

BRITANNIA INDUSTRIES LTD

FMCG

13 MAY 2019

Quarterly Update

HOLD

Target Price : Rs 2,943

CMP : Rs 2,675
 Potential Upside : 10%
 Relative to Sector : Positive

MARKET DATA

No. of Shares : 24.0Cr
 FV (Rs) : 2
 Market Cap (Rs Cr.) : 64,611
 52-week High / Low : Rs 3,472 / Rs 2,610
 Avg. Daily vol. (6mth) : 201,615share
 Bloomberg Code : BRITIB
 Reuters Code : BRIT. NS
 BSE Code : 500825
 NSE Code : BRITANNIA

Q4FY19: NPD pipeline strong, modest performance in a challenging quarter

Britannia delivered modest growth in a challenging quarter which was broadly in-line with our expectations. However, a 7% volume growth in the context of a slowdown in consumer demand was healthy. Margins on a YoY basis remained flat dragged by new business scale up expenses and higher brand investments. Management commentary on NPDs was buoyant and traction is expected to continue further in FY20 as well. It remains hopeful of demand recovery post General Elections and a normal monsoon forecast by IMD. Inflation is expected to be slightly elevated in FY20 to be mitigated by price hikes.

Consistent performance in core biscuits category coupled with robust innovation funnel, market share gains, distribution expansion, focus on bridging portfolio gaps in bakery/cakes and entry into adjacencies should continue to drive growth for BRIT even in FY20 in our view. **Although, we remain constructive on the growth trajectory of BRIT we believe, there is little scope for error in given its premium valuations and slowdown in consumption demand. We retain HOLD rating on the stock but cut estimates a tad bit and revise TP to Rs. 2,943 (earlier Rs. 3,172) at 43x FY21E EPS.**

Key Highlights

- Q4FY19 performance – a modest growth quarter with market share gains and strong NPD launches:** Britannia reported a modest quarter with an overall in-line performance. Domestic business revenues reported 12% YoY growth led by 7% volume growth, 2.5% price led growth and 2% mix driven growth. Domestic EBITDA/PAT grew 14%/18%YoY. However, weak subsidiaries performance impacted the overall consolidated revenues which grew 10% YoY. Consolidated EBITDA Margins remained flat YoY at 15.6% in Q4FY19 as gains from lower staff costs and higher gross margins were negated by higher other expenditure. Gross Margins (GMs) expanded 273bps YoY – on account of benign RM costs. Other Expenditure came in higher by 318bps YoY due to goodwill write off in daily bread business and additional manufacturing costs owing to scale up of new businesses like croissants (Ranjangaon plant), snacks (Bangalore plant) and wafers.
- Subsidiary revenues (Consol minus Subsidiary, International + Dairy) performance** witnessed a decline of 13% YoY while EBITDA declined sharply by 47% YoY with margins collapsing to 11% (18.3% in Q4FY18). However, management highlighted that this was due to shifting of subsidiary revenues to standalone financials as exports was shut due to maintenance work in Middle East; this also caused standalone business numbers to be overstated a tad bit in Q4FY19. International business posted single digit growth with Dairy growing in strong double-digit for Q4FY19.

FINANCIAL SUMMARY (Consolidated)

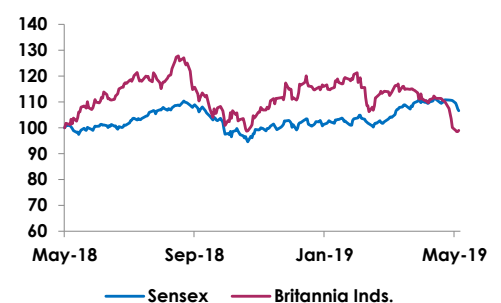
Y/E	Sales (Rs Cr)	EBITDA (Rs Cr)	PAT (Rs Cr)	EPS (Rs)	Change (YoY %)	P/E (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	DPS (Rs)
March										
FY19	11,054	1733	1159	48.2	15.4	64.0	30.2	35.7	21.9	15.0
FY20E	12,590	2075	1382	57.5	19.2	46.5	30.0	35.0	15.5	19.2
FY21E	14,448	2459	1653	68.8	19.6	38.9	30.5	36.0	13.6	22.3
FY22E	16,440	2857	1943	80.0	16.4	33.4	26.9	34.2	12.6	27.6

