Britannia Industries

BSE Sensex 19,608	S&P CNX 5,933
Bloomberg	BRIT IN
Equity Shares (m)	119.5
M.Cap. (INR b)/(USD b)	57.6/1.1
52-Week Range (INR)	600/400
1,6,12 Rel. Perf. (%)	1/-7/-17

Financials & Valuation (INR b)

Y/E March	2013E	2014E	2015E
Sales	55.0	64.2	74.9
EBITDA	2.8	3.4	4.0
Adj. PAT	2.1	2.4	2.8
Adj. EPS (INR)	17.3	20.2	23.5
EPS Gr. (%)	10.4	17.2	16.1
BV/Sh.(INR)	51.4	59.8	69.7
RoE (%)	33.6	33.8	33.7
RoCE (%)	53.7	51.2	47.7
Payout (%)	45.6	50.0	50.0
Valuations			
P/E (x)	27.9	23.8	20.5
P/BV (x)	9.4	8.1	6.9
EV/EBITDA (x)	20.1	16.0	13.1
Div. Yield (%)	1.6	2.1	2.4

CMP: INR482 TP: INR467 Sell

- **Results below expectations:** Britannia Industries' (BRIT) 3QFY13 results were below expectations. While sales grew 16.8% to INR14.5b (v/s our estimate of INR14.1b), adjusted PAT grew 5.4% to INR570m (v/s our estimate of INR622m). EBITDA remained flat at INR782m (v/s our estimate of INR859); EBITDA margin declined 90bp to 5.4%.
- **Pick-up in volume growth after 8 quarters of deceleration:** Volume growth at 5.5% indicates pick-up after 8 quarters of deceleration and remains the single key positive takeaway from 3Q results, in our opinion. Sales growth was driven by (1) volume growth: 5-5.5%, (2) mix improvement: 5%, and (3) pricing: 6-6.5%. Non-Biscuits now constitute INR15b of sales. Dairy Products, Bakery Products and Health Beverages continue to offer strong potential.
- **Sustainable volume growth, margin expansion essential for re-rating:** BRIT's efforts to drive premiumization through new launches and heavy brand investments augur well from the long-term growth and margins viewpoint, but success of these initiatives and their impact on actual numbers will be gradual. We believe sustainable volume growth and margin expansion are the key drivers for re-rating.
- **Cutting estimates; maintain Sell:** We reduce our estimates for FY14/15 by 3-3.5% to incorporate lower than expected profitability and build in higher brand spends. Our FY13-15E EPS CAGR now stands at 16.6%. The stock trades at 23.8x FY14E and 20.5x FY15E EPS. We maintain our **Sell** rating. Our target price is INR467 (20x FY15E EPS). We will look for sustainability in volume growth before turning more positive on the stock. Alleviation in competitive intensity (unlikely) and sharp decline in input prices are key risks to our rating.

Quarterly Performance (INR Million)

Y/E March	FY12				FY13				FY12	FY13E	FY13	Var.
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE			3QE	(%)
Net Sales	11,030	12,905	12,440	13,096	12,216	14,028	14,533	14,221	49,470	54,998	14,080	3.2
YoY Change (%)	21.0	17.8	15.1	16.8	10.8	8.7	16.8	8.6	17.8	11.2	13.2	
COGS	7,257	8,408	7,910	8,223	7,575	9,042	9,192	9,412	31,798	35,221	9,011	
Gross Profit	3,773	4,496	4,530	4,873	4,642	4,986	5,341	4,809	17,673	19,777	5,069	5.4
Margins (%)	34.2	34.8	36.4	37.2	38.0	35.5	36.8	33.8	35.7	36.0	36.0	
Other Exp	3,300	3,761	3,749	4,192	3,991	4,379	4,559	4,090	15,003	17,020	4,210	8.3
% of Sales	29.9	29.1	30.1	32.0	32.7	31.2	31.4	28.8	30.3	30.9	29.9	
Total Exp	7,073	12,169	11,659	12,415	11,566	13,422	13,752	13,502	46,800	52,241	13,221	
EBITDA	473	736	781	680	651	606	782	718	2,670	2,757	859	(9.0)
Margins (%)	4.3	5.7	6.3	5.2	5.3	4.3	5.4	5.1	5.4	5.0	6.1	
YoY Growth (%)	15.6	39.1	40.1	8.0	37.6	-17.6	0.1	5.6	29.4	3.3	10.0	
Depreciation	111	116	122	125	130	143	149	125	473	547	140	6.6
Interest	93	97	95	95	95	88	91	79	381	353	75	21.9
Other Income	304	146	183	226	179	266	257	235	858	937	220	16.6
PBT	573	670	747	685	605	642	797	749	2,674	2,794	864	(7.7)
Tax	155	191	206	155	170	186	228	147	707	731	242	
Rate (%)	27.0	28.5	27.6	22.6	28.1	29.0	28.6	19.6	26.4	26.2	28.0	
Adjusted PAT	418	479	540	530	435	456	570	602	1,967	2,062	622	(8.4)
YoY Change (%)	27.2	45.9	42.7	22.6	4.0	-4.8	5.4	13.5	35.4	4.8	15.1	

