

Company Results Review

24 July 2007 | 10 pages

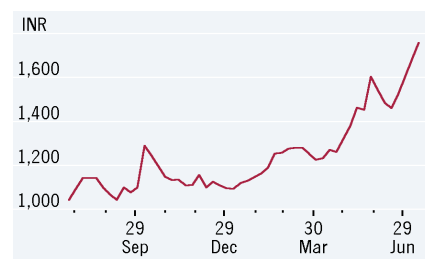
Britannia Industries (BRIT.BO)

Buy: 1QFY08 - Margins Turning Around; Potential M&A Upside

- Earnings turning around** — Britannia's margins are turning around as its key raw material (sugar, flour) are abating, while sales growth momentum continues to be strong. This is reflected in the 1QFY08 results, with net sales growing 20% and 90bps margin expansion driving EBITDA growth of 36.8%. This growth trend should only intensify, as margins are still below optimum levels.
- Stable market share despite competition** — Britannia's market share is stable, despite strong competition from ITC. Britannia's strategy of expanding its product portfolio and transiting from a 'biscuits' player into a 'snacking' player is paying off, aided by strong growth of the Indian processed foods industry. We expect Britannia to continue to deliver 15%-20% sales growth over the next few quarters.
- Potential M&A upsides** — Danone's exit from Britannia is imminent, with having spun off its biscuits business globally to Kraft. Danone is likely to sell its stake once its dispute with the promoter family (Wadias) is resolved. A potential stake sale at a premium could provide upside triggers to the stock price.
- EPS CAGR of 42%** — We forecast EPS CAGR of 42% over FY07-FY10E for Britannia, the highest among our Indian foods companies. The stock is currently trading at 22x FY08E P/E and 16.5x FY09E P/E. Maintain Buy (1L).

Buy/Low Risk	1L
Price (24 Jul 07)	Rs1,720.40
Target price	Rs1,825.00
Expected share price return	6.1%
Expected dividend yield	0.9%
Expected total return	7.0%
Market Cap	Rs41,101M US\$1,024M

Price Performance (RIC: BRIT.BO, BB: BRIT IN)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,342	56.18	-14.9	30.6	7.5	27.0	0.9
2007A	1,076	45.04	-19.8	38.2	6.7	18.5	0.9
2008E	1,861	77.90	73.0	22.1	5.5	27.3	1.0
2009E	2,495	104.42	34.0	16.5	4.3	29.4	1.2
2010E	3,051	127.73	22.3	13.5	3.4	28.5	1.3

Source: Powered by dataCentral

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Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
Valuation Ratios					
P/E adjusted (x)	30.6	38.2	22.1	16.5	13.5
EV/EBITDA adjusted (x)	20.2	29.9	17.2	12.3	9.4
P/BV (x)	7.5	6.7	5.5	4.3	3.4
Dividend yield (%)	0.9	0.9	1.0	1.2	1.3
Per Share Data (Rs)					
EPS adjusted	56.18	45.04	77.90	104.42	127.73
EPS reported	56.18	45.04	77.90	104.42	127.73
BVPS	229.85	256.83	314.42	396.27	499.17
DPS	15.00	16.00	18.00	20.00	22.00
Profit & Loss (RsM)					
Net sales	17,133	21,993	25,947	29,573	33,142
Operating expenses	-15,463	-20,994	-24,107	-27,037	-30,001
EBIT	1,670	999	1,841	2,536	3,141
Net interest expense	-51	-54	-1	-1	-1
Non-operating/exceptionals	266	239	350	400	450
Pre-tax profit	1,885	1,184	2,190	2,935	3,590
Tax	-543	-108	-328	-440	-538
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	1,342	1,076	1,861	2,495	3,051
Adjusted earnings	1,342	1,076	1,861	2,495	3,051
Adjusted EBITDA	1,888	1,252	2,105	2,812	3,429
Growth Rates (%)					
Sales	13.5	28.4	18.0	14.0	12.1
EBIT adjusted	-5.7	-40.2	84.3	37.8	23.9
EBITDA adjusted	-3.7	-33.7	68.2	33.6	21.9
EPS adjusted	-14.9	-19.8	73.0	34.0	22.3
Cash Flow (RsM)					
Operating cash flow	964	890	2,329	2,887	3,499
Depreciation/amortization	217	253	265	277	288
Net working capital	-777	-439	203	116	159
Investing cash flow	-498	-390	-1,844	-2,167	-2,726
Capital expenditure	-200	-119	-180	0	0
Acquisitions/disposals	-298	-271	-1,664	-2,167	-2,726
Financing cash flow	-284	-500	-485	-539	-593
Borrowings	32	-69	0	0	0
Dividends paid	-409	-431	-485	-539	-593
Change in cash	182	0	0	181	180
Balance Sheet (RsM)					
Total assets	8,632	9,736	11,758	14,354	17,488
Cash & cash equivalent	2,872	3,709	4,873	6,390	8,298
Accounts receivable	1,155	1,609	1,896	2,159	2,419
Net fixed assets	1,516	1,383	1,298	1,202	1,094
Total liabilities	3,124	3,583	4,230	4,871	5,546
Accounts payable	2,247	2,645	3,111	3,538	3,958
Total Debt	94	25	25	25	25
Shareholders' funds	5,491	6,135	7,511	9,467	11,925
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.0	5.7	8.1	9.5	10.3
ROE adjusted	27.0	18.5	27.3	29.4	28.5
ROIC adjusted	56.8	41.1	75.3	107.2	133.5
Net debt to equity	-50.6	-60.0	-64.5	-67.2	-69.4
Total debt to capital	1.7	0.4	0.3	0.3	0.2

