

Britannia Industries (BRIT IN)

“Good Days” ahead

27 May 2020

INDIA | FMCG | Company Update

Britannia’s stock price has remained sideways after our downgrade, due to corporate governance concerns, tapering volume growth, and rich valuations, given that it is highly dependent on a single category. We have always maintained our positive stance on foods over HPCs based on: (1) Formalisation will be more visible in foods, with higher share of the unorganized sector; (2) more large/integrated manufacturing facilities will get benefits of economies of scale and reduced wastage; (3) distribution infrastructure will improve (availability of refrigerators / other ancillary infra); and (4) focus on LUPs will drive penetration. **We upgrade our rating to BUY from Neutral with a target of Rs 3,550 (50x FY22 EPS).**

We expect Britannia to deliver superior performance (14% EPS CAGR over FY19-22) vs. FMCG peers due to its higher earnings resilience (as biscuits is a low-ticket segment with characteristics of essential products) lower share (c.5% of revenue) coming from international operations. Moreover, any decision taken by the board of directors to eradicate lingering corporate-governance concerns (ICD etc.) could re-rate valuation multiples further.

Why are we upgrading to BUY?

Low-ticket packaged foods to gain prominence: We believe low-ticket packaged foods (for e.g., biscuits, noodles) will gain prominence in the short term, as consumers are likely to avoid restaurant-made food based on COVID-19-related concerns and as Britannia is the market leader in biscuits, it is in the right position to capture this trend. However, past few quarters’ volume growth performance has been subdued because of: (1) slower category growth, (2) deceleration in the value segment of biscuits (rural growing much slower than urban), (3) new launches pushed back because of a weak macro environment, and (4) rationalizing trade inventory to improve distributor ROIs. We are confident that the management’s solid execution capabilities will be able to tide over the current crisis based on its strengthening power brands portfolio via innovation/re-launches and premiumization, enhancing direct distribution reach, increasing the share of in-house manufacturing, and focussing on cost-efficiencies (planned savings of Rs 2.7bn in FY20). Moreover, consumption of packaged foods is likely to see an uplift 1) as customers stay indoors / work from home and 2) frequency of consumption going up.

Benign input costs to aid margins in an otherwise price-point-sensitive category

Britannia’s gross margins will sustain / marginally improve in FY21 (vs. the earlier assumption of gross-margin contraction) due to softness in wheat prices on back of bumper harvests. Palm oil and milk prices are also likely to fall because of lower demand. In our view, inflationary pressure in milk is likely to subside as HORECA (which constitutes 25-30% of milk demand) will face pressure.

Impressed by its ambition of becoming a ‘Total Foods Company’

We are really impressed by its ambition of becoming a ‘Total Foods Company’ leveraging its current distribution network. However, so far, results have been mixed.

Category	Market size (Rs bn)	Comments
Cream wafers	5	#3 player with 10% market share pan-India
Milk shakes	28	#2 player with 20% market share in milk-shakes within a year of launching
Salty snacks	250	Yet to see meaningful results, given hyper local competition
Croissants	NA	Relaunched a newer variant keeping in mind customer preference, as it is a completely new category

BUY (Upgrade)

CMP RS 3,162

TARGET RS 3,550 (12%)

SEBI CATEGORY: LARGE CAP

COMPANY DATA

O/S SHARES (MN) :	240
MARKET CAP (RSBN) :	616
MARKET CAP (USDBN) :	8
52 - WK HI/LO (RS) :	3444/ 2101
LIQUIDITY 3M (USDMN) :	1.4
PAR VALUE (RS) :	1

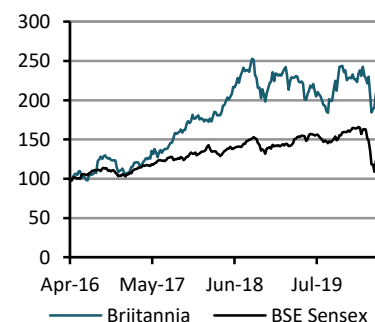
SHARE HOLDING PATTERN, %

	Mar 20	Dec 19	Sep 19
PROMOTERS :	50.6	50.6	50.7
FII / NRI :	15.0	16.1	15.5
FI / MF :	13.1	13.3	13.3
NON PRO :	6.6	5.4	5.7
PUBLIC & OTHERS :	14.7	14.6	14.9

