

Britannia Industries

BSE SENSEX	S&P CNX	CMP: INR480	TP: INR467	Sell						
18,817	5,724									
Bloomberg	BRIT IN									
Equity Shares (m)	119									
52-Week Range (INR)	600/400									
1,6,12 Rel. Perf. (%)	-1/-25/-5									
M.Cap. (INR b)	57.3									
M.Cap. (USD b)	1.1									
Year End	Net Sales (INR M)	PAT (INR M)	EPS (INR)	EPS Growth (%)	P/E (X)	P/BV (x)	RoE (%)	RoCE (%)	EV/Sales	EV/EBITDA
03/11A	41,983	1,453	12.2	-13.2	-	-	32.2	31.2	-	-
03/12A	49,470	1,867	15.6	28.5	30.7	10.7	34.9	36.1	1.1	22.1
03/13E	56,500	2,198	18.4	17.7	26.1	9.1	35.1	59.3	1.0	17.0
03/14E	66,094	2,828	23.7	28.7	20.3	7.7	37.9	53.8	0.8	12.2

- **2QFY13 numbers lower than expected:** Britannia Industries (BRIT) reported lower than expected numbers for 2QFY13, with sales at INR14b (v/s our estimate of INR14.5b) and EBITDA at INR606m (v/s our estimate of INR827m). Despite higher other income, adjusted PAT declined 4.8% to INR456m (v/s our estimate of INR548m).
- **Continued deceleration in volume growth:** We estimate volume growth during the quarter at ~2%, which indicates continued deceleration (12% in 1QFY12, 10% in 2QFY12, 7% in 3QFY12, 5.5% in 4QFY12, and 3-4% in 1QFY13).
- **Recurring EBITDA margin down 140bp:** Gross margin expanded 70bp (v/s our estimate of 40bp), led by price hike and mix improvement. Adjusted for INR150.3m VRS cost in 2QFY12 (on account of closure of Mumbai factory), recurring EBITDA margin declined 140bp to 4.3%. Prices of vegetable oil (15% of sales), sugar (18% of sales) and wheat (27% of sales) were firm during the quarter; HDPE prices are also ruling strong. Despite BRIT's continued focus on innovation and premiumization, slowdown in volumes and lack of operating leverage has resulted in sub-par operating margins.
- **Surge in other income restricts decline in recurring PAT:** Despite 18% EBITDA decline, recurring PAT declined just 5% due to 82% surge in other income. Reported PAT grew 20% to INR456m.
- **Maintain Sell:** The stock trades at 26.1x FY13E and 20.3x FY14E EPS. Maintain **Sell**. Letdown in competitive pressures (unlikely) and sharp decline in input prices are key risks to our rating.

Quarterly Performance										(INR Million)		
Y/E March	FY12				FY13E				FY12	FY13E	Estimate	Variance
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE			2QE	(%)
Net Sales	11,030	12,905	12,474	13,096	12,216	14,028	14,150	16,106	49,504	56,500	14,500	(3.3)
YoY Change (%)	21.0	17.8	15.4	16.8	10.8	8.7	13.4	23.0	17.9	14.1	12.0	
COGS	7,257	8,408	7,910	8,223	7,575	9,042	8,971	10,497	31,798	36,085	9,396	
Gross Profit	3,773	4,496	4,565	4,873	4,642	4,986	5,179	5,609	17,707	20,415	5,104	(2.3)
Margins (%)	34.2	34.8	36.6	37.2	38.0	35.5	36.6	34.8	35.8	36.1	35.2	
Other Exp	3,300	3,761	3,749	4,192	3,991	4,379	4,316	4,502	15,002	17,188	4,278	2.4
% of Sales	29.9	29.1	30.1	32.0	32.7	31.2	30.5	27.9	30.3	30.4	29.5	
Total Exp	7,073	12,169	11,658	12,415	11,566	13,422	13,287	14,999	46,800	53,273	13,674	
EBITDA	473	736	816	680	651	606	863	1,107	2,704	3,227	827	(17.6)
Margins (%)	4.3	5.7	6.5	5.2	5.3	4.3	6.1	6.9	5.5	5.7	5.7	
YoY Growth (%)	15.6	39.1	46.3	8.0	37.6	-17.6	5.8	62.7	31.1	19.3	7.1	
Depreciation	111	116	122	125	130	143	140	134	473	547	135	5.6
Interest	93	97	95	95	95	88	75	66	381	323	90	(2.3)
Other Income	304	146	148	226	179	266	160	91	824	696	160	66.4
PBT	573	670	747	685	605	642	808	998	2,674	3,053	762	(15.7)
Tax	155	191	206	155	170	186	226	272	707	855	213	
Rate (%)	27.0	28.5	27.6	22.6	28.1	29.0	28.0	27.3	26.4	28.0	28.0	
Adjusted PAT	418	479	541	530	435	456	582	726	1,967	2,198	548	(16.8)
YoY Change (%)	27.2	45.9	42.8	22.6	4.0	-4.8	7.6	36.9	35.4	11.7	12.3	

