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Britannia Industries

Margins shine in mixed bag Q3

Consumer Goods	Sharekhan code: BRITANNIA	Result Update

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 3,473**	
Price Target: **Rs. 4,200**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 83,654 cr
52-week high/low:	Rs. 4,015/2,101
NSE volume: (No of shares)	7.4 lakh
BSE code:	500825
NSE code:	BRITANNIA
Free float: (No of shares)	11.9 cr

Shareholding (%)

Promoters	50.6
FII	19.0
DII	10.7
Others	19.8

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-0.4	1.2	-8.1	8.9
Relative to Sensex	-5.1	-21.5	-42.8	-14.5

Sharekhan Research, Bloomberg

Summary

- Britannia Industries (Britannia) volumes grew by 4-5% lower than ours as well the street's expectation of 7-8%. General trade and rural markets are growing above pre-COVID levels; urban towns and alternate channels (including modern; institutional) are yet to recover.
- Adjacent products continue to perform well with rusk, cheese registering strong double-digit growth of 14%; lower milk prices helped dairy segment's profitability to improve to 22% (OP stood at 19.3%).
- New launches, recovery in alternate channels, sustained strong growth in the Hindi-speaking belts and better performance of adjacencies would drive revenue growth ahead. Input cost inflation (largely palm oil) will be mitigate with efficiencies (focus on maintaining OPM at existing levels).
- Stock trades at 41.4x/35.7x FY2022/23E EPS; with focus on becoming a large snacking company and driving up OPMs; we maintain our Buy with an unchanged PT of Rs. 4,200.

Britannia's Q3FY2021 results were mixed, with revenues growing in mid-single digits, while a strong 249 bps rise in OPM drove up PAT by 23%. Revenue grew by 6.1% y-o-y to Rs. 3165.6 crore (lower than our expectation of Rs. 3,259.3 crore). Domestic volumes grew by 4-5% as against ours and the street's expectation of 6-8%. The general trade and rural markets are growing ahead of pre-COVID levels, while urban markets are recovering. The modern trade, institutional businesses (with lower footfalls in railway service, offices, schools, etc) are yet to recover to pre-COVID levels. Hindi-speaking belt (40% of domestic revenues) such as Rajasthan, Uttar Pradesh, Madhya Pradesh and Gujarat registered revenue growth of 1.3-1.6x as compared to FY2018 levels. Adjacent products (part of subsidiaries) such as breads and cheese continue to perform well with a revenue growth of 14% and OPM of 22% (vs. 12% in Q3FY20). Gross margins improved by 224 bps to 43.1% driven benign input prices (including milk prices). This along with efficiencies led to a 249 bps improvement to 19.3%. Product innovation, recovering in alternate channels/urban markets, a strong growth in adjacencies and market share gains in Hindi-speaking regions will be key revenue growth drivers in the near to medium term. Input cost inflation stood at just 1% in Q3 with a deflation in flour and milk prices. However, with palm oil prices increasing significantly and milk prices gradually rising, inflation will be higher in the coming quarters. The company will mitigate input cost inflation through cost efficiencies would like to maintain margins at the current levels. The company has invested of Rs. 700 crore in its phase capital expenditure of the Ranjangaon facility (total capex of Rs. 1500 crore by FY2024).

Key positives

- Company gained market for sixth consecutive quarter in the domestic market.
- Factory productivity improved by 1.07x, wastage down by 0.7x and direct dispatches up by 1.5x result in cost efficiencies.
- New products such as wafers are performing well with 30%+ growth and achieved No.2 position in the category.

Key negatives

- Domestic volumes grew by 4-5%, lagging ours as well as the street expectations.

Our Call

View: Retain Buy with unchanged target price of Rs. 4,200: We have maintained our earnings estimates for FY2021/22/23, factoring in lower-than-expected volume growth but higher-than-expected OPM. With growth levers in place, the company is striving to achieve a volume growth of 8-10% in the coming years. Market share gains for thirty consecutive quarters, growth in adjacencies expansion of direct reach and product innovation remains at the core of the growth strategy in the long run. Further efficiencies would help OPM to sustain current levels. The stock is currently trading at 41.4x/35.7x its FY2022/23 earnings. We maintain a Buy recommendation on the stock with an unchanged target price of Rs. 4,200.

