INDIAN EQUITIES

ESPIRITO SANTO Securities

Incorporating Execution Noble

Management meeting | Consumer | 12th Sep 2011

Jubilant Foodworks

Growth with a corresponding price tag

We met Jubilant's management, whose bullish tone we attribute to a) robust same store sales (SSS) growth, b) new stores roll-out and c) extension into the Dunkin' Donuts brand. Management's target is 700 Domino's and 500 Dunkin' Donuts sites, venturing into all-day meals with the latter brand. With money to fund future growth, this is a rare scalable, dual brand roll-out. Key risks are macroeconomic environment, store roll-out execution risk, high attrition rates and high valuation.

The road to 700 stores

We recently met Ravi Shanker Gupta, Jubilant FoodWorks CFO in Delhi, keen to hear from India's best performing stock this year, now trading at 45.5x 12-month consensus EPS estimates. Management certainly appeared to us to strike a confident tone. While robust SSS growth (average 20% in last 6 years; 37% in FY11) continues, the company is on track to roll out 80 new stores of *Domino's Pizza* in FY12, implying 458 at year end. There is no debt on the balance sheet and the company has sufficient internal accruals to fund capex. Jubilant also owns the franchise for Sri Lanka, Nepal and Bangladesh. It is opening a couple of sites in Sri Lanka, with a target of ~20-25 stores in the next 5 years. It aims to enter Bangladesh in FY13 through partnership. It is assuming the store potential for India is 700 stores – our experience of covering Domino's in the UK suggests this number will drift up, as fewer households are required per delivery area (currently 20,000). Low penetration (only 3,000 outlets of organized quick service restaurants, QSRs), frequency (~50% of Domino's consumers order pizza once a year, average consumption only 4 times a year) and per capita consumption (average monthly spend on outside food is just INR 671 in Tier I towns) offer room for further growth.

More than donuts & coffee; all day meals planned

With ~15 years of experience in the QSR (quick service restaurant) business, management is confident of extending its experience to other meal formats. The intention is to extend *Dunkin' Donuts* beyond the coffee and donuts to an all day menu and vary store size from 100-2,000 sq ft. The plan is for ~80-100 stores in first 5 years, with a commitment to take it to 500 stores within 15 years. Synergies should come from Domino's Administration team, Information Technology and supply chain for the new business of *Dunkin' Donuts*. The real estate cost of a successful restaurant site will be very different to the delivery model.

First mover advantage; highly scalable model

While other QSRs (Nirula's, Haldiram's, Subway, KFC and Pizza Hut) are still struggling to get the model right, low penetration of QSRs in India and absence of a strong national competitor should ensure uninterrupted expansion. 10 years of media investment has ensured strong brand recognition of *Domino's Pizza,* which, in turn, is resulting in strong pricing power and mass acceptance. With another strong brand, *Dunkin' Donuts* in the portfolio, Jubilant represents a compelling roll-out story.

Key risks

~45% of Jubilant's sales are from Delhi, Mumbai and Bengaluru. Concerns on the macroeconomic environment could result in a drop in SSS growth and downward revision of expansion plans. 6% growth was the worst performance in the last downturn (full year FY09). ~14,000+ employees are on company payroll and attrition rate (~7-8% per month) is high, a risk to margins and brand equity. The ESOP policy covers only 80-90 employees in the company. Jubilant is doing the new store roll-out itself (vs. sub-franchise model in US); hence is taking all the marketing, execution and competitive risk, to focus on quality control.

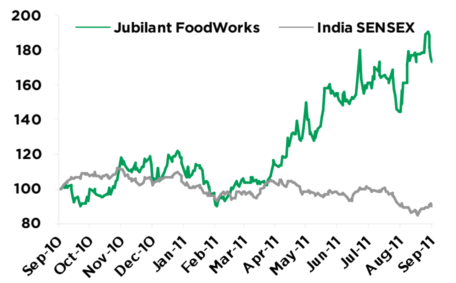
Valuation

In our recent report "*India – a port in a global storm*", we highlighted that overall domestic demand remains strong, driven by robust services growth, rising incomes and higher middle class aspirations. India remains overwhelmingly exposed to the domestic economy and Jubilant's expansion into Tier II and Tier III should hedge it from any global slowdown. Negative working capital and balance sheet prudence makes any comparison to Retailers of 2008 unwarranted. But all this good news comes at a price: Jubilant Foodworks is currently trading at P/E of 45.5x on 12-month consensus EPS estimates. *We do not cover or have a rating on Jubilant Foodworks.*

