Britannia Industries (BRIT IN)

Target Price	Rs4,100
Current Price	Rs3,533
% Upside	16%

Q4: Slight Miss on Estimates; Expect Recovery Post GST

Food
India
1 Jun 2017

BUY

Target: Rs4,100
% Upside: 16%

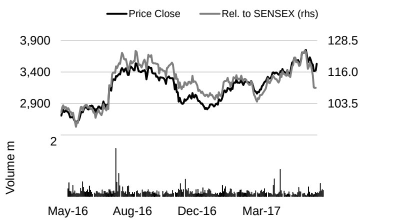
52wk Low Rs2,565 (-27%) | Rs3,533 31 May 2017 | 52wk High Rs3,753 (6%)

Unchanged

Basic Share Information

Market cap	Rs423.9b / US$6.56b
Daily traded value (3mth)	US$8.18m
Shares outstanding	120.0m
Free float	49%
Net debt-to-equity	-0.2%
1 yr high	Rs3,753
1 yr low	Rs2,565
Foreign Shareholding	11.0%
Share price date	31 May 17

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-2.5%	9.4%	30.5%
Absolute USD	-3.2%	12.8%	35.6%
Relative to SENSEX	-6.6%	1%	13.7%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Volume Growth Estimated to Recover from H2 FY3/18

Summary: Britannia Industries (BRIT) reported Q4 FY3/17 results that came in slightly below our estimates. Volumes in the core business (biscuits, cakes and rusks) in India grew by 2% YoY, which was below our and consensus estimates of 3–4% YoY growth. Management attributed the slow growth to challenging market environment and sluggish consumer demand. In the quarter, the company managed to see 10bps YoY improvement in its EBITDA margin on account of its cost-saving efforts and cuts in advertising and promotion (A&P) spending by 20–22% YoY which helped minimize the impact of over 10% inflation in key raw material prices. We expect the company to start delivering uptick in volume growth from H2 FY3/18 onwards, once the overhang with respect to GST implementation is behind it. We have roughly maintained our EPS forecasts over FY3/18–19 and retain our BUY rating on the shares.

Target Price and Catalyst: We raise our target price to Rs4,100 (from Rs3,725) as we increase our PER to 36x (from 33x earlier) applied to our new FY3/19 EPS estimate as we expect BRIT to be favorably impacted with a likely lower GST rate than the current 18% revenue-neutral rate as well as higher share of unorganized segment (36%). Key catalysts would be higher volume growth and inflation moderation in raw material prices.

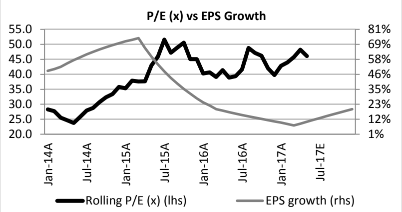
Earnings: Q4 FY3/17 consolidated revenues grew by 5.2%, EBITDA by 6.1% and NP by 6% YoY with international business (contributing about 7% of total sales) impacted by deteriorating geopolitics and currency volatility in the Middle East and Africa region. For its standalone business, revenue (which includes the key domestic businesses of biscuits, bread, cakes and rusks) grew by 6.6% YoY led by core business volume growth of 2% YoY (we estimated a 3–4% growth). The consolidated gross margin declined by 165bps YoY due to raw material price inflation, but cost cutting coupled with cuts in A&P spending helped the EBITDA margin expansion of 10bps YoY to 13.7% (versus our estimate of 13.4%). Standalone gross and EBITDA margins declined by 150bps and 10bps YoY to 37.8% and 13.7%, respectively. Lower other income (down 7.5% YoY) partially offset by a lower tax rate (down 80bps YoY to 21.6%), boosted by benefits coming from recently commissioned R&D facility, resulted in overall NP growth of 6% YoY to Rs2.1bn and standalone NP growth of 2.5% YoY to Rs1.97bn.

Valuation: We raise our target price to Rs4,100 (previously Rs3,725), based on a PER of 36x (previously 33x) our FY3/19 EPS estimate. The main risks to our rating and target price include sharp inflation in key raw materials prices, and sluggish consumer demand along with a GST trade disruption if any, which would further impact volume growth.

