Sharekhan by BNP PARIBAS

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Stock Update

Tata Consumer Products

Mixed Q2; merger synergies to shield margins

Consumer Goods	Sharekhan code: TATACONSUM	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. 504**	
Price Target: **Rs. 630**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

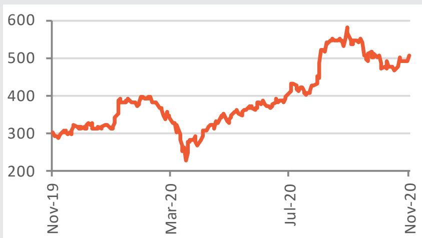
Company details

Market cap:	Rs. 46,474 cr
52-week high/low:	Rs. 592 / 214
NSE volume: (No of shares)	50.7 lakh
BSE code:	500800
NSE code:	TATACONSUM
Free float: (No of shares)	60.2 cr

Shareholding (%)

Promoters	34.7
FII	21.7
DII	17.7
Others	26.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-0.3	4.0	50.3	67.9
Relative to Sensex	-6.1	-6.1	18.1	64.4

Sharekhan Research, Bloomberg

Summary

- Q2FY2021 was a mixed bag, as revenues grew by ~19%, but gross margins declined by 269 bps, in turn limiting rise in OPM to 97 bps to 14.4%; operating profit grew 27%.
- The India beverages grew by 32%; India foods revenues rose 13%; Tata Coffee (including Vietnam) grew by 17%, while international tea business' growth moderated to single digits as effect of pantry loading faded.
- Market share gains in domestic branded tea and salt, doubling of distribution reach, better penetration of packaged foods portfolio and new launches remain key growth levers in the near term. A significant increase in domestic tea prices will stress margins but merger synergies would ease the impact.
- We broadly maintain earnings estimates for FY2021/22/23E and retain a Buy on the stock with an unchanged PT of Rs. 630.

Tata Consumer Products (TCPL, earlier known as Tata Global Beverages) revenues grew by a strong 19% on a comparable basis to Rs. 2,781.3crore (ahead of our expectation of Rs. 2587.8 crore) driven by a strong revenue growth of 32% in the India beverage business, 13% growth in India foods business and a 17% growth in Tata Coffee (including Vietnam). Growth of the international tea and US coffee businesses slowed to low single digit as effect of pantry loading faded. A significant increase in domestic raw tea prices dragged down gross margins by 269 bps. However, lower ad spends and other expenses led to a 97 bps improvement in OPM to 14.4% (lower than our expectation of 16.3%). Market share gains in branded tea and salt segment, doubling of distribution reach, sustained higher in-house consumption and consistent product launches would be key growth levers for the domestic business. Increasing conversion from non-black tea to specialty tea would also drive growth in the international tea business. Scale-up in NourishCo, sustained double-digit growth in Tata Coffee and sequential improvement in out-of-home consumption will continue to add to revenues in the near to medium term. Domestic raw tea prices have gone up significantly due to a lower supply (impacted by lockdown and adverse weather conditions). The company has taken price hikes to mitigate the impact. However, the same is not enough to reduce pressure on margins. Integration process of the merger with Tata Chemicals' food business with TCPL is on and is expected to be significantly completed by Q4FY2021. However, some benefit of the completed processes such as integration of organisation structure and two third of the distribution network will start flowing in from Q3, which will help to mitigate impact of higher raw material prices in the near term. However, the company aims to complete integration process before the scheduled time and reap large margin benefits of 200-300 bps over the next 2-3 years.

Key positives

- The India beverage business, India foods business and Tata Coffee registered a volume growth of 11%, 6% and 8%, respectively.
- The company gained market share in the branded tea and salt segment from organised and unorganised players.
- NourishCo contributed ~Rs. 38 crore (recovered to 87% of pre-COVID levels); Tata Starbucks recovered to 71% in September.

Key negatives

- Domestic tea prices have firmed up and dragged gross margins down by 269 bps y-o-y).
- US coffee volumes decreased by 3%.