E: MOSL Estimates

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Sales growth ahead of estimates; growth fuelled by premiumization and improved product mix

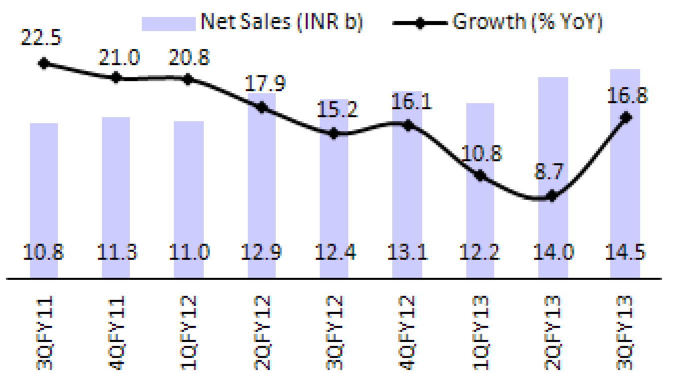
- Sales growth of 16.8% to INR14.5b (v/s our estimate of INR14b) was ahead of expectations with 5.5% volume growth , aided by lower base and sustained brand investments. BRIT had been witnessing continued deceleration in volume growth till last quarter (2% in 2QFY13, 3-4% in 1QFY13, 5.5% in 4QFY12, 7% in 3QFY12, 10% in 2QFY12 and 12% in 1QFY12) and this quarter marks the acceleration.
- Mix improvement and pricing contributed 5.5% and 6% to sales growth, respectively.
- Though gross margin expanded, EBITDA margin contracted due to higher ad spends. Ad spends were up 40% for 3Q and 25% for 9MFY13.

Subsidiary profitability improved significantly led by Dairy business(INR m)

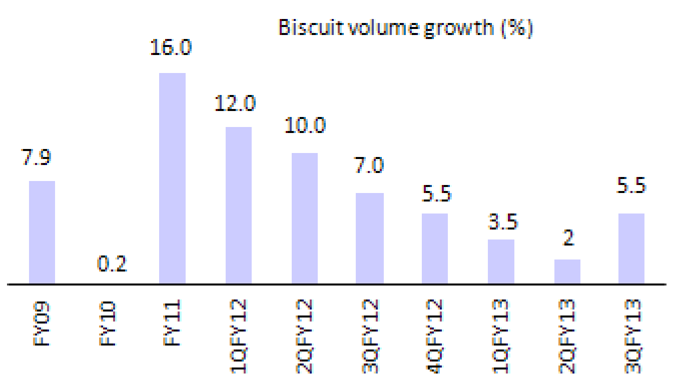
	Standlone		Consolidated		Subsidiaries		
	3QFY12	3QFY13	3QFY12	3QFY13	3QFY12	3QFY13	YoY (%)
Sales	12,440	14,533	13,814	16,079	1,374	1,546	13
PAT	540	570	559	621	19	51	169
Margins (%)	4.3	3.9	4.1	3.9	1.0	3.3	

