UPDATE

MID CAP

Britannia Industries

Upgrade to Outperformer

Price: Rs 412 | **BSE Index: 19,993** | **02 December 2010**

Share Data

Reuters code	BRTA.BO
Bloomberg code	BRIT IN
Market cap. (US$ mn)	1,088
6M avg. daily turnover (US$ mn)	1.2
Issued shares (mn)	119
Target price (Rs)	500

Performance (%)	1M	3M	12M
Absolute	0	0	27
Relative	1	(8)	9

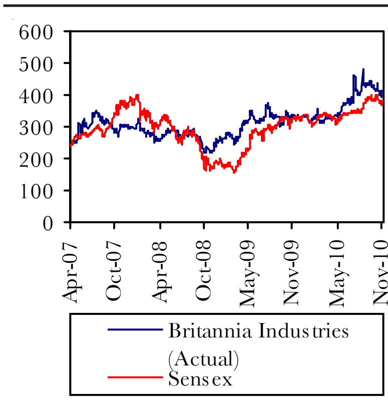
Valuation ratios (Standalone)

Yr to 31 Mar	FY11E	FY12E	FY13E
EPS (Rs)	13.4	24.9	31.3
+/- (%)	(5.1)	86.2	25.9
PER (x)	30.9	16.6	13.2
PBV (x)	10.1	7.7	5.8
Div./Yield (%)	1.2	2.4	2.9
EV/Sales (x)	1.2	1.0	0.8
EV/EBITDA (x)	22.2	12.4	9.9

Major shareholders (%)

Promoters	51
FIIs	9
MFs	10
BFSI's	9
Public & Others	22

Relative performance



Earnings to recover on higher margins and strong volumes

Improved pace of new launches and focus on affordability driving growth

Following a weak FY10, Britannia experienced strong pick up with 20%+ volume growth over the past three quarters. The pace of new launches has increased with the company leveraging the *Tiger* brand in the affordable space and *Nutrichoice* in the premium space. Moreover, higher focus on affordability, with most key brands now available at the low price point of Rs 5, is helping the company gain market share from unorganised players, driving strong volume growth across brands. We believe that Britannia is well placed to deliver robust growth with improved pace of new launches, increased focus on affordability and continued shift from the unorganised to organised segment.

Margin recovery to surprise on lower sugar prices

Despite price increases of 5-15% in key brands and a 30% decline in sugar prices from peak levels, we believe Britannia's margin recovery has been lower due to massive inventory of high-price imported sugar; however, this would likely be fully consumed in 3QFY11, thus, driving sharper recovery in margins from 4QFY11 onwards. Sugar prices are currently firm due to higher international prices. Although we expect them to soften in FY12 on buoyant domestic production, we factor in only a modest decline (Rs 28/kg). A 10% decline in sugar prices increases our earnings forecast by 10%.

Improving performance of other businesses to provide further upside

Other businesses (11% of consolidated turnover) are likely to see strong improvement, led by new launches in dairy, expansion of the Daily Bread retail chain through franchise outlets, and recovery in the Middle East operations. Despite steep input cost inflation, the dairy business has turned around and losses in Daily Bread have reduced significantly. Recovery in the Middle East market and Britannia's decision to exit the Sri Lankan market would reduce losses from international operations (net loss of Rs 350 mn from Sri Lanka and the Middle East), improving overall profitability.

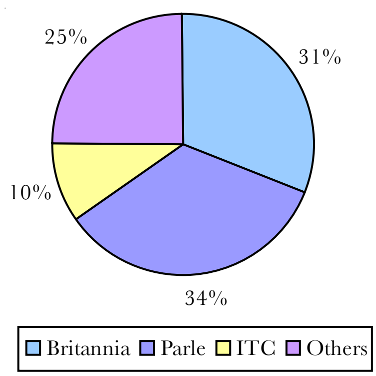
Strong brand equity provides huge opportunity in the foods space

We believe Britannia has not fully leveraged its strong brand equity in the emerging packaged foods space. It has increased focus on new categories and expanded its portfolio to dairy and snacks. However, in our view, the potential to leverage its brand equity and enter newer categories is much higher. Successful entry into newer categories could provide new growth avenues and re-rate the stock.

Earnings growth and valuations appear most attractive among peers

Stronger volume growth visibility and recovery in margins would underpin robust earnings CAGR of 31% during FY10-13E. The stock has underperformed peers over the last one year and valuations appear attractive at 17x FY12E revised earnings. We upgrade our recommendation on Britannia to Outperformer (from Underperformer) with a revised target price of Rs 500, which implies potential upside of 21%. Higher-than-expected decline in sugar prices and stronger earnings contribution from other businesses would provide further upside.

