Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Britannia Industries

Q2 just misses mark; long-term growth prospects intact

Consumer Goods	Sharekhan code: BRITANNIA	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 3,552**	
Price Target: **Rs. 4,200**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

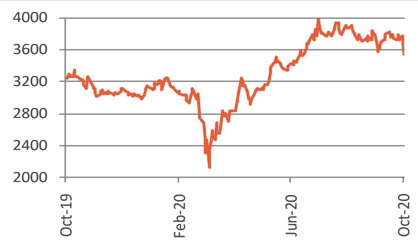
Company details

Market cap:	Rs. 85,494 cr
52-week high/low:	Rs. 4015/2101
NSE volume: (No of shares)	8.2 lakh
BSE code:	500825
NSE code:	BRITANNIA
Free float: (No of shares)	11.9 cr

Shareholding (%)

Promoters	50.6
FII	16.0
DII	11.5
Others	21.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.1	-10.8	25.5	9.4
Relative to Sensex	-8.7	-15.0	2.3	9.4

Sharekhan Research, Bloomberg

Summary

- Domestic sales volume grew by 9% in Q2FY2021, lower than ours as well as the street's expectation of 12-13%; August volume growth stood at low single-digits but improved close to double digits in September.
- Adjacencies continue to perform well with rusk and cheese clocking strong double-digit growth; lower milk prices aided good profitability of dairy segment.
- Product launches, capacity additions in key states, improving penetration in regional markets and sustained growth in adjacencies will be key revenue growth drivers in the near term. Input cost inflation is expected to be marginal.
- The stock is trading at 42x/36x FY2022/23E EPS; given its focus on becoming a large snacking company and sustained OPM expansion, we maintain a Buy rating with an unchanged PT of Rs. 4,200.

Britannia's Q2FY2021 performance slightly missed ours as well as the street's expectation. Consolidated revenue grew by 12% as against ours as well as the street's expectation of 14-15%. Domestic volume growth stood at 9% lower than the 12-13% growth anticipated. Volume growth in July stood in double digits which moderated to low single digits in August because of lower modern trade sales (in the absence of Independence Day sales). However, volume growth recovered close to low double digits in September. High single to low double-digit trends are expected to sustain in the current festive environment. The hindi speaking belt such as Rajasthan, Uttar Pradesh, Madhya Pradesh and Gujarat registered revenue growth of 1.4-1.5x of sales achieved in other markets. Rural markets (contribute 30% of sales) registered better growth ahead of urban markets. Adjacent products including cheese and rusk registered higher revenue and profitable growth during the quarter. Benign input prices and efficiencies aided in consolidated OPM to expand by 360 bps to 19.8% in Q2FY2021. With raw material inflation expected to be stable at low single digit, margin expansion would sustain but at moderated rate with recovery in operations and higher ad-spends. Loan receivables have reduced by Rs. 220 crore while inter-corporate deposits to group companies stood at Rs. 700 crore in line March 2020.

Key Positives

- Subsidiary revenues(including adjacencies) grew by 24%; OPM stood at 28% .
- Gross margins and OPM expanded by 236 bps and 360 bps, respectively.

Key Negatives

- Domestic volume growth stood at 9% as against expectation of 12-13%.

Our Call

View: Retain Buy with unchanged target price of Rs. 4,200: With demand environment normalising across categories, Britannia's volume growth is expected to be at 8-10% (still better than pre-COVID level volume growth of low single digit) driven by strong uptick in the Hindi-speaking belt and good traction to new launches. This, along with sustained improvement in performance by adjacent product categories would be key revenue drivers in the near term. Efficiencies would continue to help margins to remain high at 18-19%. Britannia's stock price has corrected by 6% after posting lower-than-expected volume growth. It is trading at 42x/36x its FY2022/23E EPS. With focus on becoming large snacking company and sustained OPM expansion we maintain our Buy with unchanged PT of Rs. 4,200.

Key Risks

Any further moderation in volume growth from current levels or significant increase in key input prices from current levels would act as a key risk our earnings estimates in the near term.