E: MOSL Estimates

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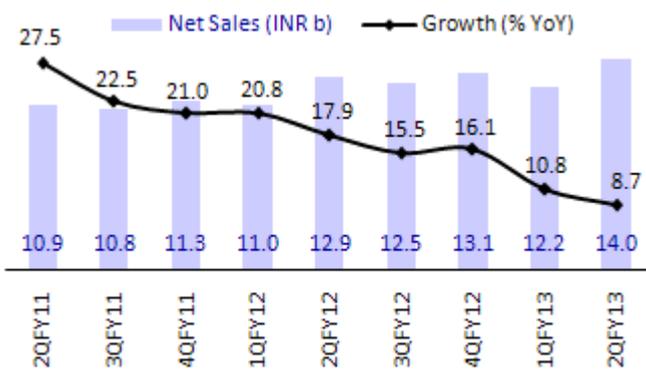
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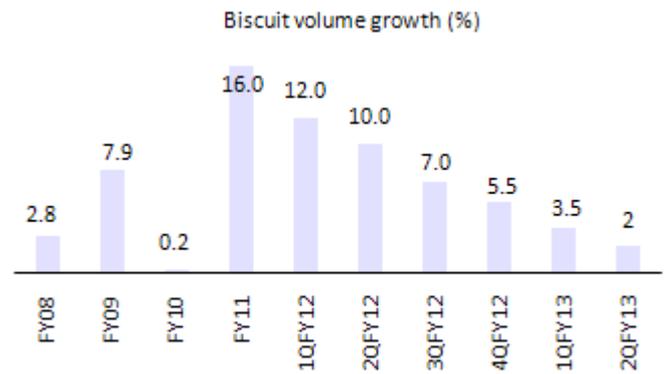
Sales lower than expected; continued deceleration in volumes

- Sales grew 8.7% to INR14b (v/s our estimate of INR14b). We estimate volume growth during the quarter at ~2%, which indicates continued deceleration (12% in 1QFY12, 10% in 2QFY12, 7% in 3QFY12, 5.5% in 4QFY12, and 3-4% in 1QFY13).
- Despite BRIT's focus on premiumization, gains are relatively muted. Single-digit sales growth is a reflection of heightened competitive intensity, in our view. The Biscuits category is facing the heat of increased competition from Parle, Kraft and ITC. Even smaller niche players like Unibic are expanding through new launches in the premium segment and capturing shelf space in modern stores through accelerated spending. This could keep near-term volume growth weak.
- Competitive headwinds coupled with slowdown in the Biscuits category has resulted in six consecutive quarters of volume deceleration.