KEY FINANCIALS

Rs mn	FY20E	FY21E	FY22E
Net Sales	1,12,548	1,20,192	1,34,604
EBIDTA	18,303	19,869	23,079
Net Profit	13,770	14,590	17,057
EPS, Rs	57.3	60.7	71.0
PER, x	55.2	52.1	44.5
EV/EBIDTA, x	41.3	37.6	32.0
P/BV, x	19.4	15.7	12.9
ROE, %	35.1	30.0	28.9
Debt/Equity (%)	25.5	20.6	17.0

PRICE VS. SENSEX



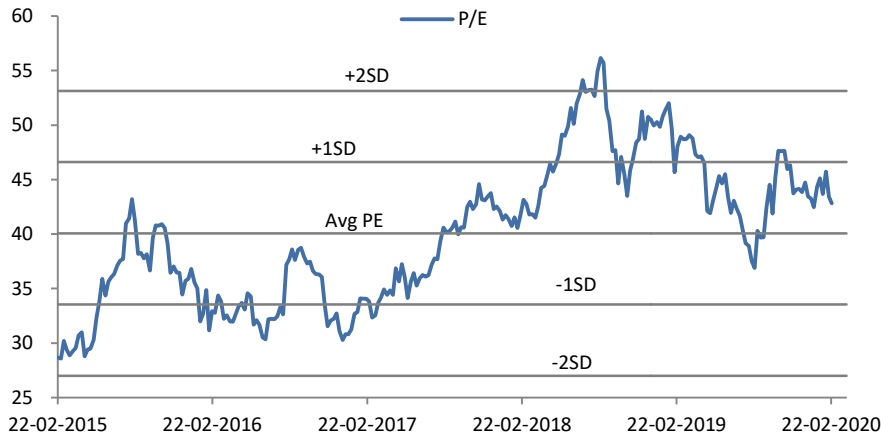
Source: Phillip Capital India Research Est.

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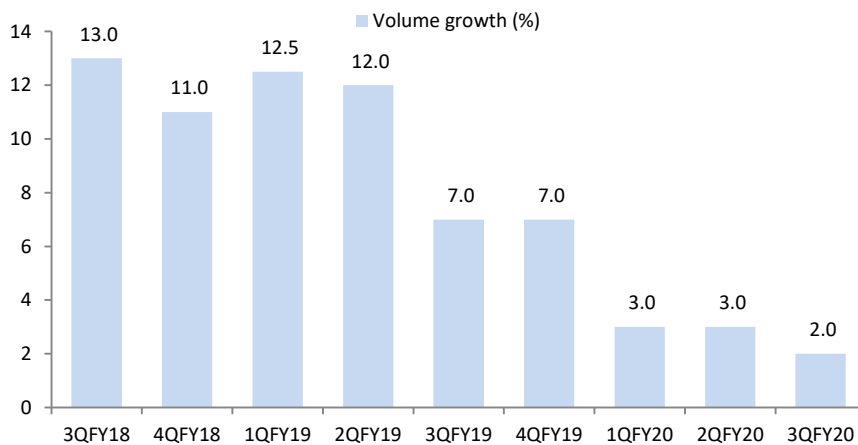
Looking relatively attractive in the context of earnings resilience and VUCA : Britannia offers the highest earning resilience (14% EPS CAGR over FY19-22) due to mainly the domestic business (95% of revenue) and characteristics of essential products.

Figure 1: Britannia trading close to its 5-year average PE multiple



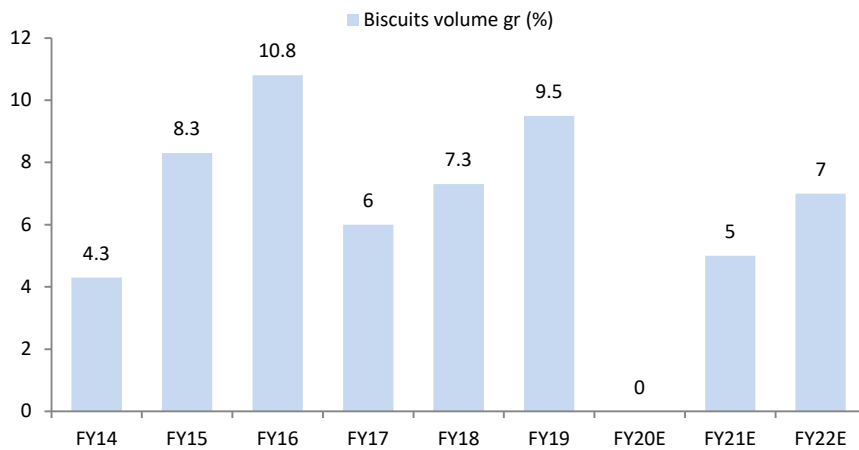
Source: Bloomberg, Phillip Capital estimates

Figure 2: Volume growth has been weak since the past few quarters due to category-related challenges and sluggishness in the value segment of biscuits, which could reverse in short to medium term



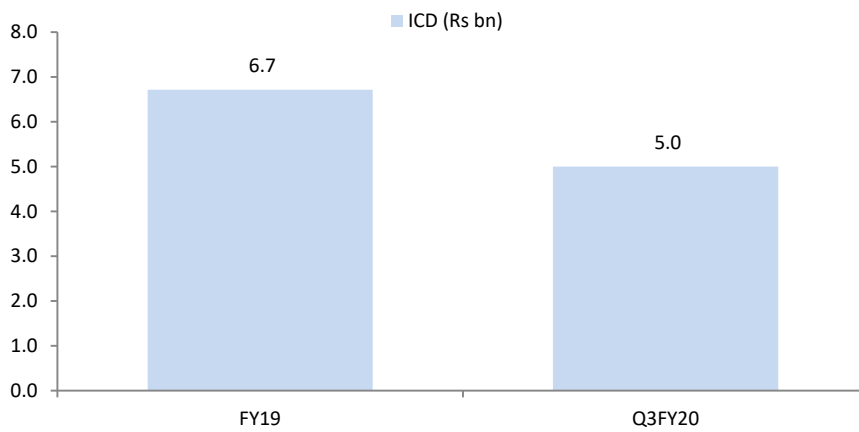
Source: Company, Phillip Capital estimates

Figure 3: Volume growth to gradually pick up due to favourable base and customers' preference for essential products



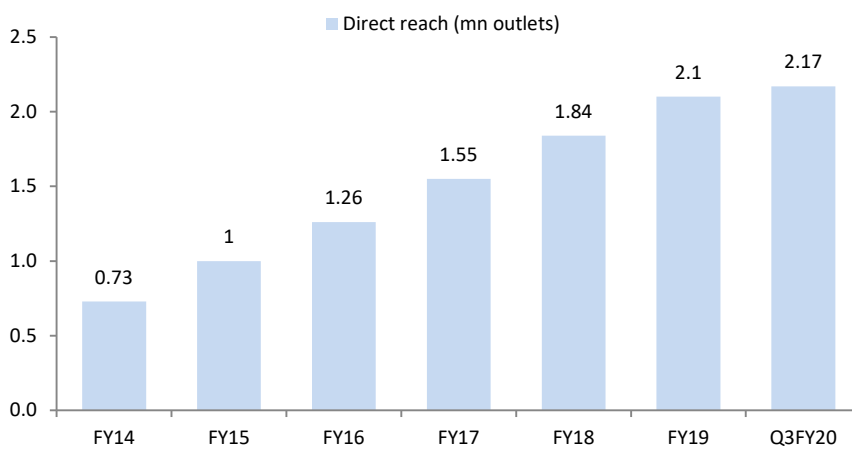
Source: Company, Phillip Capital estimates

Figure 4: ICD transaction



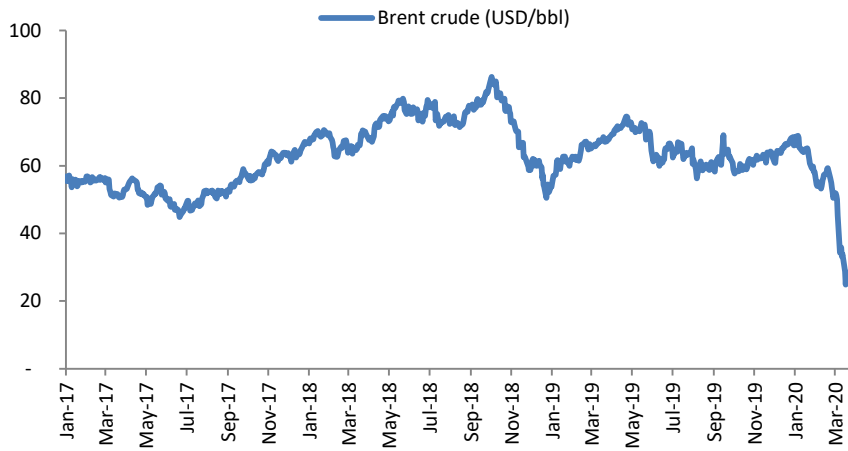
Source: Company

Figure 5: Focus on direct distribution reach has started bearing fruits



Source: Company

Figure 6: Fall in crude price will result in lower packaging costs



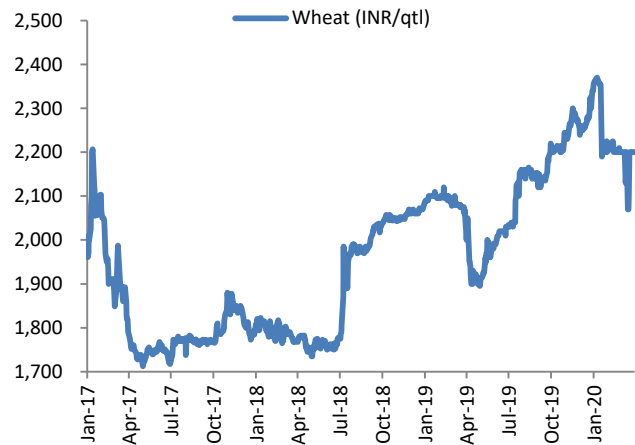
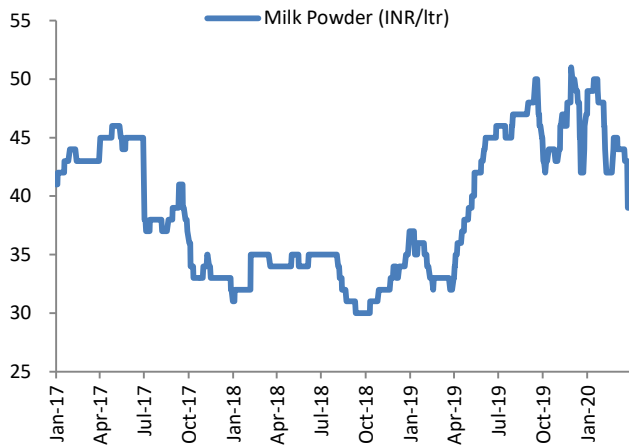
Source: Bloomberg

Figure 8: Power brands

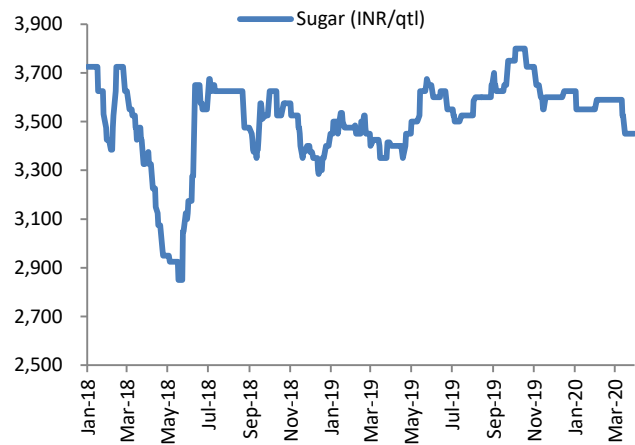
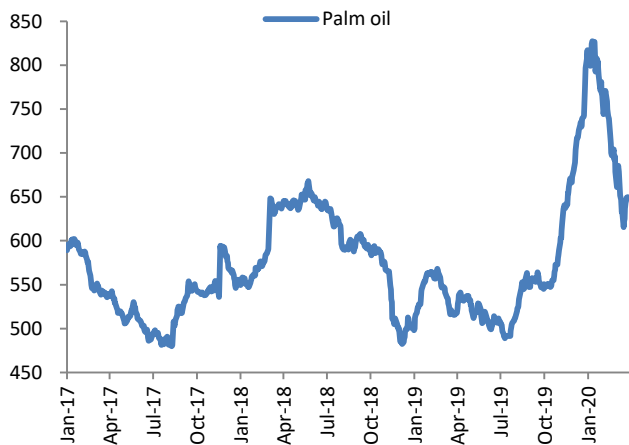


Source: Company

Figure 9: Benign input costs across key commodities to aid gross margins

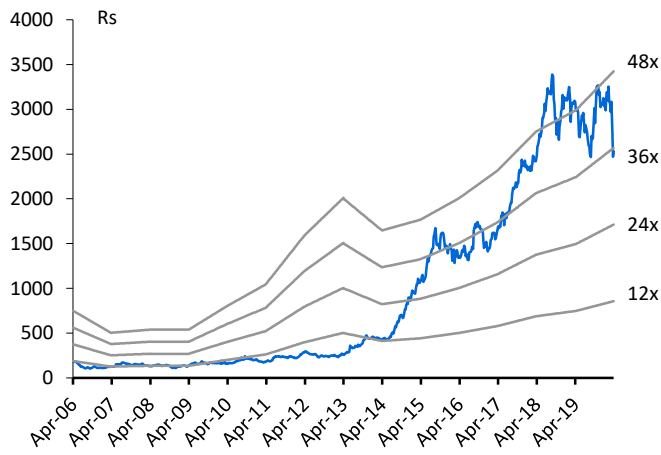


Source: Bloomberg

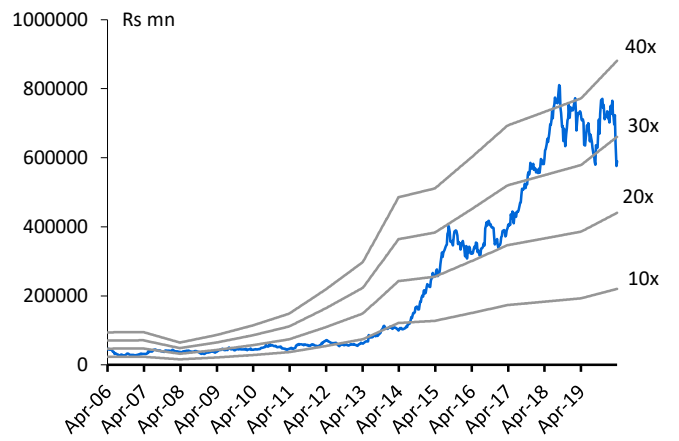


Source: Bloomberg

Two-year forward P/E band



EV/EBITDA band



Source: PhillipCapital India Research Estimates

Financials

Income Statement

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Net sales	1,09,735	1,12,548	1,20,192	1,34,604
Growth, %	11	3	7	12
Other operating income	812	1,421	1,599	1,839
Total income	1,10,547	1,13,969	1,21,791	1,36,442
Raw material expenses	-65,615	-67,583	-71,976	-79,893
Employee expenses	-4,418	-4,639	-4,871	-5,480
Other Operating expenses	-23,180	-23,443	-25,075	-27,990
EBITDA (Core)	17,334	18,303	19,869	23,079
Growth, %	15.4	5.6	8.6	16.2
Margin, %	15.8	16.3	16.5	17.1
Depreciation	-1,619	-1,845	-2,169	-2,467
EBIT	15,715	16,458	17,700	20,613
Growth, %	15.6	4.7	7.5	16.5
Margin, %	14.3	14.6	14.7	15.3
Interest paid	-91	-740	-936	-958
Other Income	2,065	2,684	2,952	3,395
Pre-tax profit	17,679	18,402	19,716	23,050
Tax provided	-6,125	-4,632	-5,126	-5,993
Profit after tax	11,555	13,770	14,590	17,057
Others (Minorities, Associates)	37	0	0	0
Net Profit	11,591	13,770	14,590	17,057
Growth, %	15.4	18.8	5.9	16.9
Net Profit (adjusted)	11,591	13,770	14,590	17,057
Unadj. shares (m)	240	240	240	240
Wtd avg shares (m)	240	240	240	240