Our Call

View - Retain Buy with unchanged PT of Rs. 630: We broadly maintain our earnings estimates for FY2021/22/23. TCPL is currently focusing on gaining market share by doubling distribution reach and supporting its brand with adequate promotional activities, which augurs well from a near to medium-term perspective. Further, with a consistent improvement in cash flows, the company is also eyeing inorganic initiatives and new product launches (likely post January 2021). Thus, with growth levers in place, the company is well-placed to achieve earnings CAGR of 20% over FY20-23E. The stock trades at 36.6x its FY2023E earnings. Thus, TCPL remains one of our top picks in the midcap consumer space. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 630.

Key Risks

Any slowdown in domestic consumption; heightened competition from new players and a spike in key input prices would act as a key risk to our earnings estimates in the near term.

Valuations (Consolidated) Rs cr

Particulars	FY19	FY20	FY21E*	FY22E*	FY23E*
Revenue	7,252	9,637	10,875	11,847	12,961
OPM (%)	10.8	13.4	15.0	15.4	15.9
Adjusted PAT	479	661	919	1,108	1,271
% Y-o-Y growth	*-16.0*	*37.9*	*39.1*	*20.5*	*14.7*
Adjusted EPS (Rs.)	5.2	7.2	10.0	12.0	13.8
P/E (x)	66.4	70.3	50.5	41.9	36.6
P/B (x)	4.3	3.4	3.2	3.1	2.9
EV/EBIDTA (x)	39.0	34.5	26.9	23.7	20.7
RoNW (%)	6.9	7.0	7.5	8.2	8.9
RoCE (%)	8.8	9.0	9.1	10.1	11.0

Source: Company; Sharekhan estimate

** FY20, FY21E, FY22E and FY23E estiamtes include the consolidation of the consumer business of Tata Chemicals*

Strong India business drives up consolidated revenue: Consolidated revenue grew by 18.5% y-o-y to Rs. 2,781.3 crore in Q2FY2021 as against Rs. 2,347.1 crore in Q2FY2020 and Rs. 2,713.9 crore in Q1FY2021. Revenue from the India beverages and India foods businesses stood at Rs. 1,120 crore and Rs. 580 crore, respectively growing by 32% and 13% y-o-y, respectively. Volumes of the India beverages and foods businesses rose by 11% and 6%, respectively. The branded international beverages (excluding food services) business, grew by 11% y-o-y, as demand normalised with unwinding of pantry loading. Revenue from Tata Coffee grew by 17% y-o-y to Rs. 243 crore, driven by an 8% volume growth. Gross margins declined by 269 bps to 40.8% due to higher commodity costs and unfavourable revenue mix. In spite of this, lower advertisement costs and other expenses drove up OPM by 95 bps to 14.4%. Consolidated operating profit grew by 37.6% y-o-y to Rs. 482.8 crore. In spite of higher depreciation, consolidated profit before tax grew by 26.9% y-o-y to Rs. 399.6 crore. Profit before tax (PBT) rose by 30.9% y-o-y to Rs. 345.4 crore. Higher tax incidence resulted in adjusted PAT before minority interest (MI) to rise by 25.4%. However, better performance of associates led post-MI adjusted PAT to grow by 38.4% y-o-y to Rs. 289.2 crore in Q2FY2021 from Rs. 208.9 crore in Q2FY2020. There was a pre-tax exceptional item of Rs. 23.9 crore (Rs. 16 crore post tax) pertaining to integration of foods business, redundancy cost and impairment of assets. Thus, reported PAT came in at Rs. 273.2 crore, growing by 31.4% y-o-y.

Integration of Tata Chemicals' foods business to be done by Q4FY2021: Integration of the consumer business of Tata Chemicals is on track and focus is on to create a sizeable consumer company with enhanced scale and financial strength, with leading Indian and international brands like Tata Salt, Tata Tea, Tetley and high-growth potential brands such as Tata Sampann. The merger has a potential to unlock significant synergies across distribution, marketing, innovation and supply chain. TCPL has completed the integration of organisation structure and identified synergies in Q1FY2021. The entire integration is expected to be completed by Q4FY2021. The company expects to start realising synergy benefits from Q3FY2021. Two-thirds of distributor consolidation has been done and the process is expected to be completed by Q4. Other processes such as digitisation across partners, CFA consolidation, ERP integration, process automation, etc, is under progress and shall be completed by Q4. TCPL has expanded its outlet reach by ~12% till H1FY2021 and expects to double the reach by the end of Q4.