Source: Company, MOSL

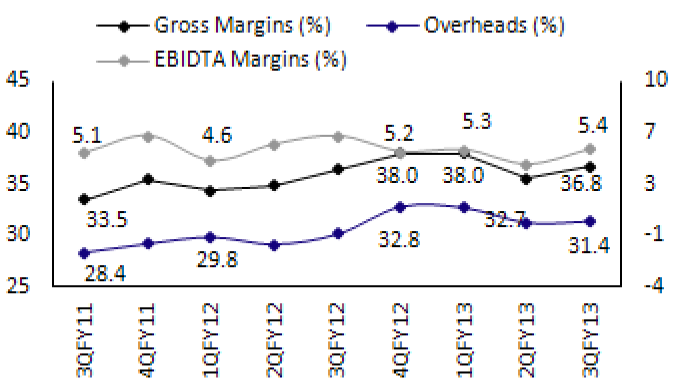
Sales growth ahead of expectations



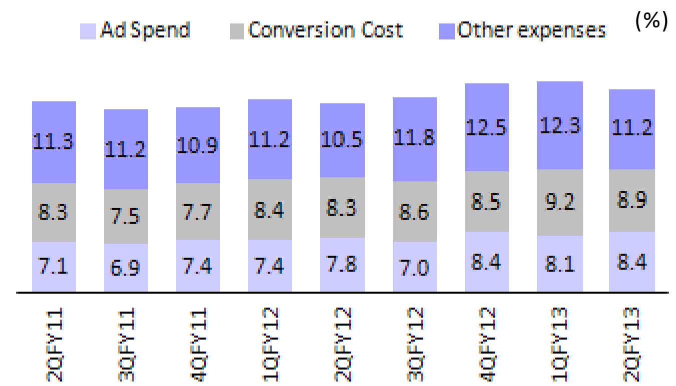
Volume growth at 5.5%



Gross margin continues to expand (up 30bp)...



...but higher ad spends result in 50bp decline in EBITDA margin

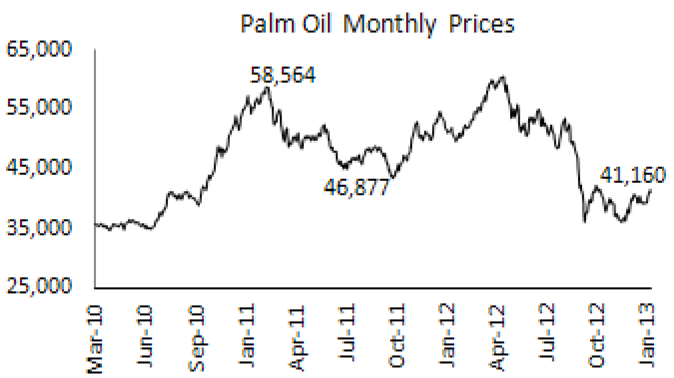


Source: Company, MOSL

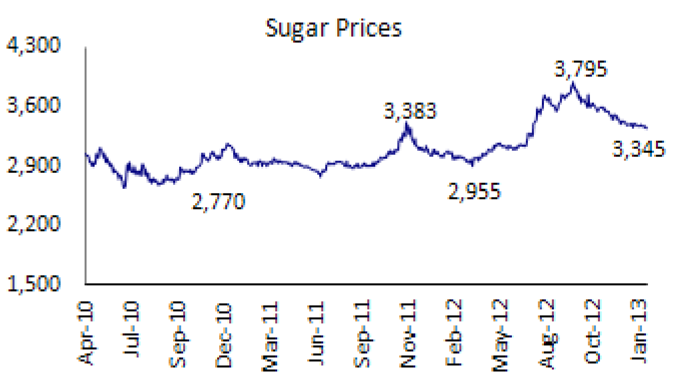
Gross margin expands 30bp; higher ad spends, conversion costs impact EBITDA margin