Not Rated

Fair Value (Rs)	NR
Bloomberg Code	JUBI IN
Share Price (Rs)	914
Market Cap (Rs bn /US$ bn)	59/1.27
Free Float / FII holding	45%/33.4%
ADV (Rs bn/ $mn)	1.49/$32m

Fig 1: Historical share price performance



Source: Factset, Espirito Santo Securities

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Analyst

Nitin Mathur
+91 22 4315 6821
nitin.mathur@execution-noble.com

Sales

Ashish Goenka
+44 20 3429 2012
ashish.goenka@execution-noble.com

Arijay Prasad
+91 22 4315 6841
arijay.prasad@execution-noble.com

Poorva Upadhyaya
+1 212 351 6056
pupadhyaya@esinvestment.com

Sunny Shah
+91 22 4315 6842
sunny.shah@execution-noble.com

Margins expansion feasible; though growth is a priority

Our takeaway from the overseas operations is that it becomes increasing difficult for just one franchisee to be able to tap into local trends across geographies and so execution errors increase with scale (this happened with Domino's US). Hence the master franchisee typically finds it better to sub franchise with strong local players (done very successfully in the UK). This implies a royalty share, but may lower the risk profile. Management's judgement so far has been that maintaining consistent quality in India is very challenging, and hence they have chosen to not sub-franchise out, instead wanting to control quality and therefore protect the brand.

General and Administrative expenses are ~13% of net sales, while A&P is ~3.6% of sales. Management believes that there is potential for margin progression as more stores are opened and operating leverage kicks in. **The key will be executing on expansion plans.**

Inflation in rents (~7.5% of sales), Cheese (~8% of sales) and wages (~17.5% of sales) are risks to current margins in the high teens. Though the brand Domino's has the pricing power to offset input cost inflation, this only goes so far, and the company has to address the issue of high attrition and training costs to ensure sustainably high margins.

Don't be too quick to dismiss the high valuation

QSR is a complex business in India as expertise in real estate and supply chain is an imperative, in addition to knowledge of the Indian palate, which varies from region to region. Jubilant Foodworks has been in existence for the last 15 years and it took some time to get the model right (it made mistakes in 2000-2001 and ended up scaling back). The combination of global expertise (for a 3% franchise fee Domino's International brings immense value in logistics, brand, menu, technology etc), and 15 years of local market knowledge is a powerful one. India QSR penetration is at a nascent stage with most of the competitors (Nirula's, Haldiram's, Subway, KFC and Pizza Hut) still struggling to get the model right.

Jubilant Foodworks is currently trading at P/E of 45.5x on 12-month consensus EPS estimates. This probably means happy existing shareholders, and wary potential ones. We don't cover it, so won't take a position on valuation, but would highlight that;

a) It is not unusual for companies with a dual brand rollout opportunity, strong brand equity, clean balance sheet, negative working capital and good corporate governance to trade at high multiples. Market scepticism often fails to derail the high growth trajectory story, as seen by continued high multiples of most consumer companies in India.

b) In categories with low penetration, de-rating risks are less given low risk of disruptive competition. Nestle did not de-rate despite the entry of GSK Consumer and ITC in noodles, which is Nestle's core category. We further note that noise created by new entrants helped increase the market size.