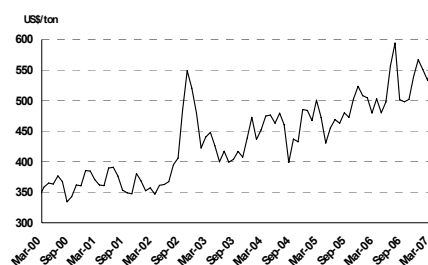
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Margins Turning Around, While Sales Growth Remains Strong

Britannia's raw material cost pressures are abating, which should aid margins. Over the last 5 quarters, Britannia has seen significant erosion in its gross margins, primarily driven by rising prices of all its key raw materials – wheat flour, sugar and vegetable oils. However, cost pressures are now abating with sugar prices declining and wheat flour prices stabilizing.

Figure 1. Wheat Price Trend (US\$ / ton)



Source: Datastream

Figure 2. Sugar Price Trend (Rupees / 100kg)



Source: Crisinfac

At the same time Britannia's sales growth momentum remains strong, despite rising competition from ITC. Biscuits segment in India is growing at about 9%-10%, with organized segment growing significantly faster through market share gains from the unorganized segment. We estimate the current market size of Indian biscuits industry to be about Rs36bn. The segment has grown at 7.4% CAGR over the last 5 years. However, growth has been accelerating, with the segment registering 7.7% growth over the last 3-years and 8.6% growth in 2006. We expect growth rates to increase further, driven by rising incomes, increasing rural penetration and change in snacking habits.

Britannia has been able to grow its top line by 15%-20% over last few quarters, driven mainly through new product introductions as well as an improving product mix. It has been able to hold on to its market share, despite entry of ITC. ITC has rapidly increased its market share, which is currently around 5%. However, ITC's gains have mainly been at the expense of Parle.

Figure 3. Market Share Trend of Leading Biscuits Players in India (%)

Company	2001	2002	2003	2004	2005
Britannia Industries Ltd	41.2	43.0	44.0	43.6	43.2
Parle Products Pvt Ltd	38.6	37.8	37.2	36.1	34.6
ITC Ltd	-	-	1.5	2.8	4.8
Surya Food & Agro Pvt Ltd	1.6	1.7	2.0	2.1	2.3
Saj Industries Pvt Ltd	1.5	1.5	2.0	2.1	2.0
Bakeman's Industries Ltd	2.5	1.1	-	-	-
Private Label	1.9	1.8	1.8	1.8	1.8
Others	12.7	13.1	11.5	11.4	11.2
Total	100.0	100.0	100.0	100.0	100.0

Source: Euromonitor

1QFY08 results reflect strong sales growth and margin turnaround for Britannia, trends that we expect will continue over the next few quarters. EBITDA profits in 1QFY08E grew 36.8% yoy, driven by 19.5% net sales growth and 90bps margin expansions. Net profit growth was moderate at 20%, mainly on account of a higher tax rate, which we expect to moderate.

Figure 4. Britannia – 1QFY08 Results Summary (Rupees in Million; Percent)

	1QFY07	1QFY08	% Change
Gross Sales from Operations	5100	5,900.0	15.7
Excise Duty	-272	-131.0	-51.8
Net Sales from Operations	4,828.0	5,769.0	19.5
Total Expenses	-4,502.0	-5,323.0	18.2
EBITDA	326.0	446.0	36.8
<i>EBITDA Margin (%)</i>	<i>6.8%</i>	<i>7.7%</i>	
Interest	-7.0	-5.0	-28.6
Depreciation & Amortisation	-57.0	-69.0	21.1
Other Income	119.0	108.0	-9.2
PBT	381.0	480.0	26.0
Tax	-55.0	-88.0	60.0
<i>Tax Rate (%)</i>	<i>14.4%</i>	<i>18.3%</i>	<i>27.0</i>
Net Profit	326.0	392.0	20.2
<i>PAT Margin (%)</i>	<i>6.8%</i>	<i>6.8%</i>	<i>0.6</i>
Extraordinary items	-23.0	-31.0	34.8
Net Profit After Exceptional	303.0	361.0	19.1