	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E	Trend
Total turnover (Rsm)	78,584	83,972	90,541	1,05,356	1,22,354	
Operating profit (Rsm)	7,194	11,010	11,590	14,439	17,904	
Pre-tax profit (Rsm)	9,496	12,205	13,040	16,176	20,002	
Net income to ord equity (Rsm)	6,886	8,246	8,847	10,954	13,544	
Net profit growth	74.2%	19.7%	7.3%	23.8%	23.7%	
P/E (x)	61.53	51.39	47.90	38.68	31.29	
Adj EV/EBITDA (x)	29.20	22.21	27.37	19.21	14.28	
P/B (x)	34.13	20.26	15.71	12.48	9.94	
ROE	67.7%	49.5%	37.0%	36.0%	35.4%	
Dividend yield	0.5%	0.6%	0.6%	0.8%	1.0%	
EPS HTI old (Rs)	57.4	67.2	74.3	91.3	112.8	
EPS HTI New (Rs)	57.4	68.7	73.8	91.3	112.9	
Consensus EPS (Rs)	47.0	70.4	74.5	88.6	105.2	
HTI EPS vs Consensus	22.2%	(2.4%)	(1.1%)	3.1%	7.3%	

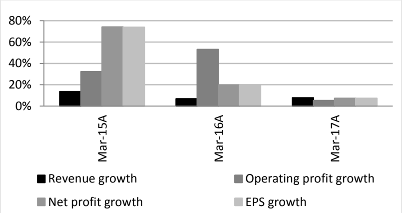
Source: Company data, Bloomberg, HTI estimates
Click here to download the working model
Note: FY15 Financial based on IGAAP; FY16-19 Financial Based on IND-AS

Valuation



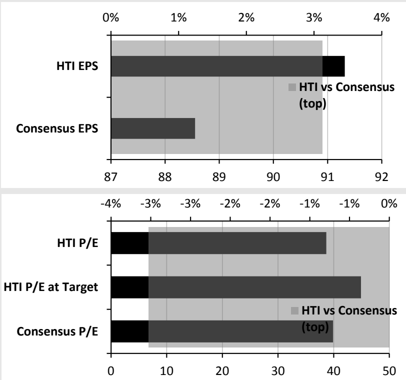
Source: Company data, Bloomberg, HTI estimates

Earnings Trends



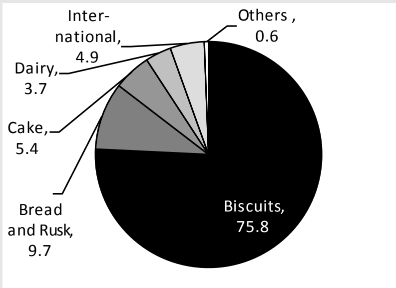
Source: Company data, Bloomberg, HTI estimates

Earnings: HTI vs Consensus



Source: Company data, Bloomberg, HTI estimates

Sales Breakdown – FY3/16



Source: Company data

Investment Thesis

BUY

- By expanding distribution, increasing sales in rural markets, boosting its share in Hindi markets where sales have been weak, and supporting new product innovation, we expect BRIT to deliver top-line growth that is above the industry average in the medium term.

- In addition to bolstering its core biscuit operation, BRIT aims to strengthen its cake, rusk, bread, dairy and international businesses, which should help it to sustain revenue growth.

- Management is looking to improve cost efficiency through automation and to reduce the company's dependence on outsourcing. This, coupled with the premiumization of its product portfolio in urban markets, should help lift the operating EBITDA margin by 190ps over FY3/18–19.

- India's per-capita consumption of biscuits is well below that in Indonesia and the Philippines. Also, the company's market penetration in domestic rural markets is just 60%, and per-capita biscuit consumption is only 72% that in its urban markets. This suggests there is scope for BRIT to increase volume growth.

- We have largely maintained our EPS forecast over FY3/18–19. However, we have increased our target PER to 36x (from 33x previously) as we believe BRIT is best placed to tackle the uncertainty on account of GST implementation and also being the market leader it would be the key beneficiary of shift from unorganized market (36% biscuit market is unorganized) to organized market. Accordingly, we raise our target price to Rs4,100 (from Rs3,725).

Company Snapshot

Britannia Industries (BRIT), a Wadia (unlisted) group company, manufactures and markets food products such as biscuits, cakes, rusks, bread, and dairy products. BRIT is the leader in India's biscuit category and garnered about 76% of its total revenue from this business in FY3/16. The company distributes its biscuit products under the Good Day, Tiger, NutriChoice, Milk Bikis and Marie Gold brands. BRIT also exports its products to Gulf Cooperation Council (GCC) countries, Africa, and the Americas. The company was founded in 1892 and is based in Bangalore, India.