- Gross margin expanded 30bp (v/s our estimate of 40bp decline) to 36.8%, led by mix improvement and price hikes. Prices of vegetable oil (a key raw material) have been declining during the last couple of quarters. However, wheat flour and packaging costs still remain firm. Sugar prices have stabilized at lower levels, though they are up on an annual basis.
- EBITDA margin contracted 90bp to 5.4% (v/s our estimate of 6.1%), dragged by 140bp increase in ad spends and 40bp increase in conversion costs. EBITDA remained flat at INR782m (v/s our estimate of INR859m).
- Adjusted PAT grew 5.4% to INR570m (v/s our estimate of INR622m), higher than the 0.1% growth in EBITDA, led by 41% higher other income. Tax rate increased by 90bp.
- We expect ad spends to remain high, as BRIT drives its premiumization strategy and sustains investments behind its recent new launches. Secondly, rising competition in the Biscuits category will preclude any let down in ad spends, in our view.
- Performance of subsidiaries (imputed) has improved - reported profits grew 169% to INR51m v/s INR19m in the base quarter.

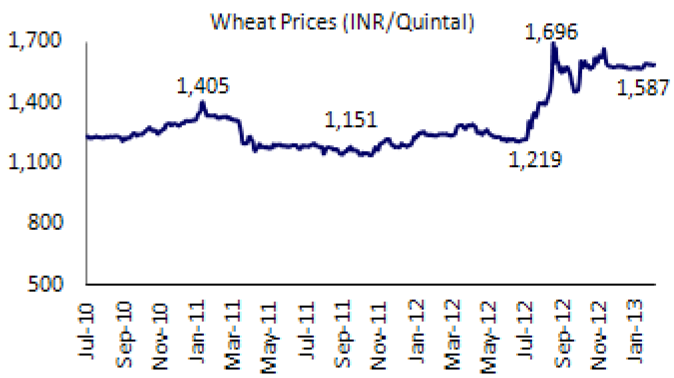
Palm oil prices providing a relative breather



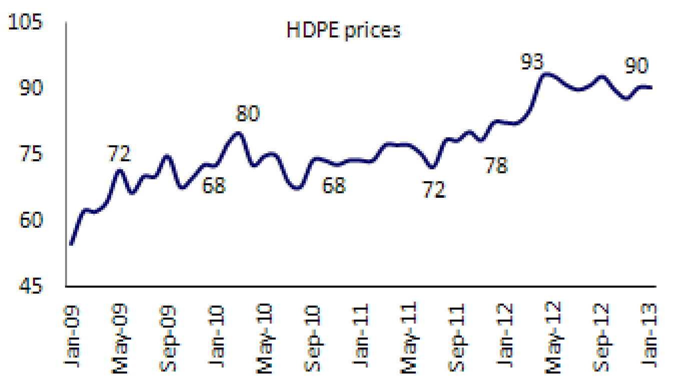
Sugar prices stable at lower levels but up YoY



Wheat prices inching up



HDPE prices steady



Source: Company, MOSL

Analyst meet takeaways

Premiumization focus to continue; sustained volume growth key for re-rating

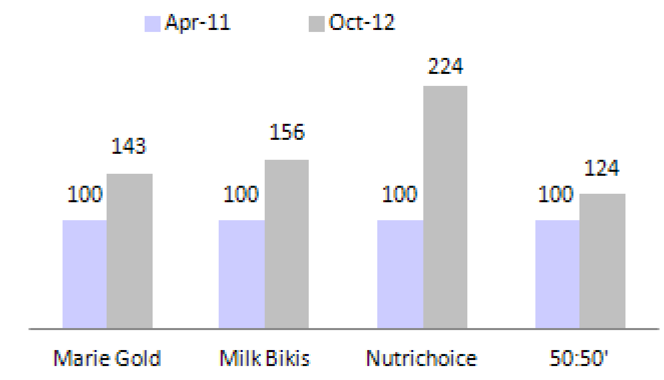
Biscuit volume growth accelerated after 8 quarters of deceleration

- Volume growth at 5.5% indicates pick-up after 8 quarters of deceleration and remains the single key positive takeaway from 3Q results, in our opinion.
- While competitive intensity remains elevated, BRIT's focus is to drive growth of its value-added portfolio through its three-pronged approach: (1) revenue management, (2) innovation, and (3) cost management.
- Improved mix contributed ~1/3rd of the sales growth for the quarter.