Source: Company, Axis Securities, Consensus Estimates

Suvarna Joshi
suvarna.joshi@axissecurities.in

Tanvi Shetty
tanvi.shetty@axissecurities.in

PRICE PERFORMANCE



Key Concall takeaways:

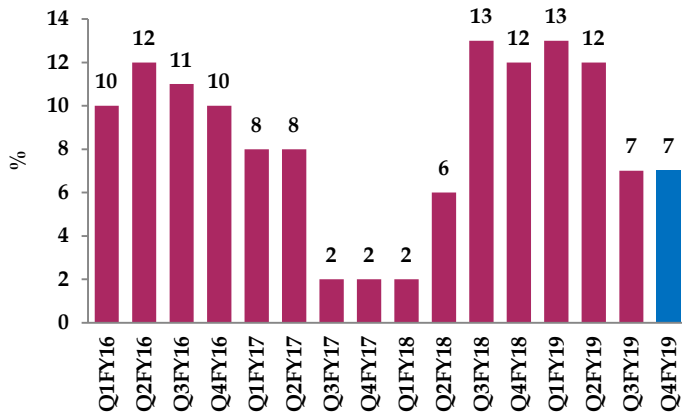
- Modest Operating performance in a challenging environment:** During Q4FY19, Net Revenue jumped 10.3% YoY to Rs. 2,799 crore. With moderate inflation in the prices of key raw materials, Gross Margin expanded by 273bps to 41.2%. However, a decline in RM costs and a 41bps fall in employee expenses were offset by 318bps rise in Other Expenses. Consequently, EBITDA Margin was stable at 15.6%. The EBITDA rose 10% YoY to Rs. 437 crore. Other Expenses included extraordinary items related to write off of the bread business. BRIT reported an 11.4% YoY growth in recurring PAT to Rs. 295 crore.
- Market share gain continues amid market slowdown:** In Q4FY19, BRIT gained market share from its largest competitor, Parle and the gap has widened every year since FY13. While, distribution led gains have aided BRIT to grow faster in the Hindi belt, it highlighted that Rural growth was in double digits while urban growth was in single digits. Management continued to highlight a slowdown in demand momentum, largely due to deceleration in rural demand (500bps slower since Sept 2018).
- Innovations gaining momentum; NPД funnel strong going into FY20:** Innovation share to revenues was 4.5% of sales in FY19 and management is targeting to double this number to ~9% in the future. During Q4FY19, it launched democratized version of centre-filled biscuits (*Treat Burst*) besides launching Swiss Rolls, Layer Cake and Brownies. It also launched *Treat Stars* and open face cream biscuit. With regards cream wafers launched in Q3FY19, BRIT is nearing an all India launch for this category. Besides these, BRIT launched innovations in its core biscuits category in Q4FY19 which included *Milk Bikis*, *Choco Cream*, *Whole Wheat Vita Marie Gold* and *GoodDay Cashew Almond*. Croissants are currently available across Modern Trade and in East India. Management highlighted that it will constantly look into launching new and innovative products in to bridge portfolio gaps and meet consumer preferences to ensure the growth momentum continues. Cookies, creams, health segment products, crackers (bridge products), other adjacencies, and dairy business are likely to be the key innovation areas for FY20.
- Entry into new category in line with vision of becoming a Total Foods company:** The company also launched products with Rs. 5, Rs. 10 and Rs. 20 SKU in salty snack category under brand '*Time Pass*' in Tamil Nadu. The initial response has been good and it will be rolled out to the entire country later. In Q4FY19, one format has been launched and two more are likely to be launched going ahead. Salty Snack category is Rs. 25,000-26,000 category with Britannia's products being present in about a third of the salted snacks market. Currently, BRIT has launched a baked product in the category, but it deliberately has not positioned itself as a baked product as for consumers taste is of primary concern. Primary focus will be on Rs. 5 pack (17gms qty in line with pieces-per-pack or price-to-kilo versus other extruded snack products available in the category) to drive penetration. BRIT targets to achieve Rs. 500 crore sales revenues from salty snacks category over the next 5 years. Milkshakes as mentioned is a Rs. 2,200 crore category in India including lassi, it is an Rs. 10,000 crore market. The company has received a good response to its milkshake launch. BRIT's management indicated that all new categories will be gross margin accretive.