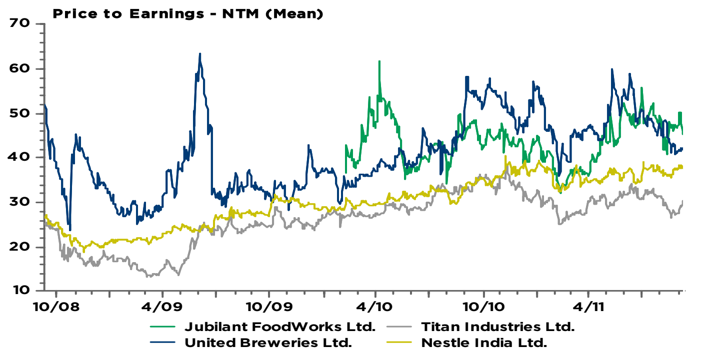
"Instant noodles market is set to grow from INR 13 bn at present to at least INR 30-35 bn by 2015 and therefore all the big FMCG players have their eyes set on it"
- Devendra Chawla, Business Head for private brands at the Future Group

c) As the company grows in size, bargaining power with business partners will increase (cost of cheese, packaging & chicken for example represents 16-17% of sales) and company will have more negative working capital.

d) Due to low visibility, consensus is still not factoring in numbers from the rollout of Dunkin' Donuts, which leaves room for earnings surprises.

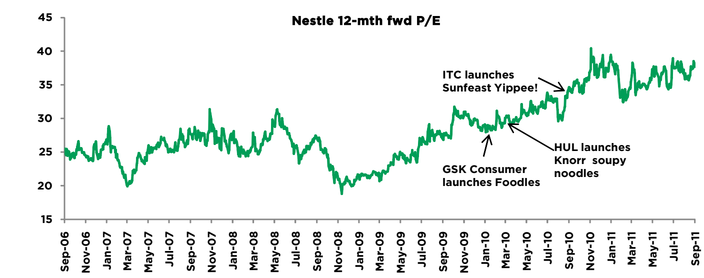
For what it's worth, our experience of covering Domino's in the UK is that it has been on a perennial upgrade cycle, sustaining a "high" valuation for several years; though admittedly this was not 45.5x earnings.

Figure 2: High multiples not unusual for companies in high growth period



Source: Factset, Espirito Santo Securities

Figure 3: No de-rating following entry of competition



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Jubilant Foodworks

Recommendation:	**Not Rated**
Share Price:	INR 914
3 Month ADV ($m)	32
Free Float	45.0%
52 Week High / Low	INR 461 - 1,021
Bloomberg:	JUBI IN
Model Published On:	12 September 2011

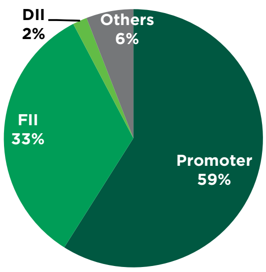
Shares In Issue (mm)	65
Market Cap (mn)	**59,796**
Net Debt (mn)	(90)
Enterprise Value (mn)	**59,706**

Forthcoming Catalysts

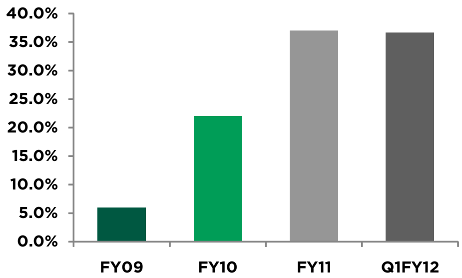
Q2FY12 results	October-11
Q3FY12 results	January-12

Espirito Santo Securities Research Analyst
Nitin Mathur
(91) 22 4315 6821
nitin.mathur@execution-noble.com

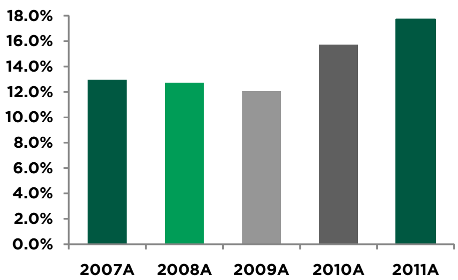
Shareholding Pattern



Same store sales (SSS) growth trend



EBITDA margin trend



Valuation Metrics	**2007A**	**2008A**	**2009A**	**2010A**	**2011A**
P/E	844.9	625.9	721.5	167.0	83.4
Reported P/E	952.7	685.3	729.7	169.2	83.4
EV / Sales	43.0	28.3	21.3	14.1	8.8
EV / EBITDA	331.7	222.0	176.6	89.6	49.8
EV / EBIT	597.1	403.4	353.3	141.1	65.9
FCF Yield	-0.1%	-0.1%	-0.2%	0.6%	0.9%
Dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%