India business performed well: The India business grew by 21.6% y-o-y (25% y-o-y including the impact of NourishCo as a subsidiary from May 2020) to Rs. 1,736.1 crore. India packaged beverages business grew by 29% y-o-y driven by 12% volume growth. The India branded tea business grew by 5.6% y-o-y (recovering from a decline of 6% in Q1). Robust revenue growth was seen across the portfolio driven by higher volumes and price realisation. Market share gains were visible both in value and volume terms. NourishCo generated a revenue of Rs. 38 crore, recovering back to 87% of pre-COVID levels (sequential recovery in both volume and value). Portfolio expansion plan for NourishCo is underway. Margins of the packaged beverages business were stable despite inflation in raw tea prices through efficiencies. The India foods business was up by 13% y-o-y to Rs. 580 crore driven by 6% volume growth. Double-digit revenue growth was witnessed across the salt and Tata Sampann portfolio. Salt grew by 10% in Q2FY2021 and continued to record market share gains. The value-added salt portfolio grew by 100%. Pulses continued to deliver a robust growth of 35%. New launches Poha and nutria-mixes showed strong traction. OPM of the India business grew by 34 bps to 14.6%.

International business normalised with unwinding of pantry loading

- **Growth normalised in the US:** The US coffee business reported good revenue growth of 11% y-o-y (4% in constant currency terms) to Rs. 301 crore. However, volumes declined by 3%. Market share in the coffee bags segment stood at 5.4%. Tea (excluding Empirical) grew by 11% in value terms and 8% in volume terms. Regular black tea was up by 1.6%, coffee bags reported strong growth of 13.2% whereas K-cup coffee grew by 10.3% driven by strong promotional activity. Good Earth Sensorial Blends is seeing good traction in the US. Food services (Empirical) business faced headwinds due to COVID-19. However, the business is recovering m-o-m. Profitability increased due to better cost management and higher efficiency.
- **UK business gained market shares:** The UK business grew by 4% y-o-y in constant currency terms, driven by a 7% volume growth. Discount channels continue to remain the biggest growth driver across segments. The UK business reported market share gains, with value share standing at 20.5%, driven largely by Everyday Black. Profitability improved on account of higher sales and improved gross margins. The

company continues to invest behind brands. Good Earth Tea and Kombucha performing well. Non-black tea (fruit & herbal, specialty, decaf, cold infusions) is witnessing strong growth in the international markets, led by shift in consumer preference for health & wellness products. Tetley launched its new herbals range in the UK to strengthen its position in the fruit & herbal category. Fruit & herbal tea market in the UK grew by 12%, whereas regular black tea was almost flat.

- **Performance was soft in the Canada business:** The Canada business recorded almost flat revenues in terms of constant currency and a volume decline of 7% in Q2FY2021 driven by a decline in foodservice business and discontinuation of ethnic teas. Demand in regular tea sales has seen a marginal downtick. The value market share rose to 29.5%. Regular black tea grew by 3% whereas specialty tea registered strong growth of 18% (25% in constant currency terms). Continued improvement in profitability was witnessed led by reduced overheads.

Tata Starbucks witnessed m-o-m recovery

Revenue of Tata Starbucks recovered to ~70% in Q2FY2021 with m-o-m recovery being seen. Revenues recovered from nil in April to 27% in June, 54% in August and 71% in September. Nearly 86% of stores have become operational. Total store count reached 196 stores across 12 cities as the company added 11 new stores in Q2FY2021. Significant savings were achieved through rental renegotiations. TCPL launched the mobile order & pay feature to allow customers to pre-order beverages on the Starbucks India App. The company also expanded its presence across all home delivery platforms. Improvement in profitability is expected driven by significant savings achieved through rental negotiations.