- **Distribution momentum contributing to grow:** Britannia has reported steady growth in its distribution network. It now directly reaches to 2.10mn outlets as of March 2019 and has seen an increase in rural distribution channel to almost 18,100 shops (growing in double digits), apart from this the Hindi belt (UP, MP, Rajasthan and Gujarat) is highly underpenetrated and has huge potential to grow and also report higher growth. In Q4FY19, Rajasthan reported the highest growth of 22.1% followed by MP (19.0%), UP (17%) and Gujarat (14.7%). All the efforts by the company to reach the local masses would ultimately lead to market share gains and incremental volumes culminating into a consistent and healthy bottom-line growth over the longer term horizon. While Rural growth slowed down, BRIT continued to expand its distribution in rural areas which highlights the huge scope for growth in volumes and topline.
- **RM inflation and price hikes:** Owing to a 9% inflation witnessed in flour, the overall Q4FY19, food inflation was at 3% which was under control as highlighted by BRIT management. While, flour saw inflation, other RMs witnessed deflation like in case of RPO prices were down 5%, milk and sugar other critical ingredients too saw sharp deflation in prices of 9% and 8% respectively during Q4FY19. Management expects food inflation to remain slightly elevated in FY20, however, to combat the same it would take calibrated price hikes across the year in selective brands, SKUs and geographies.
- **International business:** Impacting the consolidated business performance was the International business which reported a single digit growth owing to slowdown in Middle East market. During April 2019, company commenced operations at its Nepal facility which could save on import duties and allow rationalization of costs. Management expects Nepal to contribute to topline meaningfully from FY21 onwards.
- **Other takeaways:**

 - **On industry growth:** Management acknowledged slowdown in category growth rates. Overall slowdown of 500bps over past six months has been witnessed in categories that Britannia operates in. BRIT however, continued to gain market share in the industry owing to 1) innovation, 2) distribution momentum and 3) investments in brands and new categories and adjacencies. The management remains hopeful of a recovery post elections and on expectation of a normal monsoon as indicated by IMD and stable government policies post elections.
 - **Rural-Urban growth rates:** During Q4FY19 con-call management highlighted that rural growth has slowed down further with difference between urban and rural growth coming down from high double digits to single digit.
 - **Robust innovation pipeline in FY20:** Britannia is looking to accelerate the innovation funnel in FY20 with launches planned in biscuits portfolio across premium cookies, premium cream, health biscuits and crackers. It is also looking to make new launches in dairy and other adjacent categories like salty snacks, wafers, cakes etc.