Key Investment Metrics

Revenue Growth

Low | **Medium** | High

We forecast a CAGR for revenue of 16.2% over FY3/18–19, aided by an average annual volume growth of 9% over the same period.

Profit Margins

Low | **Medium** | High

With BRIT's focus on launching new premium products and on cost reductions, the operating EBITDA margin should expand by 190bps over FY3/18–19 to 16%.

Shareholder Returns

Low | Medium | **High**

We project a CAGR for NP of 23.7% over FY3/18–19, with ROE at the 35% level.

Balance Sheet Risks

High | Medium | **Low**

With a net cash position of Rs50m and estimated free cash flow CAGR of 16.6% over FY3/17–19, we believe balance sheet risk is low. We expect free cash flow to improve from Rs7.1bn in FY3/16 to Rs11.3bn in FY3/19.

Barriers to Entry

Low | **Medium** | High

The barriers to entry in the bakery market are low due to minimal capital requirements and few regulatory restrictions. As a result, BRIT has numerous competitors in this category ranging from multinational corporations to small domestic firms. However, BRIT has established a strong brand, which helps it to maintain its high market share.

International Exposure/Breakdown

High | Medium | **Low**

BRIT exports its products to Gulf Cooperation Council (GCC) countries, to Africa and to the Americas. International business contributed about 7% of overall revenue in FY3/16.

FX Exposure

High | Medium | **Low**

The foreign currency exposure for BRIT is low with only about 7% of its FY3/16 revenue earned from international markets.

Corporate Governance

Low | Medium | **High**

We believe corporate governance is strong. BRIT has an audit committee in place and four of the six members of this committee are independent directors.

Our Model Assumptions

We forecast a CAGR for revenue of 16.2% over FY3/18–19, aided by average annual volume growth of 9% over this period

We project the operating EBITDA margin to expand by 190bps from 14.1% in FY3/17 to 16% in FY3/19

Profit & Loss (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Total turnover	78,584	83,972	90,541	1,05,356	1,22,354
Cost of sales	(46,918)	(50,127)	(55,887)	(65,081)	(75,214)
Gross profit	**31,666**	**33,845**	**34,655**	**40,275**	**47,139**
Total operating costs	(24,472)	(22,835)	(23,065)	(25,837)	(29,235)
Operating profit	**7,194**	**11,010**	**11,590**	**14,439**	**17,904**
Operating EBITDA	8,639	12,144	12,782	15,833	19,523
Depreciation and amortisation	**(1,445)**	**(1,134)**	**(1,193)**	**(1,394)**	**(1,619)**
Other recurring income	880	1,244	1,505	1,806	2,168
Interest expense	(39)	(49)	(55)	(69)	(69)
Exceptional income - net	1,461	-	-	-	-
Pre-tax profit	**9,496**	**12,205**	**13,040**	**16,176**	**20,002**
Taxation	(2,611)	(3,961)	(4,197)	(5,225)	(6,461)
Minority interests	2	2	3	3	3
Net income to ord equity	**6,886**	**8,246**	**8,847**	**10,954**	**13,544**

Source: Company, HTI estimates

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Key P/L Takeaway

We expect product innovation and expanded distribution to drive strong revenue growth, while cost reductions enhance profitability

We expect expanded distribution in rural markets coupled with new product launches in the premium segment to be key growth drivers for BRIT. We believe these initiatives should support a CAGR for revenue of 16.2% over FY3/18–19 aided by an annual volume growth of 9% over the same period. We see the premiumization of the product portfolio and the cost savings realized by bolstering in-house manufacturing spurring a jump in EBITDA margin of about 190bps over FY3/18–19 to 16% in FY3/19.

Our Model Assumptions

We forecast cash and cash equivalents to increase from Rs1.21bn in FY3/17 to about Rs3bn in FY3/19