Key ratios	**2007A**	**2008A**	**2009A**	**2010A**	**2011A**
EBITDA margin	13.0%	12.7%	12.0%	15.7%	17.7%
EBIT margin	7.2%	7.0%	6.0%	10.0%	13.4%
Capex / Revenue	17.6%	20.5%	19.3%	12.3%	10.6%
Capex / Depreciation	3.05	3.57	3.20	2.14	2.45
Net Debt / EBITDA	1.7	1.8	2.4	0.0	-0.1
EBITDA / Net Interest	5.3	4.6	3.8	7.3	350.5
ROE	67%	64%	37%	47%	46%

P&L Summary	**2007A**	**2008A**	**2009A**	**2010A**	**2011A**
Revenue	**1,387**	**2,112**	**2,808**	**4,239**	**6,781**
% change		52.3%	33.0%	51.0%	60.0%
EBITDA	**180**	**269**	**338**	**666**	**1,199**
% change		49.4%	25.7%	97.0%	80.0%
% margin	13.0%	12.7%	12.0%	15.7%	17.7%
Depreciation & Amortisation	-80	-121	-169	-243	-293
EBIT	**100**	**148**	**169**	**423**	**906**
% change		48.0%	14.2%	150.3%	114.2%
% margin	7.2%	7.0%	6.0%	10.0%	13.4%
Associates	0	0	0	0	0
Operating Profit	**100**	**148**	**169**	**423**	**906**
Interest Expenses	-34	-58	-89	-91	-3
Other Income	1	2	2	4	19
Pre Tax Profit	**67**	**92**	**82**	**331**	**922**
Income Tax Expense	-4	-7	-8	-1	-204
Minority Interests	0	0	0	0	0
Reported Net Income	**56**	**78**	**73**	**330**	**717**
ES Net Income	63	85	74	334	717
Reported EPS	1.0	1.3	1.3	5.4	11.0
ES EPS	**1.1**	**1.5**	**1.3**	**5.5**	**11.0**
DPS	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Payout Ratio	0.0%	0.0%	0.0%	0.0%	0.0%
Shares In Issue (Less Treasury)	58	58	58	61	65

Cash Flow Summary	**2007A**	**2008A**	**2009A**	**2010A**	**2011A**
EBITDA	180	269	338	666	1,199
Taxes Paid	-4	-7	-8	-1	-204
Interest Paid / Received	-33	-56	-87	-88	16
Change in Working Capital	-20	-68	12	-137	-263
Other Operating Cash Flow	57	176	64	329	540
Operating cash flow	**180**	**314**	**319**	**769**	**1,288**
Capital Expenditure	-244	-432	-541	-521	-718
Free Cash Flow	**-65**	**-119**	**-222**	**249**	**569**
Equity Raised / Bought Back	0	0	0	605	22
Other Financing Cash Flow	88	103	231	-817	-570
Net Cash Flow	**23**	**-15**	**9**	**37**	**22**

Balance Sheet Summary	**2007A**	**2008A**	**2009A**	**2010A**	**2011A**
Cash & Equivalents	37	22	30	70	90
Tangible Fixed Assets	451	723	1,155	1,429	1,845
Investment in Equity Investee	0	0	0	0	205
Other Assets	153	274	299	462	924
Total Assets	**641**	**1,019**	**1,484**	**1,961**	**3,064**
Interest Bearing Debt	342	513	824	86	0
Other Liabilities	215	345	431	702	1,150
Total Liabilities	**558**	**858**	**1,255**	**787**	**1,150**
Shareholders' Equity	83	161	228	1,174	1,914
Minority Interests	0	0	0	0	0
Total Equity	**83**	**161**	**228**	**1,174**	**1,914**
Net Debt/ (Cash)	305	491	794	16	-90