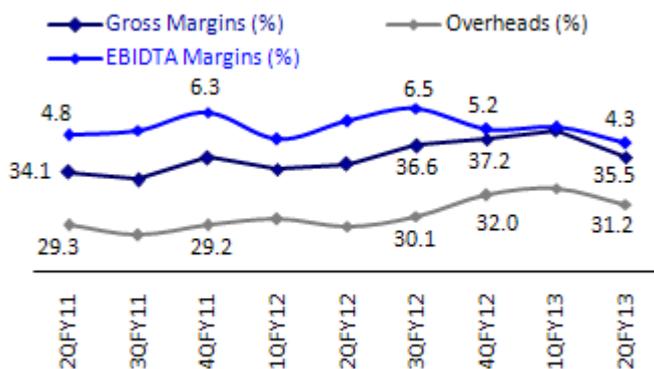
Sales below expectations



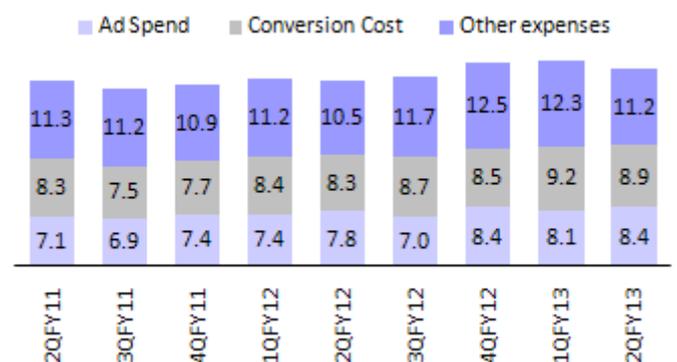
Continued deceleration in volumes



EBITDA margin down 140bp...



...dragged by higher ad expenses and overheads

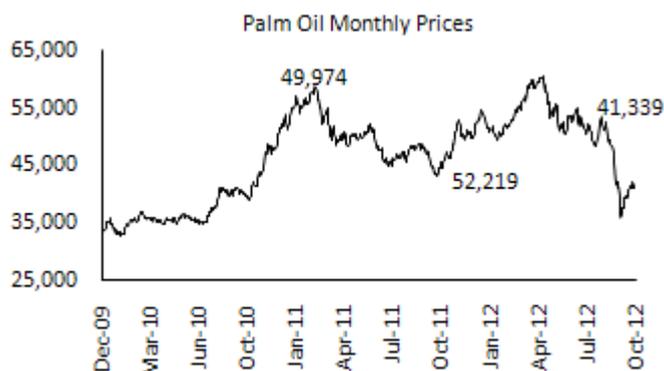


Source: Company, MOSL

Gross margin expands, but EBITDA margin shrinks due to higher conversion cost, other expenses and ad spends

- Gross margin expanded 70bp (v/s our estimate of 40bp), led by mix improvement and price hikes (estimated at 2-3%), despite firm prices of vegetable oil, sugar, wheat flour and packaging material.
- Reported EBITDA margin contracted 20bp to 4.3% (v/s our estimate of 5.7%), dragged by 70bp increase in other expenses, 70bp increase in conversion costs and 60bp increase in ad spends. Lack of operating leverage is aggravating operating profitability.
- Adjusted for INR150.3m VRS cost in 2QFY12 (on account of closure of Mumbai factory), recurring EBITDA margin declined 140bp to 4.3%.
- Adjusted PAT declined 4.8% (lower than the 18% decline in EBITDA) to INR456m due to 82% increase in other income to INR266m. Reported PAT grew 20%.
- We expect ad spends to remain high as BRIT drives its premiumization strategy and sustains investments behind its recent new launches.
- We note that prices of vegetable oil (15% of sales), sugar (18% of sales) and wheat (27% of sales) remain firm. Also, HDPE prices are ruling strong.
- Performance of subsidiaries (imputed as difference between consolidated and standalone numbers) has witnessed an about turn – profit of INR133m in 2QFY13 v/s loss of INR104m in 2QFY12.