Tata Coffee result highlights:

- Revenue grew by 17% y-o-y (15% in constant currency terms) to Rs. 243 crore driven by an 8% volume growth led by the Vietnam and plantations businesses. The plantations business grew by 26% y-o-y driven by 6% volume growth (significant growth in pepper volumes). The overall extraction business grew by 13% (11% in volume terms) led by good growth in the Vietnam business. Coffee production is back at pre-COVID levels.
- The Vietnam facility has now back to operating at ~90% of its production capacity and has turned PBIT positive. New clients have been added and the company is focusing on adding new products. Plants in India are also running at full capacity. Reasonable growth was seen in the coffee crop whereas realisations for tea improved.
- The instant coffee business was impacted by slowdown in out-of-home consumption in Q1. Healthy performance was witnessed across geographies in Q2FY2021. Significant growth was seen in pepper volumes.
- Eight 'O Clock (EOC) coffee maintained its growth momentum with 19% revenue growth and 39% PAT growth in H1FY2021. Premium products saw an up-tick due to higher in-home consumption. New launches are gaining momentum, driven by market-relevant products. Margin improvement sustained sequentially due to favourable channel mix. The company's core focus would be on productivity enhancement, strict cost control and expanding into new geographies.
- Profitability was impacted by higher coffee prices and non-accrual of export incentives (MEIS) on exports of coffee extraction.
- Timely execution of orders, a strong order book, stringent cost cutting initiatives and efficiencies would help the company pass through this uncertain environment.

Results (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	Y-o-Y (%)	Q1FY21	Q-o-Q (%)
Total Revenue	2781.3	2347.1	18.5	2713.9	2.5
Raw material cost	1646.2	1326.0	24.1	1500.6	9.7
Employee cost	229.7	220.1	4.4	229.1	0.3
Advertising	166.4	162.7	2.3	133.8	24.4
Other expenses	339.5	323.6	4.9	367.8	-7.7
Total operating cost	2381.8	2032.3	17.2	2231.3	6.7
Operating profit	399.6	314.8	26.9	482.7	-17.2
Other income	26.2	28.0	-6.5	32.7	-19.8
Interest & other financial cost	17.9	20.4	-12.4	17.3	3.4
Depreciation	62.6	58.7	6.7	61.9	1.1
Profit Before Tax	345.4	263.8	30.9	436.2	-20.8
Tax	95.0	64.1	48.2	89.5	6.2
Adjusted PAT before MI	250.3	199.7	25.4	346.7	-27.8
Minority Interest (MI)/ Profit from associates	38.9	9.2	320.5	-43.5	-189.2
Adjusted PAT after MI	289.2	208.9	38.4	303.1	-4.6
Extra-ordinary items	-16.0	-1.0	-	42.4	
Reported PAT	273.2	207.9	31.4	345.6	-20.9
Adjusted EPS (Rs.)	2.7	2.2	25.4	3.8	-27.8
			bps		**bps**
GPM (%)	40.8	43.5	-269	44.7	-389
OPM (%)	14.4	13.4	95	17.8	-342

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	Y-o-Y (%)	Q1FY21	Q-o-Q (%)
Total Revenue	1736.1	1427.2	21.6	1605.4	8.1
Operating profit	253.7	203.8	24.5	325.7	-22.1
Profit Before Tax	250.0	206.0	21.3	335.3	-25.4
Adjusted PAT	182.3	156.1	16.8	246.4	-26.0
Extra-ordinary items	12.9	1.0	-	14.1	-8.1
Reported PAT	169.4	155.1	9.2	232.3	-27.1
Adjusted EPS (Rs.)	2.0	1.7	16.8	2.7	-26.0
			bps		**bps**
GPM (%)	35.0	38.9	-391	40.8	-589
OPM (%)	14.6	14.3	34	20.3	-567