Source: Company data

Contact details

Nick Paulson-Ellis, Country Head, India

t. +91 22 4315 6814 e: nick.paulson-ellis@execution-noble.com

Sales

Ashish Goenka	t: +44 20 3429 2012;	e: ashish.goenka@execution-noble.com
Poorva Upadhyaya	t: +1 212 351 6056;	e: pupadhyaya@esinvestment.com
Arijay Prasad	t: +91 22 4315 6841;	e: arijay.prasad@execution-noble.com
Sunny Shah	t: +91 22 4315 6842;	e: sunny.shah@execution-noble.com

Sector leads

Banks and financial institutions:

Santosh SIngh	t +91 22 4315 6822;	e santosh.singh@execution-noble.com
Saikiran Pulavarthi	t +91 22 4315 6824;	e: saikiran.pulavarthi@execution-noble.com
Sri Karthik	t +91 22 4315 6826;	e: sri.karthik@execution-noble.com
Nidhesh Jain	t +91 22 4315 6823;	e: nidhesh.jain @execution-noble.com

Economy

Deepali Bhargava	t +91 22 4315 6827;	e: deepali.bhargava@execution-noble.com

Consumer

Nitin Mathur	t +91 22 4315 6821;	e: nitin.mathur@execution-noble.com

Healthcare

Chirag Talati	t +91 22 4315 6828;	e: chirag.talati@ execution-noble.com

Metals and Mining

Ritesh Shah	t: +91 22 4315 6831;	e: ritesh.shah@execution-noble.com

Power and Infrastructure

Krishnakant Thakur	t: +91 22 4315 6832;	e: krishnakant.thakur@execution.noble.com
Pawan Parakh	t: +91 22 4315 6833;	e: pawan.parakh@execution-noble.com

Strategy

Aditya Jhawar	t +91 22 4315 6819;	e: aditya.jhawar@execution-noble.com
Nitesh Sharma	t +91 22 4315 6820;	e: nitesh.sharma@execution-noble.com

Technology:

Soumitra Chatterjee	t +9122 4315 6829	e: soumitra.chatterjee@execution-noble.com

1203 A, Tower 2A,
One Indiabulls Centre,
Elphinstone Road,
Mumbai – 400076
t: +91 22 4315 6800
e:research.india@execution-noble.com

10, Paternoster Square
London EC4M 7AL
U.K
t: + 44 20 7246 0180
t: + 44 20 7246 0190

340 Madison Avenue, 12th Floor
New York NY-10173
U.S.A
t: +1 212 351 6000
t: +1 212 351 6099

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NEUTRAL	Analyst expects upside/downside potential of between +10% and -10% to fair value, which should be realized in the next 12 months.
SELL	Analyst expects at least 10% downside potential to fair value, which should be realized in the next 12 months
SHORT TERM RATING	**DEFINITION**
ST POSITIVE	Analyst expects the stock price to appreciate in value within 3 months of the rating assignation because of a specifically identified catalyst(s) or event(s)
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SELL	67	17,7%	0	0,0%	0,0%
TOTAL	**379**	**100%**	**40**	**100%**	

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Recommendation	Count	% of Total	Count	% of IBC	% of Total
SHORT TERM POSITIVE	0	0%	0	0%	0%
SHORT TERM NEGATIVE	0	0%	0	0%	0%
TOTAL	**0**	**0%**	**0**	**0%**	

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Contact Information:

Garreth Hodgson	Senior Managing Director /Head of Sales	(212) 351-6054	ghodgson@esinvestment.com
Eva Gendell	Vice President	(212) 351-6058	egendell@esinvestment.com
Joseph Mcglone	Vice President	(212) 351-6061	jmcglone@esinvestment.com
Joy Bejasa	Vice President	(212) 351-6055	jbejasa@esinvestment.com
Lisa Gottardo	Executive Director	(212) 351-6060	lgottardo@esinvestment.com
Mike Maione	Executive Director	(212) 351-6067	mmaione@esinvestment.com
MikeWilliams	Vice President	(212) 351-6052	mwilliams@esinvestment.com
Pedro Marques	Vice President	(212) 351-6051	pmarques@esinvestment.com
Poorva Upadhyaya	Assistant Vice President	(212) 351-6056	pupadhyaya@esinvestment.com

E.S. Financial Services, Inc.
New York Branch
340 Madison Avenue, 12th Floor
New York, N.Y. 10173

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