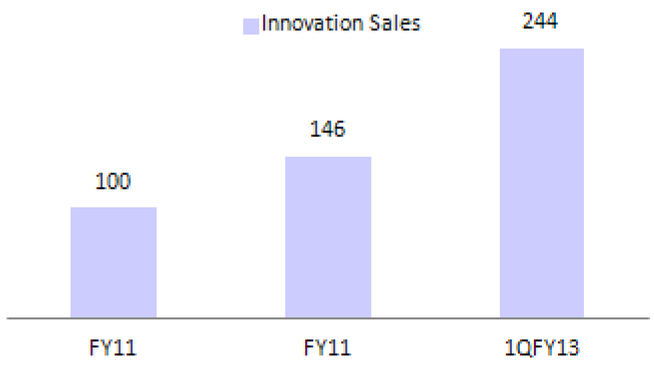
Premiumization drives gross margin despite steep input cost inflation

- For 3QFY13, BRIT's gross margin expanded 30bp despite steep input cost inflation in wheat and sugar (indexed exhibits below). Margin expansion was driven by price hikes and mix improvement.
- The management indicated continued investments in the front end through ad spends and promotion to capture share in an increasingly competitive segment. We note that BRIT's ad spends for 3Q and 9MFY13 have increased by 140bp and 90bp, respectively.
- Indexed growth in its premium portfolio - *Marie Gold*, *Nutri Choice*, *50-50* - attest the benefits of the premiumization strategy, as evident in the exhibits below.

Premium variants outperforming



Focus on innovation resulting in improved throughput



Source: Company, MOSL

Innovation a key growth driver; long-term branded foods opportunity still robust

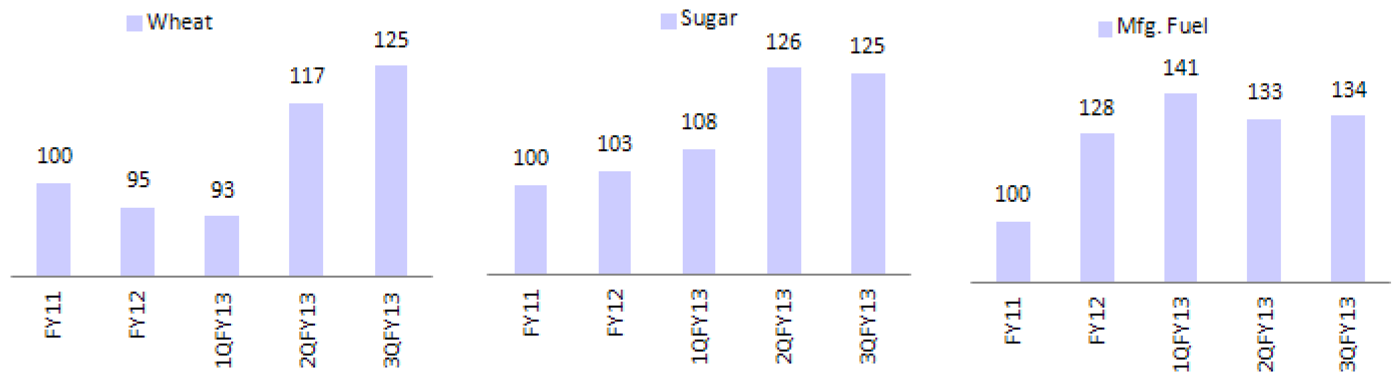
- Focus on innovation has expanded the portfolio, which has grown ~1.5x since FY11. The management reiterated its strategy of driving more opportunities for consumption and portfolio expansion.
- Given that less than 9% of the Foods category is branded, the management believes there is significant room for growth. Biscuits, despite being one of the largest processed foods category at USD2.2b and well penetrated, offers good opportunity, as per capita consumption at 2kg is half of Sri Lanka's.
- According to management, BRIT enjoys 4x relative market share of its next competitor in Health focused Biscuits (Nutrichoice) and is running neck to neck with ITC in premium cream segment.