Balance Sheet (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Total cash and equivalents	2,263	877	1,208	1,708	3,011
Inventories	4,040	4,407	6,615	6,241	7,006
Accounts receivable	1,358	1,706	1,792	2,021	2,179
Other current assets	5,934	9,219	14,474	15,827	17,289
Total current assets	**13,596**	**16,208**	**24,088**	**25,796**	**29,485**
Tangible fixed assets	8,924	10,403	11,901	14,515	17,052
Total investments	5,179	7,884	4,869	9,869	14,869
Total other assets	234	444	231	231	231
Total non-current assets	**14,337**	**18,731**	**17,000**	**24,615**	**32,152**
Total assets	**27,934**	**34,939**	**41,088**	**50,410**	**61,637**
Short-term debt	969	861	843	843	843
Accounts payable	7,034	7,691	7,573	8,806	10,178
Other current liabilities	7,022	5,069	5,368	6,458	7,659
Total current liabilities	**15,025**	**13,621**	**13,784**	**16,107**	**18,680**
Long-term debt	433	377	314	314	314
Other liabilities	36	-	-	-	-
Total non-current liabilities	**470**	**377**	**314**	**314**	**314**
Total liabilities	**15,494**	**13,998**	**14,098**	**16,421**	**18,994**
Common stocks	240	240	240	240	240
Other reserves	12,175	20,677	26,724	33,723	42,377
Shareholders' equity	**12,415**	**20,917**	**26,964**	**33,963**	**42,617**
Minority interests	24	25	26	26	26
Other equity	-	(0)	-	-	-
Total equity	**12,439**	**20,941**	**26,990**	**33,989**	**42,643**
Total liabilities & shareholders' equity	**27,934**	**34,939**	**41,088**	**50,410**	**61,637**

Source: Company, HTI estimates

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✓ **Key B/S Takeaway**

BRIT has generated strong free cash flow in the past with minimal debt, so we expect its balance sheet to remain robust over the next few years

We project a CAGR for free cash flow of 16.6% over FY3/17–19 and we expect cash and cash equivalents to increase from Rs1.21bn in FY3/17 to about Rs3bn in FY3/19. We believe balance sheet risk is minimal.

Our Model Assumptions

We project capex of Rs4–4.2bn annually over our forecast period

We forecast a CAGR for free cash flow of 16.6% over FY3/17–19

Key Cash Flow Takeaway

We expect operating cash flow to fund the company's expansion plans through FY3/19

Cash Flow (Rsm)	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
Operating profit	**7,194**	**11,010**	**11,590**	**14,439**	**17,904**
Depreciation and amortisation	1,445	1,134	1,193	1,394	1,619
Changes in working capital	(318)	(5,295)	(7,367)	1,116	187
Other operating cash flow	495	6,985	1,347	1,876	2,237
Operating cash flow	**8,817**	**13,834**	**6,762**	**18,825**	**21,946**
Interest paid	(39)	(49)	(55)	(69)	(69)
Tax paid	(2,933)	(4,172)	(3,984)	(5,225)	(6,461)
Cash flow from operations	**5,845**	**9,614**	**2,724**	**13,531**	**15,416**
Capex	(1,177)	(2,508)	(2,690)	(4,009)	(4,156)
Other investing cash flow	(3,328)	(4,542)	3,015	(5,000)	(5,000)
Cash flow from investing activities	**(4,505)**	**(7,050)**	**325**	**(9,009)**	**(9,156)**
Dividends paid to ordinary shareholders	(1,439)	(1,919)	(2,400)	(2,639)	(3,286)
Proceeds from issue of shares	(491)	2,656	(160)	-	-
Increase in debt	(270)	(156)	(81)	(0)	(0)
Other financing cash flow	386	(3,064)	(294)	(1,386)	(1,674)
Cash flow from financing activities	**(1,814)**	**(2,483)**	**(2,935)**	**(4,025)**	**(4,960)**
Cash at beginning of period	1,091	2,263	877	1,208	1,708
Total cash generated	**(474)**	**81**	**114**	**497**	**1,300**
Forex effects	1,647	(1,468)	217	3	3
Implied cash at end of period	**2,263**	**877**	**1,208**	**1,708**	**3,011**
Free cash flow	**4,668**	**7,106**	**33**	**9,522**	**11,260**

Source: Company, HTI estimates

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We forecast annual capex of about Rs4–4.2bn over FY3/18-19. We believe BRIT's strong operating cash flow should easily fund its capex requirements over our forecast period.