Market share



Source: Industry

Improved pace of new launches and focus on affordability driving growth

Over the past three quarters, Britannia recorded impressive top-line growth of 20%+, largely on strong volume growth. Continued shift from the unorganised to organised segment is aiding strong growth for players such as Britannia, Parle and ITC, which account for close to three-fourth of the biscuits market.

Britannia has renewed its focus on its *Tiger* brand, expanding brand equity to newer segments with the launch of *Tiger Krunch Cookies* at an affordable price point of Rs 5 and *Tiger Zor* chocolate milk. Moreover, introduction of low-unit packs of Rs 5 across its brand portfolio has helped the company gain share from competition and unorganised players. Britannia is also focusing on 'premiumisation' of its portfolio and it has expanded variants under *Nutrichoice* (*Nutrichoice Nature Spice Cracker*, *Ragi* and *Oats Cookies*) at higher price points. We believe Britannia is well placed to achieve robust volume growth in the coming quarters with improved pace of new launches, higher promotional activity, and increased focus on affordability.

Recent new launches

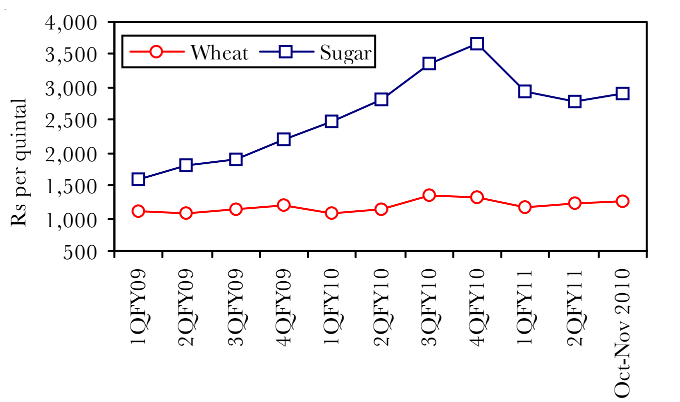
New launches	Price (Rs)	Weight (gms)
Affordable		
Tiger Krunch Cookies Chocochip	5	49
Tiger Krunch Cookies Fruit & Nut	5	55
Britannia Cookies	5	56
Timepass snacks (three flavours)	5 & 10	–
Premium		
Nutrichoice Nature Spice Cracker	25	160
Nutrichoice Ragi Cookies	50	150
Nutrichoice Oats Cookies	50	150

Margins to recover on lower input inflation and price increases

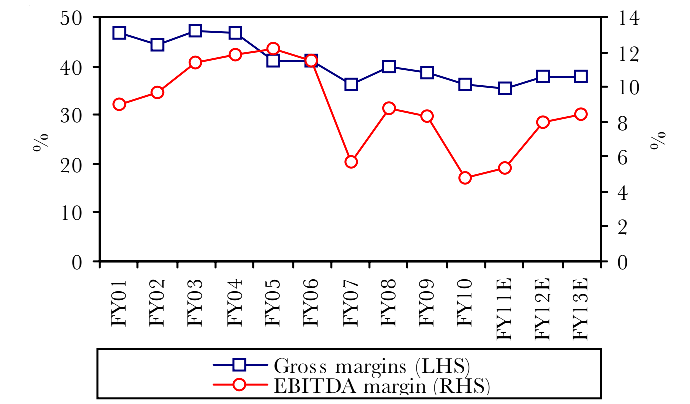
Steep increase of 60% in sugar and 8% in wheat resulted in 350 bps decline in Britannia's margins in FY10 (lowest in the past 10 years). Wheat and sugar account for 17% and 9% of sales, respectively. While wheat prices have stabilised, sugar prices are still 10% higher than in FY10, despite declining ~30% from the peak. Britannia has undertaken price increases of 5-15% in key brands, but we believe that margin recovery has been lower due to huge inventory of imported sugar, which was imported at peak prices in FY10. However, this high-price sugar inventory would be fully consumed in the current quarter; thus, we expect sharper recovery in margins from 4QFY11 onwards. A 10% decline in sugar prices increases our earnings estimate by 10%.

Although domestic sugar production is expected to be buoyant at more than 24 mn tonnes, sugar prices have remained firm due to higher international prices owing to global sugar deficit. We expect sugar prices to soften in FY12 on higher domestic sugar output, but we maintain modest assumptions at Rs 32/kg in FY11 (higher due to high price imported inventory) and Rs 28/kg in FY12. We expect Britannia to see margin recovery over FY12-13, which should drive a strong earnings growth of 86% in FY12 and 26% in FY13.