Input cost environment a key worry

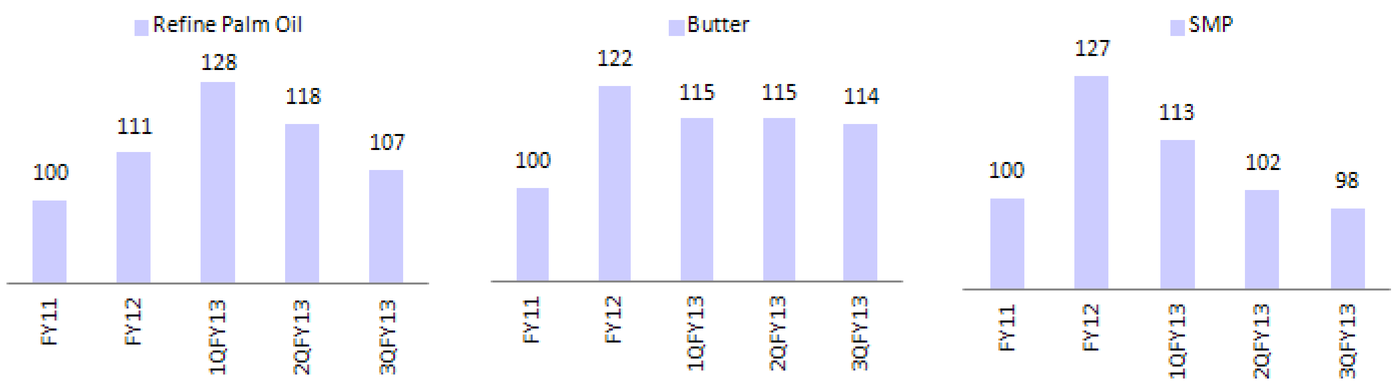
- Prices of raw materials like sugar and wheat increased sharply in FY12, as shown in the indexed charts below. Wheat and Sugar price inflation resulted in incremental INR1.8b impact during 9MFY13.
- Rising diesel prices will lead to incremental costs of INR15m per month.
- However, prices of vegetable oil and skimmed milk powder have corrected.
- We believe BRIT has limited levers to manage gross margins and will remain vulnerable to volatility in input costs, as pricing power is low in an industry which is witnessing rising competitive intensity from well entrenched players with deep pockets e.g. Parle and ITC.

Trend in prices of BRIT's key raw materials (indexed)

Wheat, sugar and fuel prices have gone up…



…while prices of palm oil, butter and SMP have corrected



Source: Company, MOSL

Backend investments to continue: Greenfield capacity in Gujarat to commence in FY14

- The management indicated that as part of its innovation and premiumization strategy, the company will invest more towards capacity expansion near key consumer clusters to reduce go to market costs (transportation, frieght etc).
- BRIT intends to increase the proportion of in-house manufacturing to capture higher margins. It is also implementing various cost efficiency projects in manufacturing, supply chain to drive margins.
- The company recently commissioned its Bihar and Orissa plants and is setting up a greenfield plant in Gujarat. These plants will cater to the demand for dairy and premium products.

- BRIT will be investing INR2b in FY13 towards new capacities (up from INR0.7b in FY12). Overheads would increase due to the ongoing capacity expansion, keeping margins under check.

Cutting estimates; sustainability of volume growth improvement key for re-rating

- Our key concerns are: (1) continued deceleration in volume growth in the core Biscuits category, notwithstanding the pick-up in 3Q, helped by lower base, and (2) rising competitive headwinds, as players like ITC, Kraft and Parle are becoming aggressive and stepping up investments in the category, as reflected in higher brand spends and consequently lower operating margins (9MFY13 ad spends up 90bp YoY and EBITDA margin down 50bp despite 150bp gross margin expansion).
- BRIT's efforts to drive premiumization through new launches and heavy brand investments augur well from the long-term growth and margins viewpoint, but success of these initiatives and their impact on actual numbers will be gradual, in our view. We believe sustainable volume growth and margin expansion are the key drivers for re-rating.
- We reduce our estimates for FY14/15 by 3-3.5% to incorporate lower than expected profitability and build in higher brand spends. Our FY13-15E EPS CAGR now stands at 16.6%.
- The stock trades at 23.8x FY14E and 20.5x FY15E EPS. We maintain our **Sell** rating. Our target price is INR467 (20x FY15E EPS). We will look for sustainability in volume growth before turning more positive on the stock. Alleviation in competitive intensity (unlikely) and sharp decline in input prices are key risks to our rating.