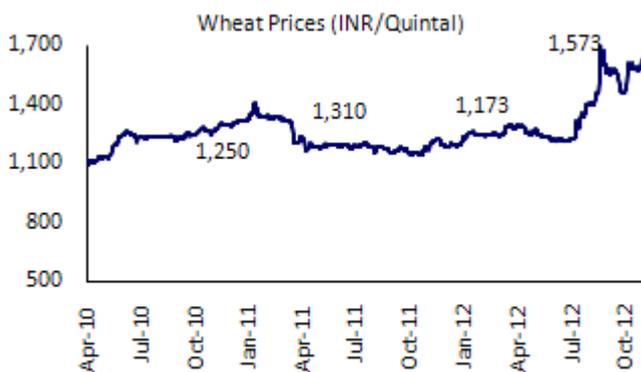
Palm oil prices providing a breather (INR/MT)



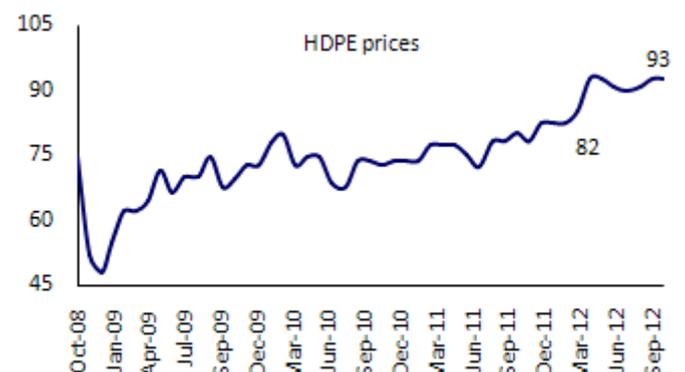
Sugar prices inching up (INR/Qt)



Wheat prices still firm; show no signs of cooling off



HDPE prices at peak (INR/kg)



Source: Company, MOSL

Volume growth decelerating, competitive pressures escalating; maintain Sell

- Our key concerns are: (1) continued deceleration in volume growth in the core Biscuits category, and (2) rising competitive headwinds, as ITC, Kraft and Parle are becoming aggressive and stepping up investments in the category, reflected in higher brand spends.
- Given the low margins at which BRIT operates, swing in input costs has disproportionate impact on profits and capital efficiency ratios.
- BRIT's efforts to drive premiumization through new launches and heavy brand investments augur well from the long-term growth and margin perspective. We believe that the impact of these measures will be gradual.
- The stock trades at 26.1x FY13E and 20.3x FY14E EPS. Maintain **Sell**. Letdown in competitive pressures (unlikely) and sharp decline in input prices are key risks to our rating.

Key quarterly numbers (INR m)

	Standalone		Consolidated		Subsidiaries		YoY (%)
	2QFY12	2QFY13	2QFY12	2QFY13	2QFY12	2QFY13	
Sales	12,905	14,028	13,961	15,426	1,056	1,398	32
PAT	479	456	375	589	(104)	133	-228
Margins (%)	3.7	3.3	2.7	3.8	(10)	9.5	

Source: MOSL

Britannia Industries: an investment profile

Company description

Britannia Industries (BRIT) is the market leader in the biscuits category, with a market share of 38% (in value terms). Biscuits has been one of the fastest growing categories in the FMCG segment, with annual volume growth rate of 12-15% in the last five years.

Key investment arguments

- Biscuits have high sensitivity to income levels. The increase in disposable income should result in expansion in demand for biscuits, particularly in rural areas.
- Reduction in excise duty, increasing capacity utilization at Baddi and reduction in pack sizes will drive volumes and result in improved profitability.

Key investment risks

- BRIT is facing increasing competition from ITC Kraft and Parle on the one hand and regional players like Priyagold on the other.
- Biscuits is a highly elastic category, with high sensitivity to any price increase. Intense competition and price sensitivity makes it difficult to pass on any price increase to consumers, particularly in the Glucose segment.

