

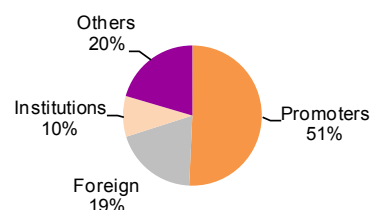
Britannia Industries

Reco: Buy
Base business performs well, volume growth sustains at high single-digit level
CMP: Rs3,126

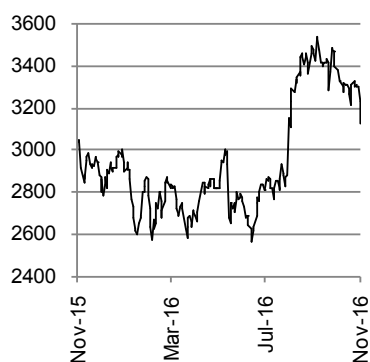
Company details

Price target:	Rs3,950
Market cap:	Rs37,496 cr
52-week high/low:	Rs3,575/2,507
NSE volume: (No of shares)	1.9 lakh
BSE code:	500825
NSE code:	BRITANNIA
Sharekhan code:	BRITANNIA
Free float: (No of shares)	5.91 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.5	14.5	18.0	6.2
Relative to Sensex	-0.5	16.7	7.2	0.1

Key points

- Volume growth at 7% YoY; higher raw material inflation affects profitability:** For Q2FY2017, Britannia Industries' (Britannia) consolidated total revenue grew by 11.2% YoY to Rs2,430.3 crore, driven by 7% YoY volume growth while the price-led growth stood at 4.2%. Volume growth in the base business (includes Biscuit, Cake and Rusk) grew by 10% YoY, while Bread has seen a double-digit decline in volume - affecting the overall volume growth during the quarter. Hindi-speaking markets continued to perform well, with Gujarat and Rajasthan growing at strong double-digit rate of 28% YoY and 21% YoY, respectively (MP and UP grew by 13% YoY and 10% YoY). Gross Profit Margin (GPM) contracted by ~300BPS to 39.2%, mainly on account of 12% YoY increase in Raw Material (RM) inflation, while the company managed to take only 4.0% price hike. However, operating efficiencies helped to arrest a significant decline in OPM to 93BPS at 13.8%. The adjusted PAT grew by 5.7% YoY to Rs234 crore.
- Volume growth to sustain in high single digit; management targeting to maintain OPM at last year levels:** Britannia expects RM inflation of 10% for FY2017 and has taken a price hike of 6.0% (4% was reflected in Q2FY2017). It is planning to take further price increase of 1-2% in the coming quarters. The company is yet to see the impact of price increase on volume growth in the base business and expects steady growth in the coming quarters. The Bread category's volume is expected to gradually improve in the coming quarters. We expect 7-9% volume growth trajectory to sustain in the near term and gradually improve to 10-12% in the medium term (likely to be in H1FY2018). The management is targeting to maintain OPM at last year's level of 14.5% in FY2017, with the help of prudent price hike of 7-7.5% and operating efficiencies (through various initiatives undertaken in the past).
- Long-term growth prospects intact, retain Buy:** We have reduced our FY2017 earnings estimates by 2% to factor in higher-than-expected RM inflation, but broadly maintain estimates for FY2018 and FY2019. We believe that Britannia's long-term focus of adding new product/ entering new category every year, expanding the distribution reach and deepening penetration in Rural India would help it to achieve double-digit revenue and earnings growth in the coming years. The stock is currently trading at 32x its FY2018E earnings and 28x its FY2019E earnings. In view of long-term growth prospects and better earning visibility, we maintain our 'Buy' recommendation with an unchanged price target (PT) of Rs3,950.

Results (Consolidated)

Particulars	Q2FY17	Q2FY16	YoY (%)	Q1FY17	Rs cr QoQ (%)
Total income from operations	2,456.1	2,204.0	11.4	2,196.6	11.8
Total expenditure	2,117.2	1,879.3	12.7	1,880.4	12.6
Operating profit	338.9	324.6	4.4	316.2	7.2
Other income	41.2	33.0	24.8	39.4	4.4
interest expenses	1.5	1.5	2.0	1.5	2.0
depreciation	28.9	27.2	6.4	27.9	3.8
Profit before tax	349.6	328.9	6.3	326.3	7.2
Tax	115.6	107.6	7.4	107.1	7.9
Adjusted PAT	234.0	221.4	5.7	219.2	6.8
Reported PAT	234.0	221.4	5.7	219.1	6.8
Adjusted EPS (Rs)	19.5	18.5	5.7	18.3	6.8
Gross margin (%)	39.3	42.3	(297)BPS	41.4	(205)BPS
OPM (%)	13.8	14.7	(93) BPS	14.4	(60)BPS

Other key highlights:

- **FY2017 RM inflation to be 10%; targets to maintain OPM at 14.5%:** With some of the key input prices rising in double digits (Sugar up by 46%, Palm Oil up by 19% and Flour up by 15%), the RM inflation for the quarter stood at 12% YoY. However, the government actions (curbing the stocking of Sugar and reduction in import duties on Wheat and Palm Oil) helped stabilise the prices of some of the key inputs such as Sugar and Wheat. The company expects RM inflation of 10% for FY2017 and has taken a price hike of 6.0% (4% in Q2FY2017). It is planning to take further price increase of 1-2% in the coming quarters. The management is targeting to maintain OPM at last year's level of 14.5% in FY2017 with the help of prudent price hike of 7-7.5% and operating efficiencies (through various initiatives undertaken in the past).
- **Focus on distribution sustains:** In line with its strategy to enhance the distribution reach, Britannia has added 80,000 direct distributors, resulting in total direct reach of 1.4 million outlets. It has managed to narrow the gap with the nearest competitor by 0.45 million outlets. The company has more than 9,000 distributors in the rural market (added 1,000 distributors in Q2FY2017).
- **Progressing well in Hindi-speaking belt; UP and MP see improvement in sales:** The company's focus on weak markets (mainly Hindi-speaking belt) has resulted in double-digit growth across the key markets and consistent improvement on a sequential basis (QoQ). Value growth in Gujarat and Rajasthan stood strong at 28% YoY and 21% YoY, respectively during the quarter. UP, which saw single-digit growth in the past two quarters, achieved double-digit growth of 10% YoY, while MP achieved a growth of 13% YoY. The management is expecting double-digit growth momentum to sustain in the coming quarters, with larger focus on penetrating through mass products (under Tiger brand). Also, going ahead, the company's focus will be on improving its presence in some of the other weak states (where it is currently 1/5th of market leader).
- **Focus on efficiencies prevails:** Britannia's continuous focus on improving operating efficiencies led to a 30% reduction in trade spends, 35% cut in market returns and 80% fall in write-offs. Also, the increase in the scale of production in the newly-commissioned facility at Bangalore and Tamil Nadu would result in higher in-house manufacturing, leading to better operating efficiencies. The company is targeting cost-saving of ~Rs200 crore for FY2017, which will support margins in the inflationary RM environment.
- **Focus on Innovations, growing adjacencies and plans to enter new categories:** Innovation remains one of the key growth drivers for Britannia. The

company has launched local flavor Mathri Masti under the 50:50 brand and new bread variants - Kulchas (atta and maida). Also, its long-term focus is on improving the revenue mix by growing in ancillary areas such as Cake and Rusk, where the unorganised players hold a larger pie. Further, the company has targeted to enter a new category every year, and in-line with the strategy, it is focusing on entering the macro-snacking category. We believe that Varun Berry's experience in the domestic snack market would help the company to do well in the domestic snacking category.

- **Key subsidiaries see lower profitability:** Britannia's Dairy business revenue grew in double-digit on the back of strong growth in Cheese category. However, higher milk prices and normal tax rate affected the profitability of the business. The supply chain integration plan is currently under review for the dairy business. On the international front, exports revenue and PAT grew in double digits, but the Middle East region's topline remained under stress due to weak macro environment and political unrest in key regions (almost no sales in countries such as Libya, Syria). Britannia continues to focus on countries with a sizeable Indian Diaspora has been progressing well.
- **Capex of Rs350-400 crore in FY2017 and will sustain at Rs300 crore from FY2018:** Britannia is planning to do a capital expenditure (capex) of Rs350-400 crore, largely on building new capacities at various geographies in India. The capex plan will largely be funded through internal accruals. The company is planning to set up a dedicated factory in Mundra SEZ (Gujarat) for improving the prospects of the export business in the coming years.

Outlook and valuation: We have reduced our earnings estimates by 2% for FY2017 to factor in higher-than-expected RM inflation, but broadly maintain our estimates for FY2018 and FY2019. We believe that Britannia's long-term focus of adding a new product/entering a new category every year, expanding the distribution reach and deepening penetration in Rural India would help it to achieve double-digit revenue and earnings growth in the coming years. The stock is currently trading at 32x its FY2018E earnings and 28x its FY2019E earnings. We maintain our 'Buy' recommendation with the unchanged PT of Rs3,950.

Valuations (Consolidated)					Rs cr
Particulars	FY15	FY16	FY17E	FY18E	FY19E
Net sales	7,858.4	8,397.2	9,943.3	11,345.8	12,830.7
OPM (%)	11.0	14.6	14.5	15.0	15.3
Adjusted PAT	542.5	831.3	984.3	1180.9	1355.1
EPS (Rs)	45.2	69.3	82.0	98.4	112.9
P/E(x)	69.1	45.1	38.1	31.8	27.7
EV/EBIDTA (x)	43.3	30.7	25.8	21.5	18.4
RoE (%)	53.3	55.3	48.1	43.7	38.2
RoCE (%)	61.7	69.5	76.4	67.3	62.1



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