Balance Sheet

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Cash & bank	1,098	6,294	15,241	24,110
Marketable securities at cost	7,499	7,499	7,499	7,499
Debtors	3,942	4,043	4,318	4,836
Inventory	7,814	8,014	8,558	9,585
Loans & advances	12,039	12,039	12,039	12,039
Other current assets	2,871	2,871	2,871	2,871
Total current assets	35,263	40,760	50,527	60,940
Investments	7,264	7,264	7,264	7,264
Gross fixed assets	21,908	23,908	26,408	30,408
Less: Depreciation	-5,025	-6,870	-9,039	-11,506
Add: Capital WIP	1,012	1,012	1,012	1,012
Net fixed assets	17,895	18,050	18,381	19,914
Non-current assets	1,858	1,858	1,858	1,858
Total assets	62,380	68,031	78,128	90,075
Current liabilities	18,514	18,806	19,601	21,099
Provisions	115	115	115	115
Total current liabilities	18,629	18,921	19,715	21,213
Non-current liabilities	892	9,532	9,532	9,532
Total liabilities	19,520	28,453	29,247	30,745
Paid-up capital	240	240	240	240
Reserves & surplus	42,292	39,012	48,314	58,763
Shareholders' equity	42,859	39,579	48,881	59,330
Total equity & liabilities	62,380	68,031	78,128	90,075