Trend in sugar and wheat prices



Gross and EBITDA margins to recover



Source: Company, B&K Research

Improving performance of other businesses to provide further upsides

Other businesses (11% of consolidated turnover) are likely to experience strong improvement, led by new launches in dairy, expansion of the Daily Bread retail chain through franchisee outlets, and recovery in the Middle East operations. Despite steep input cost inflation, Britannia's dairy business turned around in FY10, recording 17% sales growth and net profit of Rs 101 mn (excluding exceptional loss of Rs 445 mn). Daily Bread reported 10% decline in revenue, but losses were reduced to Rs 45.5 mn in FY10 from Rs 247 mn in FY09. Addition of new institutional accounts and expansion of the retail chain through the franchise route would further improve the performance of this business. The Sri Lanka and Middle East operations are also likely to see reduced losses (losses of Rs 350 mn as of FY10) due to the company's decision to exit the Sri Lankan market and recovery in the Middle East market.

Performance of other businesses

	Britannia Dairy			Daily Bread			Midde East			Sri Lanka		
(Rs mn)	**FY09**	**FY10**	**YoY (%)**	**FY09**	**FY10**	**YoY (%)**	**FY09**	**FY10**	**YoY (%)**	**FY09**	**FY10**	**YoY (%)**
Revenue	1,620	1,891	16.7	163	149	(8.7)	2,308	2,091	(9.4)	121	134	10.9
EBITDA	89	189	113.9	(111)	(29)	(74.2)	–	–	–	–	–	–
Adjusted PAT	(35)	101	–	(248)	(46)	(81.6)	(338)	(254)	(24.9)	(66)	(92)	39.7

Strong brand equity provides huge opportunity in the foods space

Although the Indian packaged foods market entails strong long-term growth prospects, we believe that Britannia has not leveraged its strong brand equity in other emerging food categories. The company has increased focus on newer categories and expanded its dairy portfolio by launching *Tiger Zor* chocolate milk and Britannia *Actimind*, a milk-based health drink. It also extended its *Timepass* brand to the snacks category and launched three new flavours, which are currently being test-marketed in Bangalore. We, however, believe that the potential to leverage its brand equity is much higher and successful entry into newer categories could provide new growth avenues, driving a re-rating in the stock.

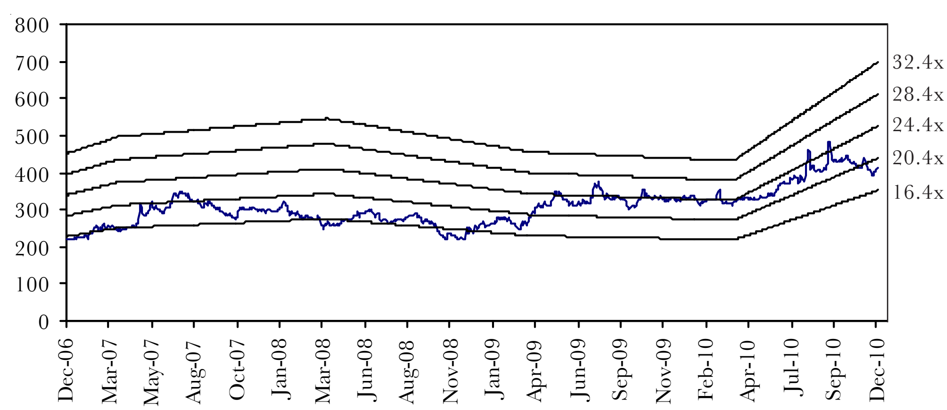
Earnings growth and valuations appear most attractive among peers

With stronger volume growth visibility and recovery in margins, Britannia's earnings growth trajectory would improve; we expect robust earnings CAGR of 31% during FY10-13. The stock has underperformed peers over the last one year and valuations appear attractive at 17x FY12E earnings. Our revised target price of Rs 500 (from Rs 375 earlier), based on 20x standalone FY12E EPS, indicates potential upside of 21% from the current level. We upgrade our recommendation on the stock to Outperformer (from Underperformer). Higher-than-expected decline in sugar prices and stronger earnings contribution from other businesses could provide further upside.