Source: Company Reports

Figure 5. Britannia – 1QFY08 Key Costs (Rupees in Million; Percent)

Key Costs	1QFY07	1QFY08	% Change
Net Sales	4,828.0	5,769.0	19.5
Raw Material Cost	3,033.0	3,552.0	17.1
<i>% of Sales</i>	<i>62.8%</i>	<i>61.6%</i>	
Advertising Cost	303.0	355.0	17.2
<i>% of Sales</i>	<i>6.3%</i>	<i>6.2%</i>	
Staff Cost	166.0	215.0	29.5
<i>% of Sales</i>	<i>3.4%</i>	<i>3.7%</i>	
Other Expenditure	1,000.0	1,201.0	20.1
<i>% of Sales</i>	<i>20.7%</i>	<i>20.8%</i>	

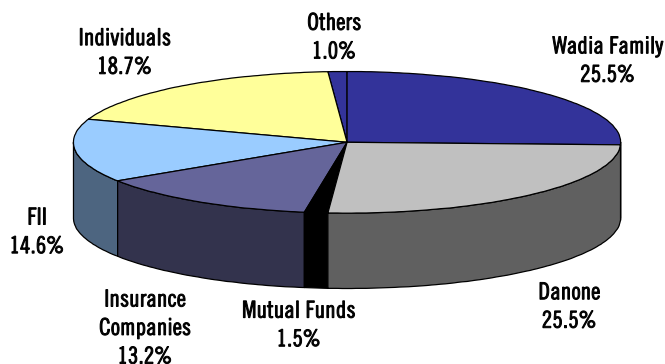
Source: Company Reports

Potential M&A Upside

Danone has sold its global biscuits business (except in Latin America and India) to Kraft for US\$7.2bn in cash. Danone has presence in the biscuits market through its 25.5% share in Britannia. Currently the Wadia family (the other large shareholder) and Danone are involved in a dispute pertaining to Danone's other business interests in India outside Britannia. Now that Danone has exited from the biscuits business globally, we believe its exit from Britannia is imminent. Question is who buys it out? We think one of the following four potential scenarios could play out: (1) Wadias buy out Danone's stake, (2) Kraft buys out Danone, (3) Kraft buys out both Danone and Wadias or (4) A third party trying to pitch for Danone's stake in Britannia. While we believe that there is value in the stock on account of the turnaround in Britannia's margins, there could be

upside from Britannia’s potential stake sale, if carried at a premium, the chances of which are very high given high chances of multiple suitors.

Figure 6. Britannia – Shareholding Pattern



Source: BSE website; company reports

Britannia Industries

Company description

Britannia is a leading player in the bakery business in India. In the biscuit segment, Tiger is its largest brand, and has been a key growth driver. The company has brands that straddle all segments of the biscuit market. It has also launched small packs to drive up volumes. The shift in the bakery segment from branded to unbranded products should benefit Britannia.

Investment thesis

We rate Britannia Buy (1L). At current valuations, the stock looks attractive and free cash yield of 7.4% should provide downside support. While raw material cost pressures have been building up for some time now, we believe commodity prices may be nearing their peak and cost pressures may ease soon. As such, Britannia management is looking to increase the proportion of high-end products, which should improve the overall mix and margin profile. We acknowledge the rising presence of ITC in the bakery segment, but see room for another player, given that a large part of the market is still unbranded. In our view, entry of a new player would help grow the market.

Valuation

At current valuations we rate the Britannia Buy (1L). Our Rs1,825 target price is based on 20x mid-FY09E P/E, at the higher end of its recent trading band. Our

target P/E reflects new top management appointments that should quell corporate governance concerns and ensure strong business growth, as well as recent resurgence in sales growth and margins. We expect a 42% EPS CAGR over FY07-10E. At 20x mid-FY09E P/E, Britannia would trade at a 20% premium to the market average P/E. We use P/E as our base valuation methodology, as Britannia has steady earnings growth. At our target price, the stock would trade at 15x 12-month forward EV/EBITDA, which is at about 20% premium to the average market multiple.

Risks

We rate Britannia Low Risk based on our quantitative risk-rating system, which tracks 260-day share price volatility. The key downside risks that could impede the stock from reaching our target price are: 1) continuation of the inflationary trends in raw-material prices, which could put further pressure on margins; 2) slowing demand resulting in poor top-line growth; 3) and increased competitive intensity, which could restrain pricing power. The key upside risks that could prevent the shares attaining our target are: further pick-up in volume growth on the back of resurgence in rural demand; rationalization of competition allowing for price increases in biscuits especially in the high volume glucose biscuits where prices have not seen increases in the last three years; a potential stake sale by the Wadias to Danone International which along with the Wadias is an equal majority stake holder in Britannia; turn in the agri-commodity price trend which could mitigate raw-material cost pressure.

Appendix A-1

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Britannia Industries (BRIT.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Princy Singh (covered since October 6 2004)



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