Valuation (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	11,055	11,600	13,371	14,951	16,636
OPM (%)	15.7	15.9	18.7	18.8	19.1
Adjusted PAT	1,156	1,410	1,821	2,048	2,366
% YoY growth	15.2	21.9	29.2	12.4	15.5
Adjusted EPS (Rs.)	48.1	58.6	75.7	85.2	98.4
P/E (x)	73.9	60.6	46.9	41.7	36.1
P/B (x)	20.1	19.4	22.0	16.8	12.9
EV/EBIDTA (x)	49.4	47.3	34.7	30.3	26.8
RoNW (%)	30.2	32.6	43.9	45.6	40.4
RoCE (%)	42.8	35.2	42.0	45.4	43.3

Source: Company; Sharekhan estimates

Consolidated revenue grew by 12%; OPM expanded by 361 bps: Consolidated revenue grew by 12.1% y-o-y to Rs. 3,419.1 crore in Q2FY2021 from Rs. 3,048.8 crore in Q2FY2020, slightly lower than ours as well as the street's expectation, driven by a 9% volume growth in the domestic business. Moderation in prices of key raw materials including flour and milk and an improvement in revenue mix resulted in gross margins to expand by 236 bps to 42.5%. This, along with a fall in other expenditure, largely advertisement costs (other expenditure fell by 221 bps as a percentage of sales) and cost efficiencies drove up OPM by 361 bps to 19.8% (in line with our expectations). This resulted in operating profit growing by 37.2% y-o-y to Rs. 675.4 crore. Higher interest and depreciation charges led to profit before tax to grow by 34.3% y-o-y to Rs. 670.6 crore. A higher incidence of tax resulted in adjusted PAT to grow by 22.8% y-o-y to Rs. 495.6 crore. Certain tax gains of Q1FY2020 were accounted in the base quarter Q2FY2020 due to the new tax rate, which resulted in a lower tax rate in the base quarter. Excluding the impact of this, adjusted PAT would have grown by 34% y-o-y.

Domestic business registered good growth; Adjacencies performed well: Domestic business revenue grew by 11.4% y-o-y to Rs. 3,227.6 crore. The company continued its investment momentum in key brands through innovative product launches and relevant activations. The company ran on-air as well as print and digital promotions for key brands such as Good Day and Nutrichoice, which helped brands gain good traction. Revenues of subsidiaries grew by ~25.4% y-o-y led by good growth in the dairy business. The dairy business performed well led by good growth in cheese and registered improvement in profitability due to benign milk prices. However, a decline in out-of-home consumption impacted the drinks portfolio. Adjacent bakery products (such as rusk and bread) grew faster than the company's overall growth due to higher in-house consumption and market share gains from small players. A significant improvement was seen in the profitability of the breads segment. In terms of the international business, Middle East and Africa witnessed recovery and are back to single-digit growth rate, whereas other regions are growing at a healthy pace, in double digits. Operating profit of subsidiaries stood at Rs. 54.5 crore in Q2FY2021 as against Rs. 21.9 crore in Q2FY2020 with OPM improving significantly to 28.4%.

Other conference call highlights:

- Revenue grew strongly in double digits in July. However, growth was affected in August due to as the Big Day in the month of August was affected leading to poor growth in modern trade. September growth recovered to 10%. Traditional trade (~90% of total sales) saw strong growth in all three months.
- Rural geographies (that contribute ~30% to total revenue) have been growing faster than the urban geographies due to no significant frequent lockdowns.
- Cost inflation stood at 2-3% in Q2FY2021 with a strong deflation seen in milk prices and some deflation in flour prices. Milk and flour prices are expected to remain soft for the next one to two quarters and thus, raw material cost inflation will remain at low single digits. With advertising costs normalising, we expect the OPM to normalise in the near term.
- Britannia's direct distribution reach, which fell to 19.7 lakh outlets in March 2020, recovered back to 22.3 lakh outlets in September 2020. The number of rural preferred dealers rose to 22,000 from 19,000 for the same period. The Hindi-speaking belt witnessed a good growth of 1.4x-1.7x over the last three years.
- The company's continuous replenishment system improved to 1.05x in Q2 from 0.36x in Q1. Further, Britannia's direct dispatches from the factory have increased considerably to 1.5x of pre-COVID levels.
- The company had reduced its total SKUs to 0.75x of pre-COVID levels in May, which has now increased back to almost pre-COVID levels at 0.98x. Moreover, factory productivity has increased to 1.1x the pre-COVID levels.
- Britannia is looking to expand its capacity with three green field projects in Tamil Nadu, Uttar Pradesh and Bihar as well as two brown field projects at its Odisha and Ranjangaon facilities to meet the growth in demand. It had intended to incur a capex of approximately Rs. 500 crore.
- The company is focusing on innovation and expects contribution of new products to sustain at 4-5%.
- Inter-company deposits (ICDs) remain at the same level as of March 2020, at Rs. 700 crore.