- Biscuit industry growth has declined from 24% in 1QFY12 to single digit.

Recent developments

- Standard pack sizes regulation came into effect in November 2012.
- BRIT recently launched Shubh Kaamnayein range with 5 themes - Meetha Namkeen, Choco Delight, Healthy Gifts, Cookie Delight, and Premium Assorted Cookies.

Valuation and view

- The stock trades at 26.1x FY13E and 20.3x FY14E EPS. Maintain **Sell**. Letdown in competitive pressures (unlikely) and sharp decline in input prices are key risks to our rating.

Sector view

- We have a cautious view on the sector on back of inflationary tendency in the economy, which might impact volumes as well as profit margins of companies.
- Companies with low competitive pressures and broad product portfolios will be able to better withstand any slowdown in a particular segment.
- Longer-term prospects bright, given rising incomes and low penetration.

Comparative valuations

		Britannia	Dabur	Colgate
P/E (x)	FY13E	26.1	27.9	31.7
	FY14E	20.3	23.3	28.0
P/BV (x)	FY13E	9.1	9.8	31.2
	FY14E	7.7	8.1	25.9
EV/Sales (x)	FY13E	1.0	3.5	5.1
	FY14E	0.8	3.0	4.4
EV/EBITDA (x)	FY13E	17.0	20.8	22.9
	FY14E	12.2	17.4	19.7

Shareholding pattern (%)

	Sep-12	Jun-12	Sep-11
Promoter	50.9	51.0	51.0
Domestic Inst	14.0	14.9	16.8
Foreign	15.9	15.1	11.3
Others	19.2	19.1	21.0

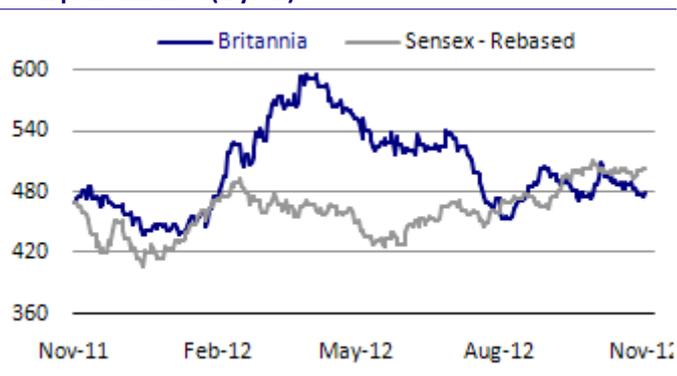
EPS: MOST forecast v/s consensus (INR)

	MOSL Forecast	Consensus Forecast	Variation (%)
FY13	18.4	21.1	-12.9
FY14	23.7	23.9	-0.6

Target price and recommendation

Current Price (INR)	Target Price (INR)	Upside (%)	Reco.
480	467	-2.7	Sell

Stock performance (1 year)