Our Model Assumptions

We forecast a CAGR for EPS of 23.7% over FY3/18–19

We project a CAGR for revenue of 16.2% over FY3/18-19, aided by an average annual volume growth of 9% over the same period

We forecast the operating EBITDA margin to expand by 190bps from 14.1% in FY3/17 to 16% in FY3/19

Key Driver Takeaway

We expect the premiumization and innovation of the product portfolio, expanded distribution and cost saving measures to drive a CAGR for EPS of 23.7% over FY3/18–19

Per Share Data	Mar-15A	Mar-16A	Mar-17A	Mar-18E	Mar-19E
EPS (Rs)	57.4	68.7	73.8	91.3	112.9
FDEPS (Rs)	57.4	68.7	73.8	91.3	112.9
Revenue per share (Rs)	655	700	755	878	1,020
Operating EBITDA per share (Rs)	72.0	101.2	106.6	132.0	162.8
BVPS (Rs)	103.5	174.4	224.8	283.1	355.3
DPS (Rs)	16.00	20.00	22.00	27.40	33.87
Recurrent cash flow per share (Rs)	48.7	80.1	22.7	112.8	128.5
Shares in issue (million)	120.0	120.0	120.0	120.0	120.0
Year end adjusted shares in issue (m)	120.0	120.0	120.0	120.0	120.0
Key Ratios	**Mar-15A**	**Mar-16A**	**Mar-17A**	**Mar-18E**	**Mar-19E**
Valuation Measures					
P/Sales (x)	5.39	5.05	4.68	4.02	3.46
P/E (x)	61.53	51.39	47.90	38.68	31.29
P/CF (x)	72.5	44.1	155.6	31.3	27.5
P/B (x)	34.13	20.26	15.71	12.48	9.94
Adj EV/EBITDA (x)	29.20	22.21	27.37	19.21	14.28
Dividend yield	0.5%	0.6%	0.6%	0.8%	1.0%
Growth					
Revenue growth	13.7%	6.9%	7.8%	16.4%	16.1%
Operating profit growth	32.2%	53.0%	5.3%	24.6%	24.0%
Net profit growth	74.2%	19.7%	7.3%	23.8%	23.7%
Margins					
Gross margin	40.3%	40.3%	38.3%	38.2%	38.5%
Operating EBITDA margin	11.0%	14.5%	14.1%	15.0%	16.0%
Operating margin	9.2%	13.1%	12.8%	13.7%	14.6%
Pretax profit margin	12.1%	14.5%	14.4%	15.4%	16.3%
Tax rate	27.5%	32.5%	32.2%	32.3%	32.3%
Net profit margin	8.8%	9.8%	9.8%	10.4%	11.1%
Key Ratios					
ROE	67.7%	49.5%	37.0%	36.0%	35.4%
ROA	28.2%	26.2%	23.3%	23.9%	24.2%
Capex/revenue	1.5%	3.0%	3.0%	3.8%	3.4%
Current ratio (x)	0.90	1.19	1.75	1.60	1.58
Creditor days	54.72	56.15	49.46	49.39	49.39
Debtor days	6.31	7.44	7.22	7.00	6.50
Inventory days	31.43	32.17	43.20	35.00	34.00
Sales/avg assets	3.21	2.67	2.38	2.30	2.18
Credit analysis					
EBITDA/interest paid (x)	223.8	249.4	234.5	228.1	281.2
OCF/interest paid (x)	151.4	197.4	50.0	194.9	222.1
Debt/EBITDA (x)	0.16	0.10	0.09	0.07	0.06
Debt/equity	11.3%	5.9%	4.3%	3.4%	2.7%
Net debt to equity	(6.9%)	1.7%	(0.2%)	(1.6%)	(4.3%)

Source: Company, HTI estimates

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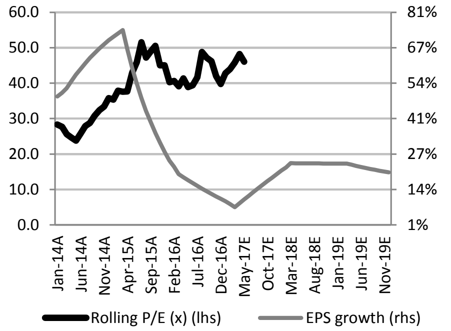
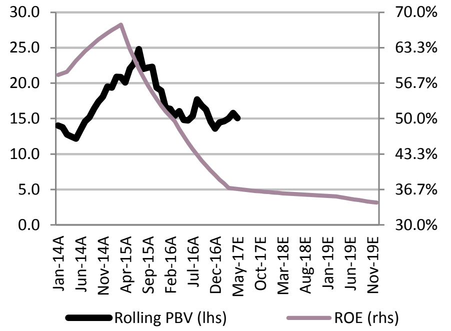
BRIT's core strategy of the premiumization of its product portfolio through innovation, expanded distribution including increased throughput per store, and cost reductions realized by bolstering in-house manufacturing should, in our view, strengthen its top-line performance. We forecast a CAGR for revenue of 16.2% over FY3/18–19, supported by average annual volume growth of 9% over the same period. Additionally, we forecast the operating EBITDA margin to improve by 190bps over FY3/17–19 largely due to cost savings initiatives, such as increased automation at manufacturing units and reduced freight costs. We project a CAGR for EPS 23.7% over FY3/18–19.