Britannia Industries: an investment profile

Company description

Britannia Industries (BRIT) is the market leader in the biscuits category, with a market share of 38% (in value terms). Biscuits has been one of the fastest growing categories in the FMCG segment, with annual volume growth rate of 12-15% in the last five years.

Key investment arguments

- Biscuits have high sensitivity to income levels. The increase in disposable income should result in expansion in demand for biscuits, particularly in rural areas.
- Reduction in excise duty, increasing capacity utilization at Baddi and reduction in pack sizes will drive volumes and result in improved profitability.

Key investment risks

- Limited flexiblity to take pricing actions keeps margins vulnerable.
- Biscuits is a highly elastic category, with high sensitivity to any price increase. Intense competition and price sensitivity makes it difficult to pass on any price increase to consumers, particularly in the Glucose segment.
- Rising competitive intensity from deep pocket and well entrenched competitors.

Recent developments

- Standard pack sizes regulation came into effect in November 2012.
- BRIT recently launched Shubh Kaamnayein range with 5 themes - Meetha Namkeen, Choco Delight, Healthy Gifts, Cookie Delight, and Premium Assorted Cookies.
- Capacity expansion - greenfield unit at Jhagadia, Gujarat.

Valuation and view

- The stock trades at 23.8x FY14E and 20.5x FY15E EPS. We maintain our **Sell** rating. Our target price is INR467 (20x FY15E EPS).

Sector view

- We have a cautiously optimistic view on the sector on back of inflationary tendency in the economy, which might impact volumes as well as profit margins of companies.
- Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- Longer-term prospects bright, given rising incomes and low penetration.

Comparative valuations

		Britannia	Dabur	Colgate
P/E (x)	FY13E	27.9	27.9	31.7
	FY14E	23.8	23.3	28.0
P/BV (x)	FY13E	9.4	9.8	31.2
	FY14E	8.1	8.1	25.9
EV/Sales (x)	FY13E	1.0	3.5	5.1
	FY14E	0.8	3.0	4.4
EV/EBITDA (x)	FY13E	20.1	20.8	22.9
	FY14E	16.0	17.4	19.7

Shareholding pattern (%)

	Dec-12	Sep-12	Dec-11
Promoter	50.9	50.9	51.0
Domestic Inst	13.0	14.0	17.3
Foreign	15.7	15.9	12.6
Others	20.3	19.2	19.2

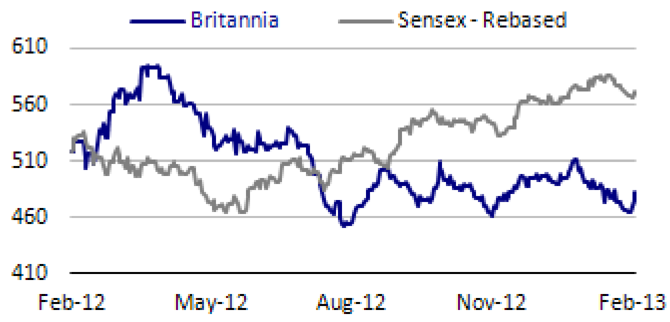
EPS: MOST forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	17.3	19.4	-10.6
FY14	20.2	23.2	-12.9

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
482	467	-3.1	Sell

Stock performance (1 year)



Financials and Valuation

Income Statement (INR Million)

Y/E March	2012	2013E	2014E	2015E
Net Revenues	49,470	54,998	64,223	74,903
Change (%)	17.8	11.2	16.8	16.6
Raw Material Cost	31,798	35,221	41,216	47,595
Gross Profit	17,673	19,777	23,007	27,308
Margin (%)	35.7	36.0	35.8	36.5
Advertising	3,810	4,400	5,138	5,992
% of Sales	7.7	8.0	8.0	8.0
Other Expenditure	11,343	12,620	14,469	17,288
EBITDA	2,521	2,757	3,399	4,028
Change (%)	33.2	9.4	23.3	18.5
Margin (%)	5.1	5.0	5.3	5.4
Depreciation	473	547	636	723
Int. and Fin. Charges	381	353	113	142
Financial Other Income	585	587	580	600
Operating Other Income	272	350	174	189
PBT	2,524	2,794	3,404	3,952
Change (%)	27.4	10.7	21.9	16.1
Margin (%)	5.1	5.1	5.3	5.3
Tax	656	784	1,021	1,186
Deferred Tax	0	-52	-34	-40
Tax Rate (%)	26.0	26.2	29.0	29.0
PAT	1,867	2,062	2,417	2,806
Change (%)	28.5	10.4	17.2	16.1
Margin (%)	3.8	3.7	3.8	3.7
Non-rec. (Exp.)/Income	0	0	0	-1
Reported PAT	1,867	2,062	2,417	2,805

Balance Sheet (INR Million)

Y/E March	2012	2013E	2014E	2015E
Share Capital	239	239	239	239
Reserves	5,108	5,896	6,909	8,084
Networth	5,347	6,135	7,148	8,323
Loans	4,326	811	851	1,509
Capital Employed	9,674	6,947	7,999	9,832
Gross Block	6,386	7,636	8,886	10,136
Less: Accum. Depn.	-3,379	-3,926	-4,562	-5,285
Net Fixed Assets	3,007	3,710	4,324	4,851
Capital WIP	1,000	250	250	250
Investments	5,264	1,960	3,009	4,221
Deferred Liability	10	62	97	136
Currents Assets	7,387	8,468	9,148	10,731
Inventory	3,741	4,125	5,138	5,992
Account Receivables	690	796	964	1,122
Cash and Bank Balance	614	1,089	433	842
Others	2,343	2,459	2,614	2,774
Curr. Liab. & Prov.	6,995	7,504	8,828	10,356
Account Payables	4,560	5,040	5,880	7,018
Other Liabilities	1,073	1,175	1,288	1,412
Provisions	1,362	1,289	1,660	1,927
Net Current Assets	393	964	321	374
Misc Expenditure not w/of	0	0	0	0
Net Assets	9,674	6,947	7,999	9,832

E: MOSL Estimates

Ratios

Y/E March	2012	2013E	2014E	2015E
Basic (INR)				
EPS	15.6	17.3	20.2	23.5
BV/Share	44.8	51.4	59.8	69.7
DPS	8.5	7.9	10.1	11.7
Payout (%)	54.4	45.6	50.0	50.0
Valuation (x)				
P/E	30.8	27.9	23.8	20.5
EV/Sales	1.1	1.0	0.9	0.7
EV/EBITDA	22.2	20.1	16.2	13.4
P/BV	10.8	9.4	8.1	6.9
Dividend Yield	1.8	1.6	2.1	2.4
Return Ratios (%)				
RoE	34.9	33.6	33.8	33.7
RoCE	36.1	53.7	51.2	47.7
Working Capital Ratios				
Debtor (Days)	5	5	5	5
Asset Turnover (x)	5.1	7.9	8.0	7.6
Leverage Ratio				
Debt/Equity (x)	0.8	0.1	0.1	0.2

Cash Flow Statement (INR Million)

Y/E March	2012	2013E	2014E	2015E
OP Profit	2,521	2,757	3,399	4,028
Financial Other Income	585	587	580	600
Interest Paid	381	353	113	142
Direct Taxes Paid	656	784	1,021	1,186
Inc in WC	-512	96	13	-356
CF from Operations	2,581	2,111	2,832	3,656
Extraordinary Items				
(Inc)/Dec in FA	1,333	500	1,250	1,250
(Pur.)/Sale of Investments	-186	-3,304	1,048	1,213
Other Non Rec Exp	0	0	0	1
CF from Investments	1,147	-2,804	2,298	2,464
Issue of Shares	0	0	0	0
Inc in Debt	-281	-3,515	40	658
Dividend Paid	902	1,157	1,093	1,404
Other Item	-76	-233	138	37
CF from Fin. Activity	-1,107	-4,439	-1,191	-783
Inc/Dec of Cash	327	476	-657	410
Add: Beginning Balance	287	614	1,089	433
Closing Balance	614	1,090	432	842

N O T E S

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