Source: Company; Sharekhan Research

Performance of key businesses

Particulars	Revenue (Rs. cr)	Revenue growth	Volume growth
India beverages	1120	32%	11%
India foods	580	13%	6%
US Coffee	301	11%	-3%
International tea	444	11%	0%
Food service (International)	56	-23%	-19%
Tata Coffee	243	17%	8%
Consolidated business*	**2781**	**19%**	

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector outlook - Demand for in-house consumption products and essentials to continue; pantry loading to stabilise

Nation-wide lockdown in April-May 2020 had severe impact on the supply chain of the consumer goods companies. Strong recovery was seen in June. Staples, health foods and health & hygiene products registered strong demand while out-of-home and discretionary categories posted a decline in Q2FY2021. We believe higher demand for branded products to stay due to shift of consumers to trusted brands and increase in purchases from online channels in the post pandemic era. Thus branded staples, beverages and packaged food would lead the growth for the Rs. 21 lakh crore in-the-kitchen consumption market in the near to medium. Pantry loading in international markets will stabilise with receding scare of the virus in the quarters ahead.

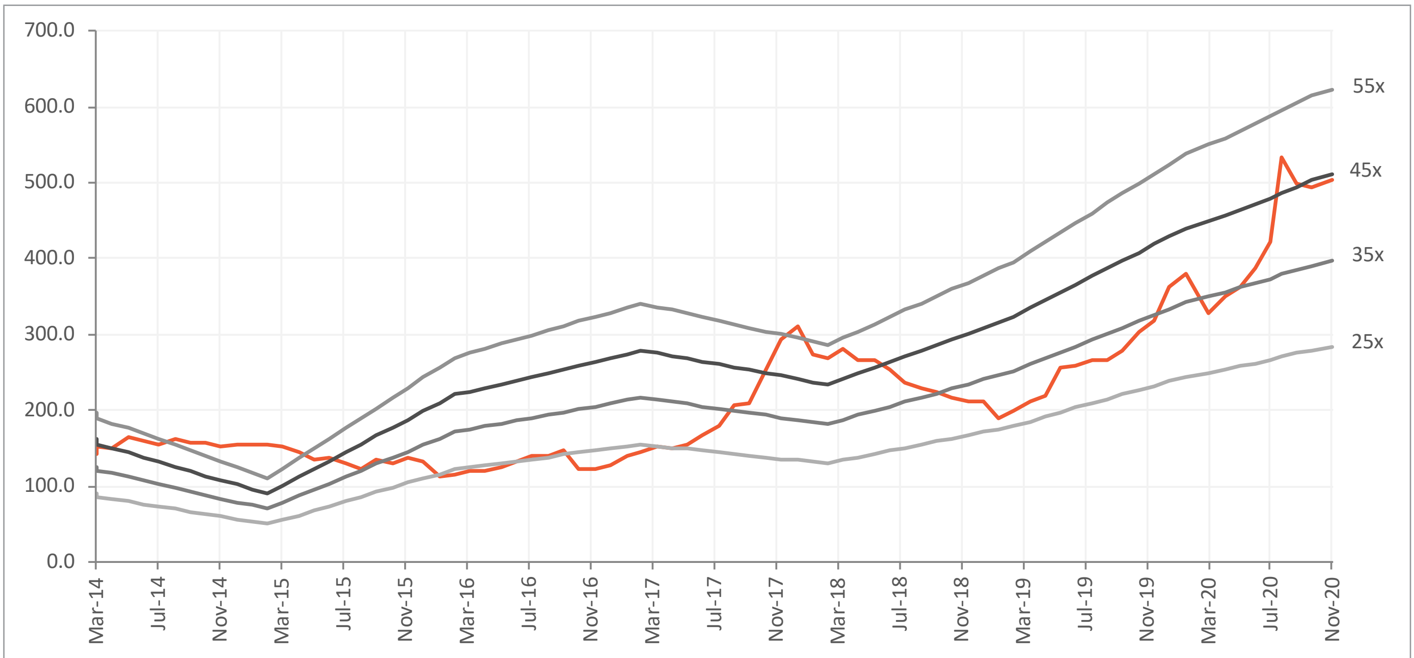
■ Company outlook - Growth momentum to sustain; margin expansion to moderate

