861	852
Taxation	297	277	281
Profit After Tax	551	584	571

Table 2: Balance Sheet

Year End Mar. (Rs. Mn.)	FY07	FY08	FY09E
Share Capital	154	154	154
Reserves and Surplus	1,948	2,165	2,374
Net Worth	2,102	2,319	2,529
Capital Employed	2,102	2,319	2,529
Gross Block	1,933	2,306	2,456
Depreciation	984	1,117	1,409
Net Block	948	1,189	1,047
Capital WIP	23	29	25
Investments	1,873	2,233	2,344
Inventories	580	761	615
Sundry Debtors	52	43	35
Cash and Bank Balances	315	46	531
Loans and Advances	111	130	151
Other Current Assets	14	2	2
Current Liabilities	1,539	1,884	1,950
Provisions	385	322	351
Working Capital	(851)	(1,224)	(967)
Deferred Tax Asset	110	92	80
Capital Deployed	2,102	2,319	2,529

Table 3: Key Ratios

Year End Mar.	FY07	FY08	FY09E
EPS (Rs.)	35.68	37.79	36.95
P/E (x)	5.89	5.56	5.68
Book Value (Rs.)	136.14	150.20	163.74
P/BV (x)	1.54	1.40	1.28
EBITDA (%)	28.63	29.35	25.51
NPM (%)	16.39	17.16	14.59
ROCE (%)	40.32	37.10	33.68
RONW (%)	26.21	25.16	22.56
Market Cap./Sales (x)	0.96	0.95	0.83

Table 4: Cash Flow Statement

Year End Mar. (Rs. Mn.)	FY07	FY08	FY09E
Profit before Tax	848	861	852
Adjustments	(30)	(3)	(43)
Operating Profits Before W/Capital	818	857	809
Working Capital Changes	183	158	249
Operating Profits After W/Capital	1,001	1,015	1,058
Taxes	(315)	(322)	(354)
Net cash - Operating Activities	677	683	704
Net cash - Investing Activities	(285)	(584)	150
Net cash - Financing Activities	(225)	(368)	(369)
Net Inc/Dec in Cash	166	(269)	485
Cash at the beginning of year	149	315	46
Cash at the end of year	315	46	531

Table 5: Q3FY09 and 9 monthly results

Particulars (Rs. Mn.)	Q3FY'09	Q3FY'08	YTD FY'09	YTD FY'08
Net Sales	1,279	925	2,809	2,518
Other Income	42	27	146	136
Total Income	1,320	952	2,955	2,654
Total Expenditure	-957	-667	-2,239	-1,881
Operating Profit	364	285	716	773
Interest	1	2	1	11
Depreciation	-40	-35	-116	-101
PBT	325	252	601	683
Taxes	-107	-84	-164	-219
PAT	218	168	437	464