Revised estimates

	FY11E			FY12E		
(Rs mn)	Old	Revised	YoY (%)	Old	Revised	YoY (%)
Net Sales	40,655	42,124	3.6	46,680	50,040	7.2
EBITDA	2,287	2,240	(2.0)	3,135	4,030	28.5
EBITDA margin (%)	5.6	5.3	–	6.7	8.1	–
Adjusted PAT	1,709	1,595	(6.7)	2,424	2,970	22.5
Adjusted EPS (Rs)	14.3	13.4	(6.6)	20.3	24.9	22.5

PER Band



Source: B&K Research

Peer comparison

Company	Price	M.Cap	Adj. EPS (Rs)		EPS CAGR (%)	PER (x)		EV/EBITDA (x)		RoCE (%)		RoE (%)	
(Rs mn)	(Rs)	(Rs mn)	FY11E	FY12E	2010-12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E	FY11E	FY12E
Britannia Industries	412	49,267	13.4	24.9	33.0	30.9	16.6	21.8	11.6	29.2	44.3	36.2	52.6
Nestle India	3,646	351,494	84.4	107.1	21.6	43.2	34.1	28.6	22.5	155.5	162.7	125.3	127.2
Glaxo Consumer	2,255	94,836	71.0	86.3	24.9	31.7	26.1	22.5	17.8	45.0	45.2	29.9	30.0
Dabur India	93	174,682	3.4	4.0	18.5	27.8	23.0	23.2	18.9	56.3	53.8	53.1	48.2
Colgate-Palmolive	885	120,313	32.3	36.9	8.9	27.4	24.0	22.5	19.6	155.1	151.2	124.1	120.2
Godrej Consumer	409	132,478	15.2	18.4	29.1	26.9	22.3	21.2	16.9	29.2	22.4	36.6	31.3
Marico Industries	127	78,133	4.8	5.7	19.4	26.7	22.5	19.8	15.9	31.2	31.9	37.6	33.8

Income Statement (Standalone)

Yr end 31 Mar (Rs mn)	FY10	FY11E	FY12E	FY13E
Net sales	**34,014**	**42,124**	**50,040**	**59,302**
Growth (%)	*9.3*	*23.8*	*18.8*	*18.5*
Operating expenses	(32,392)	(39,883)	(46,010)	(54,275)
Operating profit	1,622	2,240	4,030	5,027
EBITDA	**1,622**	**2,240**	**4,030**	**5,027**
Growth (%)	*(37.2)*	*38.1*	*79.9*	*24.7*
Depreciation	(375)	(408)	(448)	(487)
Other income	532	710	826	914
EBIT	**1,779**	**2,542**	**4,408**	**5,454**
Interest paid	(42)	(373)	(367)	(367)
Pre-tax profit (before non-recurring)	1,736	2,170	4,041	5,087
Non-recurring items	(529)	0	0	0
Pre-tax profit (after non-recurring)	1,208	2,170	4,041	5,087
Tax (current + deferred)	(56)	(575)	(1,071)	(1,348)
Net profit (before Minority Interest, Pref. Dividend, etc.)	1,151	1,595	2,970	3,739
Reported PAT	**1,151**	**1,595**	**2,970**	**3,739**
Adjusted net profit	**1,680**	**1,595**	**2,970**	**3,739**
Growth (%)	*(16.4)*	*(5.1)*	*86.2*	*25.9*

Balance Sheet (Standalone)

Yr end 31 Mar (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and Marketable sec.	3,768	4,648	6,999	9,015
Other current assets	4,977	5,747	6,451	7,591
Investments	1,372	1,200	1,200	1,200
Net fixed assets	2,931	3,207	3,209	3,372
Other non-current assets	66	66	66	66
Total assets	**13,114**	**14,868**	**17,924**	**21,245**
Current liabilities	4,855	5,712	7,191	8,444
Total debt	4,296	4,296	4,296	4,296
Total liabilities	**9,151**	**10,008**	**11,487**	**12,740**
Share capital	239	239	239	239
Reserves & surplus	3,724	4,621	6,199	8,266
Less: Misc. expenditure	(0)	(0)	(0)	(0)
Shareholders' funds	**3,963**	**4,860**	**6,437**	**8,505**
Total equity & liab.	**13,114**	**14,868**	**17,925**	**21,245**
Capital employed	**8,258**	**9,156**	**10,733**	**12,801**

Cash Flow Statement (Standalone)

Yr end 31 Mar (Rs mn)	FY10	FY11E	FY12E	FY13E
Pre-tax profit	1,208	2,170	4,041	5,087
Depreciation	375	408	448	487
Change in working capital	731	87	775	112
Total tax paid	(222)	(575)	(1,071)	(1,348)
Cash flow from oper. (a)	**2,093**	**2,089**	**4,194**	**4,338**
Capital expenditure	(419)	(684)	(450)	(650)
Change in investments	(675)	(181)	(972)	(1,215)
Others	218	(0)	(0)	(0)
Cash flow from inv. (b)	**(877)**	**(865)**	**(1,422)**	**(1,865)**
Free cash flow (a+b)	**1,215**	**1,224**	**2,772**	**2,473**
Debt raised/(repaid)	4,045	0	0	0
Dividend (incl. tax)	(696)	(696)	(1,393)	(1,671)
Others	(4,738)	(1)	0	0
Cash flow from fin. (c)	**(1,390)**	**(697)**	**(1,393)**	**(1,671)**
Net chg in cash (a+b+c)	**(175)**	**527**	**1,379**	**802**

Key Ratios (Standalone)

Yr end 31 Mar (%)	FY10	FY11E	FY12E	FY13E
Adjusted EPS (Rs)	14.1	13.4	24.9	31.3
Growth	(16.4)	(5.1)	86.2	25.9
Book NAV/share (Rs)	33.2	40.7	53.9	71.2
Dividend/share (Rs)	5.0	5.0	10.0	12.0
Dividend payout ratio	41.5	43.7	46.9	44.7
Tax	4.7	26.5	26.5	26.5
EBITDA margin	4.8	5.3	8.1	8.5
EBIT margin	5.2	6.0	8.8	9.2
RoCE	21.3	29.2	44.3	46.3
Net debt/Equity	13.3	(7.2)	(42.0)	(55.5)

Valuations (Standalone)

Yr end 31 Mar (x)	FY10	FY11E	FY12E	FY13E
PER	29.3	30.9	16.6	13.2
PCE	24.0	24.6	14.4	11.7
Price/Book	12.4	10.1	7.7	5.8
Yield (%)	1.2	1.2	2.4	2.9
EV/Net sales	1.5	1.2	1.0	0.8
EV/EBITDA	30.7	22.2	12.4	9.9

Du Pont Analysis – ROE (Standalone)

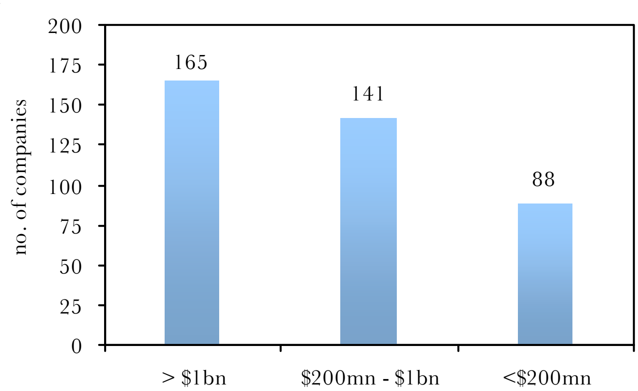
Yr end 31 Mar (x)	FY10	FY11E	FY12E	FY13E
Net margin (%)	4.9	3.8	5.9	6.3
Asset turnover	2.6	3.0	3.1	3.0
Leverage factor	2.2	3.2	2.9	2.6
Return on equity (%)	28.1	36.2	52.6	50.0

Ashit Desai
ashit.desai@bksec.com
+91-22-4031 7132

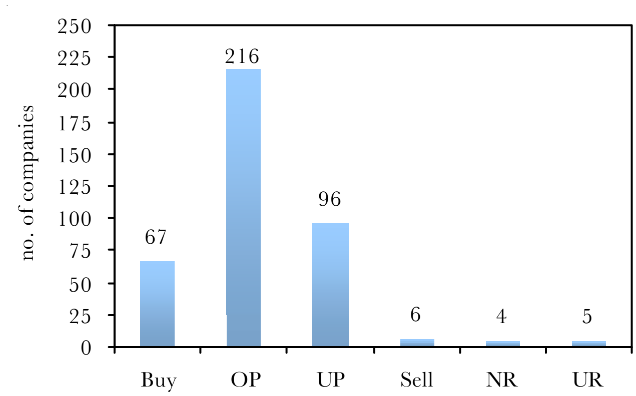
Analyst Declaration: I, Ashit Desai, hereby certify that the views expressed in this report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Universe Profile

By Market Cap (US$ mn)



By Recommendation



B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

B & K SECURITIES INDIA PRIVATE LTD.

Equity Research Division: City Ice Bldg., 298, Ground/1st Floor, Perin Nariman Street, Behind RBI, Fort, Mumbai - 400 001, India. Tel.: 91-22-4031 7000, Fax: 91-22-2263 5020/30.

Registered Office: Room No. 3/4, 7 Lyons Range, Kolkata - 700 001. Tel.: 91-33-2243 7902.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.