Result Snapshot (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Net revenue	3419.1	3048.8	12.1	3420.7	0.0
Raw materials	1965.1	1824.1	7.7	1995.9	-1.5
Employee costs	134.5	123.6	8.8	137.0	-1.8
Other expenditure	644.1	608.9	5.8	570.9	12.8
Total expenditure	2743.7	2556.6	7.3	2703.7	1.5
Operating profit	675.4	492.2	37.2	716.9	-5.8
Other income	73.5	68.2	7.9	93.7	-21.5
Interest expenses	29.8	16.1	84.7	25.6	16.4
Depreciation	48.5	44.9	8.1	48.0	1.1
Profit Before Tax	670.6	499.4	34.3	737.0	-9.0
Tax	175.0	95.9	82.5	194.4	-10.0
Adjusted PAT	495.6	403.5	22.8	542.7	-8.7
Adjusted EPS (Rs)	20.6	16.8	22.8	22.6	-8.7
			Bps		**Bps**
GPM (%)	42.5	40.2	236	41.7	87
OPM (%)	19.8	16.1	361	21.0	-121

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Net revenue	3227.6	2896.1	11.4	3219.9	0.2
Operating profit	620.9	470.4	32.0	671.8	-7.6
Profit Before Tax	624.8	549.9	13.6	697.1	-10.4
Adjusted PAT	462.3	469.1	-1.5	515.9	-10.4
Extra-ordinary items	0.0	23.5	-	0.0	-
Reported PAT	462.3	445.7	3.7	515.9	-10.4
Adjusted EPS (Rs)	19.2	19.5	-1.5	21.5	-10.4
			Bps		**Bps**
GPM (%)	40.5	39.4	114	40.2	39
OPM (%)	19.2	16.2	300	20.9	-162

Source: Company; Sharekhan Research

Result Snapshot (Subsidiaries) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)
Net revenue	191.5	152.8	25.4
Operating profit	54.5	21.9	-
Adjusted PAT	33.3	-65.7	-
Extra-ordinary items	0.0	-24.2	-
Reported PAT	33.3	-89.9	-
			bps
GPM (%)	75.8	54.7	-
OPM(%)	28.4	14.3	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Supply chain back to normal; rural growth stays ahead of urban

Consumer goods companies saw strong revival in June with production and supply recovering to 90% of pre-COVID levels. Operations and distribution normalised with easing of lockdown norms. Rural is seeing strong growth ahead of urban backed by improved demand. With a strong pick-up in rural demand, general trade normalising and higher sales through online channels, we expect normalisation in business performance from Q2FY2021. Q1FY2021 was one of the strongest quarters for biscuit and other food companies as pantry loading during the lockdown phase boosted growth. However, post the easing of lockdown norms, sales have normalised in most categories. We expect biscuit companies to clock normal growth in H2FY2021.

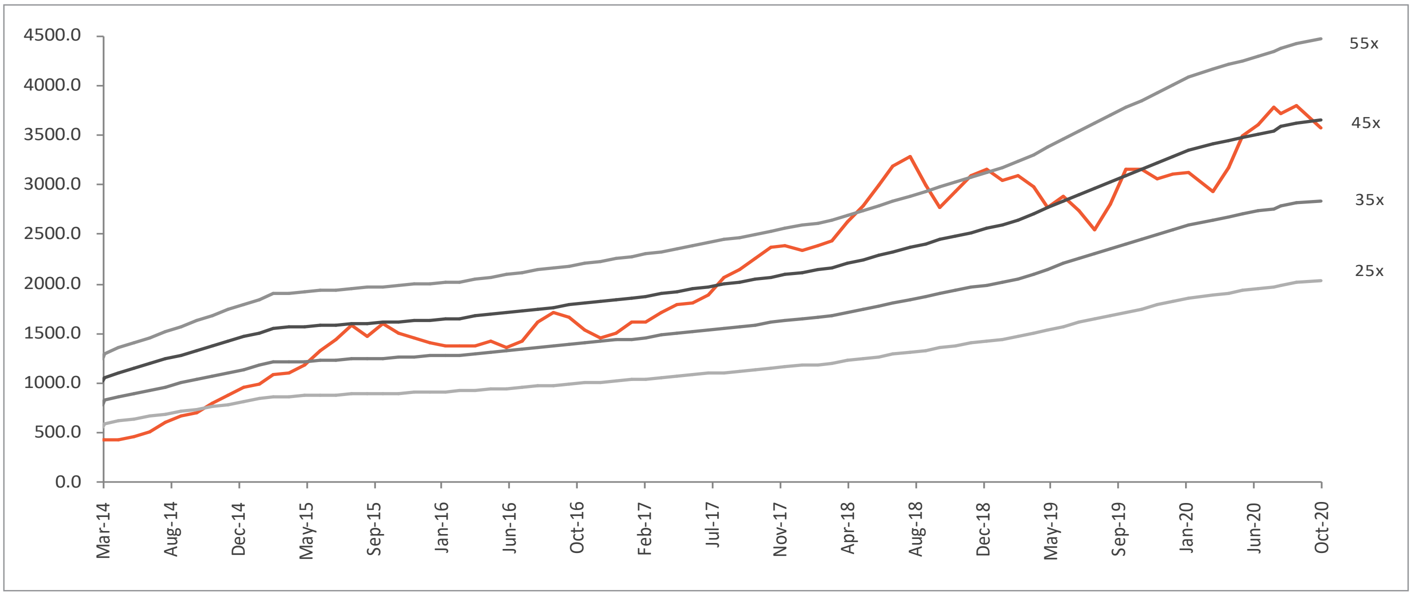
■ Company outlook - Volume growth to sustain at 8-10%; OPM to stand 18-19%