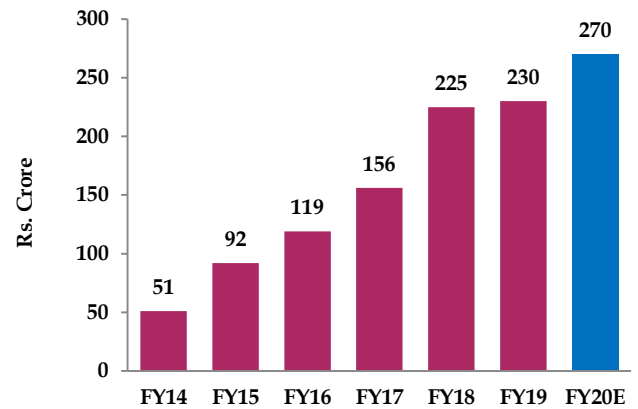
- **Salty snacks market and BRITs entry:** BRIT at presents operates in the Rs. 8,000cr category. It will look to position itself on the shelf by offering a differentiated product vis-à-vis organized as well as unorganized players in the market. Management indicated that to ensure product differentiation, it has installed twin screw extruder which gives different bite to its product and is also looking to be the first one to launch center filled products in snacks category.
 - **Ranjangaon manufacturing plant:** Commissioning of the facility is on track and progressing as per the plan charted out by BRIT. Thus far it has already commissioned 7 lines – 4 biscuits lines, 2 cake lines and 1 croissant line. Over the next 3-4 months it expects to commission another 3 more lines. BRIT has already invested Rs. 600cr so far in this facility. 2 biscuit lines have been fully scaled up and another 2 will be scaled up by September, leading to a current annualized rate of 30,000 tonnes. Croissants line is expected to fully scale up in next 2-3 months.
 - **FY20 cost savings target** – Britannia is targeting Rs. 270cr cost savings in FY20 vs. Rs. 230cr savings it clocked in FY19; all of these savings are fresh savings
 - **Revenue contribution from new launches:** As per management new launches (products launched 24 months ago, only new launches considered, variants/extensions are not included in new launches) contribute 4.5% to total revenue in FY19 and this contribution is expected to double to ~9% in FY20 given strong Innovation pipeline.
 - **ICDs to group companies:** Of the total investment portfolio of Rs. 2,700-2,800cr, almost 25% of investments in ICD's are to associate group companies. This could be a key concern area going forward and we note that ICDs to associate group companies have increased quite significantly over FY14 levels.
 - **FY20 Capex:** FY20 capex is expected to be in similar range as FY19. The management outlined a capex of about Rs. 400-450cr in current financial year FY20.
- **Outlook:** Given the modest performance in a challenging environment, we like Britannia's narrative of driving topline and bottomline growth over the ensuing fiscal years. This we believe, will be supported by BRIT management sustained focus on strengthening its brands across the portfolio of biscuits, cakes, rusks and new adjacencies via innovation/re-launches, variants launch and premiumization, increasing the revenue share of new launches (innovations) to ~9% in FY20 from 4.5% in FY19, persistently growing its direct distribution reach, growing share of in-house manufacturing, focussing on a cost-efficiencies programme (fresh savings of Rs 270cr targeted in FY20, and foraying into newer categories (croissants/salty snacks) in its endeavour to become a total foods company. However, its premium valuations at 44x FY21 EPS, particularly in the context of 12-15% EPS CAGR over FY18-21E look to price in the growth narrative. **We maintain HOLD with a target of Rs 2,943 (42x FY21 EPS) vs. Rs 3,172 earlier as elevated valuations do not leave room for any error (even if it's a marginal miss).**