Market share gains in the branded tea and salt segment, doubling of distribution reach, sustained trend of higher in-house consumption and consistent new product addition would be key levers of growth for the domestic business. Domestic raw tea prices have gone up significantly due to lower supply (impacted by lockdown and adverse weather conditions). The company has taken price hikes to mitigate the impact. However, the same is not enough to reduce pressure on margins. Integration process of merger of Tata Chemicals' food business with TCPL is on and expected to significantly complete by Q4FY2021. However, benefit of some of the completed processes will start flowing in from Q3, which will help to mitigate impact of higher raw material prices in the near term.

■ Valuation - Retained Buy with revised PT of Rs. 630

We broadly maintain our earnings estimates for FY2021/22/23. TCPL is currently focusing on gaining market share by doubling distribution reach and supporting its brand with adequate promotional activities, which augurs well from a near to medium-term perspective. Further, with a consistent improvement in cash flows, the company is also eyeing inorganic initiatives and new product launches (likely post January 2021). Thus, with growth levers in place, the company is well-placed to achieve earnings CAGR of 20% over FY20-23E. The stock trades at 36.6x its FY2023E earnings. Thus, TCPL remains one of our top picks in the midcap consumer space. We maintain our Buy recommendation on the stock with an unchanged price target of Rs. 630.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBITDA (x)			RoE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Britannia Industries	59.9	46.4	41.3	46.8	34.3	30.0	35.2	42.0	45.4
Nestle India*	83.3	74.0	62.8	56.8	50.2	43.8	50.2	59.8	60.0
Tata Consumer Products	70.3	50.5	41.9	34.5	26.9	23.7	9.0	9.1	10.1

Source: Company, Sharekhan estimates
**Numbers for Nestle India are for CY19, CY20E and CY21E*

About company

TCPL is the world's second-largest branded tea player in the world with a strong portfolio of brands such as Tata Tea, Tetley, Eight O' Clock coffee and Himalayan (mineral water brand). Recently, the company has announced the merger of TCL's consumer business with TCPL to expand its India business, the contribution of which will increase to ~61% from 48% currently. TCPL has a very vast presence in international geographies such as UK, US, Canada, South Asia and Africa through various subsidiaries. NourishCo markets and distributes branded non-carbonate beverage products such as Tata Gluco Plus (TGP), Tata Water Plus and Himalayan. TCPL has a 50:50 joint venture with Starbucks Corporation named Tata Starbucks Private Limited which is performing well.

Investment theme

After the integration of TCL's consumer business with TGBL, the India business is expected to become a key revenue driver for the company. Rising per capita income, increasing awareness of brands and increase in in-house consumption and consumption through modern channels such as large retail stores/e-commerce would act as key revenue drivers for the branded pulses and spices businesses in India in addition to the consistently growing tea business. Along with margin expansion, innovation and diversification, the merger will help TCPL to expand its distribution network. An enhanced product portfolio and expanded distribution reach would help India business revenue to grow by 9-12% in the next two-three years as against a 5% CAGR over FY2016-20.

Key Risks

Sustained slowdown in the domestic consumption; heightened competition from new players and spike in the key input prices would act as a key risk to our earnings estimates in the near term.

Additional Data

Key management personnel

N. Chandrasekaran	Chairman
Sunil D'Souza	Managing Director & CEO
John Jacob	Chief Financial Officer
Neelabja Chakrabarty	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	First State Investments ICVC	6.3
2	Life Insurance Corp of India	2.1
3	Reliance Capital Trustee Co Ltd	2.0
4	Mirae Asset Global Investments Co	1.7
5	Government Pension Fund - Global	1.5
6	HDFC Asset Management Co Ltd	1.4
7	Sundaram Asset Management Co Ltd	1.3
8	Franklin Resources Inc	1.2
9	Dimensional Fund Advisors LP	1.2
10	Norges Bank	1.1

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

Sharekhan

by BNP PARIBAS

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