Britannia's Q1FY2021 performance was boosted by pantry loading/stocking of essentials during the lockdown. However, growth normalised in Q2FY2021 with logistics and supply improving overall India post easing of the lockdown. With volume growth standing close to 10% in September, we expect volume growth trajectory of 8-10% to sustain in the coming quarters with good festive season and recovery in overall market. Raw material cost inflation is expected to be nominal at 2-3% as milk and wheat prices remain benign. This will keep OPM high at 18-19% and efficiencies would continue to support profitability in the near term.

■ Valuation - Retained Buy with Target price of Rs. 4200

We expect Britannia's revenues and PAT to grow at CAGR of 13% and 19% over FY2020-23E. Efficiencies would continue to help margins to remain high at 18-19%. We have fine-tuned our earnings estimates to factored in little lower than expected performance. Britannia's stock price has corrected by 6% after posting lower than expected volume growth. It is trading at 42x/36x its FY2022/23E EPS. With focus on becoming large snacking company and sustained OPM expansion we maintain our Buy with unchanged TP of Rs. 4,200.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Nestle	79.5	71.3	59.9	54.2	48.4	41.8	50.2	59.4	60.3
Hindustan Unilever	68.1	59.4	47.6	48.3	41.8	35.8	105.2	39.7	28.6
Britannia	60.6	46.9	41.7	47.3	34.7	30.3	35.2	42.0	45.4

Source: Company, Sharekhan Research
**Values for Nestle India are for CY2019, CY2020E and CY2021E*

About company

Britannia is one of India's leading packaged food companies with a 100-year legacy and annual revenue in excess of Rs. 11,000 crore. The company is among the most trusted food brands and manufactures well-known brands such as Good Day, Tiger, NutriChoice, Milk Bikis and Marie Gold, which are household names in India. Britannia's product portfolio includes biscuits, bread, cakes, rusk and dairy products, including cheese, beverages, milk and yoghurt. The company is the market leader in the biscuit category, with close to 34% market share in the domestic market. The dairy business contributes 5% of overall revenue.

Investment theme

Britannia is a strong brand with market leadership in the domestic biscuit market. Sustained new launches and entry into healthier and premium variants helped it gain market share and beat category growth. The company is also focusing on growing its adjacent categories such as dairy and bakery. Revenue performance in FY2021 will be boosted by strong demand from in-house consumption, recovery in rural demand, market share gains from small players and strong growth in adjacencies. Operating efficiencies and stable raw material prices would help OPM expansion to sustain, which is expected to reach 18% by FY2022 from 15.9% in FY2020.

Key Risks

- Regular lockdown in some of the key domestic markets would act as an obstacle to the strong growth momentum and will consequently have an impact on earnings growth.
- Dismal performance by some of the new ventures would affect the company's overall performance in the near to medium term.

Additional Data

Key management personnel

Nusli N Wadia	Chairman
Varun Berry	Managing Director
N Venkataraman	Chief Financial Officer
T V Thulsidass	Company Secretary

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	5.3
2	JP Morgan Chase & Co	1.6
3	General Insurance Corp of India	1.6
4	Arisaig Partners Asia Pte Ltd	1.5
5	SBI Funds Management Pvt Ltd	1.4
6	Kotak Mahindra Asset Management Co	1.2
7	Arisaig India Fund Ltd	1.1
8	SBI Pension Fund	1.1
9	ICICI Prudential Asset Management	1.0
10	Vanguard Group Inc	0.9

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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