Key risk

Any further moderation in volume growth from current levels or significant increase in key input prices from the current level 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	13,082	14,628	16,501
OPM (%)	15.7	15.9	19.2	19.4	19.8
Adjusted PAT	1,156	1,410	1,820	2,018	2,341
% YoY growth	15.2	21.9	29.1	10.9	16.0
Adjusted EPS (Rs.)	48.1	58.6	75.7	83.9	97.3
P/E (x)	72.2	59.2	45.9	41.4	35.7
P/B (x)	19.6	19.0	19.8	16.6	13.5
EV/EBIDTA (x)	48.3	46.3	33.8	29.5	25.7
RoNW (%)	30.2	32.6	42.2	43.6	41.7
RoCE (%)	28.0	26.7	30.6	32.5	33.0

Source: Company; Sharekhan estimates

Consolidated revenue grew by 6%; OPM expanded by 249 bps: Consolidated revenue grew by 6% y-o-y to Rs. 3,165.6 crore in Q3FY2021 from Rs. 3,419.1 crore in Q3FY2020, slower than our as well as the street's expectation, driven by a 4-5% volume growth in the domestic business. Benign input prices with raw material cost inflation of 1% led to gross margins expanding by 224 bps to 43.1%. This along with cost efficiencies drove up OPM by 249 bps to 19.3% (in line with our expectation). This resulted in operating profit growing by 21.8% y-o-y to Rs. 611.5 crore. Higher interest and depreciation charges led to profit before tax to grow by 34.3% y-o-y to Rs. 670.6 crore. Profit before tax grew by 23.5% y-o-y to Rs. 613.7 crore and reported profit grew by 22.4% y-o-y to Rs. 452.6 crore.

Domestic business clocks mid-single digit growth; Adjacencies performed well: Domestic business revenue grew by 5.3% y-o-y to Rs. 2,916.1 crore in Q3. General trade and rural markets are growing ahead of pre-COVID levels, while urban markets are recovering. The modern trade, institutional business (with lower footfalls in railway service, offices schools) yet to recover to pre-COVID levels. Revenues of subsidiaries grew by ~14% y-o-y to ~Rs. 187 crore led by good growth in the dairy and bakery products. Dairy business performed well led by double-digit growth in cheese and registered improvement in profitability due to benign milk prices. With out-of-home consumption regaining momentum drinks portfolio is also seeing a recovery. The bakery adjacencies (such as rusk and bread) are growing faster due to good demand and market share gains from small players. Significant improvement was seen in the profitability of bread & rusk. In terms of international business, Middle East and Africa witnessed recovery to healthy growth, whereas other regions are growing in strong double digits. Standalone business OPM stood at 19.2% in Q3FY21 better than the 17.1% achieved in Q2FY2020. Subsidiaries OPM improved strong to 22% from 12.4% in Q3FY2020.

Other conference call highlights

- Britannia's direct distribution reach, which fell to 19.7 lakh outlets in March 2020, recovered back to 22.9 lakh outlets in December 2020 (improved from 22.3 lakh outlets in September). The number of rural preferred dealers rose to 23,000 from 19,000 in March. The company has maintained its thrust on scaling up the direct and rural distribution in the coming years.
- Rural geographies (that contribute ~30% to total revenue) have been growing faster than the urban geographies due to higher demand. With higher growth in rural markets the small packets sales were higher than the large packs. However, with expected recovery in the modern trade sales, the large packs would also see good traction in the coming quarters.
- The Hindi-speaking belt (including Rajasthan, MP, UP and Gujarat) witnessed a good growth of 1.4x-1.6x over the last three years. On y-o-y basis the Hindi speak belt is growing in the double digits. The Hindi-speaking belt which contributes 35-40% of overall revenues has seen market share seen improving from base of 10% to 15% due to improving penetration.
- New products are gaining strong traction. The company has become No.2 player in the wafers category, which is growing by over 30% and has seen shelf space improving in the modern trade. Croissants are growing in double digits in test markets. In adjacencies, the company has gained share in cake categories as new launches are gaining good response.
- Revenue grew strongly in double digits in July. However, growth was impacted in August as the Big Day during that month was affected, weakening growth in modern trade. In September, growth recovered to 10%. Traditional trade (~90% of total sales) saw strong growth in all the three months.
- Cost inflation stood at 2-3% in Q2FY2021 with 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 continue to remain at low single digits. With advertising costs normalising, we expect OPM to normalise in the near term.
- Input cost inflation stood at just 1% with deflation in the flour and milk prices. Flour prices and milk prices were down by 7% and 15% respectively, while palm oil prices were up by 25% in Q3. However, with palm oil prices increasing significantly and milk prices gradually growing up, the inflation will be higher than Q3. The company will mitigate input cost inflation through cost efficiencies would like to maintain margins at current levels.
- The company continued to derive cost efficiency through 1) increasing the factory productivity by 1.07x 2) reducing wastage to 0.7x 3) increasing the dispatches by 1.5x and 4) depot space to 0.9x.