Source: Company, PhillipCapital India Research Estimates

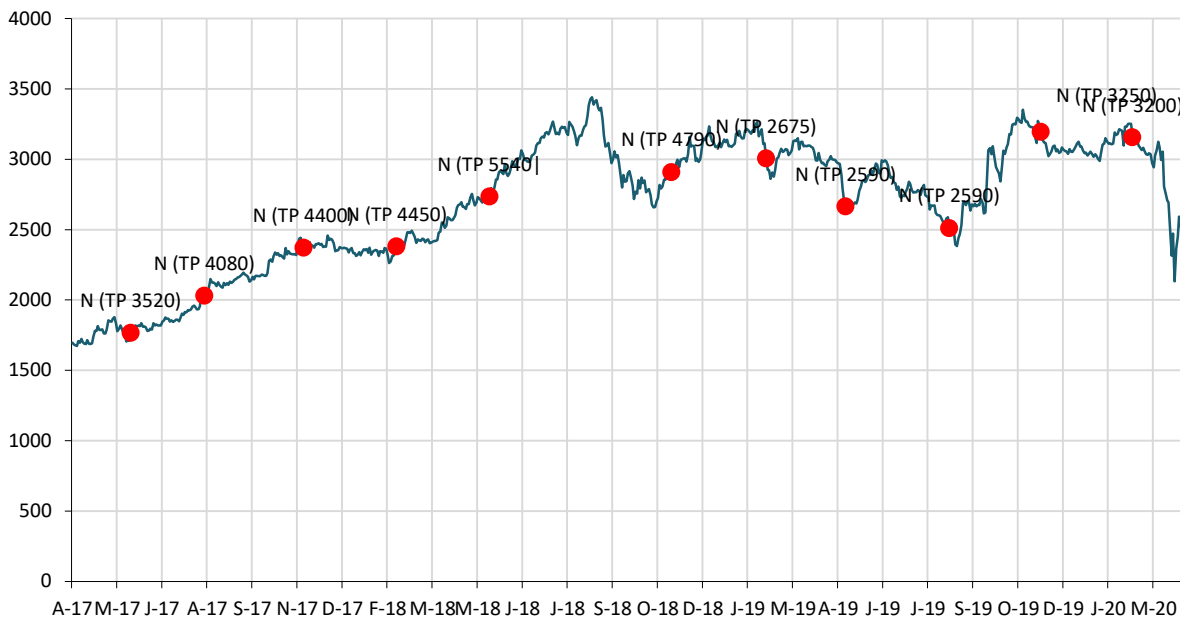
Cash Flow

Y/E Mar, Rs mn	FY19	FY20E	FY21E	FY22E
Pre-tax profit	17,679	18,402	19,716	23,050
Depreciation	1,619	1,845	2,169	2,467
Chg in working capital	-2,951	-9	-24	-46
Total tax paid	-5,998	-4,632	-5,126	-5,993
Other operating activities	0	0	0	0
Cash flow from operating activities	10,350	15,607	16,734	19,478
Capital expenditure	-4,030	-2,000	-2,500	-4,000
Chg in investments	-5,039	0	0	0
Chg in marketable securities	1,069	0	0	0
Other investing activities	0	0	0	0
Cash flow from investing activities	-8,010	-2,000	-2,500	-4,000
Free cash flow	2,340	13,607	14,234	15,478
Equity raised/(repaid)	1,573	-8,640	8,640	0
Debt raised/(repaid)	-227	8,640	0	0
Dividend (incl. tax)	-4,339	-8,411	-5,287	-6,609
Other financing activities	131	0	0	0
Cash flow from financing activities	-2,629	-8,411	3,353	-6,609
Net chg in cash	-289	5,196	17,587	8,869

Valuation Ratios

	FY19	FY20E	FY21E	FY22E
Per Share data				
EPS (INR)	48.2	57.3	60.7	71.0
Growth, %	15.4	18.8	5.9	16.9
Book NAV/share (INR)	177.0	163.3	202.0	245.5
FDEPS (INR)	48.2	57.3	60.7	71.0
CEPS (INR)	55.0	65.0	69.7	81.2
CFPS (INR)	32.9	53.8	57.3	66.9
DPS (INR)	15.0	35.0	22.0	27.5
Return ratios				
Return on assets (%)	20.4	22.3	21.2	21.4
Return on equity (%)	27.3	35.1	30.0	28.9
Return on capital employed (%)	29.4	31.2	28.8	28.3
Turnover ratios				
Asset turnover (x)	4.6	4.2	4.5	4.8
Sales/Total assets (x)	1.9	1.7	1.6	1.6
Sales/Net FA (x)	6.6	6.3	6.6	7.0
Receivable days	13.1	13.1	13.1	13.1
Inventory days	26.0	26.0	26.0	26.0
Payable days	44.7	44.6	44.7	45.0
Working capital days	27.1	26.5	24.9	22.3
Liquidity ratios				
Current ratio (x)	1.9	2.2	2.6	2.9
Quick ratio (x)	1.5	1.7	2.1	2.4
Interest cover (x)	172.9	22.3	18.9	21.5
Total debt/Equity (%)	3.2	25.5	20.6	17.0
Net debt/Equity (%)	0.7	9.5	(10.8)	(23.9)
Valuation				
PER (x)	65.6	55.2	52.1	44.5
PEG (x) - y-o-y growth	4.3	2.9	8.8	2.6
Price/Book (x)	17.9	19.4	15.7	12.9
EV/Net sales (x)	6.9	6.7	6.2	5.5
EV/EBITDA (x)	43.4	41.3	37.6	32.0
EV/EBIT (x)	47.9	45.9	42.2	35.8

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year. We have different threshold for large market capitalisation stock and Mid/small market capitalisation stock. The categorisation of stock based on market capitalisation is as per the SEBI requirement.

Large cap stocks

Rating	Criteria	Definition
BUY	$\geq +10\%$	Target price is equal to or more than 10% of current market price
NEUTRAL	$-10\% > \text{to} < +10\%$	Target price is less than +10% but more than -10%
SELL	$\leq -10\%$	Target price is less than or equal to -10%.

Mid cap and Small cap stocks

Rating	Criteria	Definition
BUY	$\geq +15\%$	Target price is equal to or more than 15% of current market price
NEUTRAL	$-15\% > \text{to} < +15\%$	Target price is less than +15% but more than -15%
SELL	$\leq -15\%$	Target price is less than or equal to -15%.

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