Modest volume growth in Q3FY19

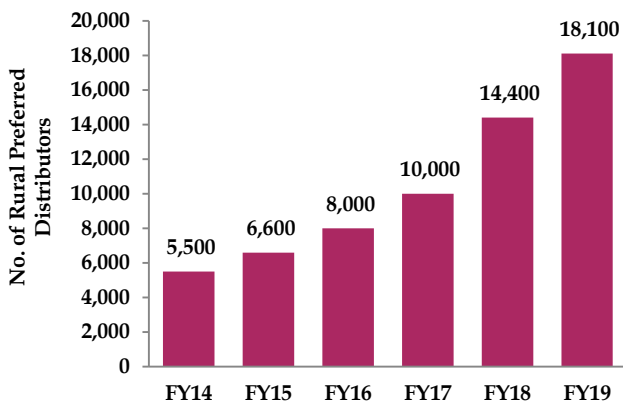


Source: Company, Axis Securities

Cost Saving initiative to aid EBITDA Margin

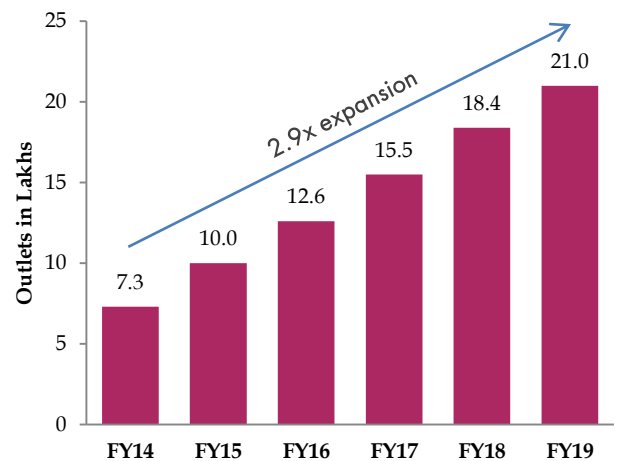


Rural distribution growing in double-digits

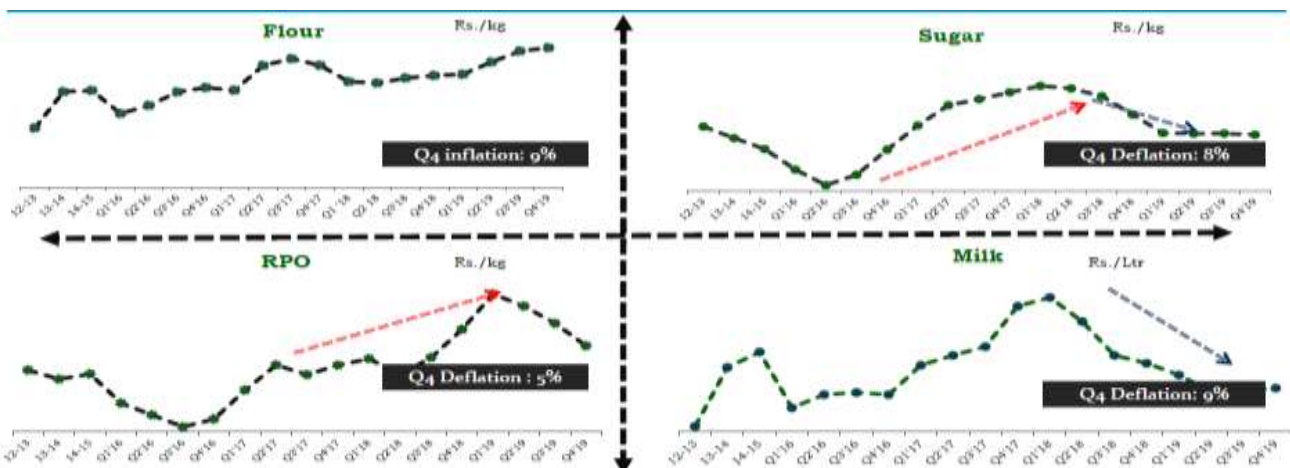


Source: Company, Axis Securities

Direct reach expansion at 2.9x

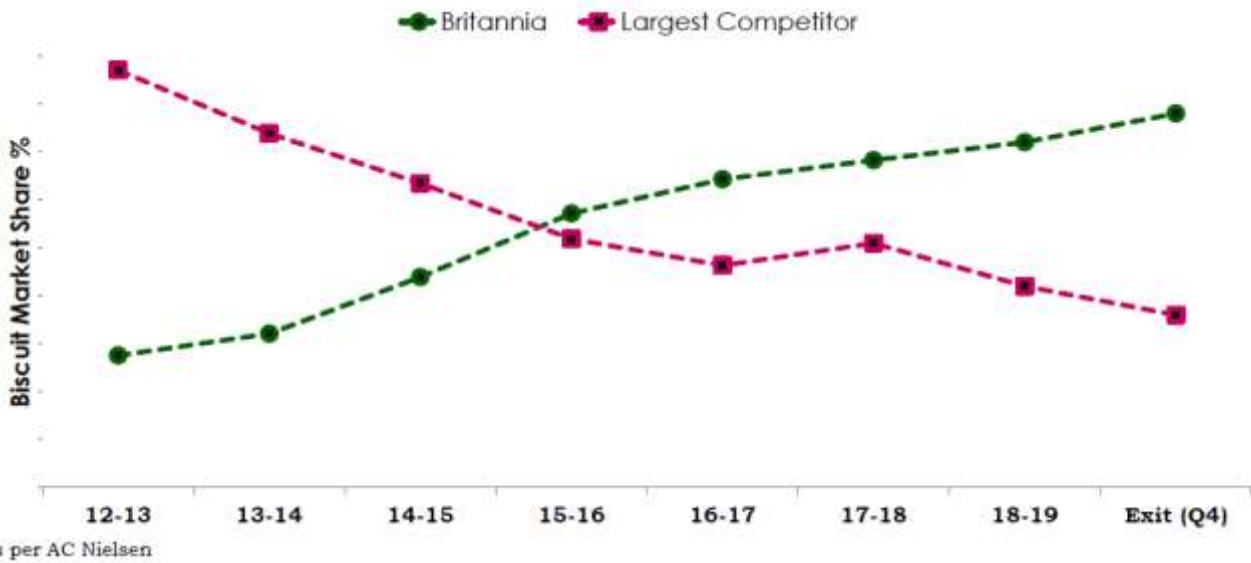


Overall commodity inflation stood at 3% in Q4FY19



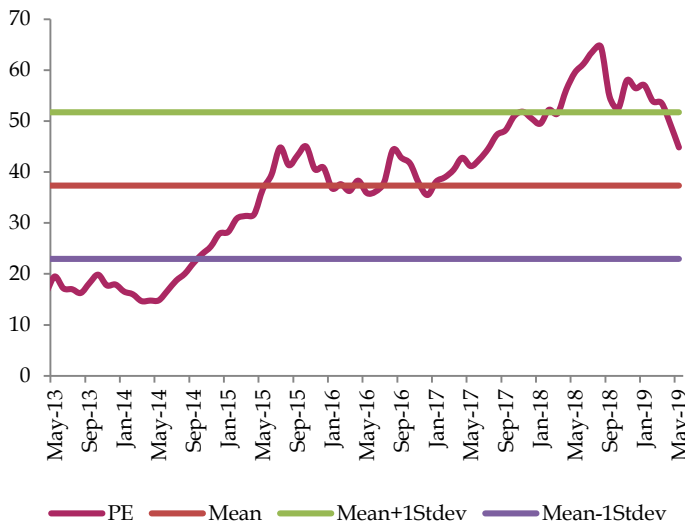
Source: Company, Axis Securities

Market share gains continued amid slowdown

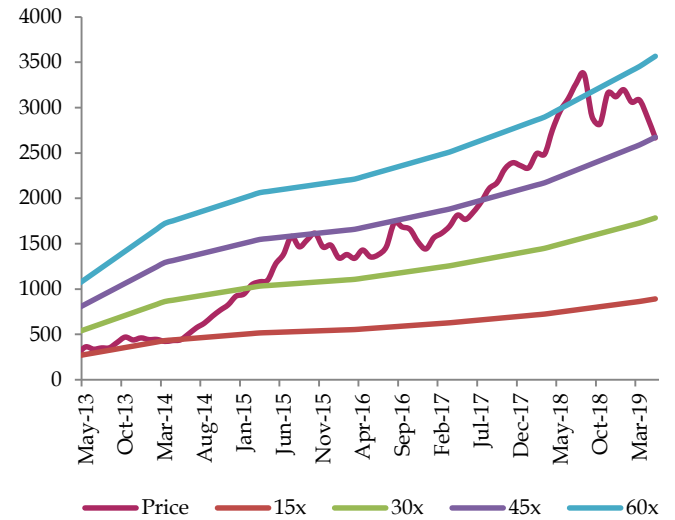


Source: Company, Axis Securities

P/E Band



12 month Forward P/E (x)



Source: Company, Axis Securities

Results Update

(Rs.Cr.)	Quarterly Performance				
	Q4FY19	Q4FY18	% Change (YoY)	Q3FY19	% Change (QoQ)
Net Sales	2,764	2,510	10.1	2,827	(2.2)
Other Op. Inc	35	28		15	
Total Revenue	2,799	2,538	10.3	2,842	(1.5)
GM	41.2	38.5		41.3	