Result Snapshot (Consolidated) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y (%)	Q2FY21	q-o-q (%)
Net Sales	3106.1	2936.0	5.8	3354.4	-7.4
Other operating income	59.5	46.7	27.4	64.8	-8.1
Net revenue	3165.6	2982.7	6.1	3419.1	-7.4
Raw materials	1801.4	1764.2	2.1	1965.1	-8.3
Employee costs	131.8	121.6	8.4	134.5	-2.0
Other expenditure	620.9	594.9	4.4	644.1	-3.6
Total expenditure	2554.1	2480.6	3.0	2743.7	-6.9
Operating profit	611.5	502.0	21.8	675.4	-9.5
Other income	82.6	65.2	26.7	73.5	12.3
Interest expenses	31.8	23.7	34.3	29.8	6.6
Depreciation	48.6	46.7	4.0	48.5	0.2
Profit Before Tax	613.7	496.9	23.5	670.6	-8.5
Tax	161.1	127.3	26.6	175.0	-7.9
Reported PAT	452.6	369.9	22.4	495.6	-8.7
Adjusted EPS (Rs.)	18.8	15.4	22.5	20.6	-8.7
			bps		**bps**
GPM (%)	43.1	40.9	224	42.5	57
OPM (%)	19.3	16.8	249	19.8	-44

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	Y-o-Y (%)	Q2FY21	Q-o-Q (%)
Net revenue	2978.7	2819.2	5.7	3227.6	-7.7
Total expenditure	2408.0	2337.4	3.0	2606.7	-7.6
Operating profit	570.7	481.8	18.5	620.9	-8.1
Other income	77.8	64.6	20.4	71.2	9.2
Interest expenses	28.7	22.1	29.6	26.7	7.3
Depreciation	40.9	38.4	6.4	40.6	0.7
Profit Before Tax	578.9	485.8	19.2	624.8	-7.3
Tax	150.5	125.4	20.0	162.4	-7.3
Reported PAT	428.4	360.4	18.9	462.3	-7.3
Adjusted EPS (Rs.)	17.8	15.0	18.9	19.2	-7.3
			bps		**bps**
GPM (%)	41.6	39.9	168	40.5	100
OPM (%)	19.2	17.1	207	19.2	-8

Source: Company; Sharekhan Research

Result Snapshot (Subsidiaries) Rs cr

Particulars	Q3FY21	Q3FY20	y-o-y%
Net revenue	186.9	163.5	14.3
Operating profit	40.8	20.3	101
Reported PAT	24.2	9.2	162.5
			bps
GPM (%)	67.7	57.8	991
OPM(%)	21.8	12.4	942

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Long term growth prospects intact

The Indian biscuits and bakery retail market is valued at Rs. 450 billion and is expected to grow at a CAGR of ~9% over the next five years. Biscuits and other snacking bakery products such as rusks, wafers and tea cakes contribute almost Rs. 400 billion or 89% of the total market. The Indian biscuit market's size is estimated to be Rs. 400 billion in 2020 representing ~5% of the global market. Indian market is expected to grow at a CAGR of 9% till 2025 and reach Rs. 620 billion. This growth will increase India's share in the global market to ~6% by 2025.Per capita yearly consumption of biscuit in India is only 2.5 kg, compared to more than 10 kg in USA and Western European countries and more than 4.25 kg in south-east Asian countries such as Singapore, Hong Kong, Thailand and Indonesia. Higher demand for branded products, upgrades to premium categories and improving penetration in the rural markets are some of the key growth levers for domestic biscuit industry.