Financials and Valuation

Income Statement					Ratios				
(INR Million)									
Y/E March	2011	2012	2013E	2014E	Y/E March	2011	2012	2013E	2014E
Net Revenues	41,983	49,470	56,500	66,094	Basic (INR)				
Change (%)	23.4	17.8	14.2	17.0	EPS	12.2	15.6	18.4	23.7
Raw Material Cost	27,643	31,798	36,085	41,742	BV/Share	37.8	44.8	52.5	62.4
Gross Profit	14,340	17,673	20,415	24,352	DPS	6.5	8.5	9.2	11.8
Margin (%)	34.2	35.7	36.1	36.8	Payout (%)	53.4	54.4	50.0	50.0
Advertising	3,042	3,810	4,351	4,957	Valuation (x)				
% of Sales	7.2	7.7	7.7	7.5	P/E		30.7	26.1	20.3
Other Expenditure	9,236	11,343	12,837	15,021	EV/Sales		1.1	1.0	0.8
EBITDA	2,063	2,521	3,227	4,374	EV/EBITDA		22.1	17.0	12.2
Change (%)	35.4	33.2	7.4	35.5	P/BV		10.7	9.1	7.7
Margin (%)	4.9	5.1	5.7	6.6	Dividend Yield		1.8	1.9	2.5
Depreciation	446	473	547	617	Return Ratios (%)				
Int. and Fin. Charges	378	381	323	71	RoE	32.2	34.9	35.1	37.9
Financial Other Income	489	585	528	123	RoCE	31.2	36.1	59.3	53.8
Operating Other Income	252	272	168	174	Working Capital Ratios				
PBT	1,981	2,524	3,053	3,984	Debtor (Days)	5	5	5	5
Change (%)	15.4	27.4	21.0	30.5	Asset Turnover (x)	4.6	5.1	8.6	8.5
Margin (%)	4.7	5.1	5.4	6.0	Leverage Ratio				
Tax	528	656	916	1,195	Debt/Equity (x)	1.0	0.8	0.1	0.0
Deferred Tax	0	0	-61	-40	Cash Flow Statement	(INR Million)			
Tax Rate (%)	26.6	26.0	28.0	29.0	Y/E March	2011	2012	2013E	2014E
PAT	1,453	1,867	2,198	2,828	OP Profit	2,063	2,521	3,227	4,374
Change (%)	-13.2	28.5	17.7	28.7	Financial Other Income	489	585	528	123
Margin (%)	3.5	3.8	3.9	4.3	Interest Paid	378	381	323	71
Non-rec. (Exp.)/Income	0	0	0	0	Direct Taxes Paid	528	656	916	1,195
Reported PAT	1,453	1,867	2,198	2,828	Inc in WC	121	-512	-90	-324
Balance Sheet	(INR Million)				CF from Operations	1,526	2,581	2,606	3,556
Y/E March	2011	2012	2013E	2014E	Extraordinary Items				
Share Capital	239	239	239	239	(Inc)/Dec in FA	475	1,333	500	750
Reserves	4,274	5,108	6,030	7,215	(Pur.)/Sale of Investments	544	-186	-3,157	1,439
Networth	4,513	5,347	6,268	7,454	Other Non Rec Exp	0	0	0	0
Loans	4,607	4,326	316	316	CF from Investments	1,018	1,147	-2,657	2,189
Capital Employed	9,120	9,674	6,585	7,770	Issue of Shares	0	0	0	0
Gross Block	5,936	6,386	7,636	8,386	Inc in Debt	279	-281	-4,010	0
Less: Accum. Deprn.	-2,899	-3,379	-3,926	-4,543	Dividend Paid	696	902	1,157	1,277
Net Fixed Assets	3,037	3,007	3,710	3,843	Other Item	36	-76	-48	192
Capital WIP	117	1,000	250	250	CF from Fin. Activity	-454	-1,107	-5,119	-1,469
Investments	5,450	5,264	2,108	3,547	Inc/Dec of Cash	54	327	144	-103
Deferred Liability	-62	10	71	111	Add: Beginning Balance	234	287	614	758
Currents Assets	6,254	7,387	8,280	9,224	Closing Balance	288	614	758	655
Inventory	3,112	3,741	4,238	4,957					
Account Receivables	573	690	814	981					
Cash and Bank Balance	287	614	758	655					
Others	2,282	2,343	2,472	2,631					
Curr. Liab. & Prov.	5,676	6,995	7,834	9,205					
Account Payables	3,329	4,560	5,153	5,975					
Other Liabilities	1,073	1,073	1,175	1,288					
Provisions	1,274	1,362	1,506	1,942					
Net Current Assets	578	393	446	19					
Misc Expenditure not w/of	0	0	0	0					
Net Assets	9,120	9,674	6,585	7,770					

E: MOSL Estimates

N O T E S

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Britannia Industries

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2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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