P/E (x) vs EPS Growth (%)



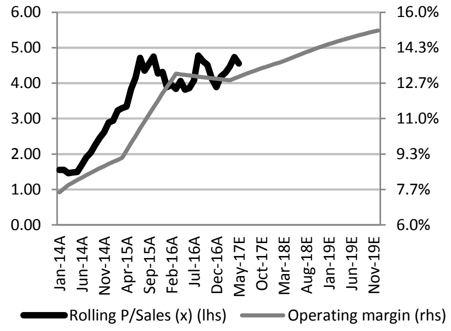
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



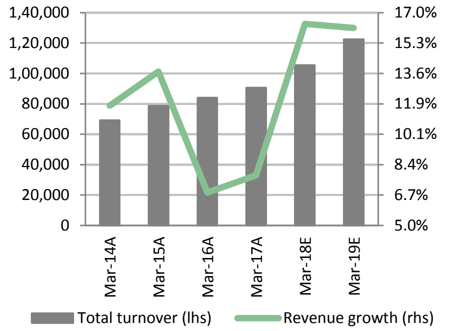
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



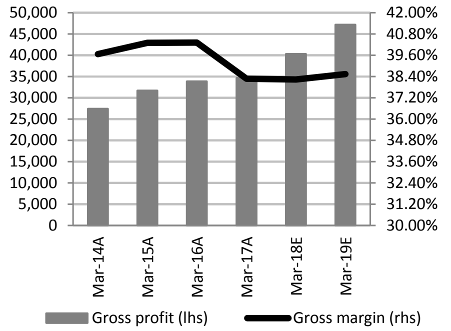
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



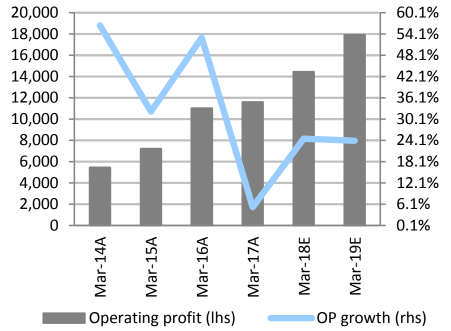
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



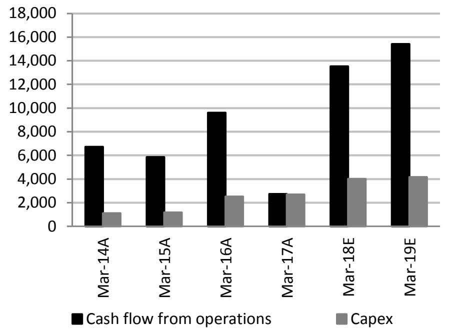
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



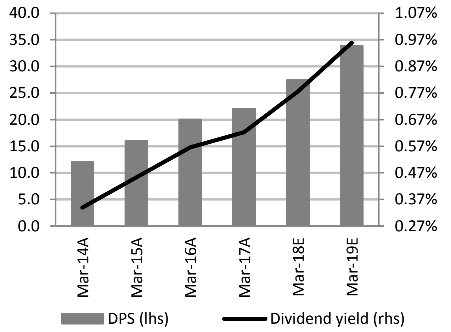
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



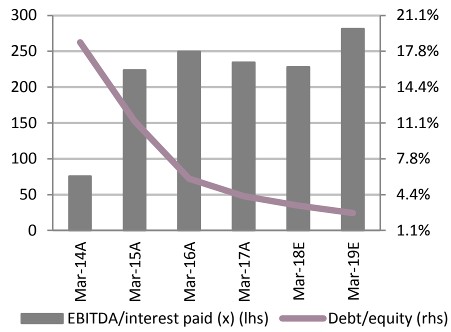
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