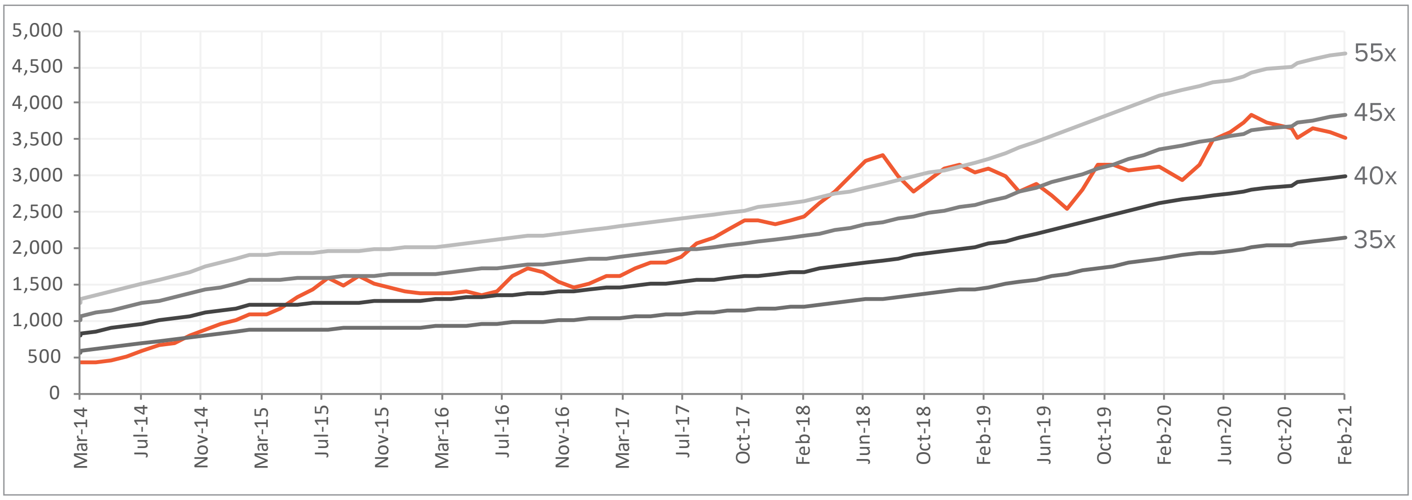
■ Company Outlook – Focus on improving volume growth trajectory

Britannia's revenues grew by 14% driven by 11% volume growth in 9MFY2021. The OPM stood at 20%. Product innovation, recovering in the alternate channels/urban markets, strong growth in adjacencies and market share gains in the Hindi speaking better will be key revenue growth drivers in the near to medium term. Input cost inflation stood at just 1% with deflation in the flour and milk prices. However with palm oil prices increasing significantly and milk prices gradually growing up, the inflation will be higher than Q3. The company will mitigate input cost inflation through cost efficiencies would like to maintain margins at current levels.

■ Valuation – Retain Buy with unchanged target price of Rs. 4,200

We have maintained our earnings estimates for FY2021/22/23 to factor in the lower than expected volume growth but higher than expected OPM. With growth levers in place, the company is striving to achieve a volume growth of 8-10% in the coming years. Market share gains for thirty consecutive quarters, growth in adjacencies expansion of direct reach and product innovation remains core of growth strategy in the long run. Further efficiencies would help OPM to sustain current levels. The stock is currently trading at 41.4x/35.7x its FY2022/23 EPS. We maintain a Buy recommendation on the stock with an unchanged target price of Rs. 4,200.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer valuation

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Nestle	74.9	63.6	55.3	50.8	44.3	39.1	59.8	60.0	56.9
Hindustan Unilever	66.2	50.2	43.8	44.9	36.3	31.5	37.1	28.3	30.7
Britannia	45.9	41.4	35.7	33.8	29.5	25.7	30.6	32.5	33.0

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 19% 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Life Insurance Corp of India	4
2	JP Morgan Chase & Co	1.7
3	General Insurance Corp of India	1.6
4	Arisaig Partners Asia Pte Ltd	1.5
5	Blackrock Inc	1.4
6	SBI Funds Management Pvt Ltd	1.4
7	Vanguard Group Inc	1.3
8	Kotak Mahindra Asset Management Co	1
9	Arisaig India Fund Ltd	1.1
10	Mirae asset global investment company	0.8

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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

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