Expenditure					
Net Raw Material	1,646	1,561	5.4	1,669	(1.4)
Employee expenses	108	108	(0.2)	117	(7.5)
Other Exp	608	471	29.2	605	0.6
Total Expenditure	2,362	2,140	10.4	2,391	(1.2)
EBIDTA	437	397	9.9	452	(3.4)
EBITDA Margin (%)	15.6%	15.6%		15.9%	
Oth. Inc.	62	44	39.1	60	3.0
Interest	1	2	(47.3)	3	(58.1)
Depreciation	47	42	10.7	42	10.6
Exceptional Item	0	0		0	
PBT	450	397	13.5	466	(3.5)
Tax	156	133	17.0	166	
PAT	295	264	11.7	301	(2.0)
Share of profit of Associates	0	0		0	
Adjusted PAT	295	264	11.7	300.7	(2.0)
EPS (Rs.)	12.3	11.0		12.5	
Key Ratios					
Gross Margin (%)	41.2	38.5	+273bps	41.3	-9bps
EBITDA Margin (%)	15.6	15.6	-5bps	15.9	-30bps
PAT Margin (%)	10.5	10.4	+13bps	10.6	-5bps
Cost Analysis					
RM Costs (%)	58.8	61.5	-273bps	58.8	+9bps
Employee Cost (%)	3.9	4.3	-41bps	4.1	-25bps
Other Expenses (%)	21.7	18.6	+318bps	21.3	+45bps

Source: Company, Axis Securities

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