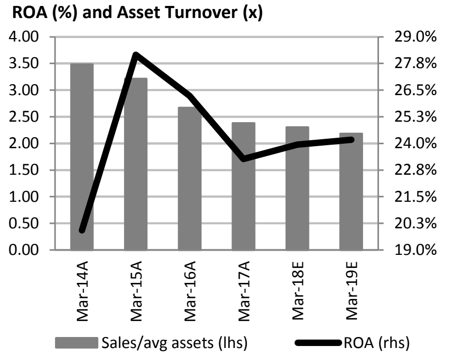
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



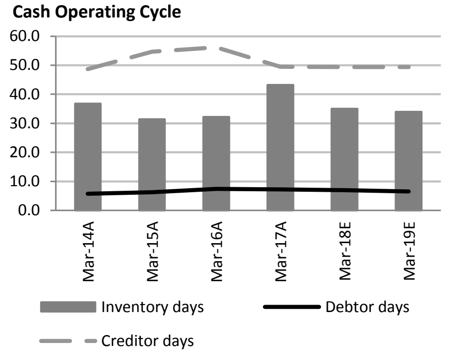
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



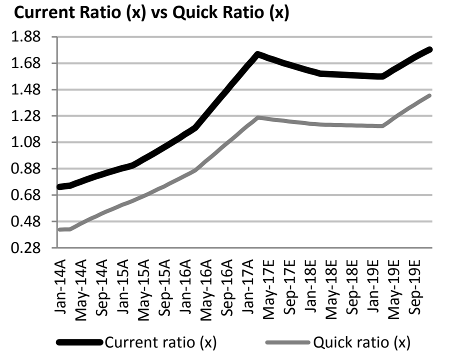
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

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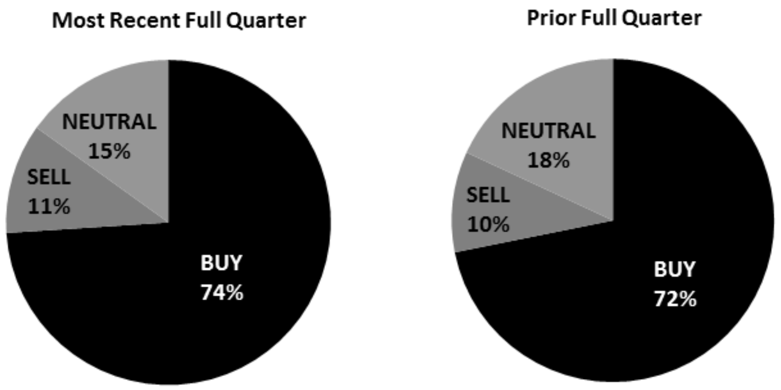
BUY ≥ 15% absolute upside performance expected within the next 12 months

SELL ≥ 15% absolute downside performance expected within the next 12 months

NEUTRAL: A stock under coverage with insufficient upside or downside to justify a BUY or SELL rating. For purposes only of FINRA/NYSE ratings distribution rules, our Neutral rating falls into a hold rating category.

Rating Distribution



Haitong International Equity Research Ratings Distribution, as of March 31, 2017

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*Percentage of investment banking clients in each rating category.
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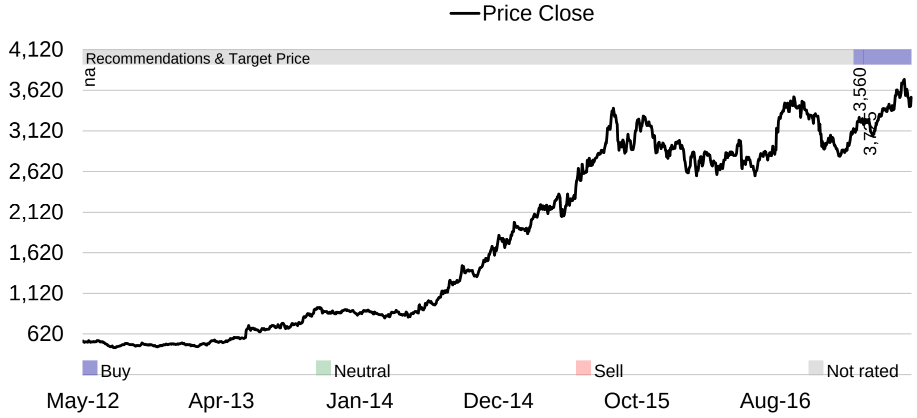

Date	Recommendation	Target (Rs)	Price (Rs)
2017-02-16	Buy	3,725	3,231
2017-01-24	Buy	3,560	3,148

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity