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Institutional Equities

INDIAN FOOD SECTOR

LIVE TO EAT

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Indian Food Sector

13 March 2018

Initiating Coverage

LIVE TO EAT

The Indian food scene has exploded in the past few years spurred by vast changes in consumer preferences along with equally innovative product and service offerings by companies. Digitisation and social media have played a key role in improving the risk-taking appetite towards innovative food formats. Consumers have also become increasingly mindful of their choices and are willing to pay a premium for more tasty and healthy alternatives. On account of macro factors similar to a lot of other consumption categories, the food sector also witnessed a slowdown in the past three years (FY15-FY18). Food companies, however, kept pace with changes in preferences and lifestyle and are now poised to deliver much higher growth in FY19-FY20. We initiate coverage on the Indian Food sector with a positive view and our top investment recommendations from the sector are Britannia Industries and Nestle India.

Innovation tailwind to bring mojo back to the sector: Snack-sized miniature produce which packs it all will be the fastest growing sub-category within the processed food space. Local and regional flavours and ingredients will also trend above those from overseas. Finally, modern trade which plays the key role of an enabler, continues to grow at a healthy rate of 20%-40%, higher than traditional trade. In our opinion, the higher pace of innovation and acceptance could well lift growth rate for the sector by about 2%-3% in FY19-FY20.

Consumers willing to pay more for Le'SSS': Considering health challenges and lifestyle preferences, most consumers will continue to gravitate towards foods which are less in Sugar, Salt and Saturated Fats. As these areas also offer a significant premiumisation opportunity, we expect innovation and renovation in these areas from most leading food companies witnessing a further acceleration.

Regulation standards have become fairly progressive: Regulator FSSAI and other government bodies are now playing a fairly more supportive role considering that overall value addition in the food sector is still fairly low at 10%-15%, and it is one of the largest employers in India ranking and third in terms of output.

Improved product mix and moderate input price inflation to aid continuous margin expansion: Despite challenges, most food companies managed to hold and/or improve margins in the past three years. Support by way of continued improvement in product mix and somewhat moderate input price inflation will lead to continued gains in the range of 100bps-300bps for most companies in FY19-FY20.

Consolidation has improved attractiveness of valuations: After a fair degree of outperformance in 2017, most food companies have been consolidating in the past six months. As the improved growth trajectory is still not fully priced in, we recommend Buy rating for Britannia Industries and Nestle India and Accumulate rating for GlaxoSmithKline Consumer Healthcare and ITC.

View: Positive

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Company	Rating	Market cap.		CMP	Target	Up/	EPS (Rs)			P/E (x)			*RoE (%)*		
		Rsbn	US$bn	(Rs)	price (Rs)	down (%)	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	*FY18E*	*FY19E*	*FY20E*
Nestle India*	Buy	734.6	11.3	7,619	9,400	23	126.5	155.9	188.0	60.2	48.9	40.5	*37.4*	*42.7*	*46.7*
Britannia	Buy	584.3	8.9	4,867	5850	20	82.4	104.1	130.2	59.1	46.8	37.4	*32.5*	*32.3*	*31.7*
ITC	Acc	3,295.0	50.7	270	290	7	8.8	10.0	11.0	30.5	27.0	24.6	*22.9*	*24.1*	*24.4*
GSK Consumer	Acc	287.5	4.4	6,837	7,300	7	161.2	179.1	209.1	42.4	38.2	32.7	*22.5*	*24.2*	*24.8*

**Nestle India follows calendar year hence figures mentioned above are pertaining to the period CY17-CY19E.*

Source: Nirmal Bang Institutional Equities Research

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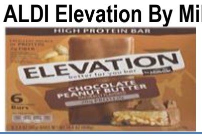
"The secret of success in life is to eat what you like and let the food fight it out inside." Mark Twain

Mindful and Instagrammable

Global consumers are most conscious than ever about their food choice and increasingly are focused on natural and sustainable products. They want to know what is in their food and how it is produced and not satisfied by just the manufacturer's claims. 'Instagrammable' food is the other mega trend influencing the sector, especially where millennials are concerned. Social media has played a huge part in the launch of foods with bright and vibrant colours which connect to health and wellness. Some of the other mega trends, according to leading food consultants such as Innova influencing the global food sector are:

1. Celebrating heritage – Move over authentic and ethnic. The new culinary buzz is clearly heritage with focus on people who bring culinary traditions to life and personal stories that define our food.
2. Feel good treats – Nutrient dense indulgences are driving the healthy trend with next generation snacks which include fortified ice-creams, vegetable desserts, mood-enhancing ingredients, protein-packed chips, fresh produce and more.
3. Snacks to mini-meals – Busy lifestyles means that meal occasions are increasingly becoming irrelevant and people are constantly seeking quick, convenient and healthy solutions. Also, lightness in terms of sweetness, flavour, texture and portion size is increasing the appeal constantly.
4. Eat and drink to your wellness – From breakfast boost, snacking soups and end-of-day sips, everything is being re-imagined with flavours and plant profiles such as mint, ginger, cucumber, turmeric, cardamom and honey. They help awaken, stay energised, rebalance and importantly, give enjoyment.
5. Limited edition innovation – Playful twist on classic products, retro releases and seasonal themes are feeding a growing appetite for exclusive flavour experiences and meaningful insta-friendly moments with food.

Exhibit 1: Products of the year

Product	Name of the company	Description
Duncan Hines Perfect Size no 1 	Pinnacle Foods	These mug cakes have no added artificial preservatives or artificial flavours, and the breakfast varieties have 18gm of whole grains. And there's no cleanup needed!
Skinny Cow High Protein Low Fat Ice cream 	Nestle	For over 20 years, Skinny Cow has been redefining indulgence, pioneering the idea that you don't have to sacrifice the things you love to feel good about what you eat.
Toffifay 	Storck USA L.P.	Toffifay® is a bite-sized treat sure to bring a little excitement and satisfaction to your every day! Toffifay® is made up of a chewy caramel cup, a whole roasted hazelnut, chocolate hazelnut cream, and a drop of smooth chocolate.
Oreo Chocolate Candy Bar 	Mondelez International	Introducing new OREO Chocolate Candy Bars — It is the only chocolate candy filled with real OREO cookies and cream. Experience a delectable combination of rich, creamy, melt-in-your-mouth chocolate on the outside, combined with delicious, crunchy real OREO cookie pieces and smooth cream on the inside — to give you a delicious & fun experience that is uniquely OREO.
Pure Protein Super Food 	The Nature's Bounty Co.	Each serving contains 140-160 calories, 3gm-5gm of sugar, and 20gm of 100% plant-based complete protein providing all essential amino acids for lean muscle and strength. The delicious non-GMO formula contains naturally sourced super greens, no soy or dairy, and is free of artificial flavours, colours, and sweeteners to keep your active life on track.
Sandwich Bros. Breakfast Sandwiches 	Sandwich Bros of Wisconsin	The Sandwich Bros. believe in the goodness of real, simple ingredients and partner with local Wisconsin companies to handcraft really…really tasty protein-packed sandwiches. Perfectly portioned, only 150 calories and hot and ready in less than a minute.
ALDI Elevation By Millville High Protein Bars 	ALDI Inc.	ALDI-exclusive Elevation by Millville High Protein Bars live up to their name by containing 20 grams of protein and 13 vitamins and minerals in each bar! Elevation by Millville High Protein Bars come in Mint Chocolate and Chocolate Peanut Butter flavours.

Imagine Super Soups 	Hain Celestial	Imagine's Super Soups focus on power-packed ingredients like organic farm-fresh broccoli, spinach, and green peas simmered in coconut cream with a splash of ginger and farm-fresh beets, sweet potatoes, and hearty red lentils with a splash of pomegranate juice to provide a good source of fibre and Vitamin A. This powerhouse combo of beans, vegetables and body-boosting plants delivers good nutrition in a delicious, creamy soup.
Cooked Perfect Fire Grilled Chicken 	Home Market Foods	Cooked Perfect Fire Grilled Chicken is heating up the freezer aisle with unique fire grilled flavours. Each piece of chicken is grilled over an open fire to produce juicy, tender, perfectly seasoned and mouth-wateringly delicious chicken. Cooked Perfect Fire Grilled Chicken's broad range of chicken tenders, wings, thighs and chunks offers convenience and simple versatility that makes it a great for many situations - as an appetizing entrée, a protein-packed plus-up to salad, a game day snack and more.
Green Giants Veggie Tots 	B&G Foods	Green Giant® Veggie Tots are the family-friendly way to add an additional serving of vegetables to a meal. They're filled with veggies, making them the perfect replacement for potato tots and fries.

Source: Nielsen USA

Innovation and premiumisation witnessed a fillip on account of health and digitisation in India

Food has taken a dominant part in Indian consumer's spending and currently stands at overall level of about 50%. In the past, per capita spending witnessed an average growth of 10% and we expect this pace to be maintained. There has been an increased shift from cereals/staples to processed foods and fruits and vegetables and we expect this trend to continue. Now, we expect processed food to even gain from fresh fruit and vegetable segments.

Similar to global trends, there are several mega trends that continue to influence the growth of the industry in India but clearly the mega trends of health and digitisation stand out as among the most powerful trends driving acceleration towards innovative and premium products. The risk-taking appetite of consumers on account of these trends and enablers has gone up manifold. Most shopping baskets starting with cereals/staples itself have witnessed significant changes such as multigrains and organic. Organic along with ayurveda/natural foods has been among the fast-growing category within the food segment.

Exhibit 2: Monthly per capita expenditure of food in India

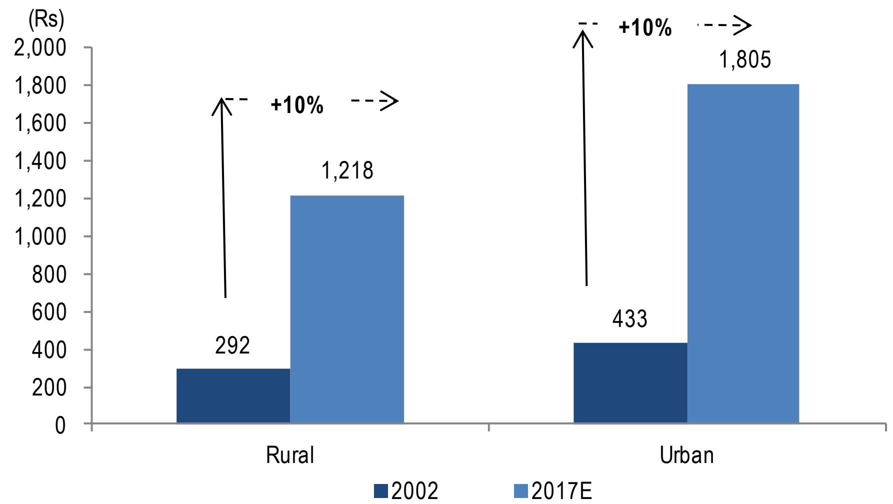
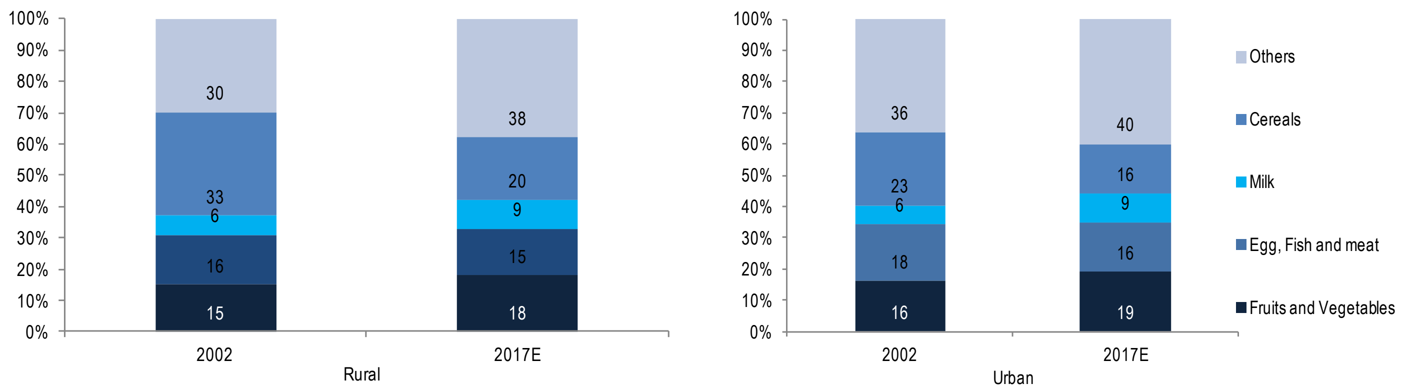
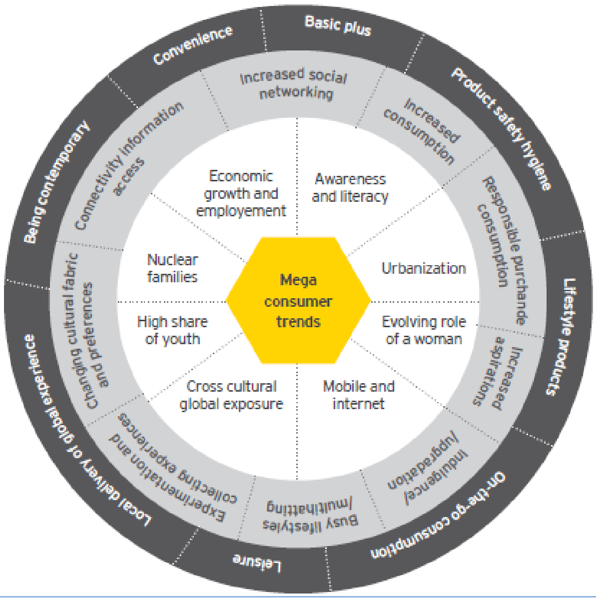


Exhibit 3: Share of food expenditure in India



Source: MOFPI Report

Exhibit 4: Mega consumer trends



Source: MOFPI Report

Food industry still characterised by low value addition and remains a key priority for the government

Food processing industry is the top employer in the country and ranks third in terms of overall output. Considering the fact that there is scope to increase overall value addition in the sector fairly significantly, which currently averages around 11%, we expect the government to continue playing an important enabler role. The government already has accorded the sector a priority status and this has resulted in decline of interest costs for micro, small and medium enterprises or MSMEs which currently dominate the sector. It has also been engaged in supporting the scheme of mega food parks, and research and development efforts to reduce wastage and support higher value addition.

Exhibit 5: GVA contribution from food processing sector

Items	Total output	GVA	GVA%	EMP per mn
Manufacture of vegetable and animal oils and fats	15,70,012	70,147	*4.68*	76.6
Processing and preserving of fish, crustaceans and molluscs and products thereof	2,70,613	19,318	*7.69*	179.6
Manufacture of grain mill products	17,57,462	1,39,410	*8.62*	165.2
Manufacture of dairy products	11,06,562	1,00,684	*10.01*	120.9
Manufacture of prepared animal feeds	3,71,662	35,343	*10.51*	109.4
Manufacture of sugar	8,58,839	88,801	*11.53*	51.9
Processing and preserving of meat	2,75,197	29,068	*11.81*	111.4
Manufacture of other food products N.E.C.	8,62,715	1,01,352	*13.31*	243.2
Manufacture of starches and starch products	1,03,363	13,292	*14.76*	63.4
Manufacture of cocoa, chocolate and sugar	1,47,502	27,725	*23.15*	64.1
Manufacture of wines	29,471	5,913	*25.1*	106.5
Manufacture of macaroni, noodles, couscous and similar farinaceous products	39,733	8,248	*26.2*	66.5
Processing and preserving of fruits and vegetables	1,38,930	30,146	*27.71*	88.8
Distilling, rectifying and blending of spirits; ethyl alcohol production from fermented materials	2,48,539	54,743	*28.25*	53.8
Manufacture of bakery products	2,04,837	45,183	*28.3*	194.5
Manufacture of prepared meals and dishes	27,647	6,662	*31.75*	194.6
Manufacture of soft drinks; production of mineral waters and other bottled waters	2,15,482	52,311	*32.06*	66.6
Manufacture of malt liquors and malt	1,17,404	31,173	*36.15*	49.6
Total	**83,45,969**	**8,59,519**	***11.48***	**100.3**

Source: Industry Reports

Food standards and regulations have become fairly progressive

After the Nestle – Maggi saga which marked a fairly low point for the industry, the regulator (FSSAI) has been taking fairly collaborative and supportive steps that will foster faster growth for the industry. This was also reflected in the recent collaboration between FSSAI and Nestle India to jointly set up a food safety institute. FSSAI acts a single-point reference for all matters relating to food safety and standards in the country. Food safety is assessed through a science-based risk assessment process for developing food standards, regulations and guidelines. In a good practice, eight new standard groups were set up in December 2016 to identify gaps and propose the development of new standards and ensure that these standards are demand-based and updated taking into account developments in India as well as globally. The eight standard review groups also consist of industry associations and is currently engaged in looking at areas such as oils and fats, milk and milk products, fruit, vegetables and their products, cereals and their products, sweets and confectionery, meat and fish products, beverages and nutraceuticals. FSSAI initially prescribed standards for 377 products/ product categories and thereafter standards for 134 products were notified and an equal number are now in the process of being finalised.

Exhibit 6: New products likely to be notified under FSSAI

Segment	Particulars
Health supplement and nutraceuticals	Health supplements, special dietary use, probiotics, prebiotics , novel foods, nutraceuticals, etc.
Fruit and vegetable products	Quick frozen potato french fries, vegetable protein products , coconut milk powder, etc.
Cereal and cereal products	Durum wheat, wheat protein including wheat gluten, wheat bran, textured vegetable protein, etc.

Source: Industry report, FSSAI

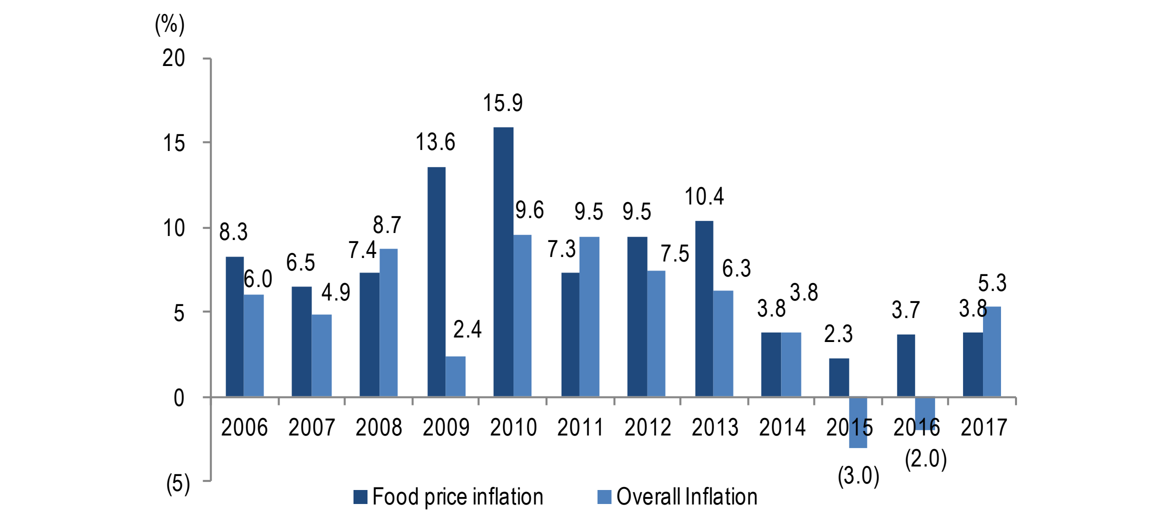
Technology and packaging remain significant disruptors

In the pursuit to provide an enhanced consumer experience, significant investments are being made in the areas of food research and technology. In the areas of food technology, the key trends are plant-based meat and dairy products, food products grown using big data, IoT and artificial intelligence or AI, and use of 3D printers to make chocolates and various snacks. Considering the fast-paced changes in food consuming habits and the constant need for more nutrition and convenience has resulted in significant changes also on the packaging side. According to studies, nearly three out of four Indian consumers have explicitly stated that they are looking for healthier alternatives and nearly a third willing to spend more on products that offer a better alternative. Considering this equation, the whole paradigm of food nutrition, safety and paradigm has undergone a significant change. Food packaging accounts for nearly 50% of the US$17bn packaging industry in India. Packaging segment was dominated by rigid packaging which contributes nearly 80% to overall requirement, but in recent times there is a rising shift towards flexible packaging. Retort packing and aseptic technology are two other areas which had a significant impact on the Indian food packaging scene in recent years. Modified atmosphere packaging to help foods maintain their visual and nutritional value, use of bio-degradable packaging considering that usage of plastic packaging has increased manifold and finally increased use of paper considering it is both renewable and bio-degradable are the new trends.

Moderate food inflation to aid margin expansion

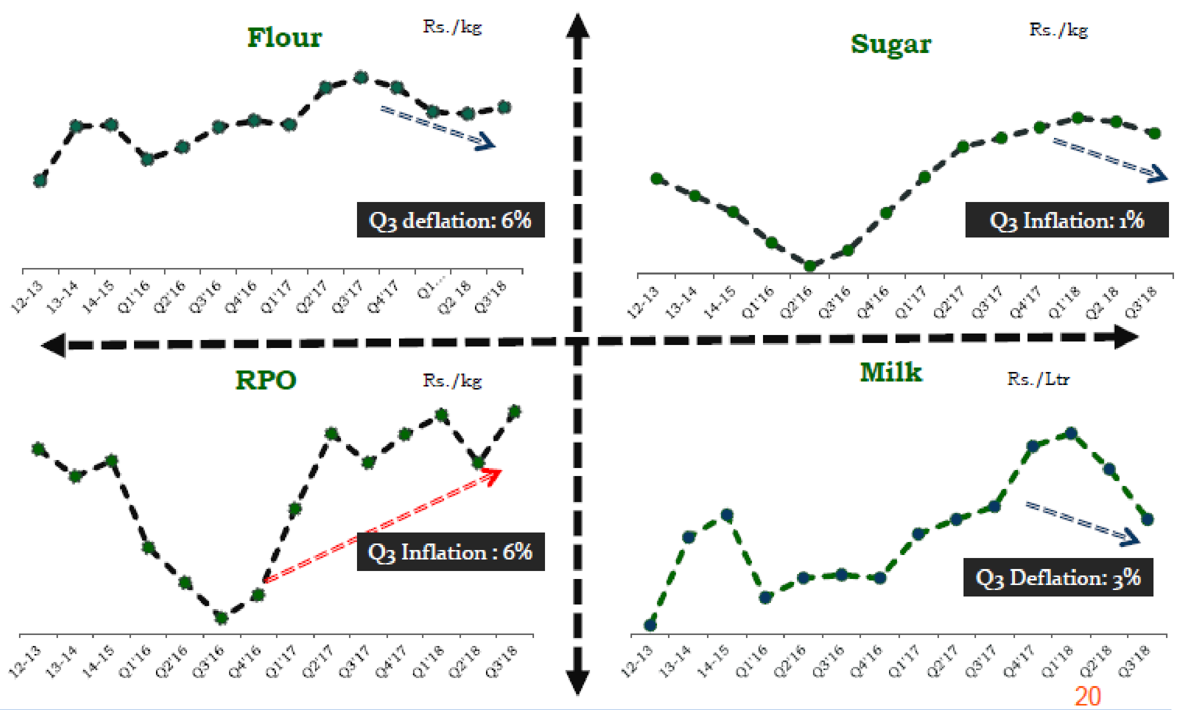
Food inflation in India has been continuously high over the past several years and it was particularly high after the drought in 2009 which saw nearly double-digit inflation in the range of 15%. Since 2014, there has been a significant decline in food inflation, especially in the area of cereals and dairy. This moderation along with an improved product mix has favourably impacted COGS for most companies in the range of 200bps-300bps. We believe the companies will continue to gain in this area and could see another reduction by about 100bps-200bps in the medium term.

Exhibit 7: Food inflation vis-à-vis overall inflation trend (WPI)



Source: Office of the Economic Adviser, Ministry of Commerce and Industry

Exhibit 8: Pricing trend of key raw materials



Source: Britannia company presentation

Supply chain will make a further difference to fortunes

Food supply chain is fairly complex considering the quality, safety and regulation aspects. Several ingredients and process have to measure upto rigourus standards. Raw Mmaterial inflation so far has been moderate and this to some extent will ease the challenge. The impact of Goods and Services Tax or GST on logistics so far has been limited, but we expect this can be a substantial game changer in future as companies reassess their priorities. Most food companies have a fairly wide manufacturing footprint spread across India and we believe they will continue to expand this, considering the substantial opportunity. Similar to HPC, we believe a more efficient supply chain can support a 50bps expansion in margins annually over the next three to five years.

Exhibit 9: Details of plant location, employees and its sensitivity to profitability

Company	Employee base and plant locations	Other points, if any	Impact on profitability as a result of 100bps savings in raw material costs and overheads (%)	
			EBITDA	PAT
Britannia Industries	Operates eight plants in India that are located in Kolkata (West Bengal), Rudrapur (Uttarakhand), Hajipur (Bihar), Khuruda (Odisha), Jhagadia (Gujarat), Perundurai (Tamil Nadu) and Bidadi (Karnataka) with total employee base of 3,206.	-	6.2	6.2
GSK Consumer	Operates three plants in India at Nabha, Rajamundhry and Sonepat with total employee base of 3,800.	High quality certifications such as ISO 22000 and OHSAS 18001	4.7	4.0
Nestle India	Operates eight factories across India in Moga (Punjab), Choladi (Tamil Nadu), Nanjagud (Karnataka), Samalkha (Haryana), Ponda & Bicholim (Goa), Pantnagar (Uttrakhand) and Tahliwal (Himachal Pradesh) with total employee base of 7,600.	-	4.9	5.4
ITC	Operates eight food factories located in Uluberia and Dhulagarh (West Bengal), Haridwar (Uttarakhand), Kamrup (Assam) Munger (Bihar), Pune (Maharashtra) and Nanjagud (Karnataka) with total employee base of 25,883 across business verticals which includes food.	Highest level of quality and safety. Targets 50% energy from renewable resources by 2020.	2.6	2.5

Source: Company, Nirmal Bang Institutional Equities Research

Rural markets remain a major opportunity area

Rural marketing has been a fair bit of challenge, especially for food companies, unlike their HPC counterparts, considering shorter shelf life and the need for associated infrastructure such as cold chains. According to our estimate, the contribution of food companies from rural markets is nearly half at around 20%-25% as compared to 35%-40% in case of HPC companies. Rural markets, which had seen a significant deceleration in recent years, will see improvement as more direct linkage gets established to these markets and dependence on wholesalers is reduced. Most food companies are also building a product portfolio which addresses the needs of these consumers in a more effective manner. Our expectation is that over the next five years these markets will outperform their urban counterparts in terms of growth rate and could see a higher contribution of about 5% to overall sales from the current level.

Exhibit 10: Company-wise distribution strategy

	Distribution reach	Distribution plan	Rural contribution
Britannia Industries	Total reach of 4.7 mn with direct reach of 1.6mn outlets	Increase direct reach to about 2.5mn and raise the share in Hindi belt.	About 20%
GSK Consumer	Reaches more than 3.5mn outlets in India. Reaches 20,000 villages directly.	Horlicks Swasthya Abhiyan.	More than 30%
Nestle India	Four sales branches and 40 distribution centres across the country, 1,700+ distributors. Reaches about 4mn outlets with direct reach of nearly 1mn. Makes 160,000 calls per day.	Looking to expand beyond top 100 towns, has a hyper-local strategy.	About 20%-25%
ITC	Reach of nearly 5mn, 2mn of which are directly serviced.	-	About 15%-20%

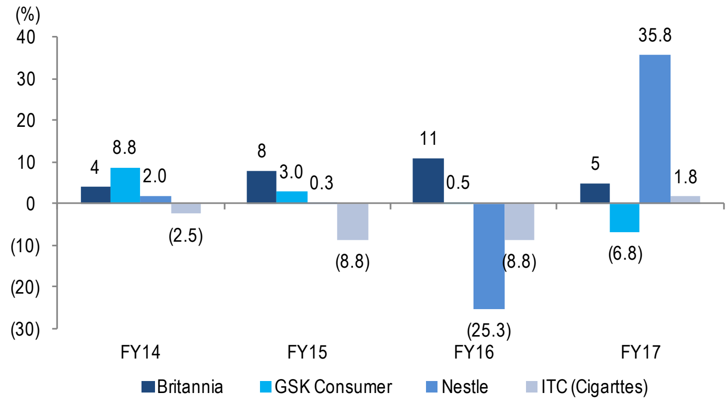
Source: Company, Nirmal Bang Institutional Equities Research

Sector financials

Volume growth bottomed out, likely to revive because of improvement in macros

Last few years for the food sector were characterised by overall sluggishness in demand, rural distress and regulatory surprises like demonetisation and implementation of GST. Therefore, the underlying volume growth was weak during the period. All companies except Britannia Industries faced volume pressure during the past three to four years. However, now with trade stablising and rural economy showing signs of recovery, we believe that volume growth will witness an upswing in the medium term because of improvement in the macro-economic environment and also improvement in consumer confidence. All major players in the F&B space are focusing more on meaningful innovation and expansion of distribution network which will lead to volume-led growth going forward. Following a lot of competition and moderate food inflation, pricing-led growth is expected to be marginal compared to the past, but the premiumisation trend will continue and products of strong brands will continue to get a premium over others. However, in our opinion, cigarette business volume will remain under pressure because of regulatory pressure and tax-related problems. As ITC's larger share of revenues come from cigarette business, overall company growth will be impacted to some extent.

Exhibit 11: Weakness in the underlying volumes in the past

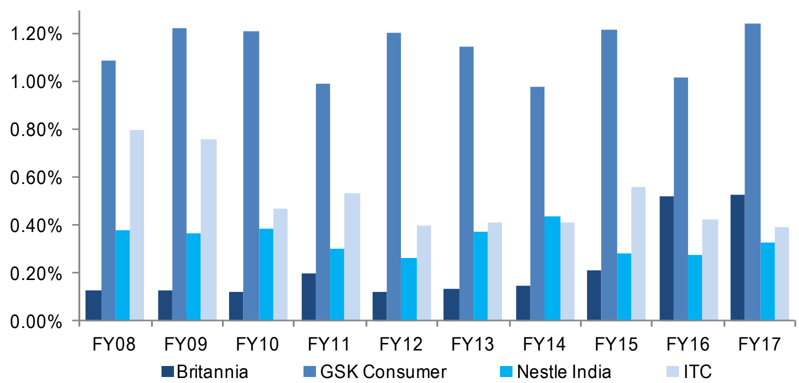


Source: Company, Nirmal Bang Institutional Equities Research

Innovation and rural market revival to boost the top-line

As stated above, a larger share of revenue growth will be led by volume. Food companies have been spending a lot on R&D to innovate and catch up with the trend. For example, Britannia Industries set up a new R&D centre in Bengaluru and systematically ramped up its R&D spending over the past few years and its performance is reflective of the success of its strategy. GSK Consumer Healthcare's entire product profile is research-based. Nestle India has a strong parent which leverages its expertise in Indian operations. In our opinion, innovation is of paramount importance and hence growth will be largely led by that in the coming years. Also, after a long time, early signs of recovery in rural market have been witnessed and with the government's thrust on boosting rural income, we believe rural growth will be back on track. Only in case of ITC, we believe that cigarette business - which accounts for a major portion of its revenues- will continue to witness stress because of pressure on volume.

Exhibit 12: R&D expenses as a percentage of sales

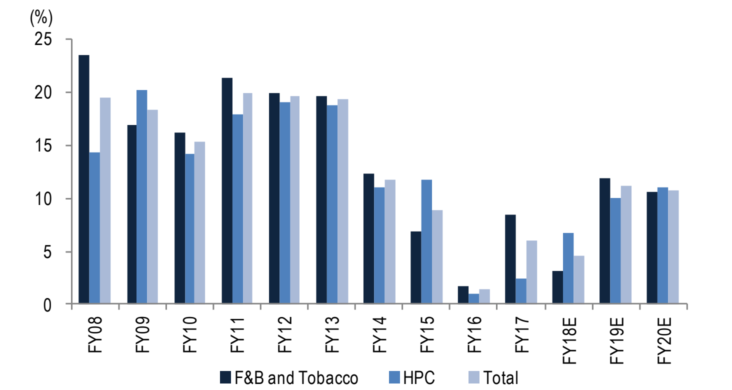


Source: Company, Nirmal Bang Institutional Equities Research

Healthy improvement in operating margin

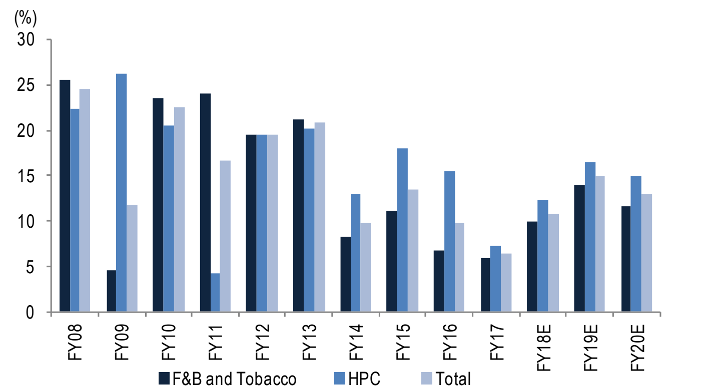
Companies across the board are focusing on supply chain efficiency and overall cost optimisation. Also, the prevalent trend of premiumisation will continue to improve the product mix of companies going forward. Britannia Industries and Nestle India are the biggest beneficiaries of this trend, in our opinion. Prices of most inputs have been stable and are expected to remain at a similar level and also soften in some cases. Hence, the commodity basket of most food companies is likely to remain stable. All this will lead to improvement in operating margin of food companies. Also, double digit top-line growth will lead to operating leverage benefits. In our food coverage universe, Britannia Industries and Nestle India are going to be the companies with highest operating margin expansion i.e. 300bps and 150bps, respectively, over FY18E-FY20E (CY17 to CY19E for Nestle India.).

Exhibit 13: Top-line growth trend



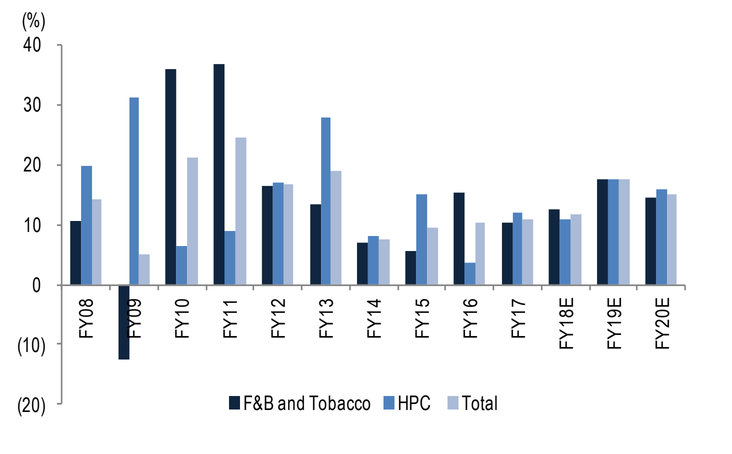
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Operating profit growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Net Income growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Growth trends over the years

	5-YEAR CAGR		3-YEAR CAGR	2-YEAR CAGR
Revenues	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B and tobacco	19.6	9.7	8.4	11.2
HPC	17.1	8.8	9.3	10.6
Total	18.5	9.3	8.8	10.9
EBITDA	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B and tobacco	19.2	10.5	11.9	12.8
HPC	18.3	14.7	14.6	15.8
Total	18.9	12.0	12.9	14.0
PAT	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B and tobacco	16.0	10.3	14.8	16.1
HPC	16.4	13.1	14.8	16.8
Total	16.2	11.4	14.8	16.4

Source: Company, Nirmal Bang Institutional Equities Research

Note: For the analysis of growth trends as above following companies have been considered

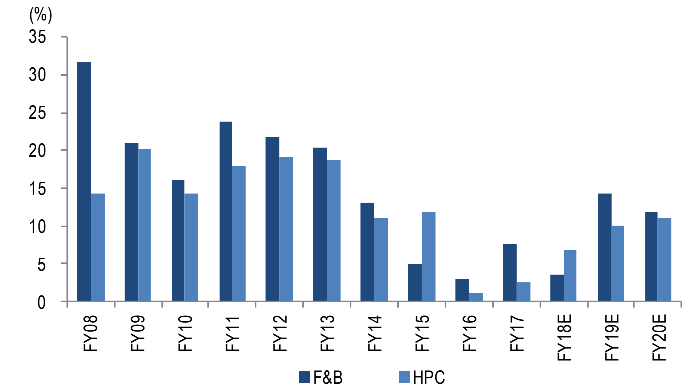
***F&B and Tobacco** – ITC, Nestle India, GSK Consumer, Britannia, United Spirits, United Breweries, Heritage Foods, Hatsun Agro, Prabhat Dairy, Parag Milk Foods, Agro Tech Foods, VST Industries, Godfrey Philips India, Manapasand Beverages, Varun Beverages, Prataap Snacks, Jubilant Foodworks, Westlife Development*

***HPC** – Dabur India, Hindustan Unilever, Emami , Colgate-Palmolive (India), Gillette India, P&G Hygiene and Healthcare, Marico, Godrej Consumer Products, Jyothy Labs*

Although the recovery seems more or less similar to that of the HPC segment in the above charts, this is largely because of inclusion of ITC which has a very high weight in terms of revenues as well as profitability numbers and weak sentiment in the cigarette business dragging down overall growth of F&B tobacco segment. If we compare pure F&B (i.e. excluding ITC), the growth rate is likely to outpace growth of the HPC segment reasonably.

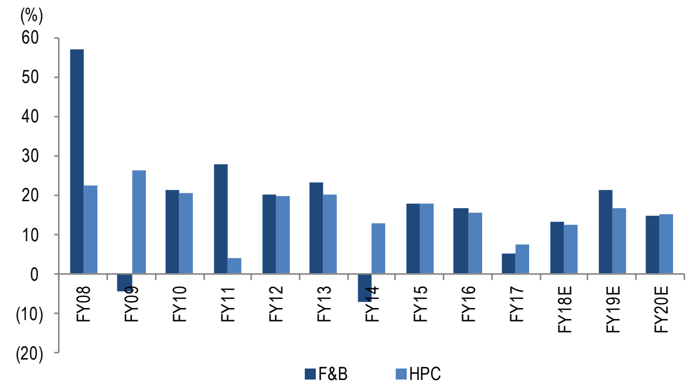
Excluding ITC, growth expectations of food companies is ahead of HPC

Exhibit 17: Top-line growth trend



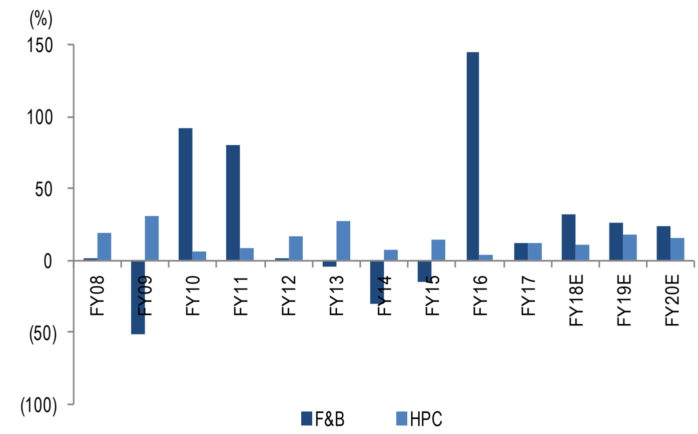
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Operating profit growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Net income growth trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Growth trends over the years

	5-YEAR CAGR		3-YEAR CAGR	2-YEAR CAGR
Revenues	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B	22.7	9.6	9.8	13.1
HPC	17.1	8.8	9.3	10.6
Total	19.5	9.2	9.5	11.8
EBITDA	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B	22.7	10.5	16.3	17.9
HPC	18.3	14.7	14.6	15.8
Total	20.1	13.0	15.3	16.6
PAT	**2007-12**	**2012-17**	**2017-20E**	**2018-20E**
F&B	11.8	9.5	27.6	25.6
HPC	16.4	13.1	14.8	16.8
Total	14.8	12.0	18.6	19.6

Source: Company, Nirmal Bang Institutional Equities Research

Growth trajectory differs significantly

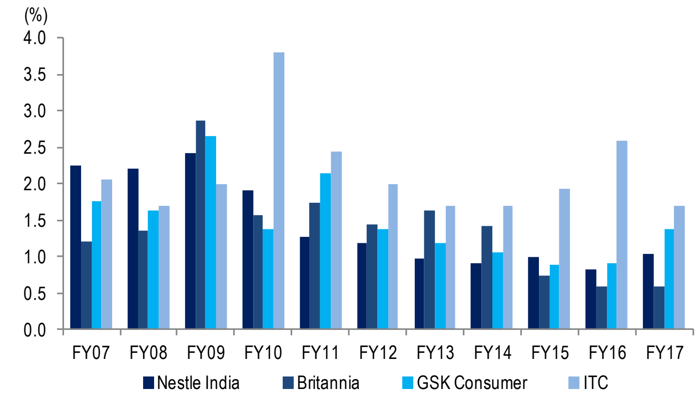
Although we are positive about the food consumption story in India, there is a deviation in growth profile of various companies which impacts overall growth of our coverage universe. For example, Britannia Industries and Nestle India are likely to grow their top-line in low-mid teens whereas GSK Consumer is likely to grow it in high single-digit despite a smaller size compared to the former two. In our opinion, weakness in cigarette business will prevail because of regulatory pressure and increased pricing. Hence, we expect mid-high single-digit growth in case of ITC. Thus, even though top-line growth of the food coverage universe will be in high teens, we expect our top Buy ideas namely, Britannia Industries and Nestle India to outperform the overall growth rate.

Similarly, in case of profitability, although we expect our food coverage universe to grow in low-mid teens, the companies where we are confident of strong improvement in fundamentals and likely to post very strong double-digit growth in the next two years are Britannia Industries and Nestle India.

Dividend for food companies has been under pressure

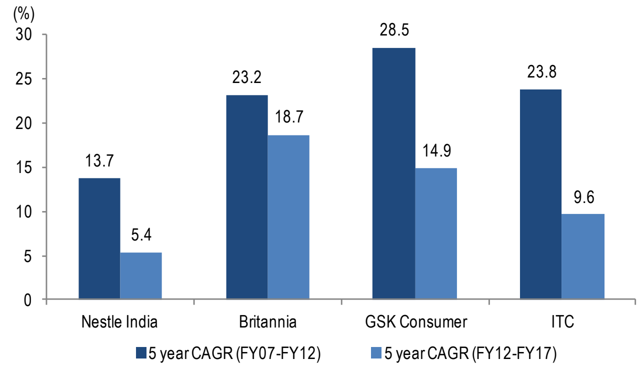
We have compared DPS growth of consumer companies (HPC and food companies) by forming two bands of five years each i.e. FY07-12 and FY12-17. Historically, growth in dividend payout has been higher in case of food companies compared to HPC players. It should be noted that during FY07-FY12, Colgate-Palmolive (India) and Emami from the HPC space delivered strong growth in dividend payout. During FY12-FY17, DPS growth of food companies fell significantly i.e. almost by 50% (except in case of Britannia Industries which largely maintained its dividend growth). The trend in HPC companies in this parameter varied on company-to-company basis. In terms of dividend yield, however ITC and Hindustan Unilever have relatively higher yield in the food and HPC space, respectively.

Exhibit 21: Dividend yield trend of food companies



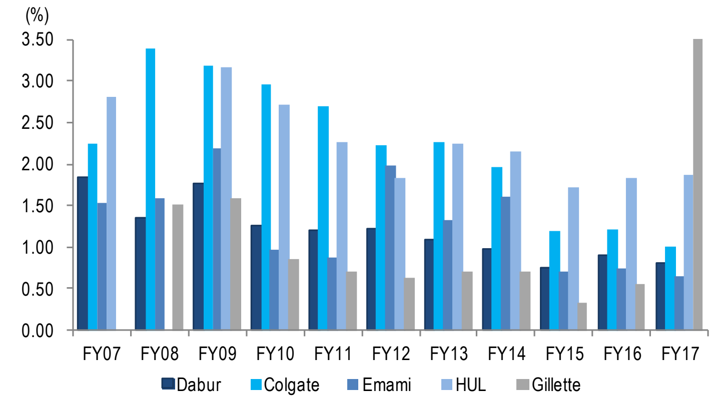
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: DPS growth bands of food companies



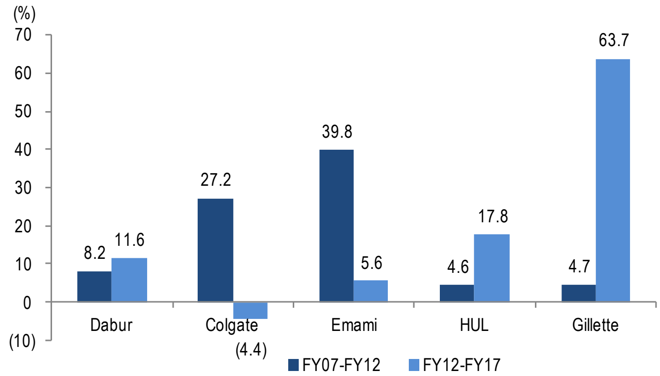
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Dividend yield trend of HPC companies



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 24: DPS growth band of HPC companies



Source: Company, Nirmal Bang Institutional Equities Research

Valuation and recommendation

Price performance is a clear indicator of fundamental performance

Similar to HPC, past couple of years have been sluggish for F&B companies in terms of price performance. This was largely because of the slowdown in earnings of these companies. Britannia Industries was the exception as its top-line and profitability grew robustly in the past five years. In CY17, following a better monsoon and early signs of economic recovery, Britannia Industries further extended its rally and GSK Consumer grew to negate the underperformance of the past on the back of better growth expectations. Nestle India's focus on volume-led growth increased earnings expectations and hence witnessed a strong upward movement in stock price in CY17. ITC faced regulatory challenges during GST implementation and hence growth outlook of cigarette business does not look promising, at least in the medium term. Hence, the stock has reasonably underperformed the Nifty index in CY17. On a relative basis, Nestle India and GSK Consumer Healthcare's performance was almost in line with index performance. Britannia Industries has consistently outperformed the index in the past five years.

Exhibit 25: Absolute price performance of Indian FMCG players

Absolute performance (%)	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
F&B and Tobacco												
ITC	19	(18)	46	42	16	42	12	15	(11)	11	9	-
NESTLE INDIA	32	(3)	75	50	7	22	6	21	(9)	3	31	-
BRITANNIA INDUSTRIES	35	(10)	27	23	8	11	85	100	61	(3)	63	5
GLAXOSMITHKLINE CONSUMER HEALTHCARE	31	(23)	130	80	10	50	17	32	9	(22)	31	4
UNITED SPIRITS	131	(56)	42	16	(66)	286	37	7	7	(35)	89	(12)
UNITED BREWERIES	85	(76)	116	200	(24)	142	(17)	8	13	(18)	38	(2)
HERITAGE FOODS	93	(80)	204	14	(36)	237	(18)	85	52	55	87	(17)
HATSUN AGRO PRODUCTS	158	(42)	155	16	67	30	136	53	33	23	128	(9)
AGRO TECH FOODS	186	(57)	174	33	3	32	8	9	(9)	(16)	56	(8)
VST INDUSTRIES	(5)	(44)	152	19	72	80	(11)	9	(11)	42	33	(1)
HPC												
DABUR INDIA	17	(26)	89	26	(1)	30	32	37	18	-	26	(7)
COLGATE PALMOLIVE (INDIA)	8	-	62	32	14	58	(14)	32	9	(7)	22	(4)
HINDUSTAN UNILEVER	-	17	6	18	30	31	9	33	14	(4)	66	(3)
EMAMI	24	(30)	120	64	(15)	77	19	66	27	(5)	40	(19)
PROCTER & GAMBLE HYGIENE	(9)	(2)	127	7	1	46	10	91	(3)	26	39	-
MARICO	27	(19)	86	16	21	50	2	51	39	15	24	(3)
GILLETTE INDIA	58	(47)	81	44	6	26	(17)	60	42	(8)	62	(2)
GODREJ CONSUMER PRODUCTS	(9)	3	90	47	-	87	19	13	36	14	32	8
JYOTHY LABORATORIES	N.A.	(56)	132	55	(40)	102	17	37	21	8	13	(10)
Others												
TITAN CO.	82	(41)	54	153	(5)	66	(19)	66	(9)	(6)	163	(6)
ASIAN PAINTS	49	(19)	101	60	(10)	71	11	54	17	1	30	(3)
NIFTY FMCG INDEX	22	(20)	42	31	9	49	12	18	-	3	29	(1)
NIFTY 50	55	(52)	76	18	(25)	28	7	31	(4)	3	29	(1)

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 26: Relative (Nifty) price performance of Indian FMCG players

Relative performance (%)	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
F&B and Tobacco												
ITC	(23)	70	(17)	21	54	12	5	(13)	(7)	8	(15)	1
NESTLE INDIA	(15)	102	-	27	42	(5)	(1)	(8)	(5)	-	1	-
BRITANNIA INDUSTRIES	(13)	86	(28)	4	44	(13)	73	52	68	(6)	27	6
GLAXOSMITHKLINE CONSUMER HEALTHCARE	(16)	59	31	52	46	17	9	1	14	(24)	2	5
UNITED SPIRITS	49	(8)	(19)	(2)	(55)	202	29	(19)	12	(37)	47	(11)
UNITED BREWERIES	20	(51)	23	154	1	89	(22)	(18)	18	(20)	8	(2)
HERITAGE FOODS	25	(59)	73	(3)	(16)	164	(23)	41	58	50	46	(16)
HATSUN AGRO PRODUCTS	67	21	45	(2)	121	2	121	16	39	19	77	(9)
AGRO TECH FOODS	85	(10)	56	12	37	3	1	(17)	(5)	(18)	22	(7)
VST INDUSTRIES	(39)	16	43	1	128	41	(17)	(17)	(7)	37	4	-
HPC												
DABUR INDIA	(25)	53	8	7	32	2	24	4	23	(3)	(2)	(6)
COLGATE PALMOLIVE (INDIA)	(30)	107	(8)	12	51	24	(19)	-	14	(10)	(5)	(3)
HINDUSTAN UNILEVER	(35)	143	(40)	-	73	2	2	1	18	(7)	29	(3)
EMAMI	(20)	45	25	39	12	39	11	26	32	(8)	9	(18)
PROCTER & GAMBLE HYGIENE	(41)	104	29	(9)	34	15	3	45	1	22	8	1
MARICO	(18)	68	6	(2)	61	17	(5)	15	45	12	(4)	(3)
GILLETTE INDIA	2	9	3	22	41	(2)	(22)	21	48	(10)	26	(1)
GODREJ CONSUMER PRODUCTS	(41)	114	8	24	32	47	11	(14)	41	11	3	9
JYOTHY LABORATORIES	N.A.	(9)	32	31	(21)	58	9	4	26	5	(12)	(9)
Others												
TITAN CO.	17	23	(12)	114	26	30	(24)	27	(5)	(9)	104	(5)
ASIAN PAINTS	(4)	69	14	36	19	34	4	17	22	(2)	1	(3)
NIFTY FMCG INDEX	(21)	67	(19)	11	44	16	5	(10)	5	-	1	(1)

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 27: Absolute price performance of global FMCG players

Absolute performance (%)	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
F&B and tobacco												
NESTLE SA-REG	20	(20)	21	9	(1)	10	10	12	2	(2)	15	(11)
MONDELEZ INTERNATIONAL INC-A	(9)	(18)	1	16	19	4	39	3	23	(1)	(3)	2
BRITISH AMERICAN TOBACCO PLC	38	(8)	12	22	24	2	4	8	8	23	9	(15)
PHILIP MORRIS INTERNATIONAL	N.A.	N.A.	11	21	34	7	4	(7)	8	4	15	(1)
ALTRIA GROUP INC.	17	(35)	30	25	20	6	22	28	18	16	6	(13)
JAPAN TOBACCO INC.	16	(56)	6	(4)	20	35	41	(3)	34	(14)	(6)	(17)
DIAGEO PLC	8	(11)	13	9	19	27	12	(8)	-	14	29	(11)
PEPSICO INC	21	(28)	11	7	2	3	21	14	6	5	15	(10)
THE COCA-COLA CO	27	(26)	26	15	6	4	14	2	2	(3)	11	(5)
PERNOD RICARD SA	9	(33)	22	17	2	22	(5)	11	14	(2)	28	1
HPC												
UNILEVER PLC	32	(16)	26	(2)	10	9	5	6	11	13	25	(10)
RECKITT BENCKISER GROUP PLC	25	(12)	30	5	(10)	22	24	11	21	10	-	(17)
L'OREAL	29	(36)	25	7	(3)	30	22	9	11	12	7	(6)
PROCTER & GAMBLE CO	14	(16)	(2)	6	4	2	20	12	(13)	6	9	(14)
BEIERSDORF AG	7	(20)	9	(9)	4	41	19	(8)	25	(4)	21	(12)
Index												
MSCI WORLD INDEX	7	(42)	27	10	(8)	13	24	3	(3)	5	20	(1)

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 28: Relative (MSCI World Index) price performance of global FMCG players

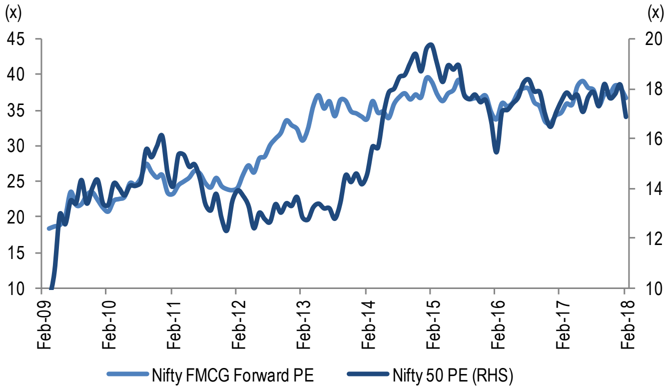
Relative performance (%)	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
F&B and tobacco												
NESTLE SA-REG	12	38	(5)	-	7	(2)	(12)	9	5	(7)	(4)	(11)
MONDELEZ INTERNATIONAL INC-A	(15)	42	(20)	6	28	(8)	12	-	27	(6)	(20)	3
BRITISH AMERICAN TOBACCO PLC	28	58	(12)	12	34	(10)	(16)	5	11	16	(10)	(14)
PHILIP MORRIS INTERNATIONAL	N.A.	N.A.	(13)	11	45	(6)	(16)	(9)	11	(1)	(4)	-
ALTRIA GROUP INC.	10	12	3	14	30	(6)	(2)	25	21	10	(12)	(12)
JAPAN TOBACCO INC.	8	(24)	(16)	(12)	30	19	13	(6)	38	(18)	(21)	(17)
DIAGEO PLC	1	54	(11)	-	28	12	(10)	(10)	3	8	8	(10)
PEPSICO INC	13	25	(13)	(2)	10	(9)	(2)	11	9	(1)	(5)	(9)
THE COCA-COLA CO	19	27	(1)	5	15	(8)	(8)	(1)	5	(8)	(8)	(5)
PERNOD RICARD SA	2	16	(4)	7	10	8	(24)	8	17	(7)	7	2
F&B and tobacco												
UNILEVER PLC	24	44	(1)	(10)	19	(3)	(15)	3	14	7	4	(9)
RECKITT BENCKISER GROUP PLC	17	53	3	(4)	(2)	8	-	8	24	4	(16)	(17)
L'OREAL	21	10	(1)	(3)	5	15	(2)	6	15	6	(11)	(6)
PROCTER & GAMBLE CO	7	45	(23)	(3)	12	(10)	(3)	9	(10)	1	(9)	(14)
BEIERSDORF AG	-	37	(14)	(17)	13	25	(4)	(11)	28	(9)	1	(12)

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Valuation of select F&B players supported by improved future earnings outlook

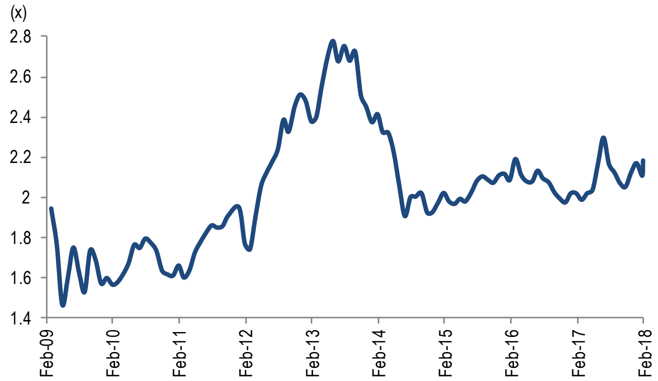
Indian consumer and consumer discretionary stocks have consistently traded at a significant premium to their peers and this has been evident not just in a bear market, but also in a bull market. As discussed above, we expect a recovery in the F&B segment on account of a favourable base and pick-up in growth momentum on a gradual basis. To understand the sustainability of current earnings multiples, we have compared the PEGs of food companies and arrived at a conclusion that ITC and GSK Consumer Healthcare trade at a relatively higher valuation compared to Britannia Industries and Nestle India. This was despite the fact that on absolute basis these two companies trade at more than 30% discount to Britannia Industries and Nestle India. In our opinion, Britannia Industries and Nestle India will continue to command higher multiples because of better growth expectations compared to others in the food space. We have compared the PEGs of these companies with that of HPC companies in our coverage universe. It showed that HPC companies trade at relatively higher prices. However, our top Buys from the HPC space, namely Hindustan Unilever and Gillette India have somewhat similar PEGs (although higher compared to food companies), thereby reflecting positive earnings outlook. We understand that currently all stocks trade at a premium, but looking at the earnings outlook of companies we believe that price multiples in case of ITC and GSK Consumer Healthcare have already priced in a modest growth going forward and hence will continue to trade at a discount to other companies like Britannia Industries, Nestle India, Hindustan Unilever etc. Global consumer companies trade at a substantial discount to Indian companies because of stagnancy in growth, mainly in top-line. Most companies are expected to grow their top-line in low to mid single-digit, although global companies focus more on cost optimisation and margin expansion.

Exhibit 29: Nifty versus Nifty FMCG P/E



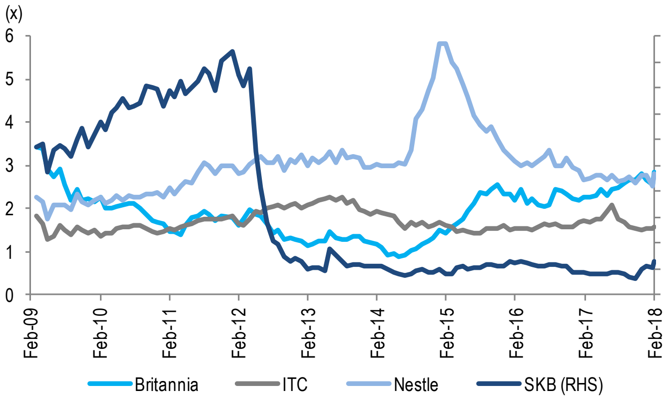
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 30:Nifty FMCG relative P/E



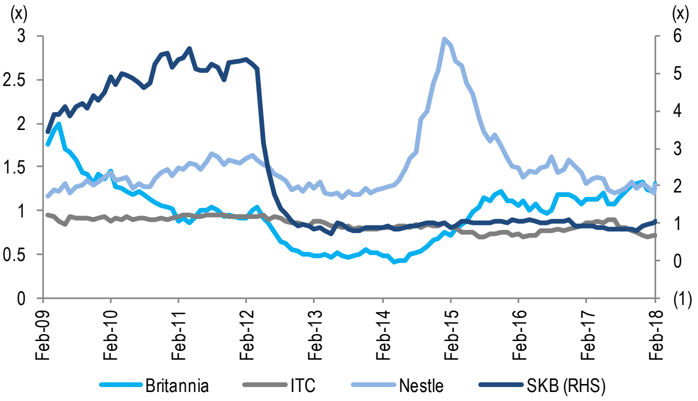
Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 31: Relative P/E (Nifty)



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 32: Relative P/E (Nifty FMCG)



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 33: Valuation of Indian FMCG players

Company	CMP* (Rs)	Mkt. cap. (USD mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
F&B and tobacco sectors															
ITC	270	50,679	8.0	7.4	6.8	19.9	18.0	16.3	30.5	27.0	24.6	6.4	9.2	9.3	3.3
NESTLE INDIA	7,619	11,302	7.3	6.5	5.8	33.7	28.4	24.2	60.2	48.9	40.5	11.6	15.6	21.9	2.7
BRITANNIA INDUSTRIES	4,867	8,989	5.9	5.2	4.6	38.9	31.0	24.5	59.1	46.8	37.4	12.6	21.7	20.9	2.8
GLAXOSMITHKLINE CONSUMER HEALTHCARE	6,837	4,423	6.6	6.1	5.5	29.7	26.1	22.1	42.4	38.2	32.7	9.4	10.4	10.2	4.2
UNITED SPIRITS	3,134	7,007	5.4	4.8	4.2	44.5	34.0	28.0	85.9	57.4	43.5	7.0	20.6	117.0	0.7
UNITED BREWERIES	1,033	4,203	5.1	4.5	4.0	32.7	28.3	24.6	76.0	61.4	50.7	15.3	20.6	32.8	2.3
HERITAGE FOODS	695	496	1.2	1.1	0.9	23.5	16.8	13.2	48.9	33.3	24.0	10.0	21.3	24.4	2.0
HATSUN AGRO PRODUCTS	726	1,701	2.3	1.9	1.6	26.5	19.8	16.4	73.7	48.6	35.5	17.6	23.7	32.7	2.3
PRABHAT DAIRY	165	247	1.0	0.9	0.8	13.1	10.8	9.0	35.3	24.8	18.2	14.3	16.5	37.7	0.9
PARAG MILK FOODS	270	350	1.2	1.0	0.9	13.8	12.2	10.5	29.0	24.0	19.5	13.5	29.4	88.0	0.3
AGRO TECH FOODS	624	234	1.8	1.6	1.5	20.4	17.7	14.8	42.2	35.5	28.6	8.9	17.7	26.3	1.6
VST INDUSTRIES	2,941	699	4.5	4.2	N.A	14.1	12.3	N.A	23.7	20.1	N.A	N.A	N.A	N.A	N.A
MANPASAND BEVERAGES	380	669	4.8	3.6	2.9	24.5	18.7	14.4	43.6	34.9	24.9	30.4	29.9	35.2	1.2
VARUN BEVERAGES	620	1,742	2.4	2.1	1.9	13.6	11.8	11.0	43.0	30.9	27.9	15.0	14.2	33.3	1.3
PRATAAP SNACKS	1,268	458	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A	N.A
JUBILANT FOODWORKS	2,084	2,116	4.7	4.1	3.6	33.9	26.9	21.7	82.3	59.0	44.7	14.4	37.5	66.8	1.2
WESTLIFE DEVELOPMENT	317	758	4.5	3.7	3.1	61.0	41.9	32.0	283.4	111.0	72.6	19.4	49.4	N.R	N.R
HPC															
DABUR INDIA	328	8,882	7.4	6.8	6.2	36.9	33.8	30.3	45.0	39.4	35.1	6.5	7.2	8.7	5.2
COLGATE PALMOLIVE (INDIA)	1,044	4,368	6.7	6.2	5.8	25.7	24.0	21.9	41.1	38.7	35.4	5.8	10.1	11.7	3.5
HINDUSTAN UNILEVER	1,324	44,097	8.1	7.4	6.8	39.4	32.5	27.9	55.1	45.7	39.1	7.8	16.6	17.6	3.1
EMAMI	1,062	3,707	9.4	8.5	7.8	32.0	29.3	26.0	38.9	36.7	33.7	7.3	4.9	6.0	6.5
PROCTER & GAMBLE HYGIENE	9,402	4,696	11.6	10.3	8.7	39.4	34.8	29.6	66.1	57.1	46.8	11.0	12.4	12.2	5.4
MARICO	309	6,145	6.2	5.4	4.8	32.9	27.9	23.8	47.0	39.6	33.6	12.5	12.1	14.1	3.3
GILLETTE INDIA	6,600	3,309	11.8	10.4	9.1	44.4	37.4	31.5	71.6	59.3	49.3	7.7	14.5	19.9	3.6
GODREJ CONSUMER PRODUCTS	1,079	11,306	7.3	6.4	5.7	35.7	30.6	26.7	49.7	41.9	35.8	11.9	13.8	16.3	3.1
JYOTHY LABORATORIES LTD	354	989	3.7	3.3	2.8	25.0	21.1	18.0	40.0	32.4	26.5	10.3	12.0	5.2	7.7
Others															
TITAN CO	829	11,324	4.6	3.8	3.2	45.5	35.3	28.5	65.7	50.2	39.8	21.6	30.7	37.5	1.8
ASIAN PAINTS	1,132	16,698	6.3	5.5	4.7	32.9	28.1	23.8	51.5	43.8	37.0	15.1	14.5	14.8	3.5
AVENUE SUPERMARTS	1,316	12,632	5.4	4.2	3.3	59.3	44.7	34.7	102.1	75.9	58.1	27.9	33.9	38.7	2.6

**Last trading price of 12th March 2018 have been considered. ^3-year CAGR (FY17-FY20E)*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 34: Valuation of global FMCG players

Company	CMP (LC)*	Mkt. cap. (US$mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
F&B and tobacco															
NESTLE SA-REG	77	250,901	2.6	2.5	2.4	14.0	13.1	12.2	20.2	18.5	16.6	3.1	9.1	18.6	1.1
MONDELEZ INTERNATIONAL INC-A	44	66,127	2.5	2.4	2.3	15.1	14.0	13.5	18.1	16.6	15.5	3.1	22.0	38.9	0.5
BRITISH AMERICAN TOBACCO PLC	4,256	135,585	3.8	3.8	3.6	12.8	12.0	11.2	13.9	12.7	11.8	20.8	25.7	14.1	1.0
PHILIP MORRIS INTERNATIONAL	107	166,918	5.2	4.9	4.5	14.3	13.0	11.9	20.4	18.3	16.1	8.6	8.9	9.5	2.1
ALTRIA GROUP INC	66	124,936	6.3	6.2	6.0	13.7	12.8	11.9	16.6	15.0	13.8	1.5	5.1	14.2	1.2
JAPAN TOBACCO INC	3,022	56,730	2.7	2.6	2.6	9.1	8.6	8.2	13.2	12.2	11.7	2.1	4.2	4.5	3.0
DIAGEO PLC	2,463	84,154	5.0	4.8	4.6	17.1	16.1	15.2	21.3	19.7	18.3	3.2	6.4	8.3	2.6
PEPSICO INC	113	159,981	2.4	2.4	2.3	13.2	12.5	11.9	19.8	18.4	17.0	3.5	7.6	14.8	1.3
THE COCA-COLA CO	45	190,410	6.1	5.8	5.6	18.8	17.9	16.7	21.3	19.7	18.2	-6.7	8.1	17.5	1.2
PERNOD RICARD SA	135	44,151	4.0	3.8	3.6	16.3	15.5	14.6	23.4	21.6	19.9	2.9	7.9	9.0	2.6
F&B and tobacco															
UNILEVER PLC	3,879	160,505	2.5	2.4	2.3	13.8	13.2	11.9	18.6	17.2	15.3	2.2	10.2	16.1	1.2
RECKITT BENCKISER GROUP PLC	5,689	55,650	3.2	3.1	3.0	13.9	13.2	12.4	16.8	15.6	14.6	10.9	16.4	14.4	1.2
L'OREAL	182	125,365	3.8	3.7	3.5	16.7	15.8	14.8	26.0	24.6	23.1	4.0	7.7	12.2	2.1
THE PROCTER & GAMBLE CO	80	201,781	3.0	2.9	2.8	12.7	12.1	11.6	19.0	17.7	16.4	3.2	4.4	7.8	2.5
BEIERSDORF AG	89	27,718	3.1	3.0	2.9	14.1	13.2	12.3	25.9	24.2	22.3	5.2	8.4	8.6	3.0

** Respective currencies in which the companies operate and price as on 12th March 2018 .   ^3-year CAGR (FY17-FY20E)*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Nestle India – Getting priorities straight

Nestle India (NEST) is a subsidiary of Nestle SA which is the world's largest food company. NEST bounced backed smartly under the new leadership of Mr. Suresh Narayanan after the Maggi noodle fiasco. Strong and unrelenting efforts by the company to achieve high volume growth are credible. Several brands such as Kit Kat, Milkmaid and Nescafe have been re-energised fairly significantly and we expect the company to make similar efforts with a few brands to push volume growth to high single-digit.

Nestle Business Excellence model emphasises a lot on reduced process and efficiency which along with increased elbow room for pricing because of GST rate cut should support operating margin expansion by another 150bps from the current level.

Considering India's processed food opportunity and NEST's realignment of priorities, we initiate coverage on the stock with a Buy rating and a target price of Rs9,400. Our Buy rating on NEST is premised on improved growth trajectory of the company which can also surprise considering the processed food category momentum. Our target price of Rs.9,400 is based on CY19E EPS indicating an upside of 23% from CMP. We have based our target price based on a P/E multiple of 50x which is consistent with its current trading multiple as well as five year median P/E.

Britannia Industries – 'Pure Magic'

BRIT's innovation agenda has consistently remained ahead of the curve and this should help the company in maintaining double-digit growth and outperforming its peers. Strong presence in the fast-growing modern trade along with expected improvement in semi-urban and rural markets should support improvement in growth to 14% in FY18E-FY20E as compared to 8% in FY15-FY18E.

Continuous improvement in product mix, moderate competitive intensity, stable commodity price environment and sharp focus on cost optimisation should support the operating margin expansion trend and we expect further gains of 300bps over FY18E-FY20E.

Bakery segment, in our opinion, ticks all the right boxes in terms of taste, health and convenience. In our opinion, category growth opportunity, and product portfolio as well as distribution strength of the company are still underpriced. We expect the company to maintain its consistent earnings performance track record and expect it to deliver 26% growth over FY18E-FY20E.

We initiate coverage on BRIT with a Buy rating and a target price of Rs5,850 indicating an upside of 20% from CMP**.** Our target price is based on P/E multiple of 45x and is consistent with its current trading multiple.

ITC – Next is What

A dominant share in excess of 80%, wide portfolio of cigarette brands ranging from value to premium (Capstan to Classic) and low per capita consumption of cigarettes puts ITC in the most enviable position in the Indian consumer space.

Annual tax hikes well in excess of 20% and regulations such as 85% pictorial warning on cigarette packs are among the slew of measures which the government has taken to check the growing incidence of tobacco and cigarette smoking.

As the margin base is fairly high and the top-line outlook is uncertain because of continued challenges, we believe the earnings outlook beyond a cyclical recovery in the short term remains somewhat uncertain and is likely to trail its peers in the Indian FMCG space.

Although ITC stock has underperformed its Indian peers in the past 12 months considering that earnings outlook is still somewhat uncertain, we prefer to assign an Accumulate rating to the stock with a target price of Rs.290, thereby indicating an upside of 7% from CMP. Our target price is based on sum-of-parts or SOTP valuation.

GSK Consumer – Fighting for mindshare and wallet share

Considering that HFD is competing with several healthy and natural food alternatives, we believe the growth in the category could be below par. This trend, in our opinion, will certainly impact GSK Consumer, the market leader in that space, resulting in somewhat more muted top-line growth of 9.6% for FY18E-FY20E.

Category trends are somewhat uncertain the need to invest in rural markets and competitive intensity in the category is fairly high, we expect the margins to remain largely range-bound around the 20% mark.

We initiate coverage on the stock with an Accumulate rating and a target price of Rs7,300. We expect earnings growth of 13% over the period FY18E-FY20E will lag peers in the food space. This target price is based on forward P/E multiple of 35x which is in line with the five year median PE and at 8% discount to the current forward P/E.

Company Section

Initiating Coverage

Nestle India

13 March 2018

Reuters: NEST.BO; Bloomberg: NEST IN

Getting Priorities Straight

Nestle India (NEST) is a subsidiary of Nestle SA which is the world's largest food company. NEST bounced backed smartly under the new leadership of Mr. Suresh Narayanan after the Maggi noodle fiasco. NEST has rightly identified the need to reduce its dependence on a single brand (Maggi) towards the growth phase. Over the past few years, the pace of innovation and renovation has gained significant strength and we believe this will help raise the growth and competitiveness profile of the company substantially. Considering India's processed food opportunity and NEST's realignment of priorities, we initiate coverage on the stock with a Buy rating and a target price of Rs9,400. We have based our target price based on a P/E multiple of 50x which is consistent with its current trading multiple and five year median P/E.

Chasing high volume growth: Strong and unrelenting efforts by the company to achieve high volume growth are credible. Several brands such as Kit Kat, Milkmaid and Nescafe have been re-energised fairly significantly and we expect the company to make similar efforts with a few brands to push volume growth to high single-digit.

Agility and GST rate cut to aid margin expansion: Nestle Business Excellence model emphasises a lot on reduced process and efficiency which along with increased elbow room for pricing because of GST rate cut should support operating margin expansion by another 150bps from the current level.

Valuation and recommendation: Our Buy rating on NEST is premised on improved growth trajectory of the company which can also surprise considering the processed food category momentum. Our target price of Rs.9,400 is based on CY19E EPS indicating an upside of 23% from CMP. We have based our target price based on a P/E multiple of 50x which is consistent with its current trading multiple as well as five year median P/E. Higher growth as compared to peers in the food and larger FMCG space justifies the premium earnings multiple for the stock.

Y/E December (Rsmn)	CY15	CY16	CY17	CY18E	CY19E
Net revenues	81,753	91,413	1,00,096	1,12,828	1,27,212
EBITDA	16,303	18,498	20,965	24,625	28,551
Adj .PAT	10,641	10,122	12,190	15,032	18,118
EPS (Rs)	58.4	103.9	126.5	155.9	188.0
EPS growth (%)	*(52.5)*	*77.8*	*21.7*	*23.3*	*20.5*
EBITDA margin (%)	*19.9*	*20.2*	*20.9*	*21.8*	*22.4*
P/E (x)	99.7	58.0	60.2	48.9	40.5
P/BV (x)	19.4	18.4	21.9	19.9	18.0
EV/EBITDA (x)	33.6	30.3	33.7	28.4	24.2
RoCE (%)	*43.9*	*49.0*	*53.0*	*59.0*	*63.1*
RoE (%)	*19.4*	*33.1*	*37.4*	*42.7*	*46.7*

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: FMCG

CMP: Rs7,619

Target Price: Rs9,400

Downside: 23%

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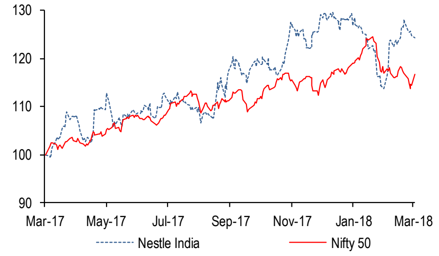
Key Data

Current Shares O/S (mn)	96.4
Mkt Cap (Rsbn/US$bn)	734.6/11.3
52 Wk H / L (Rs)	8,039/6,085
Daily Vol. (3M NSE Avg.)	58,564

Shareholding (%)	1QFY18	2QFY18	3QFY18
Promoter	62.8	62.8	62.8
Public	37.2	37.2	37.2
Others	-	-	-

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Nestle India	6.7	3.1	24.3
Nifty Index	(1.1)	3.3	16.6

Source: Bloomberg

Investment Thesis

Back to basics

Last few years have been fairly weak (even after excluding the Maggi noodle crisis) for NEST led by sluggishness in volume across the categories. NEST has realigned its strategy with a focus on volume-led double-digit top-line growth with improved sustainable profitability. The company is focusing equally on all the categories and has planned new launches in each of them keeping in mind the ongoing health and wellness theme. Sustainable demand is achieved only when a customer consumes a product on a regular basis. Also, penetration of brands across geographies through market expansion is of paramount importance. Otherwise growth of deeply-penetrated categories in select locations will remain stagnant after some point in time.

In our opinion, packaged food and beverage industry will offer substantial opportunity to the company. Our frequent consumer channel checks indicate that the eating pattern and consumer behaviour are changing fairly rapidly. Health and wellness is at the cornerstone, and also new product innovations are well accepted by modern consumers. Trust and transparency about food products is also getting higher weight before the consumer makes any purchase, where large players like NEST have an edge over local players. Therefore, in our opinion, the company will be key beneficiary of this growth going forward.

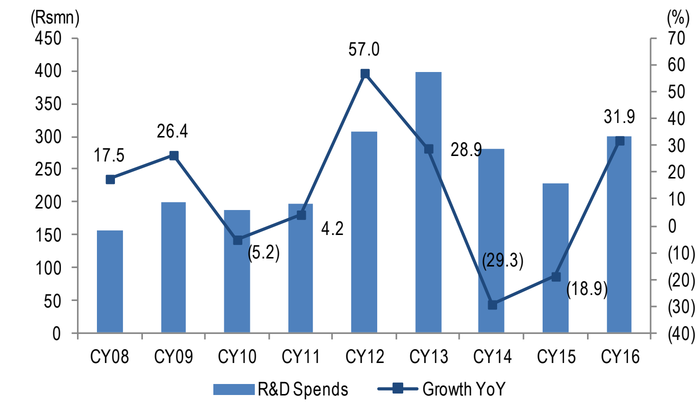
Exhibit 1: Aiming volume-led sustainable earnings growth

Source: Company, Nirmal Bang Institutional Equities Research

Insight-led smart innovation

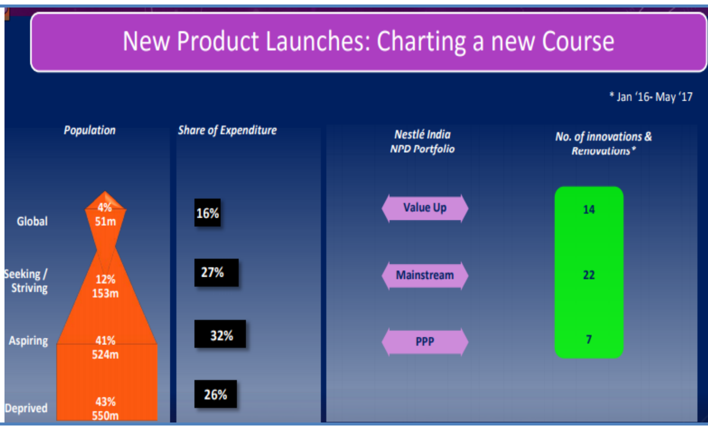
The premiumisation theme is clearly being played out in F&B business as well, similar to home and personal care companies. Hence, all food companies are shifting their focus to value-up or premium categories. NEST is no exception in this trend. However, the premiumisation story is no longer just linked with brand equity wherein the age-old or MNC brands enjoy a premium over local products. Meaningful innovation is of extreme importance in today's world where a consumer is exposed to new products across the globe on account of social media. Hence, analysing consumer trends before launching new products or innovating within the category or new category is very important. Insight-led innovation is one of the core principles of NEST and, in our opinion, goes well with the trend. The company has righty targeted this opportunity. It has targeted the upper end of the pyramid and most of its innovation in the recent past was in 'value-up' (i.e. premium) and mainstream products which are particularly consumed by people in the mid-to-high income segment. Therefore, the core focus has shifted to value-up and mainstream. Higher share of value-up and mainstream will improve revenue mix of the company, leading to incremental margins.

Exhibit 2: Gradual ramp-up in R&D spending post Maggi noodle crisis



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Innovation tilted towards 'Value Up'

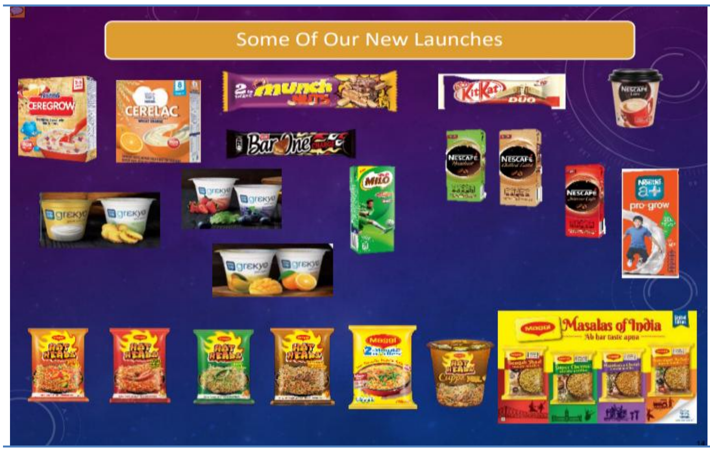


Source: Company, Nirmal Bang Institutional Equities Research

New launch initiative is broad-based

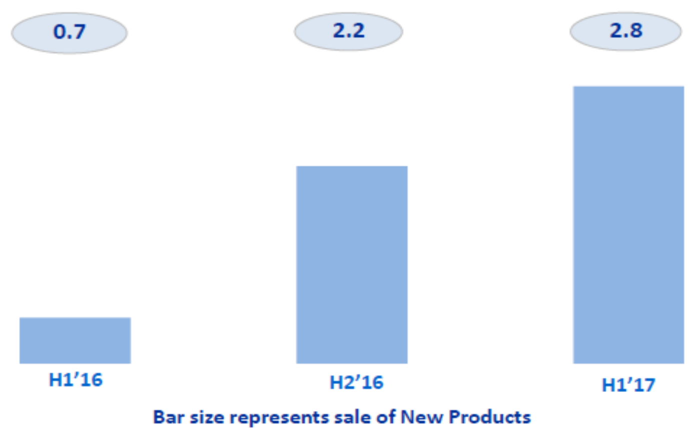
New product launches in the recent past are in sync with the broad-based strategy of the company. NEST, in the past two years, has launched more than 40 products across categories. Health and wellness is the need of the hour and NEST has taken that into account while making some of its new launches. The company's relaunch of atta and oats noodles, Milkybar with more milk content and less sugar, iron-fortified Maggi noodles, fortified milk products, etc, are some of the examples of the same. Recently, the company decided to reduce salt content in Maggi noodles. Nescafe and re launch of Milo in ready-to-drink format are some of the other launches focusing on premium consumers. All these launches were adequately marketed across various platforms including the core focus on digital. Marketing expenditure on existing products has been redirected to new launches after evaluating the growth potential and customer feedback for a particular product or brand. Also, the company aims to improve the share of overall growth coming from new launches rather than just depending on Maggi and non-Maggi traditional business. In turn, 25% of total growth during the January-June 2017 period was derived from the new product portfolio. We believe this will led to incremental growth which will be sizeable going forward as all these new launches are made under existing brands which are popular and enjoy consumer preference.

Exhibit 4: New launches across the categories



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: New products as a percentage of sales



Source: Company, Nirmal Bang Institutional Equities Research

Health at the cornerstone

Health and wellness theme in foods business is similar to what the naturals category is for the Home and Personal Care (HPC) segment. Engaging in proper eating habits, following a fitness regime, avoiding junk food, etc, is witnessed among the mid-lifers (35-45 years). Also, they have high spending power than the youth. Hence, these consumers go for brands that speak to them and about them. However, because of the disparity in income level across the country, currently only a small portion of consumers strictly adopt this new lifestyle. At the moment, only between 2% and 5% of food items are believed to be fortified with micronutrients. It is a very small microscope of whatever needs to be addressed and therefore the fortification is probably one of the solutions to micronutrient deficiency. However, we believe that gradually this is going to expand in a big way. NEST has an early mover advantage in this initiative. It has adopted a systematic approach with focus on health and nutrition across categories. In our opinion, the company is leveraging this opportunity very well and is likely to be the biggest beneficiary of this mega trend. It has identified that there is general deficiency of vitamins (A and D), iron, zinc, etc, and accordingly introduced new products. There has been a re launch of Maggi atta and oats noodles. Milkybar with higher milk content and low sugar, use of fortified milk in many products, etc, shows its commitment towards a healthy and nutritious diet. The company has introduced all these elements in its existing popular brands and hence the new products have equal or better consumer acceptance. Innovation with key thrust on health provides dual benefits in the form of premiumisation and better quality products.

Exhibit 6: Fortification across categories

Source: Company, Nirmal Bang Institutional Equities Research

Strong brand equity

NEST has a basket of strong and powerful brands across its categories which have grown multifold over a period of time.

Exhibit 7: Brand profile across the categories

Category	Brands
Milk products and nutrition	Everyday (ghee and dairy whitener), Grekyo. Nestle A+, Actiplus (dahi)
Prepared dishes and cooking aids	Maggi (noodles, cup noodles, sauces)
Beverages	Nescafe (Classic, Sunrise, Gold), Nestea
Chocolate and confectionary	Kitkat, Polo, Munch, Milkybar, Alpino, Barone, etc

Source: Company, Nirmal Bang Institutional Equities Research

The brand power could be witnessed from the rapid revival of Maggi noodle sales after the crisis. The category has gained market share quickly and is back to normal despite competitive challenges faced in the category. The company has nurtured these brands over the years with modifications or re launches as and when required based on consumer behaviour and preferences. The company claims leadership in five out of nine categories it operates in. During the period under consideration (see the table below) the company lost leadership position in infant formula and instant coffee business, but gained back a substantial portion of the pie in its Maggi noodle portfolio with other categories broadly remaining constant.

Exhibit 8: Market share movement across the categories

Category	Brand	Market share			NEST's position		
		Jan-Jun 2016	Jan-Jun2017	Gain/loss %	Jan-Jun 2016	Jan-Jun2017	Gain/loss
Instant noodles	Maggi	52	59.5	7.5	1	1	No change
Ketchups & sauces	Maggi	23.8	24.3	0.5	2	2	No change
Instant pasta	Maggi	56.7	65.2	8.5	1	1	No change
Infant formula	Lactogen, NAN	42.4	40.5	(1.9)	1	2	Lost leadership position
Infant cereals	Cerelac	96.6	96.5	(0.1)	1	1	No change
Tea cereals	Every Day	45.4	45.4	0	1	1	No change
Chocolates	Nestle	15.5	14.6	(0.9)	2	2	No change
White & wafers	Kitkat, Munch, Milkybar	63.7	62.6	(1.1)	1	1	No change
Instant coffee	Nescafe	50.4	47.3	(3.1)	1	2	Lost leadership position

Source: Company, Nirmal Bang Institutional Equities Research

Packaged dishes and cooking aids category is dominated by Maggi wherein a large portion is contributed by noodles. Noodles as a category was widely accepted by Indian consumers when NEST launched Maggi. Consumers then were also ready to explore new choices and have incorporated Maggi in their regular diet. With the increased pace of life, more working women, instant noodles gained substantial market share. NEST has been the market leader throughout the period except when some of the samples were questioned by the FSSAI and then the company had to call back its entire production. Even so, after the re launch of Maggi, Nestle has been able to gain its leadership stand within very less time. This shows consumer stickiness towards the product. Also, it was the result of strong ongoing marketing activities carried out by the company. NEST has also launched instant cuppa noodles within the category and Masalas of India, Hotheads noodles, etc, are other interesting launches wherein localised as well as western flavours have been introduced. Also, within categories, the company has timely introduced oats and atta noodle variants to keep up with the health trend.

Exhibit 9: Maggi back on track

Source: Company website, Nirmal Bang Institutional Equities Research

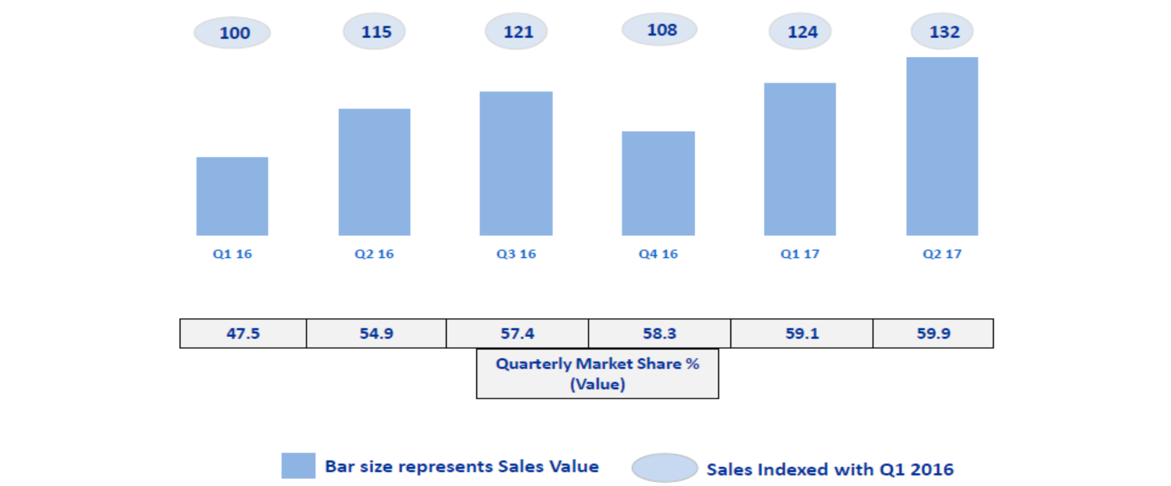
We compared the prices of the base pack of each variant of Maggi noodles and that of its competitors and one could clearly make out that NEST has strategically diversified this category so that all sections of the pyramid access the product, thereby driving further penetration. Other players are somewhere stuck between mass to mid segment and will have to make a lot of efforts to compete with NEST in the premium range.

Exhibit 10: Pricing comparison in Noodles segment (Nestle India vis-à-vis peers)

Nestle products	Price (Rs)	Quantity (gm)	Price/kg
Hotheads Cuppa Noodles	40	70	571
Instant Noodles (Cuppa Mania)	40	70	571
Nutri Licious Pazzta	24	70	343
Nutri Licious Oats Noodles	24	75	320
Hotheads Chicken Noodles	20	71	282
Hotheads Noodles (Barbeque Pepper,Green Chilli, Peri Peri)	19	71	268
Nutri Licious Atta Noodles	19	75	253
Noodles Chicken	14	71	197
Masala Noodles	11	70	157
Competitors' products	**Price (Rs)**	**Quantity (gm)**	**Price/kg**
Yippee Mood Masala Noodles	15	70	214
Knorr Desi Masala Chaska	12	66	182
Knorr Noodles (Italian Margherita and Italian Cheese & herbs)	12	68	176
Chings Instant Noodles	10	60	167
Knorr Masala Soupy Noodles	12	75	160
Yippee Noodles Classic Masala	10	70	143

Source: E-commerce websites, Nirmal Bang Institutional Equities Research

Exhibit 11: Re building Maggi noodle portfolio



Source: Company, Nirmal Bang Institutional Equities Research

Milk and nutrition is the major category in terms of revenue share for NEST. Major contributors to this segment are infant products (powder and cereals) under the brands Lactogen, NAN and Cerelac and GREKYO yoghurt. Infant foods category is dominated by one or two big players and NEST is among them and hence charges a premium for the same. Chocolate and confectionary category has shown consistent growth in the past. Similarly, Nescafe is the market leader in instant coffee segment which is growing rapidly in India. Similar to infant foods, instant coffee market has been dominated by only two players (NEST and HUL) which together account for around 97%-98% market share. Last year, the company also entered into Ready to Drink (RTD) coffee and MILO which, as a format, has relatively less competition.

Exhibit 12: Diverse product portfolio

Source: Company website, Nirmal Bang Institutional Equities Research

Supply chain is a significant source of strength

Considering the complexities involved in a food business supply chain, the advantage is fairly critical. NEST has been consolidating and strengthening its supply chain on a yearly basis. New launches were made in an efficient and speedy manner with the focus on optimising lead time. Logistics efficiency was the key area where the company has focused by running a logistics excellence programme to build logistics across the supply chain to facilitate easy and faster inflow and outflow of raw materials in the factory and warehouses. This has also reduced wastage during transit and production. Hence, we believe that benefits of these initiatives will flow through various cost lines. COGS forms around 44% of sales and hence supply chain efficiency could improve gross margin further to some extent, and other expenses like transportation, logistics, etc, will witness some savings. Also, increased use of data analytics in demand planning leads to better and faster delivery on the ground.

Food Regulation is becoming progressive

FSSAI is working to ensure safe and wholesome food to 1.3bn Indian citizens. To create responsible food businesses, FSSAI is building capacity and a culture of self compliance. The regulatory body has specified procedures and practices to be followed by food businesses. Also, guidelines have been stipulated for controlling sugar, salt and fat content in food products to promote health.

NEST is actively working with the regulatory body and Ministry for Food Processing Industries to raise awareness on food safety practices and hygiene habits across the country. Also, growing awareness about the trust and transparency with respect to the food consumed has also helped big players like NEST who follow an established set of practices and adhere to quality standards. Therefore, compared to local players, NEST is in a better position in terms of regulatory compliance.

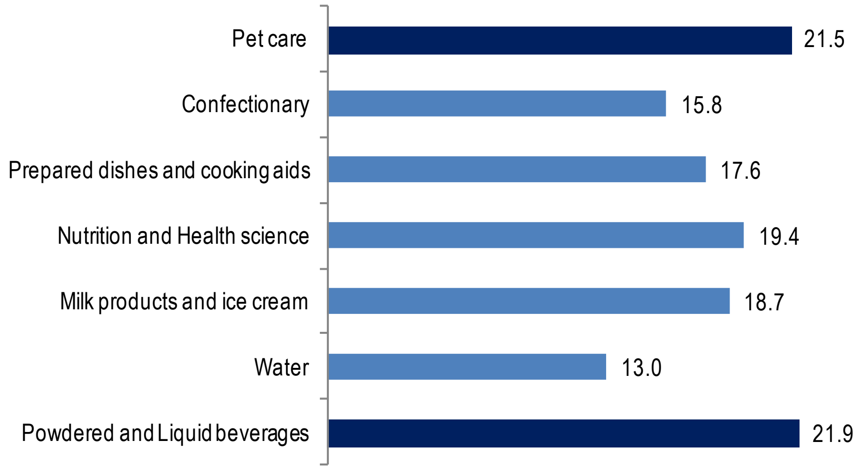
Distribution initiatives

Out of around 9mn outlets in India, NEST used to reach close to 5mn outlets i.e. around 55% outlets two years ago. Compared to other food players, this reach then was supposedly the highest. However, during the Maggi noodle crisis, the company had to remove Maggi products off the shelves and its distribution network crashed to nearly 3.5mn outlets. However, there has been a very strong rebound and Maggi noodles regained their leadership position. Consequently, NEST has access to around 4mn outlets of which the direct coverage is around 1.3mn outlets or 33%. In our opinion, the company is following the footsteps of large players like Hindustan Unilever and ITC in terms of marketing and distribution. The management stated that NEST is adopting a hyper-local model for marketing and distribution which will help increase penetration and expand reach, thereby leading to faster growth. Under this, NEST has divided India into 15 different clusters wherein each cluster will be treated differently based on factors like food preference, income level, etc. In our opinion, this is a positive move as the same will drive market penetration and improve the efficiency and quality of distribution.

Unmatched parent support

Although, India forms a smaller market for Swiss giant Nestle SA currently, there is strong growth potential in the market going forward. Emerging countries account for 43% of its revenues. India's share of revenues in consolidated sales and the AOA region is 2% and 6%, respectively. In our opinion, the opportunity is big and NEST's recent moves like introduction of ready-to-drink beverages like Nescafe and Milo and entry into the pet care market in India suggests that the focus will be on introducing some internationally successful products having operating margin above the company average.

Exhibit 13: Category-wise operating margin (%) of Nestle SA



Source: Company, Nirmal Bang Institutional Equities Research

Hence, a strong parent with core focus on categories will help the Indian arm to innovate and introduce new products in the market. Consumers are willing to pay a premium for the Nestle brand. It is to be noted that the company globally has a basket of around 2,500 products and hence global innovations will flow to its Indian operations eventually.

Financial performance

NEST had a weak financial phase during CY12-CY17 when it faced the Maggi noodle crisis and also overall sluggishness in volumes. Resultantly, over the past five years, NEST's top-line/EBITDA/PAT grew 3.7%/2.8%/2.7% as against previous five years' band of 18.9%/19.3%/16.9%, respectively. However, in the past 1.0-1.5 years the company's focus on innovation and rebound in Maggi noodle portfolio led to improvement in overall performance. We expect the growth momentum to accelerate across categories and hence expect a two-year CAGR of 12.7%, 16.7% and 21.9% in sales, EBITDA and PAT, respectively over the period CY17-CY19E.

Category-wise performance

NEST operates four divisions- milk and milk nutrition, prepared dishes and cooking aids, beverages and chocolate & confectionary. The market share of each segment has more or less remained constant except during the Maggi noodle crisis period. Past five years have been weak for NEST, as mentioned above, and the same is reflected from category-wise growth during the period.

Exhibit 14: Pickup in growth likely across the categories

Name of the category (%)	5-year CAGR CY07-CY12	5-year CAGR CY12-CY17	2-year CAGR CY17-CY19E
Milk products and nutrition	19.6	4.5	9.0
Prepared dishes and cooking aids	25.5	1.2	18.0
Beverages	9.2	5.1	13.0
Chocolate and confectionary	15.5	1.9	12.0
Total	18.7	3.3	12.3

Source: Company, Nirmal Bang Institutional Equities Research

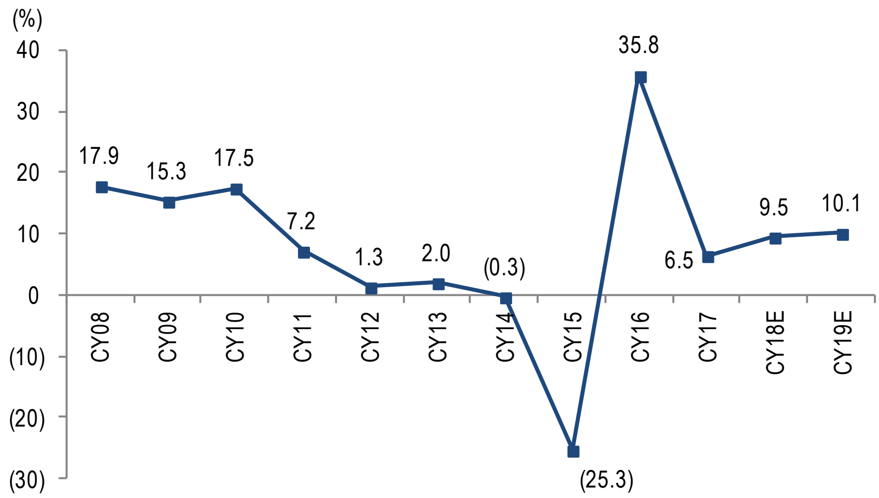
Volume growth has been flattish over the past few years across categories. This was the period wherein NEST did not come up with meaningful innovation and the entire consumer goods sector was facing the pressure. However, the management rightly shifted its focus back to innovation-led volume growth and the Maggi brand regained its lost ground in a rapid manner. Therefore, we expect around 7%-10% volume growth in the next two years.

Exhibit 15: Volume performance

Volume growth (%)	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17E	CY18E	CY19E
Milk products and nutrition	10.1	13.1	7.6	2.5	(5.1)	(1.1)	(2.3)	(2.7	(1.5)	4.0	6.0	7.0
Prepared dishes and cooking aids	30.1	21.7	24.4	13.2	8.0	3.8	3.7	(59.5)	73.0	8.0	12.0	12.0
Beverages	-	(3.1)	13.2	0.9	(5.0)	9.3	(11.0)	(10.3)	1.3	10.0	10.0	12.0
Chocolate and confectionary	12.4	9.7	21.2	(1.5)	(9.4)	(2.2)	(12.1)	(19.5)	7.7	5.0	8.0	9.0
Weighted Avg. Volume growth	**18**	**15**	**17**	**7**	**1**	**2**	**-**	**(25)**	**36**	**6**	**9**	**10**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Volume growth trend



Source: Company, Nirmal Bang Institutional Equities Research

As explained in the thesis section, NEST has been the market leader in almost all categories that it operates in. It has brands like Lactogen, NAN, Maggi, KitKat, and Nescafe under its kitty. NEST's dominance in milk and milk nutrition category is clearly seen from its historical growth rate. All three brands of the company are extremely popular and are leaders in their category. Except for the past two to three years, the category has grown in double digits. Maggi represents prepared dishes and cooking aids category and has been a steady performer in the past. Post relaunch of the brand, the company has completely gained ground that was lost to competitors during the crisis period. We expect growth to settle in mid-teens in this category. Performance of beverage portfolio (Nescafe) has been slightly volatile in the past, but considering the focus of the management and a variety of new products across different formats it will help the category to achieve low-mid teen growth going forward. Chocolate and confectionary has been a consistent performer over the years and has grown in low-mid teens. We expect similar growth to continue considering new variants launched and the ongoing innovation. Recent cut in GST rate has benefitted all categories except instant coffee. This will boost volume across categories, in our opinion.

Exhibit 17: Category-wise to-line trend

Gross sales composition %	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	CY18E	CY19E
Milk products and nutrition	43	44	44	44	45	43	45	55	50	48	46	45
Prepared dishes and cooking aids	24	26	27	28	28	29	29	16	24	25	27	28
Beverages	18	15	14	14	13	14	13	16	14	14	14	14
Chocolate and confectionary	15	15	15	14	14	14	12	13	12	13	13	13
Growth % segment-wise	**CY08**	**CY09**	**CY10**	**CY11**	**CY12**	**CY13**	**CY14**	**CY15**	**CY16**	**CY17**	**CY18E**	**CY19E**
Milk products and nutrition	23.0	19.2	20.1	20.7	15.2	5.5	12.4	2.1	0.9	2.0	8.0	10.0
Prepared dishes and cooking aids	10.9	0.4	11.8	18.8	5.1	17.9	123.7	(55.6)	74.9	12.0	18.0	18.0
Beverages	10.9	0.4	11.8	18.8	5.1	17.9	1.2	(0.3)	(3.1)	11.0	12.0	14.0
Chocolate and confectionary	19.5	13.6	26.4	12.7	6.4	10.0	(2.6)	(11.4)	6.6	8.5	12.0	12.0

Source: Company, Nirmal Bang Institutional Equities Research

NEST charges a premium on almost all its products because of its leadership position and strong brand equity that it enjoys. Also, over the years, new launches and innovations led to improvement in product mix of the company. Therefore, gross margin increased by close to 500bps in the past 10 years. However, operating margin always remained in the band of 19%-22% wherein the company continued to invest in brands and built capacity to cater to incremental demand. Now, we believe that most of the capacity addition has been done and the premium portfolio is expected to grow in low teens which will lead to better margins as a result of improved product mix and operating leverage benefits. We expect 150bps operating margin expansion over CY17-CY19E.

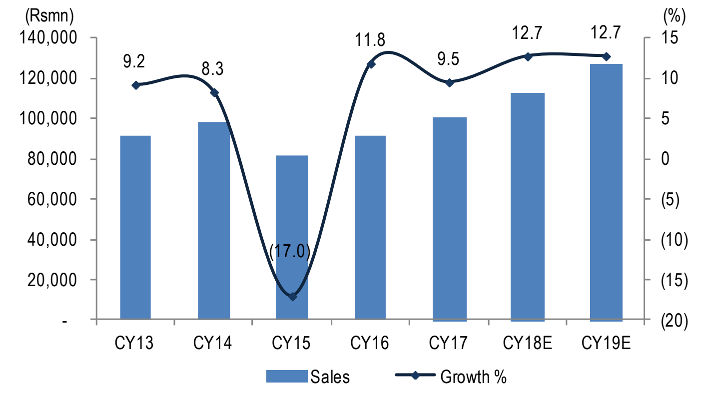
Milk, flour, edible oils, coffee etc are its key raw materials. Overall commodity basket is stable for the company. Prices of commodities like milk, wheat and sugar are softening however due to rise in the crude oil prices; the packaging material costs will be impacted. However, in our opinion, on an overall basis raw material prices relevant for the company are very much within control and in line with the company's internal budgets.

Exhibit 18: Commodity basket

% composition	CY11	CY12	CY13	CY14	CY15	CY16
Fresh milk	25.6	24.5	21.2	25.0	27.7	23.4
Milk derivatives	12.0	12.4	12.4	14.9	16.7	15.6
Grain flour	8.8	9.8	11.0	10.0	5.7	9.2
Green coffee and chicory	8.8	8.7	9.5	8.4	11.1	8.6
Edible oils	9.2	8.7	8.6	7.8	5.9	7.6
Sugar	5.3	5.5	5.0	4.0	4.1	4.6
Others raw materials	13.6	13.6	14.2	13.0	12.4	13.4
Packing materials consumed	16.7	16.8	18.0	16.9	16.3	17.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

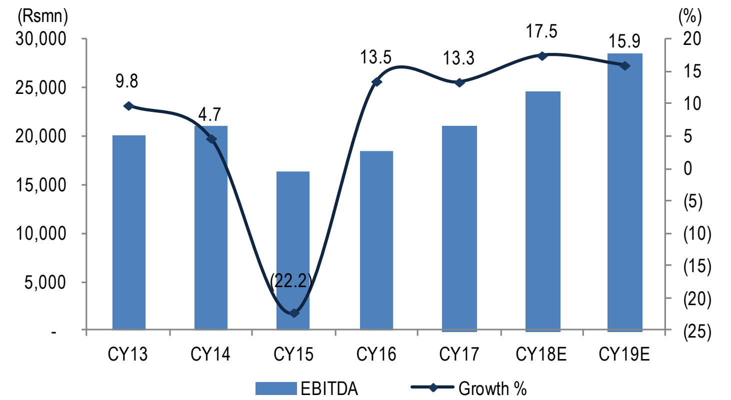
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: Top-line growth



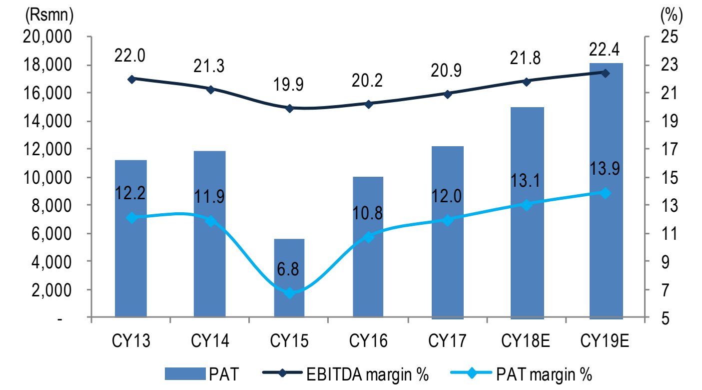
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: EBITDA growth



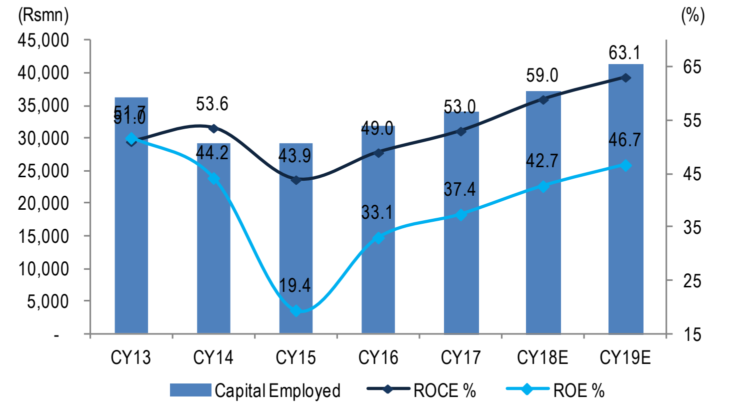
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Net profit versus net profit margin versus EBITDA margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: Return ratios



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Our estimates versus consensus estimates

Particulars	CY18E			CY19E		
	Our estimate (Rsmn)	Consensus (Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus (Rsmn)	*Variance (%)*
Sales	112,828	113,476	*(0.6)*	127,212	128,858	*(1.3)*
EBITDA	24,625	24,681	*(0.2)*	28,551	28,497	*0.2*
Net income	15,032	14,985	*0.3*	18,118	17,786	*1.9*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Comparative performance

We compared the financial performance of some F&B companies. NEST's performance can be viewed in two phases i.e. pre-Maggi noodle crisis and the period post re launch of the brand. In the meantime, the company struggled to keep up with the growth trend. During pre-Maggi noodle crisis, NEST delivered steady top-line growth i.e. high double-digit growth in five out of eight calendar years i.e. in line with the other big F&B players as can be seen in the below table. Similar trend was observed in profitability.NEST has recovered very fast after the crisis and registered double digit top-line growth. We believe that with a strong innovation pipeline, focus on value-up category and on volume will lead to healthy growth in top-line and profitability going forward.

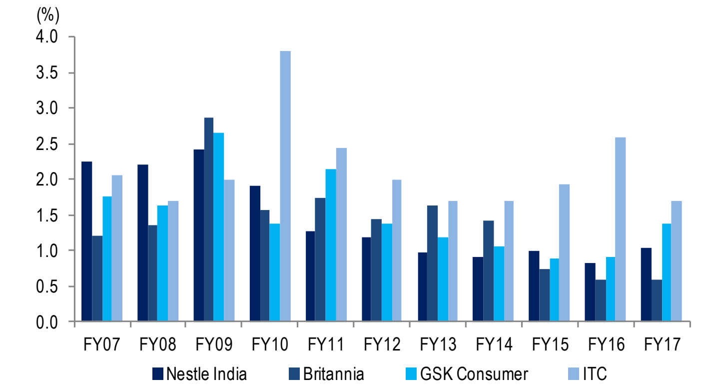
Exhibit 24: Top-line and profitability trends of the food companies

Sales growth (%)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
ITC	14.7	11.9	16.3	18.2	17.3	18.8	11.2	9.8	0.2	9.6	2.7	8.1	8.5
Nestle India	24.4	23.4	18.6	21.9	20.1	10.9	9.2	8.3	(17.0)	11.8	9.5	12.7	12.7
Britannia Industries	22.5	23.2	10.3	22.2	19.0	12.8	11.8	13.7	6.9	7.8	9.4	12.5	14.7
GlaxoSmithkline Consumer Healthcare	15.0	20.6	24.6	20.0	16.5	18.7	52.7	(11.5)	(4.0)	(3.6)	9.1	8.8	10.5
Total	**17.1**	**15.8**	**16.4**	**19.5**	**18.0**	**16.5**	**13.7**	**8.1**	**(2.1)**	**8.7**	**5.1**	**9.5**	**10.3**
EBITDA growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	11.3	10.3	25.0	22.0	19.4	20.1	17.2	8.2	1.8	6.3	8.2	9.9	9.6
Nestle India	39.0	10.5	19.1	24.1	23.4	20.2	9.8	4.7	(22.2)	13.5	13.3	17.5	15.9
Britannia Industries	81.6	1.2	(31.4)	45.3	31.3	35.3	49.1	37.7	40.6	5.3	16.5	24.2	24.5
GlaxoSmithkline Consumer Healthcare	2.0	5.7	30.8	21.3	12.8	34.9	52.2	(16.3)	15.3	(1.0)	4.3	11.7	15.7
Total	**15.9**	**9.8**	**22.3**	**22.8**	**19.9**	**21.1**	**18.7**	**7.6**	**1.4**	**6.5**	**9.1**	**11.8**	**11.7**
PAT growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	15.6	4.6	24.4	22.8	23.6	20.4	18.4	9.4	(3.1)	9.5	5.3	13.2	9.6
Nestle India	55.2	9.2	22.6	25.0	17.5	11.1	4.6	6.0	(52.5)	77.8	21.7	23.3	20.5
Britannia Industries	67.9	(18.8)	(28.0)	30.2	48.8	30.1	52.3	74.0	19.7	7.3	11.8	26.3	25.2
GlaxoSmithkline Consumer Healthcare	28.2	15.8	23.6	28.8	18.5	23.0	54.5	(13.5)	17.8	(4.5)	3.2	11.1	16.7
Total	**21.6**	**4.6**	**22.3**	**23.5**	**23.1**	**19.6**	**19.5**	**9.9**	**(5.6)**	**11.9**	**7.0**	**14.9**	**12.3**

Source: Nirmal Bang Institutional Equities Research

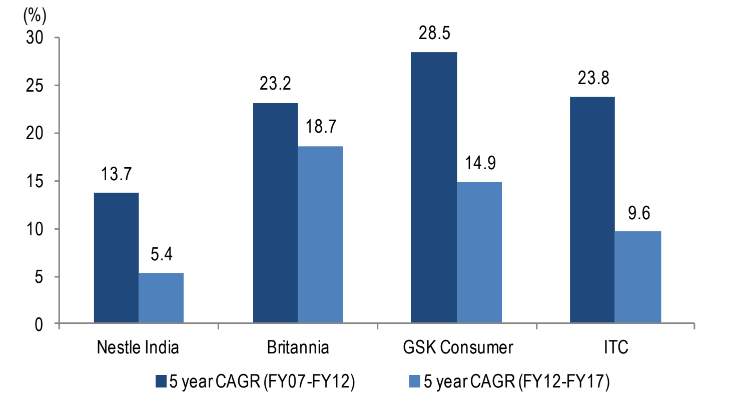
We compared DPS growth of food companies in our coverage universe by forming two bands of five years each i.e. FY07-FY12 and FY12-FY17. Except for Britannia Industries or BIL, all others witnessed a fall in the growth rate of DPS over the past five years, largely reflecting the pressure on fundamentals. Since the past four to five years, NEST has maintained its dividend yield close to 1% before which it used to be around 2%. This 1% yield is lower than that of GSK Consumer Healthcare and ITC, but slightly better than that of BIL.

Exhibit 25: Dividend yield trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 26: DPS in five-year CAGR band



Source: Company, Nirmal Bang Institutional Equities Research

Valuation and recommendation

NEST has been a steady performer over the years except during the Maggi noodle crisis and couple of years before that when volume growth was muted. On a relative basis, NEST outperformed the index before CY11 and afterwards there has been a consistent underperformance compared to Nifty 50. Therefore, over the past few years, other players were better off compared to NEST which is justified by the fundamental performance. However, we believe the company has recovered strongly and is headed for higher growth in the next two to three years which will get reflected in stock price performance in the coming years.

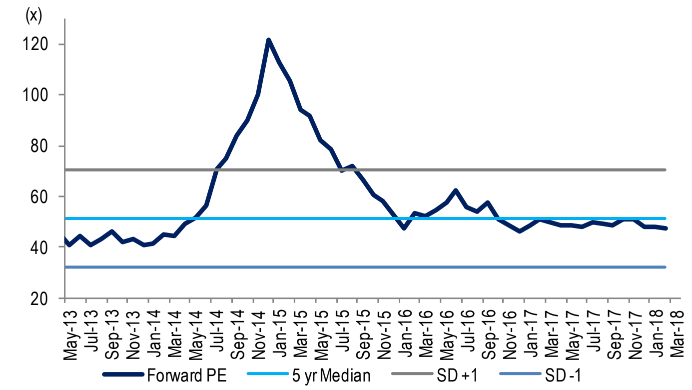
Exhibit 27: Absolute and relative price performance history

F&B companies	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
Absolute performance (%)												
ITC	19	(18)	46	42	16	42	12	15	(11)	11	9	2
Nestle India	32	(3)	75	50	7	22	6	21	(9)	3	31	(4)
Britannia Industries	35	(10)	27	23	8	11	85	100	61	(3)	63	5
GSK Consumer Healthcare	31	(23)	130	80	10	50	17	32	9	(22)	31	4
Relative performance (%)												
ITC	(23)	70	(17)	21	54	12	5	(13)	(7)	8	-15	3
Nestle India	(15)	102	-	27	42	(5)	(1)	(8)	(5)	-	1	(3)
Britannia Industries	(13)	86	(28)	4	44	(13)	73	52	68	(6)	27	6
GSK Consumer Healthcare	(16)	59	31	52	46	17	9	1	14	(24)	2	4

Source: Bloomberg, Nirmal Bang Institutional Equities

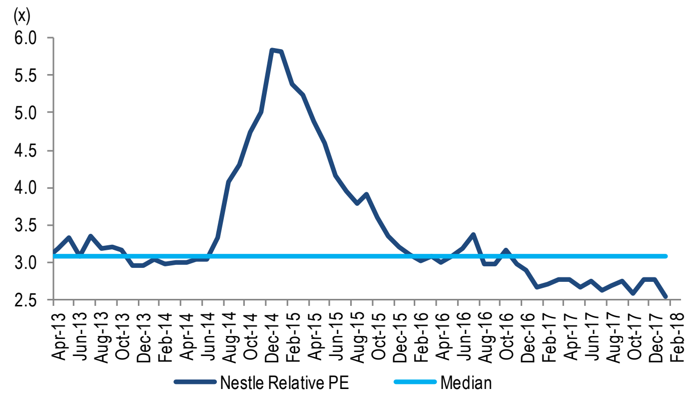
NEST stock currently trades at 47x one-year forward earnings i.e. at a discount of 7% to five-year median P/E. Similarly, the stock trades at a discount of 2% and a premium of 2% to five-year median EV/EBITDA and P/sales, respectively. We also compared forward P/E of the stock with the indices and it was observed that NEST trades at a premium to both Nifty 50 and Nifty FMCG indices.

Exhibit 28: One-year forward P/E of Nestle India



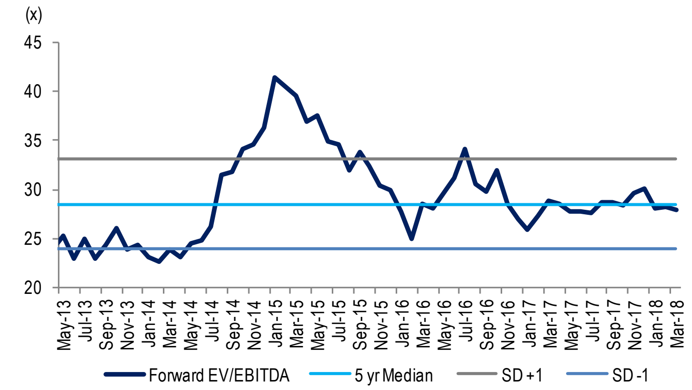
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: Relative P/E (Nifty) of Nestle India



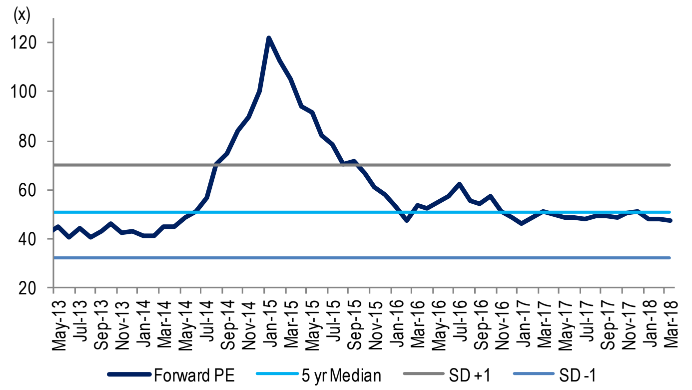
Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 30: One-year forward EV/EBITDA



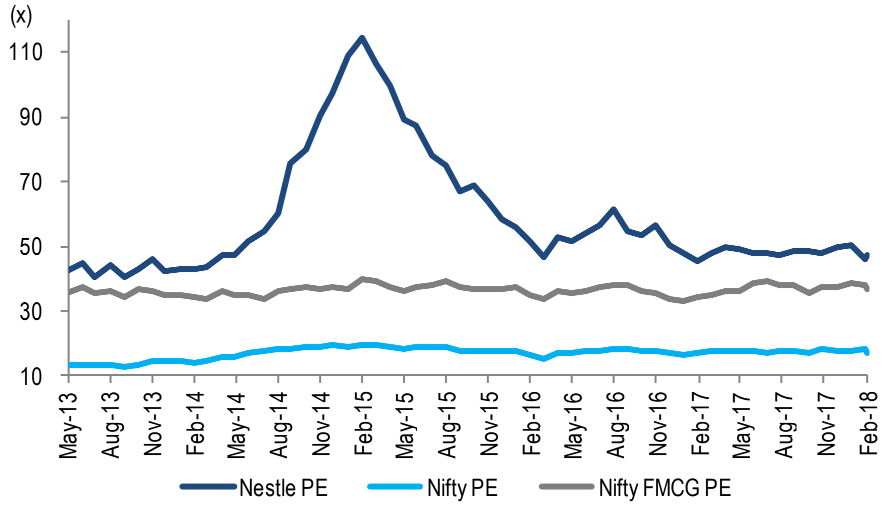
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 31: One-year forward P/Sales



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Nestle India vis-à-vis Nifty and Nifty FMCG



Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Current valuation is justified by improved growth trajectory

Indian consumer and F&B stocks have consistently traded at a significant premium to their peers and this has been evident not just in a bear market, but also in a bull market. As mentioned above, we expect overall recovery in the consumer sentiment and revival of rural markets. NEST will be one of the key beneficiaries of this incremental growth and we are factoring in low teen top-line growth over a period of three years and very high double-digit growth in earnings. In our food coverage universe, we expect NEST to clock highest growth over the medium term. Comparison of PEGs of various foods companies suggests that the current multiples of some of them are not justified by future earnings outlook. NEST will continue to trade at a higher multiple supported by strong underlying growth in earnings.

Exhibit 33: Valuation of Indian Food players

Company	CMP* (LC)	Mkt cap (USD mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
ITC	270	50,679	8.0	7.4	6.8	19.9	18.0	16.3	30.5	27.0	24.6	6.4	9.2	9.3	3.3
Nestle India	7,619	11,302	7.3	6.5	5.8	33.7	28.4	24.2	60.2	48.9	40.5	11.6	15.6	21.9	2.7
Britannia Industries	4,867	8,989	5.9	5.2	4.6	38.9	31.0	24.5	59.1	46.8	37.4	12.6	21.7	20.9	2.8
GSK Consumer Healthcare	6,837	4,423	6.6	6.1	5.5	29.7	26.1	22.1	42.4	38.2	32.7	9.4	10.4	10.2	4.2
Parent company															
Nestle SA	77	250,901	2.6	2.5	2.4	14.0	13.1	12.2	20.2	18.5	16.6	3.1	9.1	18.6	1.1

**CMP is the closing price of 12th March 2018 ^3 year CAGR (FY17-FY20E)*

Source: Nirmal Bang Institutional Equities Research

We initiate coverage on NEST with a Buy rating and a target price of Rs9,400 by March 2019, implying an upside of 23% from the CMP. Our target price is based on P/E multiple of 50x (CY2019E EPS) which is at a discount of 7% to the current one-year forward P/E (47x), and in line with the five-year median P/E. We believe that strong volume-led growth across categories going forward and strong premiumisation play will lead to healthy earnings growth compared to peers and hence the stock will continue to trade at a premium earnings multiple.

Risks

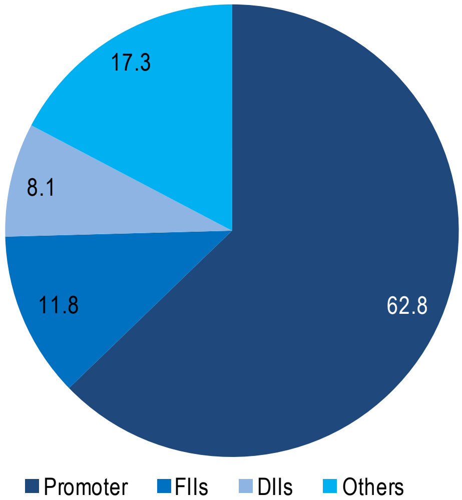
- Consumers are fairly demanding of high quality standards and any adverse product related issues that emerge in the future could pose significant risk to growth and recommendations
- Any macro-economic slowdown, disruption and/or policy announcements which substantially impacts consumer spending and the premiumisation trend in India.
- We expect the rural economy to see gradual improvement after being weak substantially in the past three years. Any weather or policy-related issue that impacts this recovery could also pose risk to our earnings estimate and recommendation.
- Pricing-related competitive challenges so far have been moderate, but if this scenario witnesses any major change it could have a substantial impact on our earnings estimate and recommendation.
- Most companies have been moderating marketing and investment spending in the recent past and any substantial increase in spending does pose substantial risk to our estimate.
- Any unprecedented event like Maggi crisis in future could have an adverse impact on the fundamentals of business and Nestle as a brand in India.

Exhibit 34: Management committee

Name	Designation
Mr. Suresh Narayanan	Chairman/MD
Mr. Shobinder Duggal	CFO
Mr. B. Murli	Senior VP – Legal
Mr. Sanjay Khajuria	Senior VP – Corporate Affairs
Mr. Anurag Dikshit	Head – Treasury

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 35: Shareholding pattern (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: Top 10 public shareholders

Particulars	% holding
Life Insurance Corporation of India	5.15
Arisaig Partners (Asia) a/c Arisaig India Fund	1.35
Commonwealth Bank of Australia	0.92
Blackrock	0.92
SBI Funds Management	0.87
Vanguard Group	0.86
Standard Life Aberdeen PLC	0.79
Franklin Resources	0.29
Jupiter Inv Mgmt Group	0.27
Matthews Intl. Capital Management	0.27

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 37: Income statement

Y/E December (Rsmn)	CY15	CY16	CY17	CY18E	CY19E
Net sales	81,753	91,413	1,00,096	1,12,828	1,27,212
% Growth	***(17.0)***	***11.8***	***9.5***	***12.7***	***12.7***
COGS	34,689	38,828	43,269	49,014	55,257
Staff costs	8,374	9,016	10,175	11,338	12,591
Other expenses	22,387	25,071	25,688	27,852	30,813
Total expenses	65,451	72,915	79,131	88,204	98,662
EBITDA	16,303	18,498	20,965	24,625	28,551
% growth	***(22.2)***	***13.5***	***13.3***	***17.5***	***15.9***
EBITDA margin (%)	***19.9***	***20.2***	***20.9***	***21.8***	***22.4***
Other income	1,101	1,509	1,769	2,261	3,012
Interest costs	786	909	919	917	917
Depreciation	3,473	3,537	3,484	3,614	3,744
Profit before tax (before exceptional items)	13,145	15,562	18,332	22,355	26,902
Exceptional items	(5,008)	(108)	-	-	-
Tax	2,504	5,440	6,141	7,323	8,783
PAT	5,633	10,014	12,190	15,032	18,118
Adj. PAT	10,641	10,122	12,190	15,032	18,118
Adj. PAT margin (%)	***12.8***	***10.9***	***12.0***	***13.1***	***13.9***
% Growth	***(52.5)***	***77.8***	***21.7***	***23.3***	***20.5***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: Balance sheet

Y/E December (Rsmn)	CY15	CY16	CY17	CY18E	CY19E
Share capital	964	964	964	964	964
Reserves	27,968	30,675	32,600	35,877	39,828
Net worth	28,932	31,639	33,564	36,842	40,792
Total debt	177	332	400	451	509
Deferred tax liability	1,729	1,542	1,802	2,257	2,671
Total liabilities	**46,800**	**53,235**	**56,786**	**63,469**	**71,196**
Gross block	51,174	52,600	54,600	56,600	58,600
Depreciation	21,913	25,187	28,671	32,285	36,029
Impairment	282	118	118	118	118
Net block	28,979	27,295	25,811	24,197	22,453
Capital work-in-progress	2,308	1,882	2,382	2,882	3,382
Investments	13,249	17,494	18,518	20,873	23,534
Inventories	8,208	9,432	10,721	12,376	13,965
Debtors	784	979	666	1,189	903
Cash	4,996	8,800	14,754	20,198	27,810
Loans & advances	2,173	1,873	1,718	1,937	2,184
Other current assets	163	301	300	338	382
Total current assets	24,855	32,790	40,170	49,578	60,509
Creditors	7,494	7,992	9,079	10,258	11,845
Other current liabilities & provisions	4,659	5,128	5,505	6,206	6,997
Total current liabilities	14,816	16,327	18,087	20,526	23,421
Net current assets	10,039	16,463	22,083	29,052	37,088
Total assets	**46,047**	**51,733**	**56,786**	**63,469**	**71,196**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: Cash flow

Y/E December (Rsmn)	CY15	CY16	CY17	CY18E	CY19E
PAT	5,633	10,014	12,190	15,032	18,118
Depreciation	3,473	3,537	3,484	3,614	3,744
Other income	(1,101)	(1,509)	(1,769)	(2,261)	(3,012)
(Inc.)/dec. in working capital	1,370	309	1,096	193	1,518
Cash flow from operations	**9,375**	**12,350**	**15,002**	**16,578**	**20,369**
Capital expenditure (-)	(1,508)	(2,070)	(2,500)	(2,500)	(2,500)
Net cash after capex	**7,867**	**10,280**	**12,502**	**14,078**	**17,869**
Interest paid (-)	786	909	919	917	917
Dividends paid (-)	(4,676)	(6,074)	(8,533)	(9,771)	(11,777)
DDT paid (-)	(956)	(1,237)	(1,732)	(1,983)	(2,391)
Inc./(dec.) in investments	(5,131)	(4,244)	(1,024)	(2,355)	(2,661)
Cash from financial activities	**(4,064)**	**(3,593)**	**(8,639)**	**(8,349)**	**(10,391)**
Opening cash balance	4,458	4,996	8,800	14,754	20,198
Closing cash balance	4,996	8,800	14,754	20,198	27,810
Change in cash balance	537	3,805	5,954	5,444	7,612

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Key ratios

Y/E December	CY15	CY16	CY17	CY18E	CY19E
Per share (Rs)					
EPS	58.4	103.9	126.5	155.9	188.0
Book value	300.1	328.2	348.2	382.2	423.2
DPS	48.5	63.0	88.5	101.4	122.2
Valuation (x)					
P/Sales	6.9	6.4	7.3	6.5	5.8
EV/sales	6.7	6.1	7.1	6.2	5.4
EV/EBITDA	33.6	30.3	33.7	28.4	24.2
P/E	99.7	58.0	60.2	48.9	40.5
P/BV	19.4	18.4	21.9	19.9	18.0
Return ratios (%)					
RoCE	43.9	49.0	53.0	59.0	63.1
RoE	19.4	33.1	37.4	42.7	46.7
Profitability ratios (%)					
Gross margin	57.6	57.5	56.8	56.6	56.6
EBITDA margin	19.9	20.2	20.9	21.8	22.4
EBIT margin	15.7	16.4	17.5	18.6	19.5
PAT margin	6.8	10.8	12.0	13.1	13.9
Liquidity ratios (%)					
Current ratio	1.7	2.0	2.2	2.4	2.6
Quick ratio	1.1	1.4	1.6	1.8	2.0
Solvency ratio (%)					
Debt to equity ratio	-	-	-	-	-
Turnover ratios					
Total asset turnover ratio (x)	1.3	1.3	1.3	1.3	1.3
Fixed asset turnover ratio (x)	2.8	3.3	3.9	4.7	5.7
Inventory days	88	83	85	86	87
Debtors days	4	4	3	3	3
Creditor days	78	73	72	72	73

Source: Company, Nirmal Bang Institutional Equities Research

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Britannia Industries

13 March 2018

Reuters: BRIT.BO; Bloomberg: BRIT IN

Initiating Coverage

'Pure Magic'

Britannia Industries (BRIT) is the market leader in biscuits which is one of the largest categories in the packaged foods space in India. BRIT has a very wide product portfolio with more than eight brands having a turnover of more than Rs5bn each. BRIT also has a best-in-class supply chain network and a world class research & development or R&D centre. The company emphasizes a lot on execution and has performed consistently over the past several years. We believe it has all the ingredients to become a successful Total Food Company. We initiate coverage on BRIT with a Buy rating and a target price of Rs5,850. Our target price is based on P/E multiple of 45x and is consistent with its current trading multiple.

Consistently delighting consumers: BRIT's innovation agenda has consistently remained ahead of the curve and this should help the company in maintaining double-digit growth and outperforming its peers. Strong presence in the fast-growing modern trade along with expected improvement in semi-urban and rural markets should support improvement in growth to 14% in FY18E-FY20E as compared to 8% in FY15-FY18E.

Margin tailwinds remain strong: Continuous improvement in product mix, moderate competitive intensity, stable commodity price environment and sharp focus on cost optimisation should support the operating margin expansion trend and we expect further gains of 300bps over FY18E-FY20E.

Valuation well supported by track record: Bakery segment, in our opinion, ticks all the right boxes in terms of taste, health and convenience. In our opinion, category growth opportunity, and product portfolio as well as distribution strength of the company are still underpriced. We expect the company to maintain its consistent earnings performance track record and expect it to deliver 26% growth over FY18E-FY20E. We initiate coverage on BRIT with a Buy rating and a target price of Rs5,850 indicating an upside of 20% from CMP. Our target price is based on P/E multiple of 45x and is consistent with its current trading multiple.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net revenues	83,972	90,541	99,059	1,11,480	1,27,911
EBITDA	12,144	12,782	14,890	18,498	23,023
Adj PAT	8,244	8,843	9,886	12,487	15,628
EPS (Rs)	68.7	73.7	82.4	104.1	130.2
EPS growth (%)	*19.7*	*7.3*	*11.8*	*26.3*	*25.2*
EBITDA margin (%)	*14.5*	*14.1*	*15.0*	*16.6*	*18.0*
P/E (x)	39.1	45.8	59.1	46.8	37.4
P/BV (x)	15.4	15.0	17.2	13.4	10.6
EV/EBITDA (x)	26.2	31.5	38.9	31.0	24.5
RoCE (%)	*57.1*	*46.0*	*42.6*	*41.9*	*41.3*
RoE (%)	*46.0*	*36.9*	*32.5*	*32.3*	*31.7*

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: FMCG

CMP: Rs4,867

Target Price: Rs5,850

Upside: 20%

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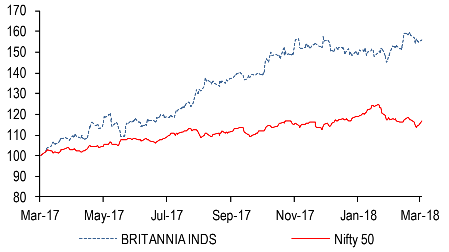
Key Data

Current Shares O/S (mn)	120.1
Mkt Cap (Rsbn/US$bn)	584.3/9.0
52 Wk H / L (Rs)	5,066/3,136
Daily Vol. (3M NSE Avg.)	153,957

Shareholding (%)	1QFY18	2QFY18	3QFY18
Promoter	50.7	50.7	50.7
Public	49.3	49.3	49.3
Others	-	-	-

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
Britannia Industries	2.0	12.7	55.9
Nifty Index	(1.1)	3.3	16.6

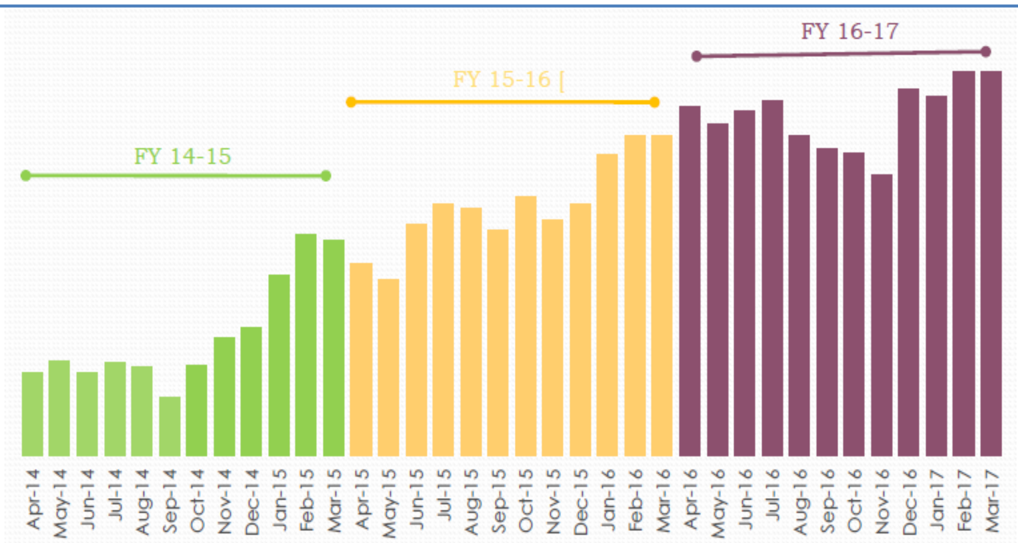
Source: Bloomberg

Investment thesis

Flexi and healthy meal mega trend should support both volume growth and premiumisation

In our opinion, BRIT should continue to deliver a balanced growth supported by healthy underlying volume growth and premiumisation. Bakery as a segment, in our opinion, ticks all the right boxes in terms of taste, health and convenience. There is also a growing trend among millennials seeking flexi and healthy meal options. We believe these factors will support the bakery segment's growth fairly substantially. This headroom along with sharp focus on execution should mean the company's growth should be competitive and well ahead of peers by at least 3%-4%. The company, under the leadership of Mr. Varun Berry, has significantly shifted gears not only on the innovation side, but also a lot on the distribution side. BRIT's key twin strategy of expanding presence in the Hindi belt and consistent focus on premiumisation continues to deliver healthy results. We believe the company will also continue to gain market share in the range of 50bps-100bps because of the above strategy and importantly also because of the confidence it enjoys among channel partners i.e. distributors and retailers who have aligned with the company since the past several years.

Exhibit 1: Consistent gain in market share

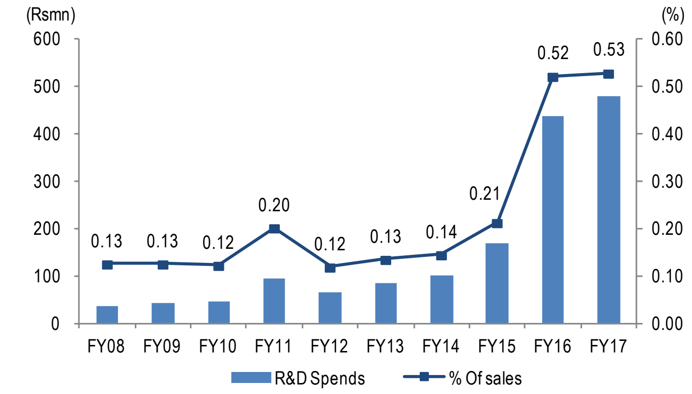


Source: Company, Nirmal Bang Institutional Equities Research

Strong innovation agenda gives a significant edge

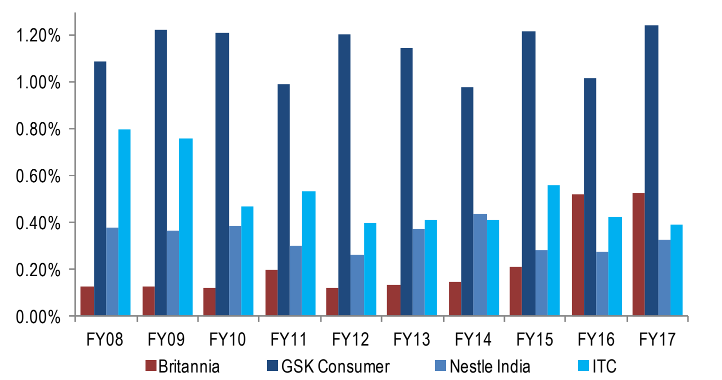
In this digital age of fast changing taste and preferences, companies need to constantly innovate and renovate their portfolio. Consumers are now more open to innovation because of social media and are consistently giving their feedback on a real-time basis. BRIT's strong focus on innovation helps it to maintain a fairly competitive presence in the market place. BRIT largely caters to the mid-to-premium segment and all its innovations in the recent past have tilted towards the premium portfolio to catch up with the trend. Apart from its biscuit portfolio, BRIT is continuously innovating in other categories which are largely underpenetrated in the Indian context like rusk, cake, beverage, snack etc which have huge potential for growth. We believe that meal patterns of the consumers are changing rapidly because of change in their lifestyle and a rise in the number of nuclear multicultural families. Consumers these days prefer quicker, easy to eat and cook options throughout the day. Hence, BRIT's move to focus on categories like rusk, cake, snack, health beverage, etc will help the company in catching up with the trend in a swift manner compared to peers. The management's focus on these categories is evident from the fact that it has created separate business centres for these categories and appointed respective heads to maintain the focus on growth. BRIT's R&D centre in Bengaluru is also operational now. BRIT has formed a joint venture with Chipita for manufacturing croissant, which is a new product category for consumers in India but has great potential looking at the nature of the product. Increase in spending on R&D is clearly evident over the past five years wherein all other major food companies have just maintained the same proportion of spending. The management had recently stated that BRIT is going to introduce around 50 more products across categories in FY19. This includes new launches in the biscuit segment and new verticals like dairy, croissant, etc, mainly in 2HFY19. Hence, we believe that BRIT's innovation agenda augurs well with its goal of becoming a 'total foods company' and these early steps will help BRIT to achieve sustainable long-term growth supported by increased volume going forward.

Exhibit 2: R&D spending



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: R&D spending (% of sales) of peers



Source: Company, Nirmal Bang Institutional Equities Research

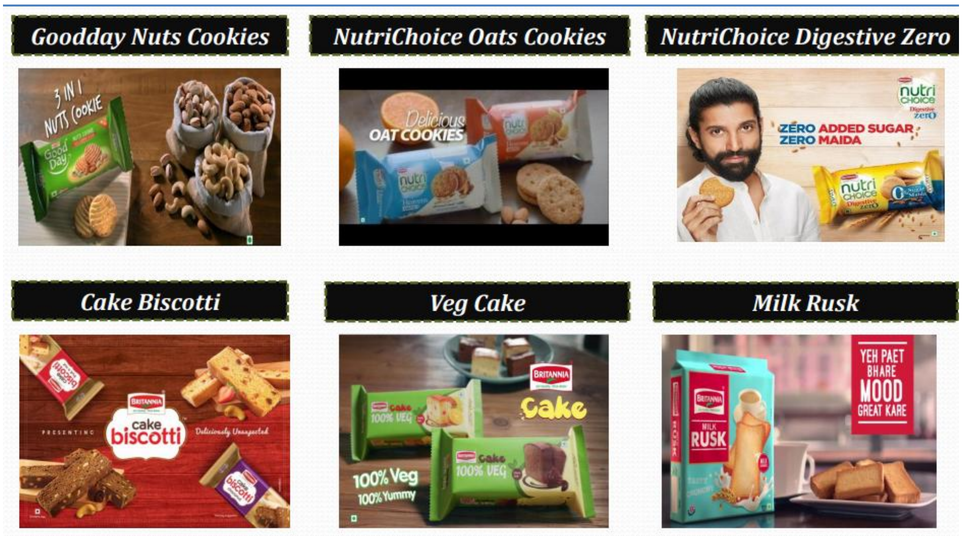
Exhibit 4: Key new launches

FY	Innovation/new launches	Segment
2011	Good Day Chip Cookies, Treat O , Nuti Choice	Biscuit
	Acti Mind , Dahi , UHT Milk, Healthy Start - Porridge, Oats , Upma	Non-biscuit
2012	Pure Magic , 50-50 Snackfruits	Biscuit
	Gourmet Cheese , Tiger Flavoured Milk, Multi Grain Bread	Non-biscuit
2013	Variants of Time Pass, Coffee variant in Bourbon	Biscuit
2014	Campaigns for Good Day , Nutri Choice, Chocolate variant in Jim Jam and Treat	Biscuit
2015	Nutri Choice Heavens, Good Day Chunkies	Biscuit
	Britannia Nut n Raisin Cake	Non-biscuit
2016	Pure Magic Chocolush, Tiger Cashew Cookies	Biscuit
2017	Good Day Choco Chips and Nuts cookie, 50-50 Mathri Masti , Nutri Choice Digestive Zero	Biscuit
	Cake Biscotti	Non-biscuit
2018	Launch of Good Day Wonderfulls, Renovation of Treat, Revamp of Good Day Chcolate, Launch of Pure Magic Deuce – Chocolate and Vanilla	Biscuit

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5: Premiumisation and reimaging of brands across the categories

Source: Company, Nirmal Bang Institutional Equities Research

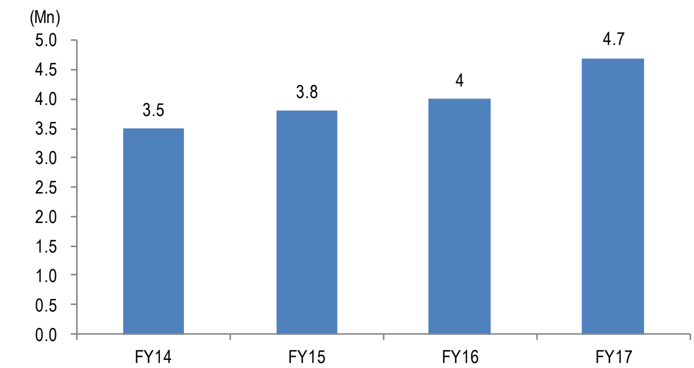


Source: Company, Nirmal Bang Institutional Equities Research

Growth potential in distribution, share of direct reach increasing rapidly

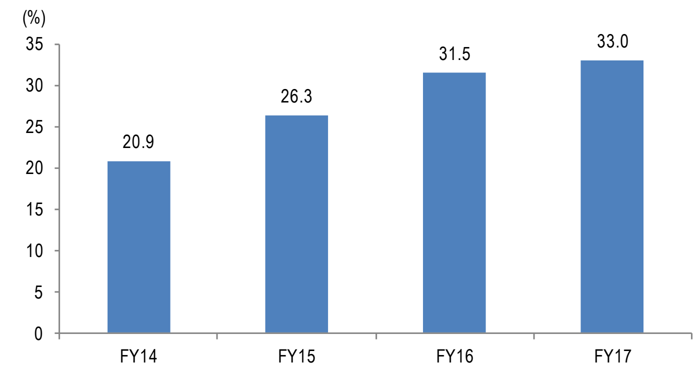
BRIT has timely identified that a growing distribution base is of paramount importance for achieving sustainable growth through increased market penetration. Otherwise, growth in specific geographies will become stagnant beyond a point in time. To penetrate existing as well as new categories into the market and to increase market share, it is extremely essential to have a wider coverage. BRIT's deliberate efforts in increasing its reach led to a 1.34x increase over FY14-FY17. BRIT catered to more than 4.7mn outlets as of FY17-end as against Parle which has nearly 6mn outlets under its coverage. Rather than just depending on wholesalers and other channels, BRIT has made its direct reach even stronger, registering a growth of 2.12x over the same period. Direct reach as a percentage of total reach is around 35% as against 21% in FY14. BRIT believes that still a lot of ground has to be covered as it has access to only 61% of total outlets for biscuits. In the Hindi belt, the gap between BRIT and Parle is around 800,000 outlets which provides further growth potential in those markets. This reflects the distribution-led growth potential going forward. Our interaction with the management indicates that BRIT can ramp up its direct reach coverage up to 2.4mn-2.5mn outlets and then the pace could be slowed down a bit as the increase in direct reach comes at a cost for the company. Also our channel checks indicate that Parle has a robust distribution network compared to BRIT, while the quality of distribution is better in case of BRIT. Also, steps such as zero-day inventory at the distributor level will improve the quality of distribution further and will keep the attrition rate minimal or zero, as is the case currently in case of BRIT.

Exhibit 6: Widening of distribution base (mn outlets)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Improvement in direct reach (%)



Source: Company, Nirmal Bang Institutional Equities Research

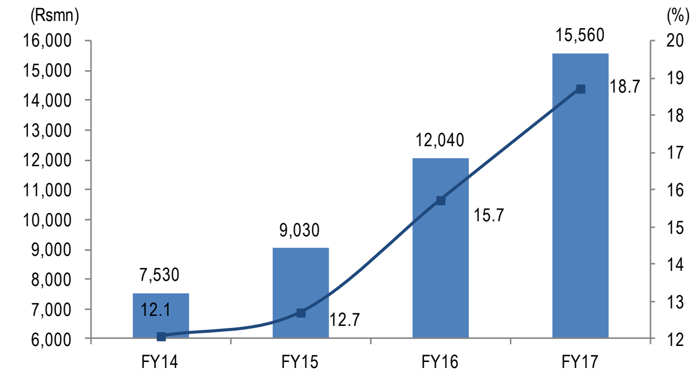
Rising presence in modern trade channels

BRIT was least impacted during the demonetisation phase because of lesser dependence on wholesale channels and a higher share of direct reach. Also, BRIT has a stronger presence in modern trade channels which are growing rapidly. We believe that growth going forward will largely come from non-traditional trade channels and BRIT's disproportionate share in these channels will help it to post growth over the players largely dependent on general trade. BRIT enjoys around 42% share in modern trade channels, which is 10% more than its overall market share across channels. This shows that BRIT is clearly the winner in the modern trade channels category which is growing rapidly.

Rural growth will improve overall market share going forward

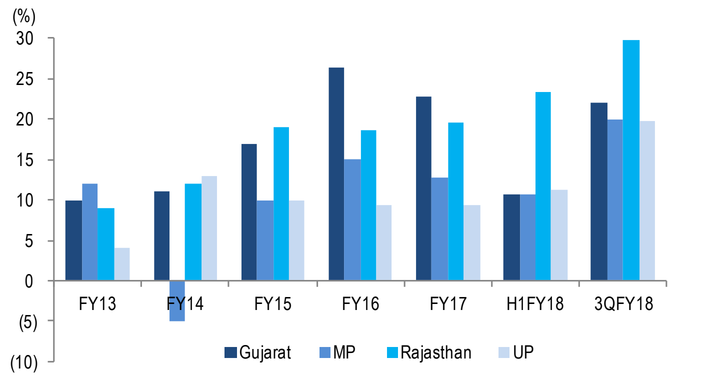
For the past couple of years, rural market was going through a tough phase because of uncertain monsoon, low income level of farmers, poor infrastructure, etc. Consumer companies' growth rate was impacted because of all this. However, things are gradually improving with the consumer sentiment witnessing a gradual uptick. Although Britannia was largely perceived as an urban-centric brand, BRIT's presence in rural markets increased sharply in recent years (19% in FY17 as against 12% in FY14). In rural India, market share of BRIT is just one-fifth of the market leader. Thus, overall, BRIT enjoys 32% market share, but its rural share is below 20%. BRIT has made dedicated efforts by reaching out to as many villages as possible. It has identified the Hindi-speaking belt as a dedicated region and is constantly focusing on growth rate and market share improvement. Focused states like Gujarat, Madhya Pradesh, Rajasthan, Uttar Pradesh, etc, are growing in double digits, but their share is very small currently. Growth rate in the Hindi-speaking belt is 1.5x the category average. BRIT's focus on rural growth is clearly reflected from the rising share of rural market as a percentage of domestic sales. Its market share in rural areas is two-thirds of its share in urban areas. In our opinion, there is big potential for the company to grow its market share by leveraging its brand and innovation at the expense of other big and small players. Growth in rural market share will improve overall market share to attain leadership status. We believe that strong performance in rural markets will help BRIT to achieve double-digit top-line growth on a sustained basis.

Exhibit 8: Rapid growth in rural markets



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 9: Focused states' growth trend

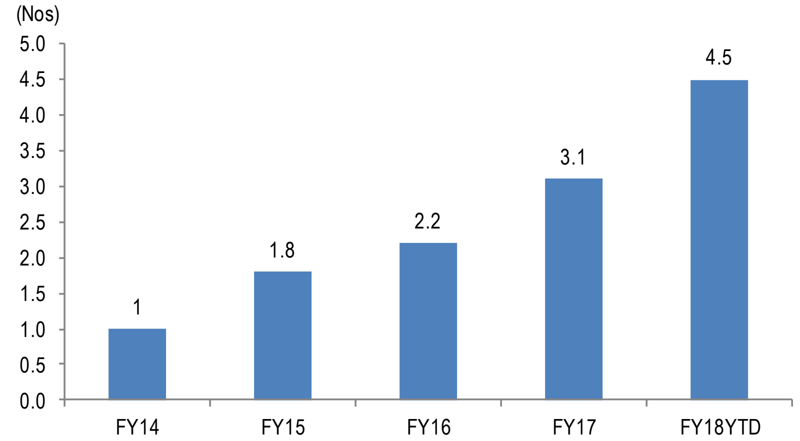


Source: Company, Nirmal Bang Institutional Equities Research

Strong focus on attaining supply chain efficiency

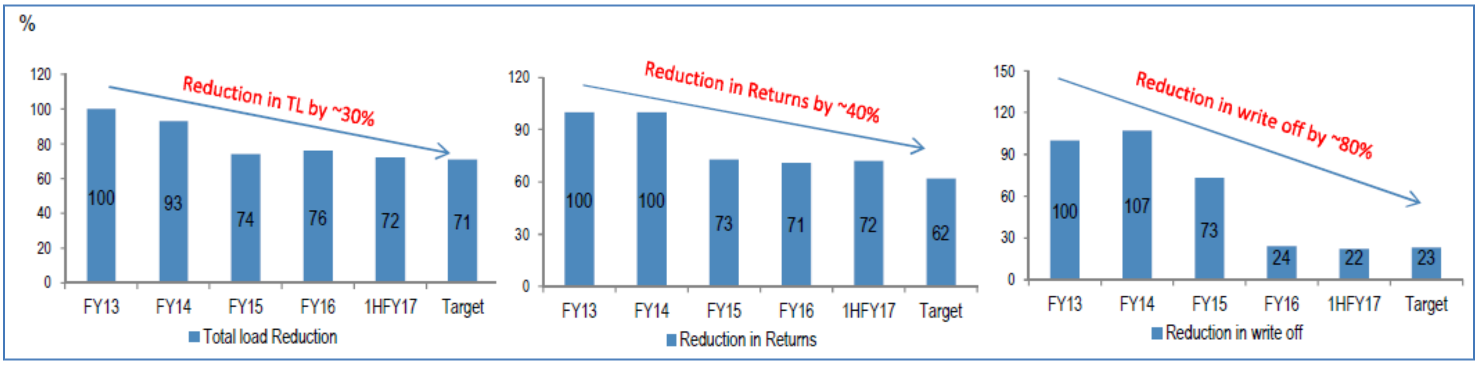
BRIT is equally focused on achieving efficiency at the organisational level apart from growth going forward. Supply chain is the core area for all consumer companies and a differentiated approach therein could help BRIT to stand out amid cut-throat competition. Raw material costs, carriage, freight, distribution, power and fuel are the major costs linked to supply chain efficiency. BRIT has consistently reduced the distance travelled (down 33%), and kept wastage and stock returns at a very low level. BRIT's production lines are not centralised and are spread across the country to facilitate faster and cost effective distribution. During FY14-FY17, expense heads namely, carriage, freight and distribution, and power and fuel witnessed savings of 70bps and 40bps, respectively, and other benefits must have flown through COGS.

Exhibit 10: Driving cost efficiency across the chain



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 11: Efforts towards achieving supply chain efficiency

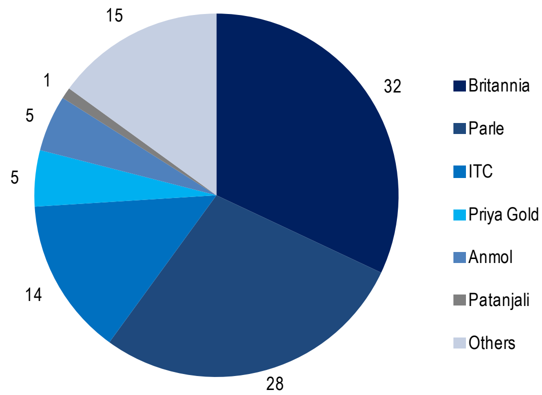


Source: Company, Nirmal Bang Institutional Equities Research

Biscuit, premium category will continue to outperform

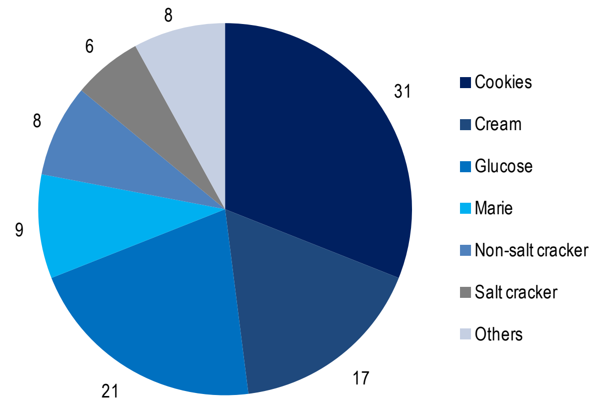
Biscuit, which is a sub-category of bakery category, is a forte of BRIT. Although biscuit is a fairly penetrated category, there is huge growth potential as per capita consumption of biscuits in India is just around 0.9kg i.e. much below that of other countries. Revenue share from biscuits is seen close to 85%. Biscuit has a higher pie (close to 67%) in the overall bakery industry. Market size of biscuit segment (including unorganised) is close to Rs390bn of which the organised market is worth Rs250bn. India is the third-largest market for biscuits after the US and China. BRIT enjoys almost 32% share in the organized segment followed by Parle (28%) and ITC (14%). Biscuit as a category has been widely accepted by consumers in India and forms an essential part of their staple diet. Hence, the category as a whole has expanded with a lot of variants being introduced during the course of time to ensure that consumption can happen at various points in time during the day. Various industry reports suggest that cookies and cream biscuits are growing at a rapid pace compared to plain biscuits wherein BRIT has a disproportionate share compared to the industry.

Exhibit 12: Market share (%) of Biscuit players



Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 13: Category-wise share of biscuit segment (%)



Source: Industry, Nirmal Bang Institutional Equities Research

Biscuit category can be broadly divided into mass, popular and premium, depending on price points. Mass or value segment (generally priced below Rs120 per kg) accounts for almost 45% of the market. Growth rate in this segment is somewhat stagnant across the industry since the past few years compared to growth in premium biscuits. Also, the latest announcement by the Goods and Services Tax or GST Council declaring an uniform tax rate of 18% for all biscuit categories has further led to pressure on the value category. Companies had no option but to increase prices in non-margin accretive categories. We believe that going forward growth in biscuit market will be led by mid-premium brands. BRIT's core strategy of focus on the premium category from the beginning augurs well with the business environment. BRIT has just 9% share in the value category and hence its profitability will not get compromised compared to players like Parle. Currently, its biscuit mix of premium and value biscuits is nearly 75:25, which is reasonably favourable than that of the industry. BRIT is focused on the mid-to-premium segment, but it is yet to cater to the super premium segment driven by ITC. Premiumisation trend lends a gross margin delta in the range of 3%-8%. We believe that with the kind of innovation initiatives, strong brand equity and focus on premiumisation, BRIT will continue to grow its premium portfolio and also cater to the super-premium range in the coming years currently dominated by ITC.

Total foods company opportunity is fairly significant

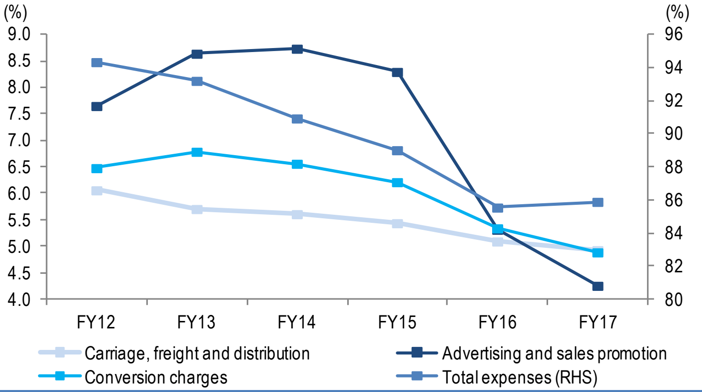
BRIT aims to become a total foods company rather than just focusing on biscuits which account for a large part of its portfolio right now. Portfolio diversification indicates expansion in other categories of the bakery industry like cake, rusk, etc, which are largely dominated by the unorganised segment and is also venturing into new categories like croissant. In our opinion, rising urbanisation, increase in the population of working women, changing lifestyle, higher per capita income and rising awareness about health and wellness has strongly impacted the eating pattern of the urban consumer. We feel the bakery sector is going to evolve further, considering the willingness of consumers to explore new tastes, availability of different varieties of bread etc. The trend of health and wellness is also catching up in the bakery market. Hence, BRIT's core focus on some of these categories like cake, rusk, croissant, etc augurs well with the market trend going forward. BRIT has formed a joint venture with Greek giant Chipita to manufacture croissant. BRIT is working on the shelf life of the product and plans to introduce value propositions therein to facilitate the penetration of the product across India. All these categories in the organized segment are in a nascent stage, but we believe that availability of robust supply chain with BRIT will give it an edge over the players in the unorganised segment. All these categories have been classified as separate business centres with the appointment of a head for respective categories. We believe that as biscuits, noodles, etc have been happily accepted by consumers in India which forms a major part of their diet, all these categories will fall in line over a period of time and BRIT is taking the right steps to build future categories in order to have an early-mover advantage and market leader status.

Also, BRIT has a plan to become an end-to-end dairy player in India. Currently, dairy business accounts for less than 5% (around Rs4bn) of its business, but BRIT is eyeing close to Rs15bn in the next five years and has a detailed strategy in place. BRIT is doing some pilot projects in some regions and is in the process of finalising its plan. BRIT has already purchased the land at Ranjangaon, which is a considered as a milk production belt. Commencement of operations at Ranjangaon plant is expected in the second-half of FY19. In dairy segment, BRIT's strategy is to sell non-profitable business and focus only on profitable business. We believe that although dairy business has a very small revenue share, looking at strategic actions it could be a leading category in the medium-to-long term. BRIT is adequately expanding its capacity to meet additional demand coming in from biscuit as well as non-biscuit portfolio going forward.

Cost leadership status expected to sustain

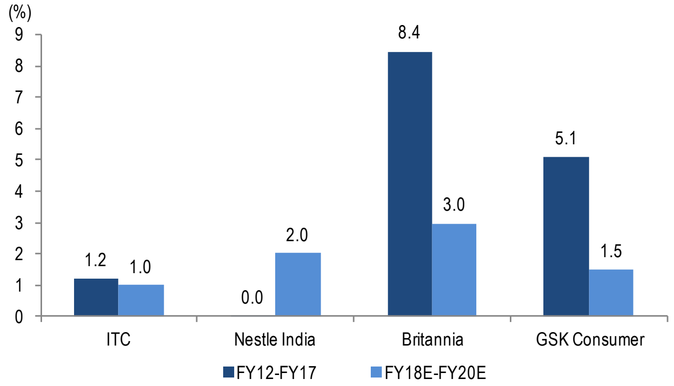
BRIT's focus on premiumisation will improve the revenue mix of its product portfolio. Besides premiumisation, the management expects annual savings of 150bps-200bps of sales to contribute to overall profitability through various cost rationalisation initiatives. Most of the savings will come from supply chain efficiency wherein BRIT will end up with savings on freight, distribution, power and fuel expenses, etc. Energy and distribution/logistics are the areas where a significant amount of savings can still be achieved. In case of energy, BRIT believes that it has achieved only 50%-60% of potential savings and in case of distribution/logistics there is still scope to reduce the average distance travelled by its products from the current average level of 400km. Apart from this, BRIT is focusing on each cost-line item and trying to optimise it. Also with growth coming in, operating leverage benefits will also flow through the cost lines. During the past five years (FY12-FY17), BRIT has achieved 840bps savings in total expenses, a part of which relate to operating leverage benefits as well. Going forward, we expect further savings of 300bps over the period FY18E-FY20E.

Exhibit 14: Costs (% of sales) on the decline



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Robust operating margin expansion of Britannia



Source: Company, Nirmal Bang Institutional Equities Research

Strong foray into international business

BRIT is expanding its distribution reach in India to cater to maximum number of households in the country. Likewise, BRIT aims to expand in overseas markets which account for around 8%-9% of its consolidated revenues. BRIT plans to enter a new geography every year. BRIT is also setting up a new plant in Mundra under a SEZ dedicated to incremental demand from export markets. The said plant is nearing completion and is expected to be commissioned soon. Also, BRIT's manufacturing facility in Nepal is expected to be commissioned by the end of FY19. Hence, BRIT is well equipped with brands, capacity and a strong market development programme to increase its presence in international markets. We expect BRIT's international business to also contribute to its overall growth going forward.

Financial performance

BRIT has witnessed a significant turnaround under the leadership of Mr. Varun Berry over the past five years. Top-line growth has largely come by way of volume and capacity addition. Although the overall FMCG sector witnessed weakness in the past couple of years, BRIT posted a five-year CAGR of 11% over FY12-FY17 in terms of top-line. Operating profit witnessed a massive growth of 33% over the same period, led by conscious efforts of the management in respect of supply chain efficiency, cost optimisation and premiumisation across its portfolio. In our opinion, BRIT is well on course of achieving its goal of becoming a total foods company and will grow in domestic as well as international markets. We expect its top-line growth to accelerate further as a result of new product launches, new product categories, growth in rural markets and capacity expansion. Therefore, top-line could post a two-year CAGR of 13.6% over FY18E-FY20E.We believe the company's core focus on cost optimisation coupled with operating leverage benefits will result in robust operating margin expansion of around 300bps overFY18E-FY20E.

Exhibit 16: Top-line trend

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Sales composition (%)							
Domestic sales (net)	90.2	90.4	91.1	91.7	92.9	93.4	93.6
International sales	8.6	8.6	8.0	7.2	6.4	6.2	6.0
Other operating income	1.2	1.1	0.9	1.1	0.7	0.4	0.4
Growth (%)							
Domestic sales (net)	12.0	13.9	7.8	8.6	11.1	12.4	15.1
International sales	4.5	13.0	(0.1)	(3.4)	(2.10)	8.50	11.0

Source: Company, Nirmal Bang Institutional Equities Research

Category-wise performance of domestic FMCG business

The biscuit category, where BRIT is the market leader, makes around 83% contribution to its domestic business. BRIT caters largely to mid and premium biscuit segments. Over the past five years, the category posted a CAGR of 13%, largely led by volume. This is after factoring in the weak sentiment over the past couple of years across the sector. Looking at the strong innovation pipeline, capacity addition, growth in rural markets and strong brand salience, we expect the category to clock a similar 13% growth over FY18E-FY20E. We believe this growth will be a function of both premiumisation as well as volume. Volume growth could be attributed to overall improvement in the consumer sentiment and capacity expansion in the near term.

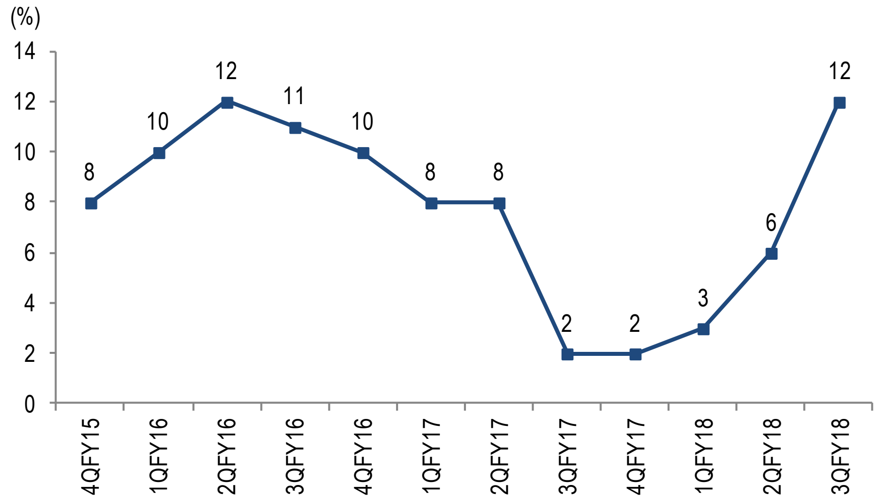
Other categories like bread, rusk and cake are largely dominated by the unorganised segment currently. However, BRIT is focusing on these categories in a big way by creating separate business verticals and appointing respective heads. There is going to be some investment in its upcoming plant in Ranjangaon for making cakes. Bread and rusk business posted a five-year CAGR of 15% over FY12-FY17, while the growth in cake business over the same period was also close to 13%. We believe that all these products enjoy higher margins and unorganised players have limitations in respect of supply chain and hence it is a big opportunity for BRIT. We expect around 17%-18% growth in both these categories over FY18E-FY20E.

Exhibit 17: Category wise growth profile

Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
% Composition (domestic sales)							
Biscuits and high-protein food	83.7	83.3	82.9	83.0	82.5	82.2	81.4
Bread and rusk	10.7	10.5	10.6	10.7	10.9	11.2	11.7
Cake	4.8	5.5	5.9	5.9	6.0	6.0	6.4
Others	0.8	0.7	0.7	0.6	0.6	0.6	0.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth (%)							
Biscuits and high-protein food	13.7	13.9	10.9	6.0	7	12	14
Bread and rusk	12.6	12.7	12.2	7.0	10	15	20
Cake	159.1	32.2	18.3	6.0	9	14	22
Others	(15.8)	(0.4)	3.5	0.5	3	5	6
Total	**16.3**	**14.5**	**11.4**	**5.9**	**7.6**	**12.4**	**15.1**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Domestic volume revival post demonetisation and GST-related challenges

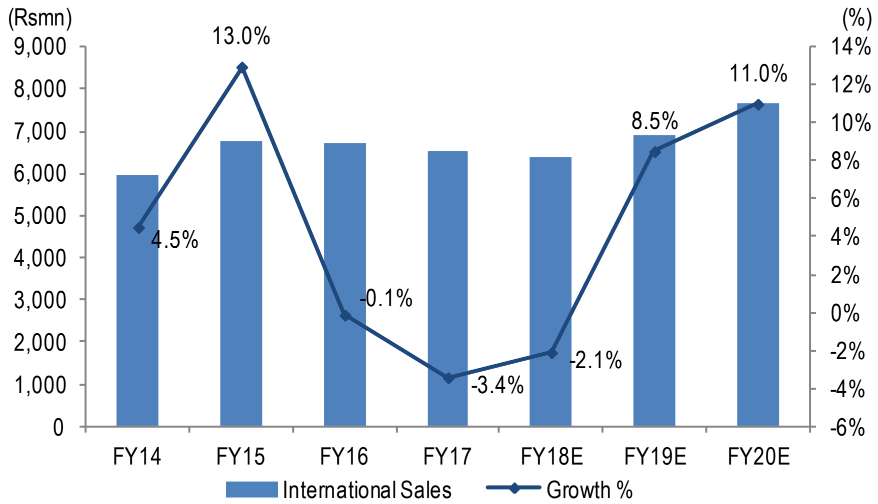


Source: Company, Nirmal Bang Institutional Equities Research

International business has significant scope for expansion

International business currently contributes around 7%-8% to BRIT's revenues at the consolidated level. However, the management plans to tap new geographies every year and expand its reach, like it did in Nepal. The Nepal plant is likely to be commissioned by the end of FY19. Also, the Mundra plant under SEZ, which is dedicated for export markets, is also nearing completion and will be commercialised soon. Capacity expansion plan to support exports augurs well with the overall strategy. During the year, following a slowdown in some of economies and currency fluctuations, international growth has been subdued. However, in our view, entering new geographies and stabilisation of economies in some countries in the Middle East and Africa will lead to incremental growth in international business going forward, especially after 2HFY19.We have factored in 10% growth in international business over FY18E-FY20E.

Exhibit 19: International business likely to grow in the coming years

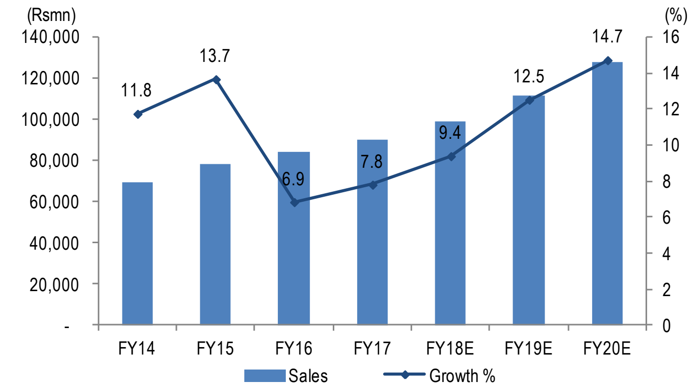


Source: Company, Nirmal Bang Institutional Equities Research

Further headroom for operating margin expansion

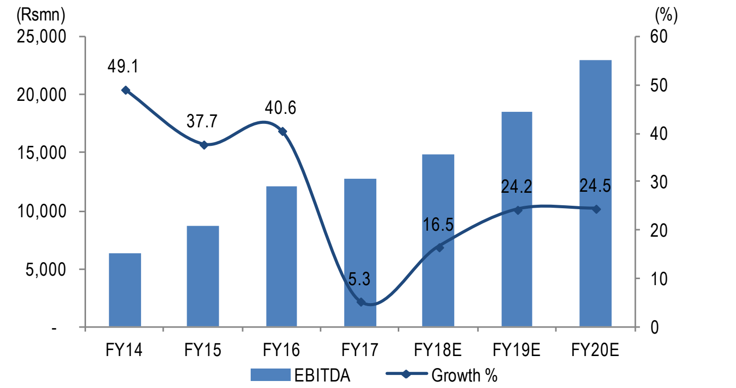
Over the past five years, BRIT's operational efficiency improved significantly because of its core thrust on supply chain efficiency and other cost rationalisation measures. Consequently, operating margin expanded by a robust 840bps over FY12-FY17. Cost control is one of the key thrust areas of its current strategy because, as per the management, there is further scope for cost optimisation - especially in logistics, power and fuel, reduction of wastage, etc. During FY18, BRIT is targeting Rs2,300mn savings in total expenses, which is 4.5x higher compared to FY14. We believe the company is equally focused on the cost side and operating margin will continue to improve further because of three factors - cost efficiency, operating leverage and premiumisation. For 9MFY18, BRIT reported 15% EBITDA margin and we expect 300bps further improvement by FY20E.

Exhibit 20: Improvement in top-line is likely



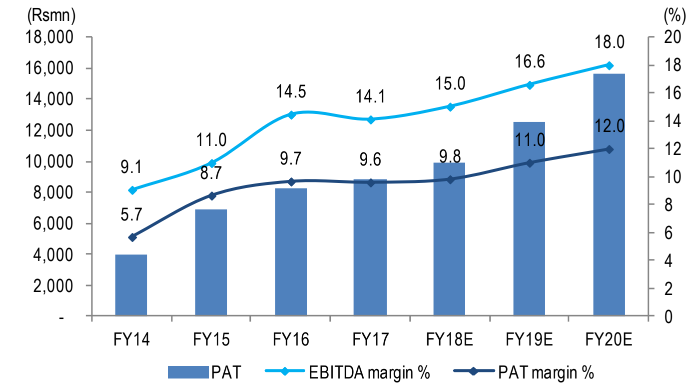
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Operating profit to continue the momentum



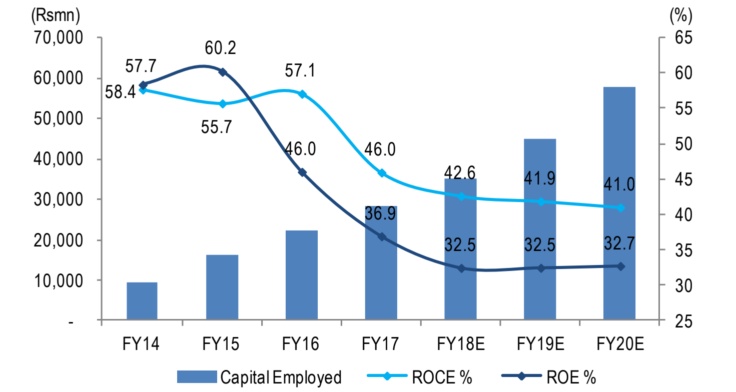
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: Net profit vs net profit margin vs EBITDA margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Return ratios



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 24: Our estimates versus consensus estimates

Particulars	FY18E			FY19E			FY20E		
	Our estimate (Rsmn)	Consensus estimate (Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus estimate (Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus estimate (Rsmn)	*Variance (%)*
Sales	99,059	99,643	*(0.6)*	1,11,480	1,14,008	*(2.2)*	1,27,911	131418.00	*(2.7)*
EBITDA	14,890	14,915	*(0.2)*	18,498	17,692	*4.6*	23,023	21,398	*7.6*
Net income	9,886	10,115	*(2.3)*	12,487	12,305	*1.5*	15,628	14,900	*4.9*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Comparative performance

We compared the financial performance of some F&B companies. BRIT has clearly outperformed other players, both in terms of top-line and profitability in the past. In the past five years, top-line growth was largely fuelled by underlying volume growth which was missing in case of others. On the profitability front as well, BRIT has emerged as the leader and has achieved 840bps operating margin expansion over the past five years. Others could not match up to that level because of regulatory/industry-related problems. We believe that a similar growth momentum is expected to continue and there could be some acceleration in the growth rate taking into account capacity expansion and a strong innovation pipeline in case of BRIT.

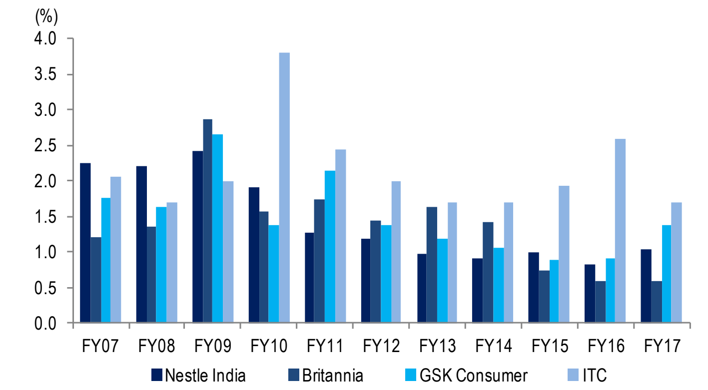
Exhibit 25: Growth trends in foods companies

Sales growth (%)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
ITC	14.7	11.9	16.3	18.2	17.3	18.8	11.2	9.8	0.2	9.6	2.7	8.1	8.5
Nestle India	24.4	23.4	18.6	21.9	20.1	10.9	9.2	8.3	(17.0)	11.8	9.5	12.7	12.7
Britannia Industries	22.5	23.2	10.3	22.2	19.0	12.8	11.8	13.7	6.9	7.8	9.4	12.5	14.7
GlaxoSmithKline Consumer Healthcare	15.0	20.6	24.6	20.0	16.5	18.7	52.7	(11.5)	(4.0)	(3.6)	9.1	8.8	10.5
Total	**17.1**	**15.8**	**16.4**	**19.5**	**18.0**	**16.5**	**13.7**	**8.1**	**(2.1)**	**8.7**	**5.1**	**9.5**	**10.3**
EBITDA growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	11.3	10.3	25.0	22.0	19.4	20.1	17.2	8.2	1.8	6.3	8.2	9.9	9.6
Nestle India	39.0	10.5	19.1	24.1	23.4	20.2	9.8	4.7	(22.2)	13.5	13.3	17.5	15.9
Britannia Industries	81.6	1.2	(31.4)	45.3	31.3	35.3	49.1	37.7	40.6	5.3	16.5	24.2	24.5
GlaxoSmithKline Consumer Healthcare	2.0	5.7	30.8	21.3	12.8	34.9	52.2	(16.3)	15.3	(1.0)	4.3	11.7	15.7
Total	**15.9**	**9.8**	**22.3**	**22.8**	**19.9**	**21.1**	**18.7**	**7.6**	**1.4**	**6.5**	**9.1**	**11.8**	**11.7**
PAT growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	15.6	4.6	24.4	22.8	23.6	20.4	18.4	9.4	(3.1)	9.5	5.3	13.2	9.6
Nestle India	55.2	9.2	22.6	25.0	17.5	11.1	4.6	6.0	(52.5)	77.8	21.7	23.3	20.5
Britannia Industries	67.9	(18.8)	(28.0)	30.2	48.8	30.1	52.3	74.0	19.7	7.3	11.8	26.3	25.2
GlaxoSmithKline Consumer Healthcare	28.2	15.8	23.6	28.8	18.5	23.0	54.5	(13.5)	17.8	(4.5)	3.2	11.1	16.7
Total	**21.6**	**4.6**	**22.3**	**23.5**	**23.1**	**19.6**	**19.5**	**9.9**	**(5.6)**	**11.9**	**7.0**	**14.9**	**12.3**

Source: Nirmal Bang Institutional Equities Research

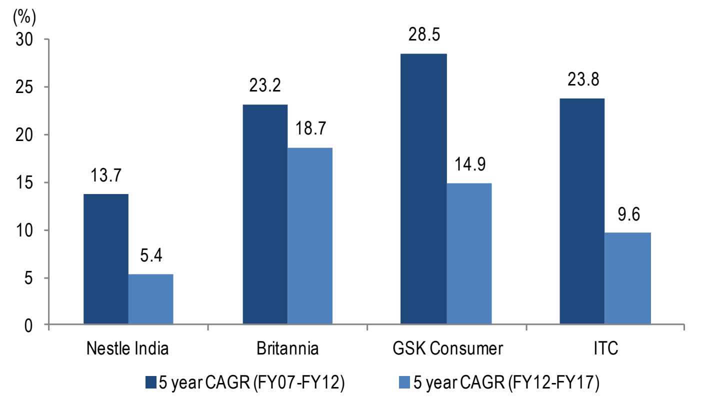
We have compared dividend payout of the food companies in our coverage universe by forming bands of 5 years each wherein it was witnessed that DPS growth of all the companies under consideration during FY07-FY12 was way above compared to subsequent 5 years. Britannia was the exception to this pattern wherein it has largely maintained its higher payout compared to that in the past. This reflects the strong financial performance delivered by BRIT vis-à-vis other food players.

Exhibit 26: Dividend yield trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 27: DPS in five-year CAGR band



Source: Company, Nirmal Bang Institutional Equities Research

Valuation and recommendation

BRIT has been a consistent performer over the past decade, but in the past five years it has clearly surpassed peers in the F&B space. Positive changes in fundamentals under the new management are evident from stock price movement over the past few years. Other players have witnessed a slump, especially after CY12, because of various company/industry problems. In terms of relative performance also, BRIT has significantly outpaced Nifty 50 Index in four out of the past five calendar years. We believe the movement in the stock is justified because of strong improvement in the fundamentals and the rally could continue the same way if BRIT achieves all that is planned.

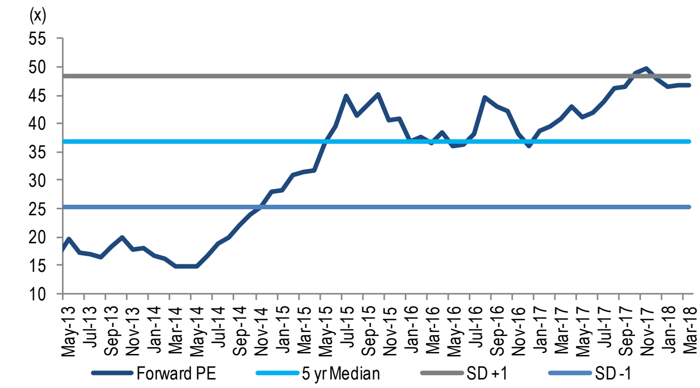
Exhibit 28: Absolute and relative price performance history

F&B companies	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
Absolute Performance (%)												
ITC	19	(18)	46	42	16	42	12	15	(11)	11	9	2
Nestle India	32	(3)	75	50	7	22	6	21	(9)	3	31	(4)
Britannia Industries	35	(10)	27	23	8	11	85	100	61	(3)	63	5
GSK Consumer Healthcare	31	(23)	130	80	10	50	17	32	9	(22)	31	4
Relative performance (%)												
ITC	(23)	70	(17)	21	54	12	5	(13)	(7)	8	(15)	3
Nestle India	(15)	102	-	27	42	(5)	(1)	(8)	(5)	-	1	(3)
Britannia Industries	(13)	86	(28)	4	44	(13)	73	52	68	(6)	27	6
GSK Consumer Healthcare	(16)	59	31	52	46	17	9	1	14	(24)	2	4

Source: Bloomberg, Nirmal Bang Institutional Equities

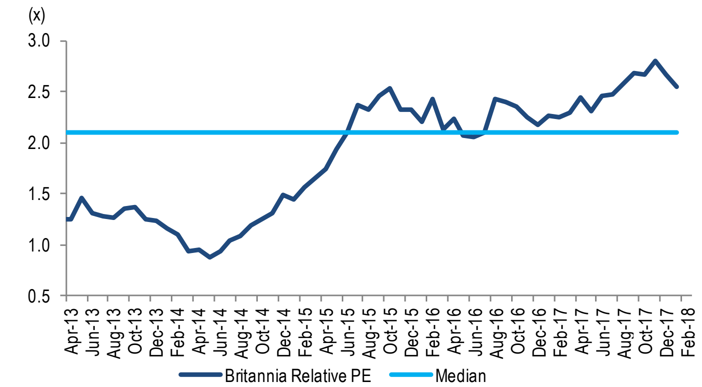
BRIT stock currently trades at 46.4x one-year forward earnings i.e. at premium of 27% to five-year median P/E. Current PE of the company is close to +1 SD. Similarly, the stock trades at a premium of 26% and 45% to five-year median EV/EBITDA and P/sales, respectively. We have also compared forward P/E of the stock with the indices and it has been observed that BRIT trades at a premium to both Nifty and Nifty FMCG indices. Improved performance post FY13 resulted in a major rerating of the stock and therefore now commands a higher earnings multiple.

Exhibit 29: One-year forward P/E



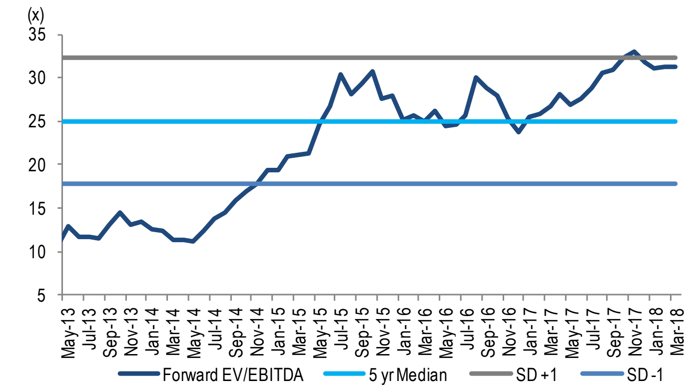
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 30: Relative P/E (Nifty)



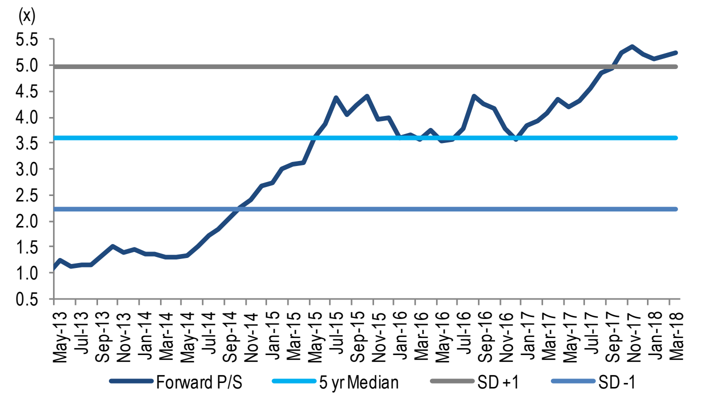
Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 31: One-year forward EV/EBITDA



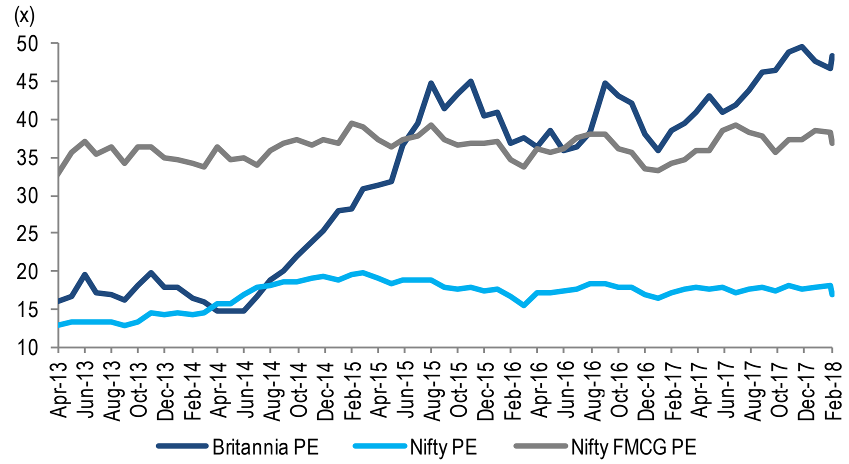
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: One-year forward P/sales



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 33: BRIT vis-à-vis Nifty and Nifty FMCG



Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Current valuation is justified by future earnings outlook

Indian consumer and F&B stocks have consistently traded at a significant premium to their peers and this has been evident not just in a bear market, but also in a bull market. As discussed above, we expect a recovery in the F&B segment on account of a favourable base and slow pick-up in growth.To understand the sustainability of current price multiples, we have compared the PEGs of F&B companies which are over and above 2.5. However, looking at the fundamentals, we believe that BRIT and Nestle India are likely to witness a robust recovery in earnings and hence will continue to trade at premium multiples. In case of BRIT, we have assigned a P/E multiple higher than the five-year median and that of its peers because of the expansion led profitable growth going forward.

Exhibit 34: Valuation of Indian Food players

Company	CMP* (Rs)	Mkt. cap. (USD mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
ITC	270	50,679	8.0	7.4	6.8	19.9	18.0	16.3	30.5	27.0	24.6	6.4	9.2	9.3	3.3
Nestle India	7,619	11,302	7.3	6.5	5.8	33.7	28.4	24.2	60.2	48.9	40.5	11.6	15.6	21.9	2.7
Britannia Industries	4,867	8,989	5.9	5.2	4.6	38.9	31.0	24.5	59.1	46.8	37.4	12.6	21.7	20.9	2.8
GSK Consumer Healthcare	6,837	4,423	6.6	6.1	5.5	29.7	26.1	22.1	42.4	38.2	32.7	9.4	10.4	10.2	4.2

**CMP is the closing price of 12th March 2018 ^Three-year CAGR (FY17-FY20E)*

Source: Nirmal Bang Institutional Equities Research

We initiate coverage on BRIT with a Buy rating and a target price of Rs5,850 by March 2019, implying an upside of 20% from the CMP. Our target price is based on P/E multiple of 45x (March 2020E EPS) which is in line with the current one-year forward P/E, and 23% premium to the five-year median P/E. We believe that expansion of distribution reach, core focus on costs, strong innovation pipeline and introduction of new categories will help in accomplishing its dream of being a total foods company along with healthy margin expansion. As a result, we believe the BRIT stock will continue to trade at premium multiples.

Risks

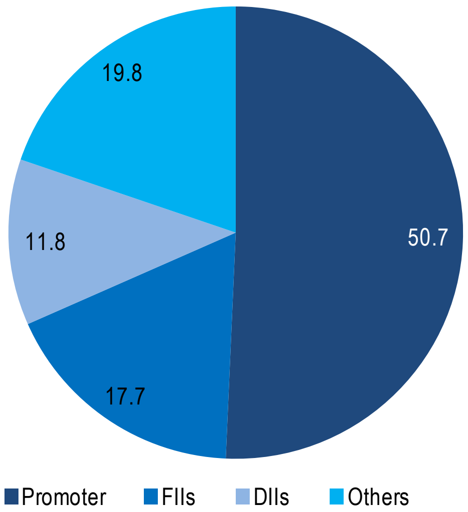
- Consumers are fairly demanding of high quality standards and any adverse product related issues that emerge in the future could pose significant risk to growth and recommendations
- Any macro-economic slowdown, disruption and/or policy announcements which substantially impacts consumer spending and the premiumisation trend in India.
- We expect the rural economy to see gradual improvement after being weak substantially in the past three years. Any weather or policy-related issue that impacts this recovery could also pose risk to our earnings estimate and recommendation.
- Pricing-related competitive challenges so far have been moderate, but if this scenario witnesses any major change it could have a substantial impact on our earnings estimate and recommendation.
- Most companies have been moderating marketing and investment spending in the recent past and any substantial increase in spending does pose substantial risk to our estimate.
- We are forecasting better revenues from international business considering the capacity expansion plans of the company. However prolonged slowdown in some of the key markets for Britannia could have a reasonable impact on the growth rate from overseas business.

Exhibit 35: Management committee

Name	Designation
Mr. Nusli Wadia	Chairman
Mr. Varun Berry	MD
Mr. Manoj Balgi	Head – Procurement
Mr. Manjunath Desai	Strategy and Business Development
Mr. N. Venkataraman	CFO
Mr. Gunjan Shah	Sales Head
Mr. Ali Harris	Head – Marketing

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 36: Shareholding pattern (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 37: Top 10 public shareholders

Particulars	% holding
Life Insurance Corporation of India	3.79
Arisaig India Fund	1.98
ICICI Prudential Value Fund - Series 4	1.38
General Insurance Corporation of India	1.02
Nomura	1.00
Vanguard Group	0.88
Motilal Oswal Asset Management	0.86
Blackrock	0.73
Kotak Mahindra	0.73
Aditya Birla Sun Life Asset Management	0.68

Source: Company, Nirmal Bang Institutional Equities Research

Financials (consolidated)

Exhibit 38: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	83,972	90,541	99,059	1,11,480	1,27,911
% Growth	***6.9***	***7.8***	***9.4***	***12.5***	***14.7***
COGS	50,127	55,887	61,014	68,373	77,810
Staff costs	3,414	3,526	3,893	4,093	4,472
Other expenses	18,288	18,346	19,261	20,515	22,606
Total expenses	71,828	77,759	84,169	92,982	1,04,888
EBITDA	12,144	12,782	14,890	18,498	23,023
% growth	***40.6***	***5.3***	***16.5***	***24.2***	***24.5***
EBITDA margin (%)	***14.5***	***14.1***	***15.0***	***16.6***	***18.0***
Other income	1,244	1,505	1,478	1,879	2,323
Interest costs	49	55	55	60	67
Depreciation	1,134	1,193	1,364	1,680	1,954
Profit before tax (before exceptional items)	12,205	13,040	14,949	18,637	23,325
Exceptional items	0	0	0	0	0
Tax	3,961	4,197	5,063	6,150	7,697
PAT	8,244	8,843	9,886	12,487	15,628
Adj PAT	8,244	8,843	9,886	12,487	15,628
Adj PAT margin (%)	***9.7***	***9.6***	***9.8***	***11.0***	***12.0***
% Growth	***19.7***	***7.3***	***11.8***	***26.3***	***25.2***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	240	240	240	240	240
Reserves	20,677	26,724	33,703	43,192	55,069
Minority Interest	25	26	26	26	26
Net worth	20,917	26,964	33,943	43,432	55,309
Total debt	1,311	1,246	1,308	1,561	1,791
Deferred tax liability	(444)	(231)	(231)	(231)	(231)
Total liabilities	**21,197**	**27,403**	**34,470**	**44,030**	**56,025**
Gross block	9,080	11,643	15,643	18,643	21,643
Depreciation	870	1,591	2,955	4,635	6,589
Net block	8,210	10,053	12,689	14,009	15,055
Intangible assets	1,292	1,395	1,500	1,600	1,700
Capital work-in-progress	901	301	701	1,101	1,501
Investments	7,884	5,021	6,043	6,800	7,803
Inventories	4,407	6,615	5,421	7,692	7,231
Debtors	1,706	1,792	2,551	2,336	2,570
Cash	877	1,208	4,631	9,275	19,017
Loans & advances	8,265	13,303	15,354	17,279	19,826
Other current assets	579	907	1,189	1,338	1,535
Total current assets	17,241	23,392	28,254	36,916	49,028
Creditors	7,691	7,573	8,474	8,759	10,427
Other current liabilities & provisions	2,611	2,789	2,972	3,400	3,901
Total current liabilities	13,298	13,454	16,201	18,179	21,235
Net current assets	3,943	9,938	12,053	18,737	27,793
Total assets	**21,197**	**27,403**	**34,470**	**44,030**	**56,025**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
PAT	8,244	8,843	9,886	12,487	15,628
Depreciation	1,134	1,193	1,364	1,680	1,954
Other income	(1,244)	(1,505)	(1,478)	(1,879)	(2,323)
(Inc.)/dec. in working capital	157	(2,120)	3,034	(313)	3,102
Cash flow from operations	**8,292**	**6,411**	**12,806**	**11,975**	**18,360**
Capital expenditure (-)	(2,555)	(2,436)	(4,400)	(3,400)	(3,400)
Net cash after capex	**5,737**	**3,975**	**8,406**	**8,575**	**14,960**
Dividends paid (-)	(1,919)	(2,400)	(2,373)	(2,497)	(3,126)
DDT paid (-)	(391)	(489)	(475)	(499)	(625)
Inc./(dec.) in investments	(2,592)	2,863	(1,022)	(758)	(1,002)
Cash from financial activities	**(2,427)**	**(2,733)**	**(2,699)**	**(2,692)**	**(3,452)**
Opening cash balance	2,263	877	1,208	4,631	9,275
Closing cash balance	877	1,208	4,631	9,275	19,017
Change in cash balance	(1,387)	331	3,423	4,644	9,742

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 41: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Per share (Rs)					
EPS	68.7	73.7	82.4	104.1	130.2
Book value	174.3	224.7	282.9	361.9	460.9
DPS	16.0	20.0	19.8	20.8	26.0
Valuation (x)					
P/Sales	3.8	4.5	5.9	5.2	4.6
EV/sales	3.8	4.5	5.8	5.1	4.4
EV/EBITDA	26.2	31.5	38.9	31.0	24.5
P/E	39.1	45.8	59.1	46.8	37.4
P/BV	15.4	15.0	17.2	13.4	10.6
Return ratios (%)					
RoCE	57.1	46.0	42.6	41.9	41.3
RoE	46.0	36.9	32.5	32.3	31.7
Profitability ratios (%)					
Gross margin	40.3	38.3	38.4	38.7	39.2
EBITDA margin	14.5	14.1	15.0	16.6	18.0
EBIT margin	13.1	12.8	13.7	15.1	16.5
PAT margin	14.3	14.2	14.9	16.4	17.9
Liquidity ratios (%)					
Current ratio	1.3	1.7	1.7	2.0	2.3
Quick ratio	1.0	1.2	1.4	1.6	2.0
Solvency ratio (%)					
Debt to Equity ratio	0.1	0.0	0.0	0.0	0.0
Turnover ratios					
Total asset turnover ratio (x)	2.4	2.2	2.0	1.8	1.7
Fixed asset turnover ratio (x)	9.2	8.7	7.4	7.4	7.7
Inventory days	30.8	36.0	36.0	35.0	35.0
Debtors days	6.7	7.1	8.0	8.0	7.0
Creditor days	52.9	49.8	48.0	46.0	45.0

Source: Company, Nirmal Bang Institutional Equities Research

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NIRMAL BANG
a relationship beyond broking

Institutional Equities

ITC

13 March 2018

Initiating Coverage

Reuters: ITC.BO; Bloomberg: ITC IN

Next is What

ITC Limited (ITC) has been the leader in the Indian cigarette space since the past several decades. Extremely popular portfolio of brands and a wide distribution reach lends the company significant competitive advantage. However, in recent years, taxation and regulation aspects have assumed new dimensions considering the health problems. This has resulted in India being the most underperforming market globally in volume terms for cigarettes. Most global companies, in line with changing consumer preference and regulatory problems, are now envisioning a smokeless future. ITC will also have to gradually transition its business model to new age consumer requirements. This transition will impact ITC's earnings growth and considering this aspect we have initiated coverage on the stock with an Accumulate rating and a target price of Rs290.

Enviable market position: A dominant share in excess of 80%, wide portfolio of cigarette brands ranging from value to premium (Capstan to Classic) and low per capita consumption of cigarettes puts ITC in the most enviable position in the Indian consumer space.

Stumped by multiple regulations and high taxation: Annual tax hikes well in excess of 20% and regulations such as 85% pictorial warning on cigarette packs are among the slew of measures which the government has taken to check the growing incidence of tobacco and cigarette smoking. This has resulted in annual spending on cigarettes going up by more than three times and cigarette smoking habit declining by 24% in last six years.

Earnings trajectory remains uncertain: As the margin base is fairly high and the top-line outlook is uncertain because of continued challenges, we believe the earnings outlook beyond a cyclical recovery in the short term remains somewhat uncertain and is likely to trail its peers in the Indian FMCG space.

Valuation and recommendation: Although ITC stock has underperformed its Indian peers in the past 12 months considering that earnings outlook is still somewhat uncertain, we prefer to assign an Accumulate rating to the stock with a target price of Rs.290, thereby indicating an upside of 7% from CMP. Our target price is based on sum-of-parts or SOTP valuation.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net revenues	3,65,827	4,00,887	4,11,590	4,45,051	4,82,867
EBITDA	1,37,146	1,45,780	1,57,707	1,73,251	1,89,807
Adj. PAT	93,130	1,02,009	1,07,460	1,21,598	1,33,332
EPS (Rs)	7.7	8.4	8.8	10.0	11.0
EPS growth (%)	*(3.4)*	*8.8*	*5.3*	*13.2*	*9.6*
EBITDA margin (%)	*37.5*	*36.4*	*38.3*	*38.9*	*39.3*
P/E (x)	28.4	33.4	30.5	27.0	24.6
P/BV (x)	6.3	7.5	6.8	6.3	5.8
EV/EBITDA (x)	18.4	22.5	19.9	18.0	16.3
RoCE (%)	*32.1*	*31.1*	*31.2*	*31.9*	*32.4*
RoE (%)	*23.6*	*23.5*	*22.9*	*24.1*	*24.4*

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: FMCG

CMP: Rs270

Target Price: Rs290

Upside: 7%

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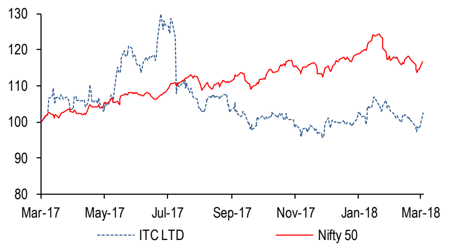
Key Data

Current Shares O/S (mn)	12,195.7
Mkt Cap (Rsbn/US$bn)	3,294.1/50.7
52 Wk H / L (Rs)	368/250
Daily Vol. (3M NSE Avg.)	13,684,030

Shareholding (%)	1QFY18	2QFY18	3QFY18
Promoter	-	-	-
Public	100.0	100.0	100.0
Others	-	-	-

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
ITC	0.1	(2.7)	2.5
Nifty Index	(1.1)	3.3	16.6

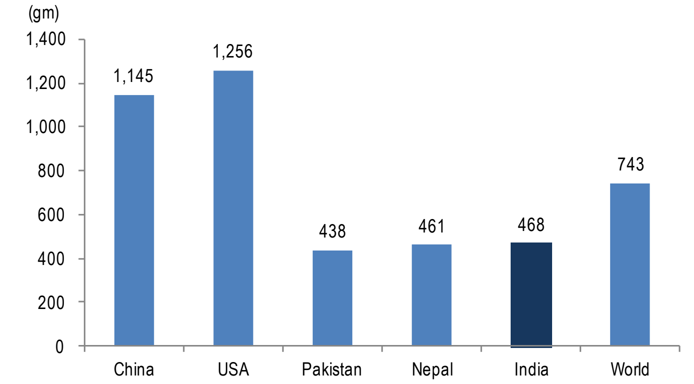
Source: Bloomberg

Investment thesis

Dominant franchise in an attractive segment

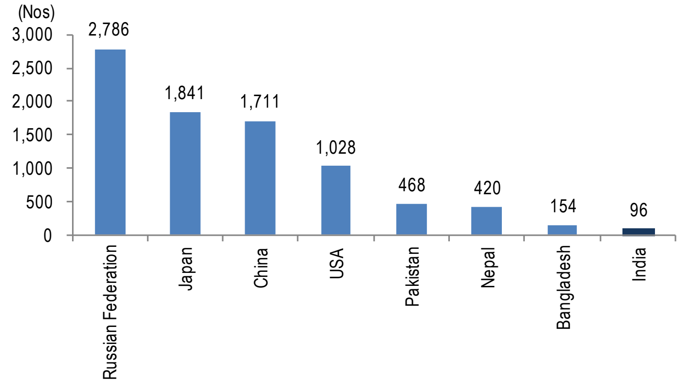
ITC has a very wide portfolio of cigarette brands (ranging from Insigna & Classic at the premium end, Gold Flake and Navy Cut in the middle and Capstan and Flake Filter at the economy end) in the cigarette segment at multiple price points, which along with an excellent distribution network lends the company an unmatched competitive advantage. ITC has able to consistently improve its leadership in this segment because of continuous innovation, superior quality and state-of-the-art of manufacturing facilities spread across five plants in India. India is the second-largest consumer of tobacco in the world and the overall level of tobacco consumption has witnessed a steady increase of about 2% in the past five years. However, in case of cigarettes, considering the high incidence of taxation its consumption has witnessed a decline of 3% in kg terms, thereby resulting in its overall share in tobacco consumption to slip from 15% in 2009-10 to about 10% currently. Per capita consumption, consequently, also because of low affordability stands among the lowest in the world at less than 100 cigarettes per annum.

Exhibit 1: Per capita consumption of tobacco (gm) is 60% of world average



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Per capita consumption of cigarettes is 11% of the world average

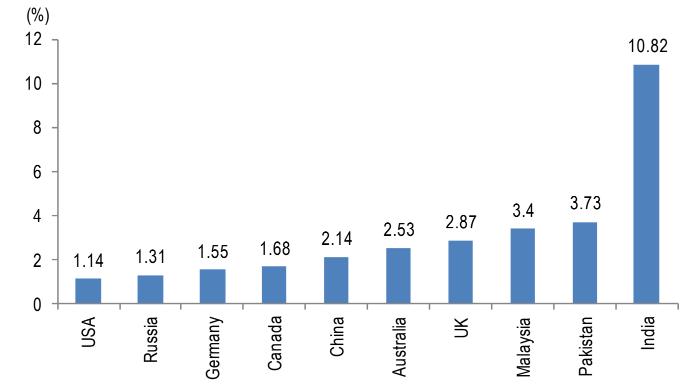


Source: Company, Nirmal Bang Institutional Equities Research

Several tax and regulatory hurdles

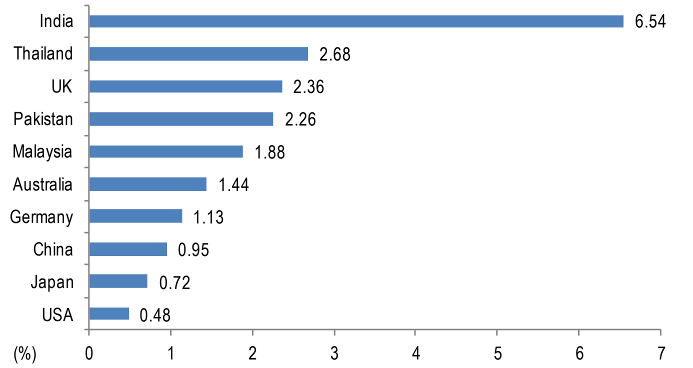
The pace of taxation on cigarettes continues to remain very high - in excess of 20% - in the past seven years and there is little to suggest that it could slow down, despite the implementation of GST, as the fiscal situation is very tight. This sharp increase in tax has resulted in more than a four-fold increase in per capita spending on cigarettes in the past seven years. However, population growth, rising disposable income and low per capita spending on cigarettes supports a long-term bull case for the company. Consumer priorities towards cigarettes are changing constantly and they are looking for value in terms of pricing, quality and innovation. Price mix has helped the company in delivering substantial growth in the past, but the equation has now moved from the zone of low elasticity to high elasticity. Tobacco regulation also continues to inhibit growth as it restricts the company's ability to communicate to its consumers, differentiate the product and launch new products. The government, in the past few years, has made warning mandatory covering nearly 85% of the packs and it is now engaged in contemplating a distribution framework where tobacco products will have to be sold on an exclusive basis and cannot be combined with other FMCG products.

Exhibit 3: Affordability (% of per capita GDP required to purchase 100 packs of 20 cigarettes of most sold brand)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Tax on cigarettes as a % of per capita GDP (for 100packs of 20 cigarettes of most sold brand covering both central and state taxes)



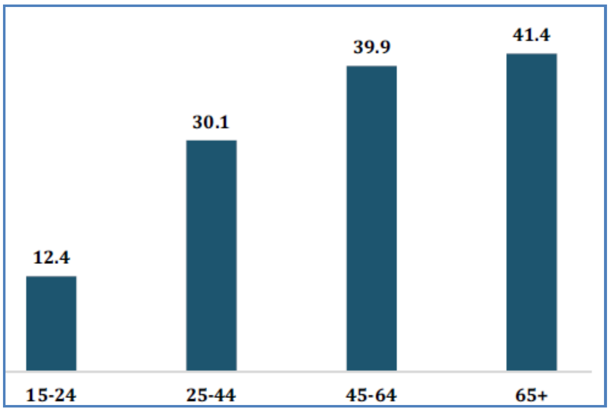
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 5 a): Global Adult Tobacco Survey 2 (Total 74,037 individuals interviewed between August 2016 and February 2017) (GATS 1 was done in 2009-10)

India tobacco usage (%)	GATS1	GATS2	*% Change*
Overall			
Tobacco users	34.6	28.6	*(17)*
Smokers	14.0	10.7	*(24)*
Smokeless tobacco users	25.9	21.4	*(17)*
Smokers			
Current tobacco smokers	14	10.7	*(24)*
Daily tobacco smokers	10.7	8.6	*(20)*
Current cigarette smokers	**5.7**	**4.0**	***(30)***
Daily Ccgarette smokers	**3.6**	**2.2**	***(39)***
Current bidi smokers	9.2	7.7	*(16)*
Daily bidi smokers	7.5	6.4	*(15)*
Economics			
Monthly expenditure on cigarettes (Rs)	**399**	**1,193**	***20****
Monthly expenditure on bidis (Rs)	93	284	*20**
Avg . amount spent on last purchase of cigarettes (Rs)	11.5	30	*17**
Avg. amount spent on last purchase ofbidis (xx)	5.6	12.5	*14**
Quitting tobacco because of warning			
Cigarettes	**38**	**61.9**	***63***
Bidi	29.3	53.8	*84*
Smokeless tobacco	33.8	46.2	*37*

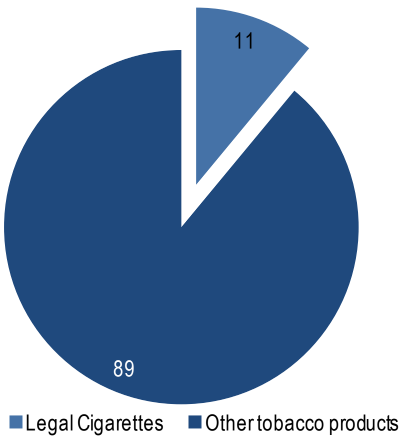
**6year CAGR* *Source: GATS-2 India 2016-17*

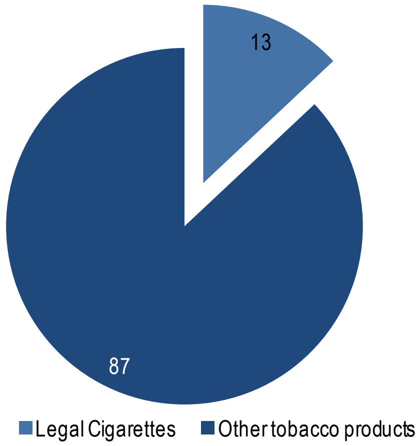
Exhibit 5 b): Percentage of tobacco users by age group



Source: GATS-2 India 2016-17

Exhibit 6: Legal cigarettes contribute 87% tax revenue despite forming just 11% of tobacco consumption





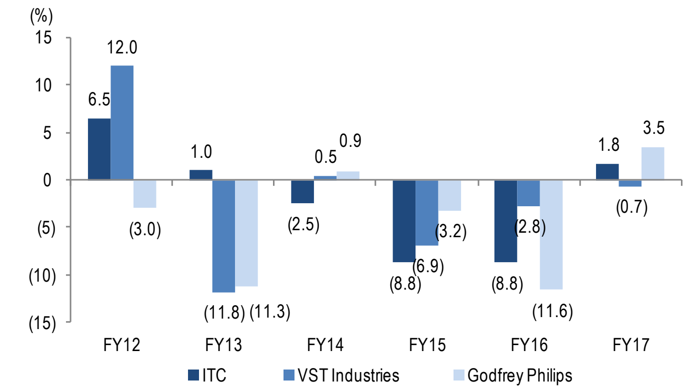
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Snapshot of regulatory headwinds in India

Year	Particulars	Increase in tax	Other remarks, if any
2000-04	Media ban	Significant tax increase in 2001.	-
	Signatory to FCTC	State-level rate rises, but declared unconstitutional by the Supreme Court.	-
2005-06	-	-	-
2007	-	Imposition of 12.5% VAT.	-
2008	Ban on smoking in public places	200% increase in excise duty on non-filter cigarettes.	-
2009	Pictorial warning	VAT increase in some states	-
2010	Ban on FDI in tobacco	15% + less than 60mm slab.	-
2011	-	VAT hike expands (substantial hike in Gujarat and Rajasthan)	-
2012	-	VAT increase continues (in West Bengal and Andhra Pradesh VAT increased to 20%). Increase in VAT rate affected in 17 states ranging from 0.75% to 11.5%.	Industry value growth at 11%.
2013	-	Excise duty increased from 11% to 21%. VAT hike continues. UP VAT rate increased.	Industry value growth at 20%. Introduced 64mm filter-tipped cigarette with new excise duty slab.
2014	-	Steep increase in excise duty of 18% on all cigarette segments except 64mm. Steep hike in VAT rates in West Bengal and Bihar from 20% to 35% and 34.5%, respectively.	Industry value growth of 14%. RSFT lost share from 76.9% to 66.3% in FY14. 64mm cigarettes contribute 14% of the industry volume. KSFT forms more than 15% of the industry volume.
2015	-	Duty on most affordable 64mm cigarettes disproportionately increased by 72% vs. 17% on other segments. Tamil Nadu and Kerala increased the tax rate from 20% to 30%	Industry value growth of 4.2%.
2016	Sale of loose cigarettes illegal in some key states. Pictorial warning extended to both panels and increased the size.	Duty on 64mm cigarettes increased by 22% vs. 12% for other segments. UP VAT rate increased from 25% to 40%.	64mm cigarettes grew 6% at industry level.
2017	-	Excise duty hike of 10% across segments.	Legal cigarettes cost seven times more than non-duty paid cigarettes.
2018	-	New tax regime under GST.	-

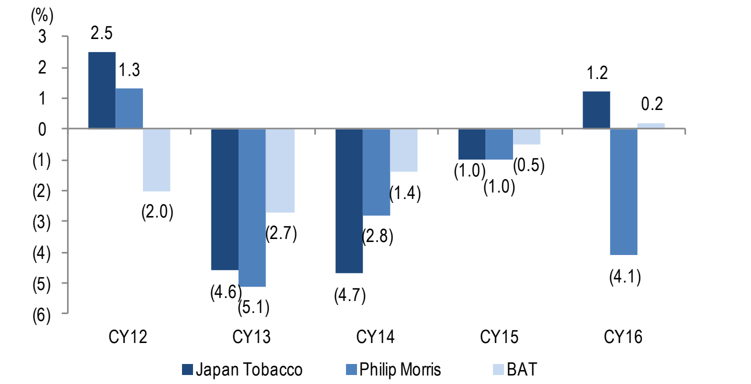
Source: Industry, Nirmal Bang Institutional Equities Research

Exhibit 8: Cigarette volume under pressure in India



Source: Nirmal Bang Institutional Equities Research estimates

Exhibit 9: Volume pressure across the globe



Source: Company presentation, Nirmal Bang Institutional Equities Research

Non-cigarette business still in an investment phase

Opportunity in non-cigarette business is fairly significant and it serves as an important diversification role from a growth and risk perspective. In FMCG business, which is the largest non-cigarette business, the company has a portfolio of brands such as Aashirvaad (branded wheat flour), Sunfeast (cream biscuits), Yipee (noodles), and Bingo (snack food) which are among the Top 2 in their respective categories.

Exhibit 10: Non-cigarette businesses and key brands

FMCG business in a good shape

ITC is betting big on its Aashirvaad brand of wheat flour which currently contributes over Rs40bn to revenues and plans to increase it to Rs100bn in next five years by expanding the base and launching new products under the umbrella of its flagship brand. Currently, Aashirvaad enjoys around 28% share in the organised wheat flour market. Also, the growth potential in this segment is huge as currently only 15% of the population consumes packaged wheat flour. In our opinion, the improvement in the macro-economic environment, higher number of working women, and rapid urbanisation will lead to an increase in the consumption of products like these. Also, the company is planning to introduce health variants of its products which augurs well with the current market trend.

Sunfeast is more than a Rs30bn brand and largely caters to the mid-to-premium segment in biscuits. Like Britannia Industries or BIL, ITC has a nominal share in the value biscuit segment and its core focus on premium brands will continue to help it in gaining market share gradually. Although there is a lot of competition in the biscuit market with BIL growing aggressively, in our opinion, ITC also has a fair chance of attaining good growth provided it expands the distribution reach (currently around 2.7mn as against 4.7mn in case of BIL and more than 5mn in case of Parle) and improves the quality of distribution where the second-largest player is facing some problems, as our channel checks indicate.

Exhibit 11: ITC ready to take on a larger pie of premium biscuit segment

Britannia brands	Price (Rs/kg)	Category	Parle brands	Price (Rs/kg)	Category	ITC brand (Sunfeast)	Price (Rs/kg)	Category
Pure Magic Deuce	500		Hide N Seek	250-400		Mom's Magic	133-500	
Nutri Choice	150-400		Fab Bourbon	167		Dark Fantasy	250-400	
Good Day	133-333		Simply Good	150		Farmlite	250-333	Mid- premium
Little Hearts	250		Parle Top	133	Mid-Premium	Sunfeast Cream	167	
Pure Magic	250	Mid-premium	Monaco	133		Nice	133	
Treat	200		Parle Crackers	130		Marie Light	100-125	Value
50-50	200		Krackjack	125				
Bourbon	167		20-20 Cookies	111				
Nice	147		Bake Smith Marie	111				
Marie	112	Value	Magix Cream	100	Value			
Tiger	81		Parle G	71-80				

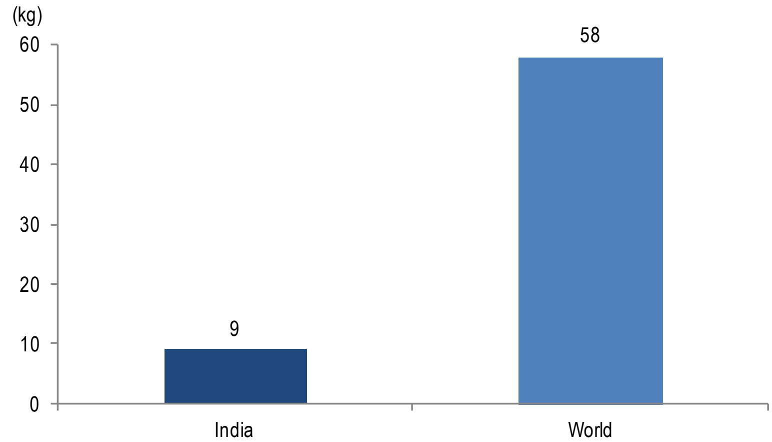
Source: E-commerce websites, Nirmal Bang Institutional Equities Research

Exhibit 12: New launches in FMCG business

Source: Company, Nirmal Bang Institutional Equities Research

Value added products (VAP) to drive paperboard and packaging business: ITC's paperboard business with nearly 700,000tpa aggregate is also India's most advanced and eco-friendly capacity. Per capita consumption of paper in India is way below the global average and hence there is huge growth potential in the business. ITC is the leader in terms of size. The market leader in value-added paperboard or VAP segment has two strategic projects underway – value-added paperboard (+1.5tpa) and décor (+0.2tpa) which will result in incremental revenues with better margins. Therefore, we expect the growth to be in low to mid-teens in the next two to three years.

Exhibit 13: Low per capita usage (kg) of paper in India

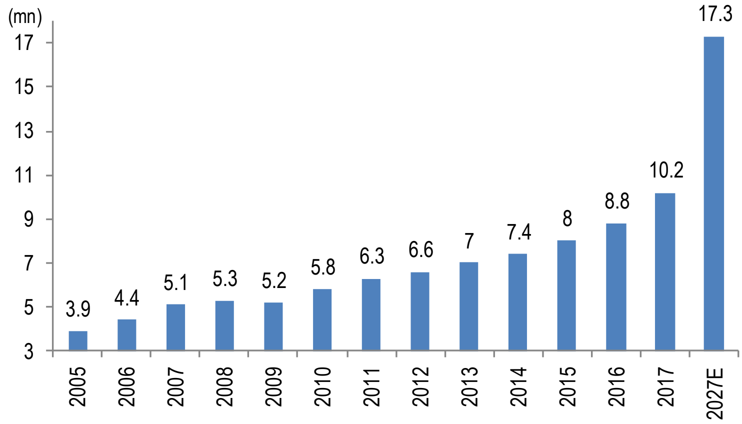


Source: Company, Nirmal Bang Institutional Equities Research

Agri-business has a very competitive and efficient supply chain which has helped ITC to become the second-largest exporter of agri-products.

Expansion-led growth in hotel business and improvement of macros: Finally, the hotel business, which is also nearly four decade-old, comprises nearly 100 properties spread over 70 different locations. It operates under four brands- ITC Hotels, WelcomHotel, Fortune & WelcomHeritage. Current room inventory is ~240,000 rooms of which ~66,000 rooms or 28% of the rooms are in the luxury and upper upscale segments. ITC is targeting this business in a big way than in the past and has many projects underway which will boost the revenue profile further. It includes four hotels under the ITC brand in Kolkata, Hyderabad, Ahmedabad, Srinagar and WelcomHotels in three cities – Bhubaneshwar, Guntur and Amritsar. Also, its first overseas project in Colombo is progressing as per schedule. Foreign tourist growth has been picking up since the past few quarters and also with the overall improvement in the macro environment we expect the hotel business to deliver better performance going forward.

Exhibit 14: Foreign tourists' arrival (mn) in India



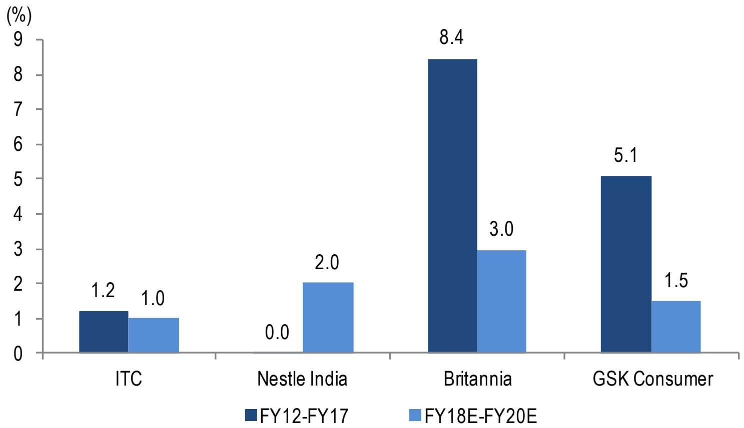
Source: IBEF Presentation, Nirmal Bang Institutional Equities Research

Although this business constitutes nearly 80% of capital employed, 90% of the employee base and over 80% of annual investments, its contribution from an overall profitability perspective is still fairly moderate at about 14%, and from return on capital perspective it is only marginally above the cost of equity of the company.

Margin upside is somewhat capped

ITC has consistently witnessed margin gain in its cigarette business portfolio. In the past decade, its cigarette business witnessed expansion by nearly 1,200bps to 37%. It was a key contributor to the nearly 14% CAGR witnessed in earnings during that period. This gain has contributed to almost nearly one-third of the overall growth in earnings, and in absence of this expansion the growth would have been more in the range of 10%. Considering that the mix is unlikely to witness any major expansion and the price has moved from a zone of high elasticity to low elasticity, we expect margin expansion to be somewhat limited in the medium term.

Exhibit 15: Operating margin expansion



Source: Company, Nirmal Bang Institutional Equities Research

Big movement towards a smoke-free environment on global basis

About 1bn adult smokers make up the global market consuming about 5trn-6trn sticks of cigarettes annually. Outside China, the four biggest manufacturers are BAT, Imperial Brands, Japan Tobacco and Philip Morris International. The tobacco market is estimated at US$770bn of which global cigarette market is valued at US$700bn. NGP/smoke-free product market is estimated at US$15bn. It remains somewhat uncertain to forecast the future but most likely the cigarette volume market will remain range-bound. The secular trend towards reduced risk tobacco products will continue as most large companies engage extensively with scientists, public health professionals and regulators in this regard.

Exhibit 16: Global cigarette market trend (volumes)

Cigarettes (bn units)	2012	2013	2014	2015	2016	Four-year CAGR (%)
China	2,462	2,491	2,550	2,490	2,351	(1.1)
Indonesia	303	308	314	320	316	1.1
Russia	371	346	316	293	278	(6.9)
US	293	280	271	270	263	(2.6)
Japan	197	194	186	182	174	(3.1)
Turkey	95	92	95	103	106	2.6
Egypt	78	80	83	86	90	3.8
Bangladesh	76	79	81	83	86	3.1
India	102	101	96	88	85	(4.5)
Philippines	103	87	82	79	79	(6.3)
Total	**4,079**	**4,057**	**4,074**	**3,995**	**3,828**	**(1.6)**

Source: Press Reports

Financial performance

Cigarette business has been the forte of ITC. The company has a very wide portfolio of brands (ranging from Insigna & Classic at the premium end, Gold Flake and Navy Cut in the middle and Capstan & Flake Filter at the economy end). However, following regulatory problems and tax hikes, ITC and other cigarette companies had to increase the prices which resulted in slowdown in consumption, and the rise of unorganised sector which is also predominant in our country. Volume growth has been under pressure for quite some time and we believe that tobacco, being the demerit good will remain on the radar of the government and further rise in cess or tax is likely. Hence, we believe that cigarette volume growth will continue to remain in low single-digit and ITC will have to tackle pricing going forward as well. This will have impact on profitability of the overall company. Although a significant investment has been made on other businesses, their share of revenues and profitability in the overall business is meagre currently Hence, concerns about profitability of the cigarette business will impact overall profitability of ITC.

Other businesses include hotels, agri-business, FMCG and paperboards, paper & packaging.

Exhibit 17: Segment-wise top-line performance

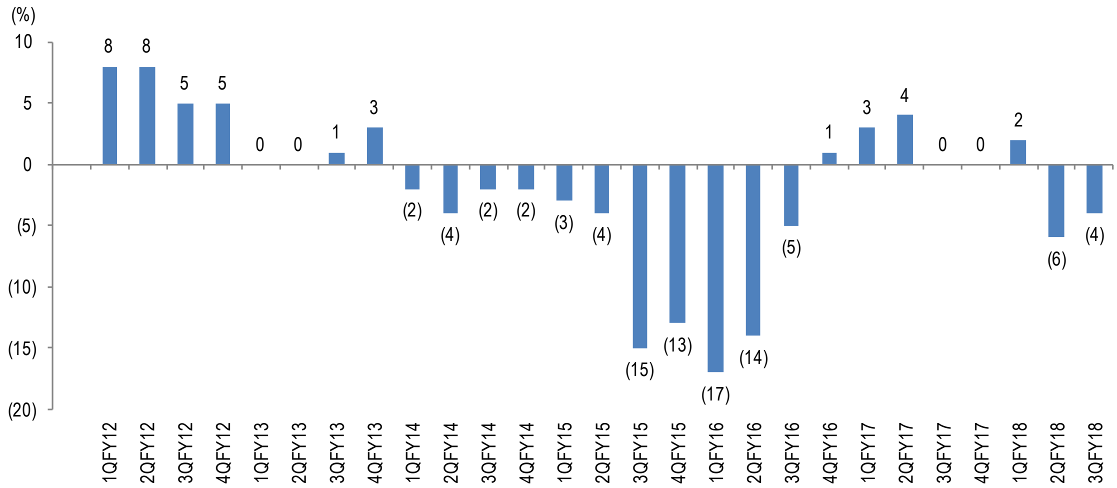
Particulars	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Revenues from operations	**Net**	**Net**	**Net**	**Gross**	**(see note)**	**Net**	**Net**
Agri-business	77,521	83,805	74,569	82,646	82,546	82,377	86,951
Cigarettes	1,54,561	1,68,046	1,74,858	3,40,020	2,28,828	1,99,527	2,13,494
FMCG(others)	80,992	90,113	97,044	1,05,118	1,14,511	1,22,912	1,36,509
Hotels	11,328	11,870	12,861	13,417	14,327	15,290	16,687
Paper boards, paper & packaging	48,605	49,739	50,174	53,629	53,490	56,945	61,225
Total	**3,73,006**	**4,03,572**	**4,09,506**	**5,94,830**	**4,93,702**	**4,77,051**	**5,14,867**
Less Inter-segment revenues	44,180	42,739	44,753	44,813	50,009	32,000	32,000
Sales	**3,28,826**	**3,60,832**	**3,64,753**	**5,50,017**	**4,43,694**	**4,45,051**	**4,82,867**
Sales proportion (%)	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
Agri-business	23.6	23.2	20.4	15.0	18.6	18.5	18.0
Cigarettes	47.0	46.6	47.9	61.8	51.6	44.8	44.2
FMCG(others)	24.6	25.0	26.6	19.1	25.8	27.6	28.3
Hotels	3.4	3.3	3.5	2.4	3.2	3.4	3.5
Paper boards, paper & packaging	14.8	13.8	13.8	9.8	12.1	12.8	12.7
Total	**113.4**	**111.8**	**112.3**	**108.1**	**111.3**	**107.2**	**106.6**
Less Inter-segment revenues	13.4	11.8	12.3	8.1	11.3	7.2	6.6
Net sales	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Growth YoY segment-wise	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E***	**FY19E***	**FY20E**
Agri-business	7.7	8.1	(11.0)	10.8	-	-	6
Cigarettes	10.6	8.7	4.1	94.5	(33)	(13)^	7
FMCG(others)	16.0	11.3	7.7	8.3	9	7	11
Hotels	5.5	4.8	8.4	4.3	7	7	9
Paper boards, paper & packaging	15.3	2.3	0.9	6.9	-	6	8
Total	**11.5**	**8.2**	**1.5**	**45.3**	**(17)**	**(3)**	**8**
Margin %	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
Agri-business	10.8	10.8	12.5	11.0	10.7	9.3	8.7
Cigarettes	64.8	66.6	67.2	36.8	58.3	70.3	71.4
FMCG(others)	0.3	0.4	0.7	0.3	1.2	1.5	2.1
Hotels	12.3	4.1	4.3	8.3	9.8	8.2	10.3
Paper boards, paper & packaging	18.4	18.5	18.1	18.0	20.2	19.0	20.5

**Due to change in the accounting treatment, numbers for FY17 and FY18 are not comparable.*

^Although due to inconsistency due to change in accounting treatment, the number is not comparable however on like to like basis, we are expecting growth of around 6%-7%.

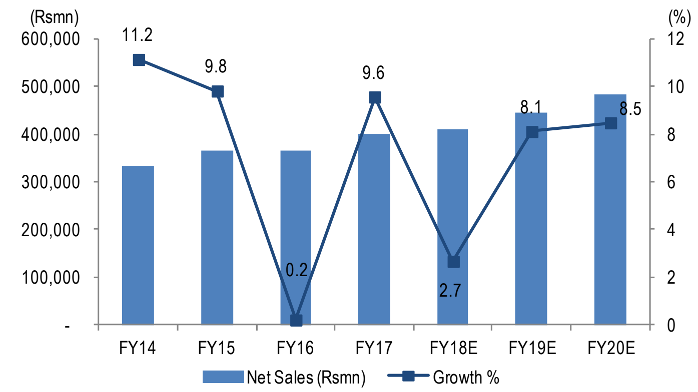
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 18: Volume growth of cigarette business of ITC



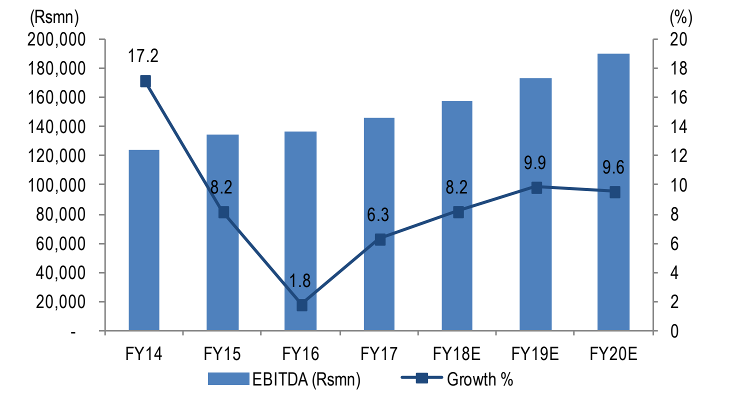
Source: Nirmal Bang Institutional Equities Research estimates

Exhibit 19: Sluggish top-line growth



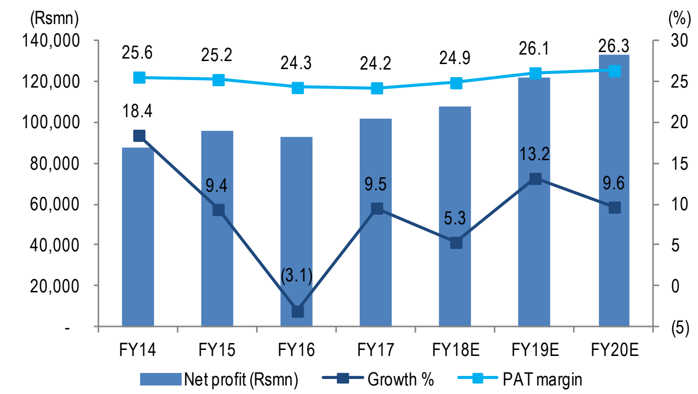
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: Moderate improvement in operating profit



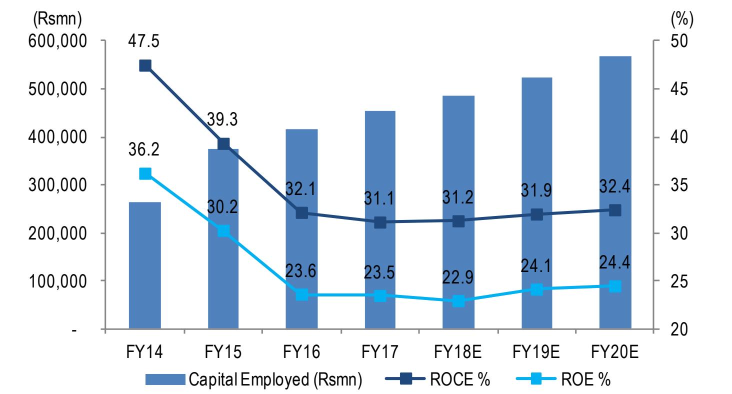
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: Net income trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: Return ratios likely to remain flat



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Division-wise capex

Capex (Rs mn)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Agri business	1,143	368	116	911	1,593	905	844	2,144	1,285	1,594
FMCG - Cigarettes	4,451	4,954	4,440	3,129	5,851	5,448	7,998	5,335	2,183	2,535
FMCG - Others	3,088	1,816	1,664	1,121	2,728	3,646	4,611	6,715	7,572	11,534
Hotels	3,024	3,670	4,179	3,223	7,207	3,956	2,829	9,569	2,915	3,987
Paperboards, paper and packaging	8,863	5,788	2,081	2,495	5,938	6,903	6,629	1,541	3,498	5,606

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 24: Division-wise RoCE

RoCE (%)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
Agri-business	9	20	33	36	39	49	50	45	43	40
FMCG - Cigarettes	169	155	163	190	207	195	188	194	212	232
FMCG - Others	(19)	(25)	(18)	(16)	(10)	(4)	1	1	2	1
Hotels	25	16	9	10	9	4	4	1	1	2
Paperboards, paper and packaging	16	14	18	22	23	21	17	17	17	17

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 25: Our versus consensus estimates

Particulars	FY18E			FY19E			FY20E		
	Our estimate (Rsmn)	Consensus (Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus (Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus (Rsmn)	*Variance (%)*
Sales	4,11,590	4,25,680	*(3.3)*	4,45,051	4,73,781	*(6.1)*	4,82,867	5,25,073	*(8.0)*
EBITDA	1,57,707	1,55,664	*1.3*	1,73,251	1,77,554	*(2.4)*	1,89,807	1,97,298	*(3.8)*
Net income	1,07,460	1,09,952	*(2.3)*	1,21,598	1,24,095	*(2.0)*	1,33,332	1,38,859	*(4.0)*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Comparative performance

We compared the financial performance of some F&B companies. Past four years have been tough for the company, especially as the cigarette volume was under pressure. During this period, growth in top-line and profitability was brought down to mid to high single-digit as against very high double-digit growth in the past. BIL has clearly outperformed other players both in terms of top-line and profitability in the past. Nestle India faced regulatory challenges and volume pressure, GSK Consumer Healthcare also witnessed subdued top-line performance during the past few years and lost market share following competitive pressure and modest growth of the category itself.

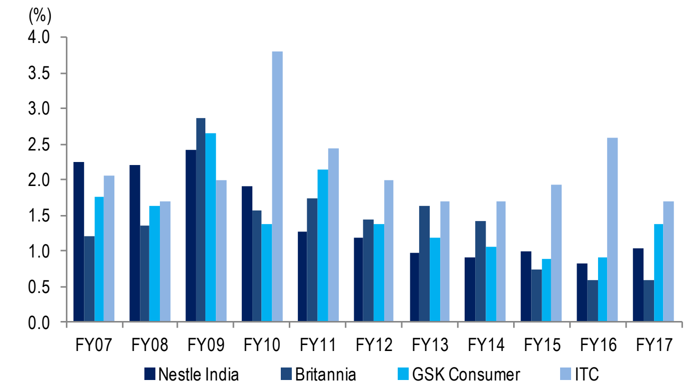
Exhibit 26: Top-line and profitability trends of the food companies

Sales growth (%)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
ITC	14.7	11.9	16.3	18.2	17.3	18.8	11.2	9.8	0.2	9.6	2.7	8.1	8.5
Nestle India	24.4	23.4	18.6	21.9	20.1	10.9	9.2	8.3	(17.0)	11.8	9.5	12.7	12.7
Britannia Industries	22.5	23.2	10.3	22.2	19.0	12.8	11.8	13.7	6.9	7.8	9.4	12.5	14.7
GlaxoSmithkline Consumer Healthcare	15.0	20.6	24.6	20.0	16.5	18.7	52.7	(11.5)	(4.0)	(3.6)	9.1	8.8	10.5
Total	**17.1**	**15.8**	**16.4**	**19.5**	**18.0**	**16.5**	**13.7**	**8.1**	**(2.1)**	**8.7**	**5.1**	**9.5**	**10.3**
EBITDA growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	11.3	10.3	25.0	22.0	19.4	20.1	17.2	8.2	1.8	6.3	8.2	9.9	9.6
Nestle India	39.0	10.5	19.1	24.1	23.4	20.2	9.8	4.7	(22.2)	13.5	13.3	17.5	15.9
Britannia Industries	81.6	1.2	(31.4)	45.3	31.3	35.3	49.1	37.7	40.6	5.3	16.5	24.2	24.5
GlaxoSmithkline Consumer Healthcare	2.0	5.7	30.8	21.3	12.8	34.9	52.2	(16.3)	15.3	(1.0)	4.3	11.7	15.7
Total	**15.9**	**9.8**	**22.3**	**22.8**	**19.9**	**21.1**	**18.7**	**7.6**	**1.4**	**6.5**	**9.1**	**11.8**	**11.7**
PAT growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	15.6	4.6	24.4	22.8	23.6	20.4	18.4	9.4	(3.1)	9.5	5.3	13.2	9.6
Nestle India	55.2	9.2	22.6	25.0	17.5	11.1	4.6	6.0	(52.5)	77.8	21.7	23.3	20.5
Britannia Industries	67.9	(18.8)	(28.0)	30.2	48.8	30.1	52.3	74.0	19.7	7.3	11.8	26.3	25.2
GlaxoSmithkline Consumer Healthcare	28.2	15.8	23.6	28.8	18.5	23.0	54.5	(13.5)	17.8	(4.5)	3.2	11.1	16.7
Total	**21.6**	**4.6**	**22.3**	**23.5**	**23.1**	**19.6**	**19.5**	**9.9**	**(5.6)**	**11.9**	**7.0**	**14.9**	**12.3**

Source: Company, Nirmal Bang Institutional Equities Research

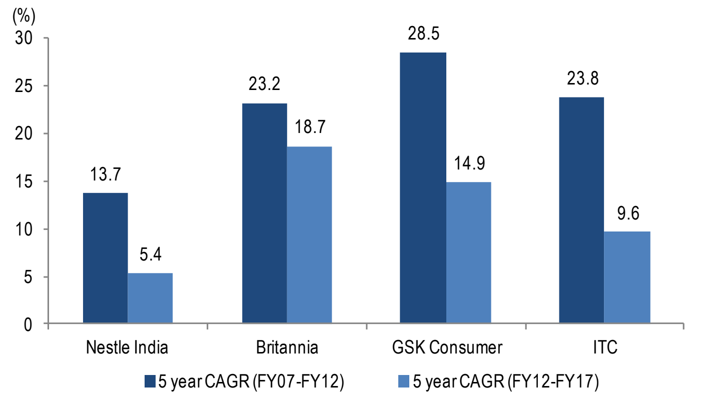
We compared DPS growth of food companies in our coverage universe by forming two bands of five years each i.e. FY07-FY12 and FY12-FY17. Except for BIL, all others witnessed a fall in growth rate of DPS in the past five years, largely reflecting the pressure on fundamentals.

Exhibit 27: Dividend yield trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 28: DPS in five-year CAGR band



Source: Company, Nirmal Bang Institutional Equities Research

Valuation and recommendation

Price performance of ITC in the past three to four years clearly indicates the pressure on earnings wherein cigarette business faced many regulatory hurdles in the form of ban and increase in tax rates. Before that, ITC largely outperformed the index and its performance was line with other F&B companies, or in fact better in some years. We compared the price performance of some global tobacco giants as well. In terms of price performance, ITC has historically outperformed these peers on the back of higher earnings and growth expectations. Performance of these companies, except Altria Group, clearly suggests the pressure on cigarette volume negatively affects the earnings profile. Comparing the returns of these companies with the MSCI World Index indicates that in the past four to five years, the performance has been quite volatile with BAT and Altria managing to outperform the benchmark during the maximum number of years, while Philip Morris and Japan Tobacco's performance stood below the benchmark index.

Exhibit 29: Absolute and relative price performance history

F&B companies	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
Absolute performance (%)												
ITC	19	(18)	46	42	16	42	12	15	(11)	11	9	2
Nestle India	32	(3)	75	50	7	22	6	21	(9)	3	31	(4)
Britannia Industries	35	(10)	27	23	8	11	85	100	61	(3)	63	5
GSK Consumer Healthcare	31	(23)	130	80	10	50	17	32	9	(22)	31	4
Relative performance (%)												
ITC	(23)	70	(17)	21	54	12	5	(13)	(7)	8	-15	3
Nestle India	(15)	102	-	27	42	(5)	(1)	(8)	(5)	-	1	(3)
Britannia Industries	(13)	86	(28)	4	44	(13)	73	52	68	(6)	27	6
GSK Consumer Healthcare	(16)	59	31	52	46	17	9	1	14	(24)	2	4

Source: Bloomberg, Nirmal Bang Institutional Equities

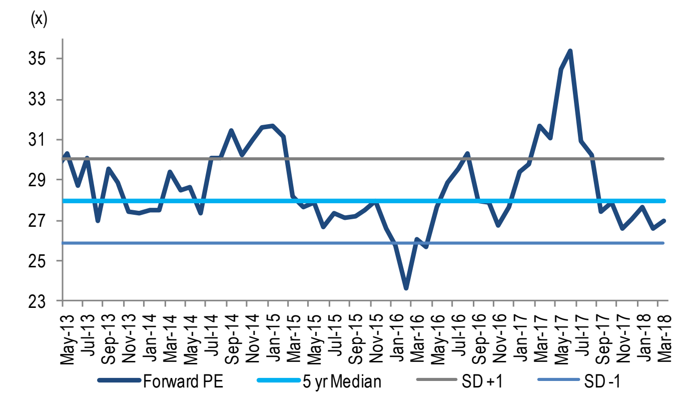
Exhibit 30: Absolute and relative (MSCI World Index) price performance history of Global tobacco players

Global tobacco companies	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
Absolute Performance (%)												
British American Tobacco Plc	38	(8)	12	22	24	2	4	8	8	23	9	(15)
Philip Morris International	N.A.	N.A.	11	21	34	7	4	(7)	8	4	15	(1)
Altria Group Inc.	17	(35)	30	25	20	6	22	28	18	16	6	(13)
Japan Tobacco Inc	16	(56)	6	(4)	20	35	41	(3)	34	(14)	(6)	(17)
Relative performance (%)												
British American Tobacco Plc	28	58	(12)	12	34	(10)	(16)	5	11	16	(10)	(14)
Philip Morris International	N.A.	N.A.	(13)	11	45	(6)	(16)	(9)	11	(1)	(4)	0
Altria Group Inc	10	12	3	14	30	(6)	(2)	25	21	10	(12)	(12)
Japan Tobacco Inc	8	(24)	(16)	(12)	30	19	13	(6)	38	(18)	(21)	(17)

Source: Bloomberg, Nirmal Bang Institutional Equities

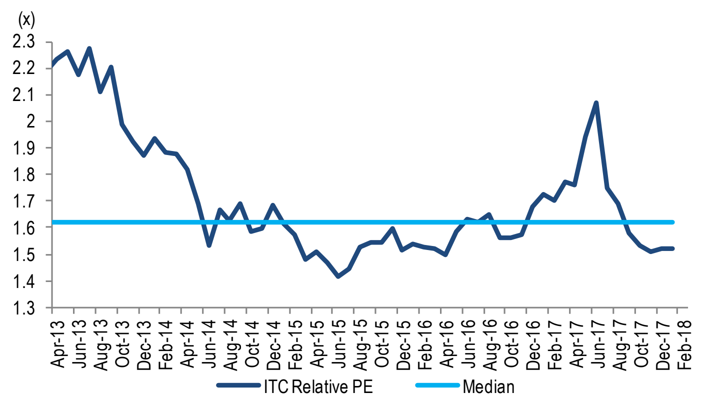
ITC stock currently trades at 27x one-year forward earnings i.e. at a discount of 4% to five-year median P/E. Current P/E of the company is close to -1SD. Similarly, the stock trades at at discount of 5% and 2% to five-year median EV/EBITDA and P/E, respectively. We also compared the forward P/E of the stock with the indices and it was observed that ITC trades between Nifty and Nifty FMCG indices' PE. Following regulatory pressure on cigarette business, the stock has been trading at a lower P/E multiple compared with other FMCG companies.

Exhibit 31: One-year forward P/E of ITC



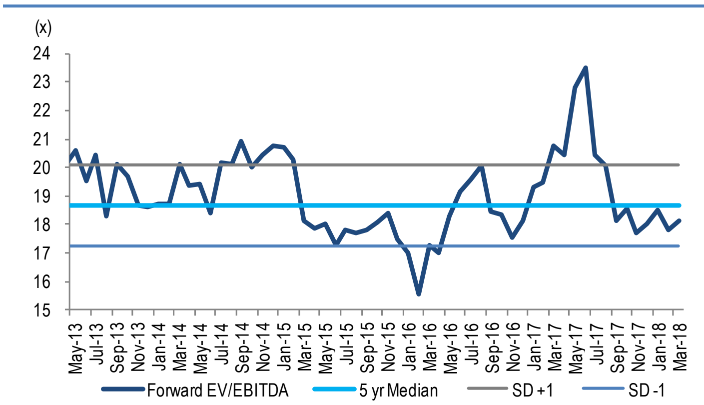
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Relative P/E (Nifty) of ITC



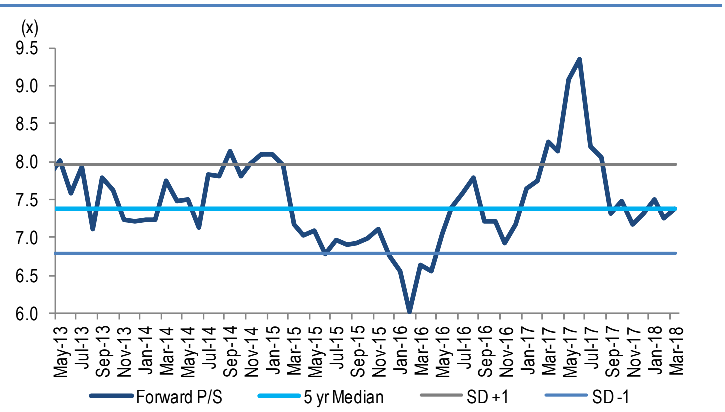
Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 33: One-year forward EV/EBITDA



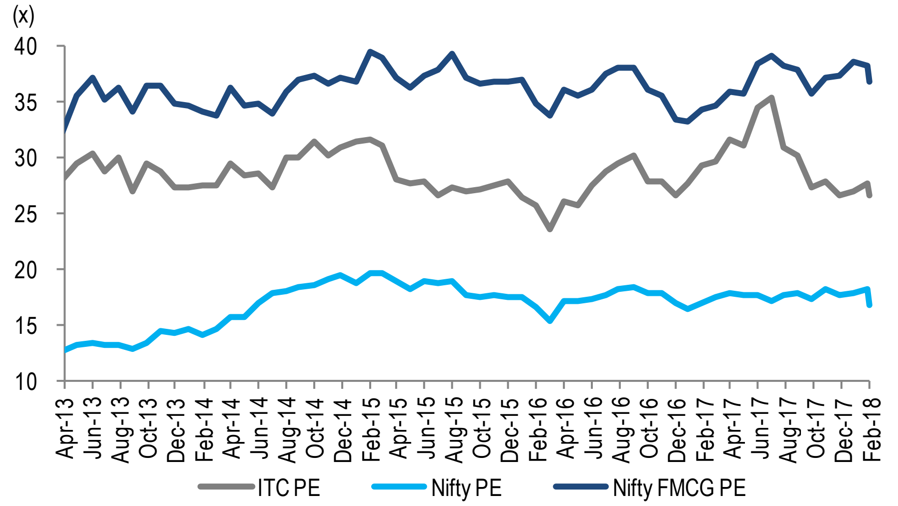
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 34: One-year forward P/Sales



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 35: ITC vis-à-vis Nifty and Nifty FMCG



Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Future earnings growth priced in

Indian tobacco stocks have been consistently trading at premium to global tobacco players because of higher growth rate opportunities in India compared to developed nations. However, this gap has narrowed down to some extent because of the pressure on volume in India during the past few years. This was largely because of regulatory problems and a rise in tax payable, thereby affecting the affordability aspect of buying cigarettes. We compared the growth forecasts of major global tobacco peers with ITC. Higher growth forecast in case of British American Tobacco (BAT) was largely because of the acquisition (Reynolds) done recently. Philip Morris is expected to grow in line with ITC and the other two namely - Altria Group and Japan Tobacco - are expected to grow by around 50% of ITC's growth estimate, both in top-line and earnings. We believe that earnings multiples of ITC vis-à-vis other global players suggest that the future earnings are completely priced in and hence a re-rating of the stock seems difficult considering the earnings outlook as per our estimate, although the stock has not moved much in the past one year.

Exhibit 36: Valuation of tobacco players

Company	CMP* (LC)	Mkt cap (USD mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
ITC	270	50,679	8.0	7.4	6.8	19.9	18.0	16.3	30.5	27.0	24.6	6.4	9.2	9.3	3.3
VST Industries	2,941	699	4.5	4.2	N.A	14.1	12.3	N.A	23.7	20.1	N.A	N.A	N.A	N.A	N.A
Global Companies															
British American Tobacco Plc	4,256	135,585	3.8	3.8	3.6	12.8	12.0	11.2	13.9	12.7	11.8	20.8	25.7	14.1	1.0
Philip Morris International	107	166,918	5.2	4.9	4.5	14.3	13.0	11.9	20.4	18.3	16.1	8.6	8.9	9.5	2.1
Altria Group Inc.	66	124,936	6.3	6.2	6.0	13.7	12.8	11.9	16.6	15.0	13.8	1.5	5.1	14.2	1.2
Japan Tobacco Inc.	3,022	56,730	2.7	2.6	2.6	9.1	8.6	8.2	13.2	12.2	11.7	2.1	4.2	4.5	3.0

**CMP Closing price of 12th March 2018 ^3-year CAGR (FY17-FY20E)*

Source: Nirmal Bang Institutional Equities Research

Exhibit 37: SOTP Valuation

Business segment	Methodology	Multiple (x)	Value (Rsmn)	Per share
Agri business	EV/EBITDA	10	81,729	7
FMCG - Cigarettes	EV/EBITDA	15	2,332,649	192
FMCG - Others	EV/Sales	5	6,82,546	56
Hotels	EV/EBITDA	12	46,211	6
Paperboards, paper and packaging	EV/EBITDA	11	1,73,468	14
			3,316,603	**275**
Net cash			67,107	6
Investment on books			1,15,888	10
			Target price	**290**

Source: Nirmal Bang Institutional Equities Research

We initiate coverage on ITC with an Accumulate rating and a target price of Rs290 by March 2019, implying an upside of 7% from the CMP. Our target price is based on SOTP valuation (refer Exhibit 37. We believe the cigarette business will continue to trade at around 25%-30% premium (EV/EBITDA) compared to global players. Other businesses have been assigned multiples in line with industry average. Considering the target price of Rs290, the stock trades at 26x P/E based on FY20E EPS which is largely in line with the current P/E and at around 7% discount to the five-year median P/E.

Risks

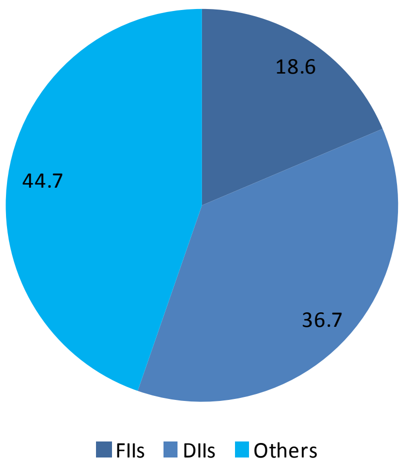
- In our opinion, cigarette business volumes will continue to remain under pressure due to regulatory challenges and likely possibility of further increase in taxes. There would be deviation in the earnings estimates if cigarette business starts growing in high single digit volume due to various possibilities like moderate taxation and less regulatory pressure.
- Consumers are fairly demanding of high quality standards and any adverse product related issues that emerge in the future could pose significant risk to growth and recommendations
- Any macro-economic slowdown, disruption and/or policy announcements which substantially impacts consumer spending and the premiumisation trend in India.
- We expect the rural economy to see gradual improvement after being weak substantially in the past three years. Any weather or policy-related issue that impacts this recovery could also pose risk to our earnings estimate and recommendation.
- Pricing-related competitive challenges so far have been moderate, but if this scenario witnesses any major change it could have a substantial impact on our earnings estimate and recommendation.
- Most companies have been moderating marketing and investment spending in the recent past and any substantial increase in spending does pose substantial risk to our estimate.

Exhibit 38: Management committee

Name	Designation
Mr. Sanjiv Puri	CEO
Mr. Rajiv Tandon	CFO
Mr.Sandeep Kaul	CEO- India Tobacco Division
Mr.Sameer Satpathy	CEO- Personal Care Division
Mr.Sanjay Singh	CEO-Paperboards & Speciality Papers
Mr. B. Sumant	President- FMCG Business
Mr. Ganesh Kumar S.	COO-Staples Snacks & meals
Mr. Nakul Sein Anand	Executive Director
Mr. Rajendra Kumar Singhi	Compliance Officer
Mr. R. Shridhar	Head – HR
Mr. Kannadiputhur Sundararaman	General Counsel
Mr. A .K. Mukherji	Controller

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: Shareholding pattern (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Top 10 public shareholders

Particulars	% holding
Tobacco Manufacturers (India)	24.48
Life Insurance Corporation of India	16.24
Specified Undertaking of the Unit Trust of India	8.43
Myddleton Investment Company	4
General Insurance Corporation of India	1.75
The New India Assurance Company	1.63
Government of Singapore	1.31
The Oriental Insurance Company	1.31
Rothmans International Enterprises	1.27
National Insurance Company	1.01

Source: Company, Nirmal Bang Institutional Equities Research

Financials (Standalone)

Exhibit 41: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net sales	3,65,827	4,00,887	4,11,590	4,45,051	4,82,867
% Growth	***0.2***	***9.6***	***2.7***	***8.1***	***8.5***
COGS	1,34,500	1,59,763	1,59,983	1,71,419	1,84,904
Staff costs	23,316	24,443	24,655	26,112	28,449
Other expenses	70,865	70,900	69,245	74,267	79,707
Total expenses	2,28,681	2,55,106	2,53,883	2,71,799	2,93,059
EBITDA	1,37,146	1,45,780	1,57,707	1,73,251	1,89,807
% growth	***1.8***	***6.3***	***8.2***	***9.9***	***9.6***
EBITDA margin (%)	***37.5***	***36.4***	***38.3***	***38.9***	***39.3***
Other income	17,693	19,859	20,555	21,303	23,255
Interest costs	491	230	550	600	620
Depreciation	10,242	10,380	11,169	12,144	13,119
Profit before tax (before exceptional items)	1,44,106	1,55,030	1,66,544	1,81,811	1,99,324
Exceptional items	-	-	4,129	-	-
Tax	50,976	53,021	57,688	60,212	65,991
PAT	93,130	1,02,009	1,12,985	1,21,598	1,33,332
Adj PAT	93,130	1,02,009	1,07,460	1,21,598	1,33,332
Adj PAT margin (%)	***24.3***	***24.2***	***24.9***	***26.1***	***26.3***
% Growth	***(3.1)***	***9.5***	***5.3***	***13.2***	***9.6***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 42: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
PAT	93,130	1,02,009	1,07,460	1,21,598	1,33,332
Depreciation	10,242	10,380	11,169	12,144	13,119
Other income	(17,693)	(19,859)	(20,555)	(21,303)	(23,255)
(Inc.)/dec. in working capital	(153)	(876)	(2,153)	(1,410)	(1,995)
Cash flow from operations	**85,527**	**91,655**	**95,921**	**1,11,029**	**1,21,200**
Capital expenditure (-)	(14,211)	(30,183)	(20,000)	(20,000)	(20,000)
Net cash after capex	**71,316**	**61,472**	**75,921**	**91,029**	**1,01,200**
Issue of share capital (incl premium)	17,524	11,448	-	-	-
Dividends paid (-)	(68,401)	(57,700)	(64,476)	(72,959)	(79,999)
DDT paid (-)	(13,335)	(11,746)	(8,382)	(9,485)	(10,400)
Inc./(dec.) in investments	(25,857)	(32,749)	17,077	3,686	5,671
Cash from financial activities	**(91,863)**	**(1,20,574)**	**(80,154)**	**(1,00,699)**	**(1,07,462)**
Opening cash balance	62,728	56,392	27,473	43,240	53,569
Closing cash balance	56,392	27,473	43,240	53,569	67,307

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 43: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	8,047	12,147	12,147	12,147	12,147
Reserves	4,08,517	4,41,262	4,72,344	5,11,849	5,54,632
Minority Interest	-	-	-	-	-
Net worth	4,16,564	4,53,410	4,84,491	5,23,996	5,66,779
Total debt	294	180	200	200	200
Deferred tax liability	18,674	18,717	19,000	19,000	19,000
Total liabilities	**4,36,770**	**4,73,859**	**5,05,176**	**5,44,781**	**5,87,678**
Gross block	1,45,607	1,64,328	1,79,328	1,94,328	2,09,328
Depreciation	9,688	19,634	30,803	42,947	56,066
Net block	1,35,920	1,44,693	1,48,524	1,51,381	1,53,262
Intangible assets	4,498	4,566	4,600	4,650	4,700
Capital work-in-progress	23,884	34,913	39,913	44,913	49,913
Investments	1,33,245	1,85,853	1,89,331	2,06,949	2,24,533
Inventories	85,198	78,640	83,535	89,294	95,104
Debtors	16,864	22,075	16,265	20,315	16,727
Cash	56,392	27,473	43,240	53,569	67,307
Loans & advances	14,504	11,140	14,406	15,577	16,900
Other current assets	5,062	6,106	6,174	6,676	7,243
Total current assets	2,32,339	2,45,374	2,60,343	2,90,017	3,16,755
Creditors	22,280	25,512	22,702	28,959	26,766
Other current liabilities & provisions	41,227	42,788	44,863	48,511	52,632
Total current liabilities	63,543	68,301	67,565	77,469	79,398
Net current assets	1,68,797	1,77,073	1,92,777	2,12,547	2,37,357
Total assets	**4,36,770**	**4,73,859**	**5,05,176**	**5,44,781**	**5,87,678**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 44: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Per share (Rs)					
EPS	7.7	8.4	8.8	10.0	11.0
Book value	34.5	37.3	39.9	43.1	46.7
DPS	5.7	4.8	5.3	6.0	6.6
Valuation (x)					
P/Sales	7.2	8.5	8.0	7.4	6.8
EV/sales	6.9	8.2	7.6	7.0	6.4
EV/EBITDA	18.4	22.5	19.9	18.0	16.3
P/E	28.4	33.4	30.5	27.0	24.6
P/BV	6.3	7.5	6.8	6.3	5.8
Return ratios (%)					
RoCE	32.1	31.1	31.2	31.9	32.4
RoE	23.6	23.5	22.9	24.1	24.4
Profitability ratios (%)					
Gross margin	63.2	60.1	61.1	61.5	61.7
EBITDA margin	37.5	36.4	38.3	38.9	39.3
EBIT margin	34.7	33.8	35.6	36.2	36.6
PAT margin	24.3	24.2	24.9	26.1	26.3
Liquidity ratios (%)					
Current ratio	3.7	3.6	3.9	3.7	4.0
Quick ratio	2.3	2.4	2.6	2.6	2.8
Solvency ratio (%)					
Debt-to-equity ratio	-	-	-	-	-
Turnover ratios					
Total asset turnover ratio (x)	0.7	0.7	0.7	0.7	0.7
Fixed asset turnover ratio (x)	2.7	2.8	2.8	2.9	3.2
Inventory days	222	187	185	184	182
Debtors days	17	18	17	15	14
Creditor days	56	55	55	55	55

Source: Company, Nirmal Bang Institutional Equities Research

GlaxoSmithKline Consumer Healthcare

13 March 2018

Reuters: GLSM.BO; Bloomberg: SKB IN

Initiating Coverage

Fighting For Mindshare And Wallet Share

GlaxoSmithKline Consumer Healthcare (GSK Consumer) is an associate of GlaxoSmithKline Plc based in the UK, one of the world's largest consumer healthcare companies. It is a category leader in the health food drink space in India with a volume share of 64% and value share of 56%. The company is also engaged in marketing various OTC products such as Crocin, Eno, Iodex and Sensodyne. HFD category's growth in India has been below par in recent years as it is competing for a wallet share with several other healthy food propositions such as RTD beverages, natural foods, cereals and cereal bars. Considering this aspect and our earnings growth expectation, we initiate coverage on the stock with an Accumulate rating and a target price of Rs7,300. This target price is based on forward P/E multiple of 35x which is in line with the five year median P/E and at 8% discount to the current forward P/E.

Category growth outlook is uncertain: Considering that HFD is competing with several healthy and natural food alternatives, we believe the growth in the category could be below par. This trend, in our opinion, will certainly impact GSK Consumer, the market leader in that space, resulting in somewhat more muted top-line growth of 9.6% for FY18E-FY20E.

Margin headroom is limited: Considering that category trends are somewhat uncertain the need to invest in rural markets and competitive intensity in the category is fairly high, we expect the margins to remain largely range-bound around the 20% mark.

Valuation and recommendation: We expect earnings growth of 13% over the period FY18E-FY20E will lag peers in the food space. Considering modest earnings growth outlook and the fact that the stock is already trading at a premium to its historical average, we prefer to assign Accumulate rating to the stock with a target price of Rs7,300 indicating an upside of 7%. This target price is based on forward P/E multiple of 35x which is in line with the five year median PE and at 8% discount to the current forward P/E.

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net revenues	41,364	39,864	43,474	47,291	52,242
EBITDA	8,420	8,335	8,693	9,708	11,229
Adj. PAT	6,312	6,566	6,779	7,532	8,792
EPS (Rs)	163.4	156.1	161.2	179.1	209.1
EPS growth (%)	*17.8*	*(4.5)*	*3.2*	*11.1*	*16.7*
EBITDA margin (%)	*20.4*	*20.9*	*20.0*	*20.5*	*21.5*
P/E (x)	36.9	33.0	42.4	38.2	32.7
P/BV (x)	9.1	6.9	9.9	8.7	7.6
EV/EBITDA (x)	26.9	22.3	29.7	26.1	22.1
RoCE (%)	*31.7*	*25.9*	*26.5*	*28.9*	*29.5*
RoE (%)	*28.0*	*22.2*	*22.5*	*24.2*	*24.8*

Source: Company, Nirmal Bang Institutional Equities Research

ACCUMULATE

Sector: FMCG

CMP: Rs6,837

Target Price: Rs7,300

Upside: 7%

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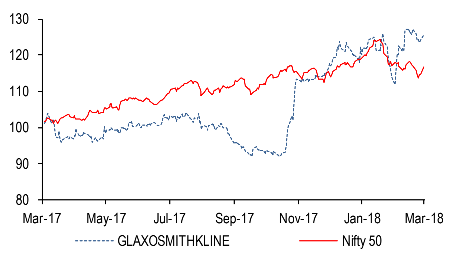
Key Data

Current Shares O/S (mn)	42.1
Mkt Cap (Rsbn/US$bn)	281.9/4.3
52 Wk H / L (Rs)	6,940/4,851
Daily Vol. (3M NSE Avg.)	16,930

Shareholding (%)	1QFY18	2QFY18	3QFY18
Promoter	75.0	75.0	75.0
Public	25.0	25.0	25.0
Others	-	-	-

One -Year Indexed Stock Performance



Price Performance (%)

	1 M	6 M	1 Yr
GSK Consumer	12.3	31.4	25.6
Nifty Index	(1.1)	3.3	16.6

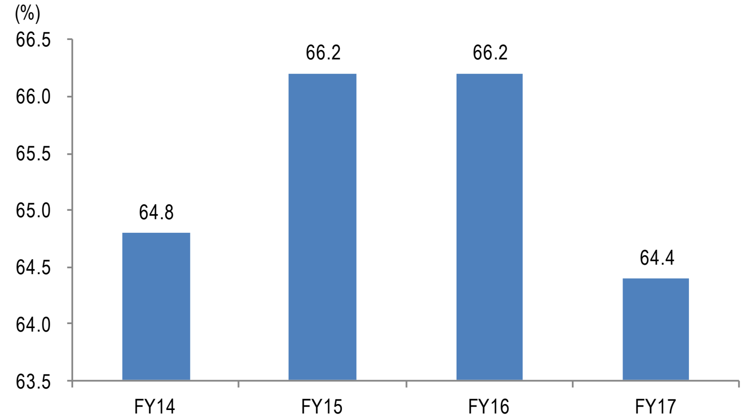
Source: Bloomberg

Investment thesis

Market leader in HFD

In a country that dotes on milk/dairy products, HFD or milk food drinks constitutes top product category for consumption. Malt-based drinks have been quite popular in India in select urban market pockets. However, overall penetration in this category is still around 40%. The category has grown more than three-fold from Rs22bn in 2009 to Rs72.6bn in 2016. GSK Consumer undoubtedly has been the market leader in the category since its inception. Many new players have come in during the course of time. Sub-categories or new variants have been introduced in the HFD category. As the category's growth itself is in single-digit in the past few few years, other players have grown at the expense of GSK Consumer and the same is reflected from loss of market share in recent years. Although the overall consumer sentiment is improving and rural growth is coming back gradually, we believe overall category growth will remain modest in the medium term and GSK Consumer will continue to face competitive challenges in this space and thus incremental growth, to some extent, could be compromised.

Exhibit 1: Volume market share under pressure

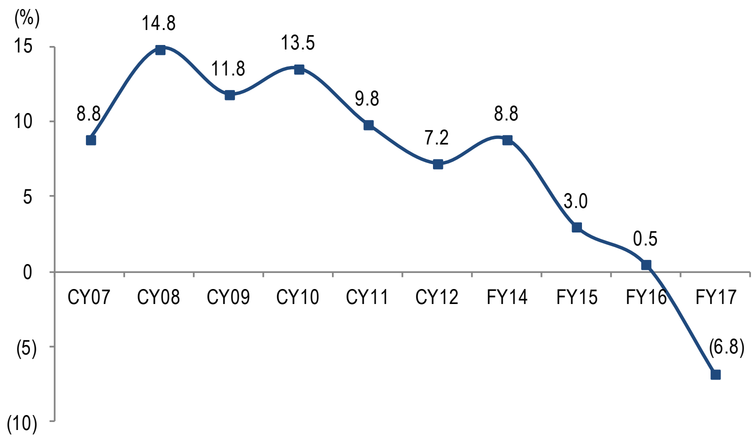


Source: Company, Nirmal Bang Institutional Equities Research

Weak underlying growth in the past

HFD category's growth has been sluggish in the past. The performance of the market leader clearly reflects the same. Volume growth was down from double-digit (13.5%) in CY10 to negative 6.8% in FY17. Volume was under pressure because of overall weakness in the industry following poor macros, subdued demand and increased competition. Growth was largely contributed by aggressive price hikes in the past. We believe the overall consumer sentiment is reviving, but HFD as a category is niche and most of the consumption happens only in select pockets. GSK Consumer is planning to expand in rural markets, its rural share is relatively less (close to 33%) and sachet sales are below 10% of overall sales. Hence, assuming rural growth comes back on track, it is a question as how much of the incremental disposable income will be used for consumption of these products. Hence, we believe that volume will show a modest trend in the medium term, but exponential volume growth is unlikely.

Exhibit 2: Volume growth

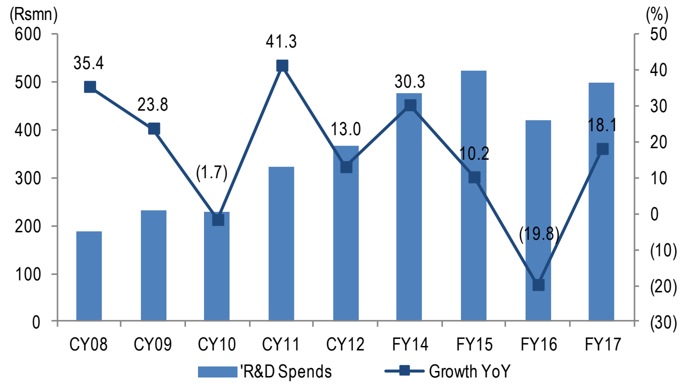


Source: Company, Nirmal Bang Institutional Equities Research

Innovation lags behind

GSK Consumer has rightly targeted different age groups of consumers like infants, toddlers, adult males and females by introducing different products. Science has always been the backbone of its portfolio as all the products are clinically proven. Brand Horlicks has Horlicks Lite and Protein Plus for active adults, Women's Horlicks which urges women turning 30 to consume the product for their bone health, Horlicks Growth Plus for toddlers, etc. But looking at the product profiles of competitors, we believe that in almost all sub-categories there is competition from peers. For example, protein segment is worth around Rs7bn is growing in double-digits i.e. outperforming the HFD category's growth.GSK Consumer is gradually increasing its presence in this category wherein the average price is around 2x the normal variant. But this category has been dominated by Protinex of Danone with around 45% share. Hence, GSK Consumer has no early mover advantage in this. In our opinion, there was lack of meaningful innovation at GSK Consumer in the past few years and as a result it caters to products where substitutes are available.

Exhibit 3: R&D spending trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: New launches

Financial Years	New launches/advertisement campaigns
CY12	• Horlicks relaunch –'Tastiest Chocolate Horlicks Ever' in northern and western regions. • Boost - new flavours launched. Made strong entry in digital space. Several advertisement campaigns.
FY14	• Horlicks campaign 'Power of Milk Proposition', Boost advertisement campaigns with cricketer Virat Kohli as its brand ambassador. • Relaunch of Horlicks Lite and Mother's Horlicks, repositioning of Junior Horlicks. • Launch of Horlicks ProMind & Horlicks Kesar Badam, Boost Choco Nut, Boost biscuits. Horlicks Savoury Oats.
FY15	• New formulation in Standard and Chocolate Horlicks • Junior Horlicks relaunched with new claims, packaging and mascot. • Launch of Milk Biscuits.
FY16	• Rs 10 sachet launched in South and East India, Boost sachets launched. • New Chocolate Horlicks launched, Horlicks Oats launched in East India. • Boost restage was launched – '3X more stamina'.
FY17	• Launch of Horlicks Growth+ • Re launch - New and improved Horlicks with 2X Immuno Nutrients, repositioning of Boost • Marie Biscuits launched in East India. • Reduced prices of sachets of Boost and Horlicks.

Source: Company, Nirmal Bang Institutional Equities Research

Premiumisation

We have seen the premiumisation trend clearly being played out across consumer companies and the HFD category is no exception. GSK Consumer is on right track as most of its innovations or new launches are tilted towards premium or super premium segment. Adults (men and women) in urban markets are more and more cautious about their health and are ready to spend on health and nutrition. The same trend goes in case of small children wherein parents are proactive to make sure that their child gets the proper nutrients and proteins on time. Pediatricians are also recommending these products for children. All these factors are driving the theme of premiumisation in the segment. However, consumer stickiness is more in his segment. Hence, once a consumer starts using a specific brand, its relatively tough to attract the same consumer to shift to the other brand. Advertising and brand promotions will help in attaining new customers.

In our opinion, all competitors like Heinz, Danone, Mondelez, Pediasure are equally competent and possess a strong premium portfolio. Undoubtedly, premiumisation is a mega trend, but we believe that in HFD category GSK Consumer will be one the key beneficiaries of the trend and not the only major one. In categories like protein, GSK Consumer does not enjoy dominant share and hence the pricing of these products is on the lower side compared to peers in order to attract consumers.

Exhibit 5: Pricing structure (GSK Consumer vs peers)

Particulars	Qty (gms)	Price (Rs)	Rs per kg
Consumer type: Children			
GSK Consumer			
Horlicks Growth+	200	275	1,375
Horlicks Kesar Badam	400	250	625
Junior Horlicks - (Stage 1 -2-3 years)	500	275	550
Junior Horlicks - (Stage 2 -4-6 years)	500	256	512
Boost Plus	450	223	496
Horlicks Classic Malt (refill pack)	1000	430	430
Boost	1000	420	420
Horlicks Chocolate Flavour	500	199	398
Danone			
Protinex- High protein (Junior)	400	650	1,625
Protinex	250	330	1,320
Mondelez			
Bournvita Lil Champs	500	278	556
Bournvita 5 Star Magic Pro Health	500	213	426
Bournvita Pro health	750	286	381
Abott (Pediasure)			
Pediasure Kesar Badam	200	305	1,525
Pediasure Nutritional Powder	400	540	1,350
Pediasure Complete and Balanced	400	510	1,275
Kraft Heinz			
Complan Kesar Badam	500	290	580
Complan	1000	500	500
Complan Creamy Classic	500	235	470
Consumer type : Men/Women			
GSK Consumer			
Horlicks Protein Plus	400	495	1,238
Mother's Horlicks	200	220	1,100
Women's Horlicks	400	285	713
Horlicks Lite	450	278	618
Danone			
Protinex - mama (Pregnancy and Breastfeeding)	400	560	1,400
Protinex - Nutritional Supplement (Diabetes care)	250	395	1,580
Protinex - High Protein Nutritional Supplement	250	330	1,320

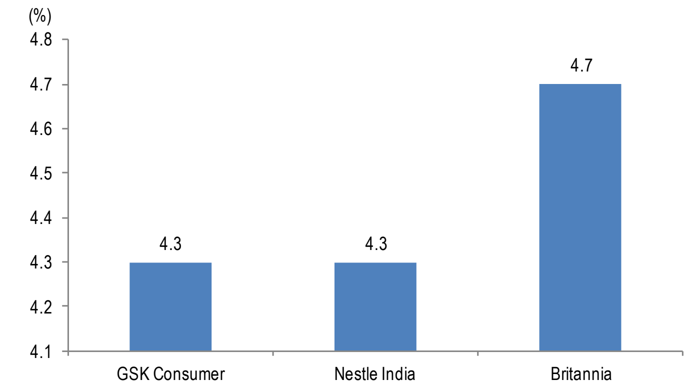
Source: e-commerce websites, Nirmal Bang Institutional Equities Research

Distribution and regional presence, concentration risk

GSK Consumer enjoys total distribution reach of 4.3mn outlets as against 3.0mn in FY15. Direct reach has increased from 0.8mn to 1.0mn outlets during the period. It is largely focusing on increasing the penetration of the brand in small towns in rural markets through its sachet strategy. Out of 4.3mn outlets, Horlicks reaches to about 1.5mn currently and hence the rise in distribution of other products will give the access to its core brands like Horlicks and Boost in the existing base. Also, the company is actively evaluating the go-to-market strategy for high-size portfolio, largely in urban and semi urban markets to facilitate faster distribution. Executing the strategy at the ground level through an increased distribution base and coverage of healthcare professionals is the core business strategy of the management.

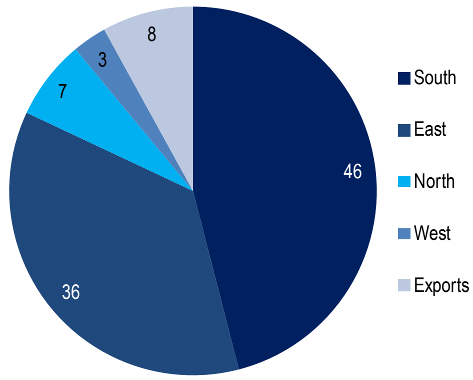
The company continues to derive more than 80% of its revenues from eastern and southern regions. In these regions, Karnataka and West Bengal are the biggest markets as they together constitute more than 22% of the sales in the HFD category. However, the company is slowly increasing its presence in the other regions also and has revised its strategy wherein the focus has shifted to Chocolate Horlicks, which is a brown malt drink, to drive growth in western and northern regions. Consumers in these regions prefer brown malt drink to white malt drink and hence competitive challenges from brands like Bournvita and Protinex remain in these regions. These are the important markets as far as the types of consumers are concerned and hence GSK Consumer's focus on premiumisation and penetration in these regions will result in better market expansion going forward. However, a larger share of revenues is derived from southern and eastern regions only which poses concentration risk to the business. Also, it is losing out on growth in western region to some extent because of lack of adequate distribution presence. Our channel checks in semi-urban markets in Maharashtra suggest that off-take of its key brands is limited and it faces competitive challenges from Bournvita and Complan.

Exhibit 6: Distribution network of peers



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 7: Regional presence of GSK Consumer



Source: Company, Nirmal Bang Institutional Equities Research

Stable commodity basket

Key raw materials for the company are milk powder, barley, wheat and liquid milk. These together form more than 60% of the total raw materials consumed. In the past couple of years, the company has witnessed a rising trend in milk powder; and milk prices are already on a higher trend. However, going forward company expects softening of majority of the raw materials. GSK Consumer enjoys highest gross margin across the board and looking at the current trend in the input prices, these margins are sustainable.

Exhibit 8: Key raw materials for GSK Consumer

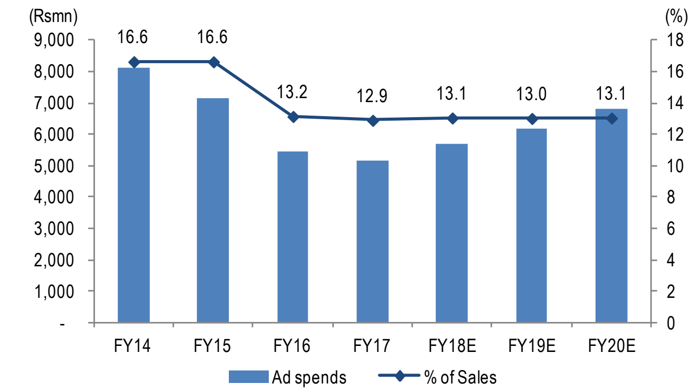
Raw materials consumed %	CY08	CY09	CY10	CY11	CY12	FY14	FY15	FY16	FY17
Milk powder	23.3	21.2	19.7	20.8	21.8	21.9	28.8	24.9	22.8
Liquid milk	19.6	20.3	20.6	20.1	17.1	16.4	12.0	10.6	10.4
Malt and Malt extract	26.2	27.7	23.9	24.4	23.7	22.9	20.4	22.6	23.8
Wheat flour	9.5	8.0	8.0	7.2	6.9	7.7	6.8	6.9	7.4
Others	21.4	22.8	27.9	27.5	30.4	31.1	31.9	35.0	35.5
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, Nirmal Bang Institutional Equities Research

Marketing is going to be the key

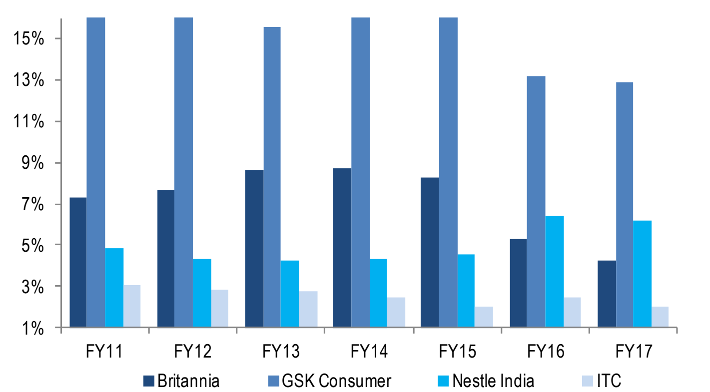
In the wake of strong competition, all companies are aggressively making brand investments and carrying out marketing activities to promote the growth of their core brands. Advertising has been done across the platforms and GSK Consumer is strengthening its presence in modern trade channels as well. Last year, the company appointed a new advertising agency- FCB India - for Horlicks which was earlier with JWT India. Various consumer campaigns like Horlicks Hunger Campaign, Growth Plus Campaign, Exam Time Campaign, etc, were launched to illustrate the benefits of these products and increase customer awareness about the brand and the need for health and wellness in today's world. In rural areas, the strategy of selling a sachet for Rs5 will result in market expansion and a strengthened distribution base will enable the company to market its core products across India. Increased penetration of television and internet will also help the company indirectly as it has been fairly aggressive on those platforms. The company has made significant efforts in respect of digital advocacy programmes including activity-targeting Moms Online. Other activities include social media amplification of TVCs (Junior Horlicks), bone density test on Women's Day, popularisation of Horlicks Brand Store, digital launches of Cardia+ & Growth+, to name a few. All these have helped increase engagement, consideration and strengthen benefit perception among customers. However, it is to be noted that a large part of the promotional activity is restricted towards its key markets i.e. South and East India. Hence, in our opinion, a lot of ground needs to be covered by GSK Consumer to strengthen its presence in western and northern markets of India.

Exhibit 9: Advertisement spending



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Advertisement spending - as a percentage of sales - comparison with peers



Source: Company, Nirmal Bang Institutional Equities Research

Competition

GSK Consumer undoubtedly has been the market leader in the category and enjoys a volume market share of 64.4% (FY17AR). The category size is estimated at around Rs72.6bn as against Rs22bn in 2009. During the last couple of years, the market share of GSK Consumer has been almost flat, and in fact decreased slightly. This is mainly because of the number of players coming into the market with innovative offerings. Horlicks, Boost, Complan, Bournvita, and Milo are key brands in the HFD space. Last year, Nestle India relaunched Milo in the ready-to-drink format. Within HFD market, there are sub-categories such as white malt drinks like Complan, Plain Horlicks etc, Brown malt drinks (Bournvita and Chocolate Horlicks) and in the protein category Danone (Protinex) is the market leader followed by British Pharmaceuticals. GSK Consumer is focusing on Chocolate Horlicks to penetrate western and northern regions of India where consumers do not prefer white malt beverages. However, in top markets, there are competitive challenges for the company in almost all sub-categories of the HFD universe.

Low parent support

Parent company of GSK Consumer i.e. GlaxoSmithKline or GSK has shifted its focus largely to drugs and vaccines. Consumer healthcare forms a very small share of its total revenues. HFD is sub-classified under nutrition category of the consumer healthcare division. HFD, which is largely dominated by Horlicks, forms just 9% of the consumer healthcare division and about 2% of overall revenues. Also 80% of Horlicks sales are done in India itself. Hence, looking at these facts, we are of the opinion that there is lack of parent focus and innovation support in this category at the global level compared to Unilever or Nestle SA. Therefore, there is no differentiating factor about Horlicks brand compared to other multinational brands of Mondelez, Abbott etc.

Financial performance

GSK Consumer has been the market leader in malt drinks category in India, but category growth has not been substantial over the past five years which is reflected from the performance of the market leader. It has posted a five-year CAGR of 8% over CY11-FY17. Volume growth was clearly under pressure and top-line growth is largely supported by price hikes. During this period, the space has become crowded with so many new players including MNCs moving in aggressively which has put profitability under pressure. EBITDA and net income posted 7% and 14% CAGR, respectively, over the same period. Although there are some tailwinds like reduced GST rate and better consumer sentiment, we believe they are applicable to all players catering to the segment and GSK Consumer won't be able to grow exponentially because of strong competition. Hence, we are assuming a two-year CAGR of 9.6% over FY18E-FY20E. Operating profit growth will remain in single-digit, in our opinion, over the said period.

Category growth has been sluggish

GSK Consumer derives a large part of its income from malt food drinks wherein Horlicks and Boost are its core brands. The growth over the past two to three years has been sluggish as the volume was under pressure. Whatever growth is led by price hikes, and the company is focusing on innovation and some of its new launches could fuel growth in the coming years.

Around 4%-5% of the revenues is derived from auxiliary business income through distribution of products like Eno, Iodex, Sensodyne etc. The growth from this segment has been decent in the past and we also expect it to post double-digit growth going forward. However, the segment's contribution as a percentage of total revenues is very small.

Exhibit 11: Segment information

Revenue share (%)	CY11	CY12	FY14	FY15	FY16	FY17
Finished goods	94	91	91	91	92	91
Traded goods	6	6	5	5	4	4
Other operating revenues	-	3	3	3	4	4
Total	**100**	**100**	**100**	**100**	**100**	**100**
Growth (%)						
Finished goods	16	15	53	(12)	1	(4)
Traded goods	24	18	37	(16)	(23)	3
Other operating revenues	-	-	73	(8)	18	6
Total	**17**	**19**	**53**	**(12)**	**1**	**(3)**

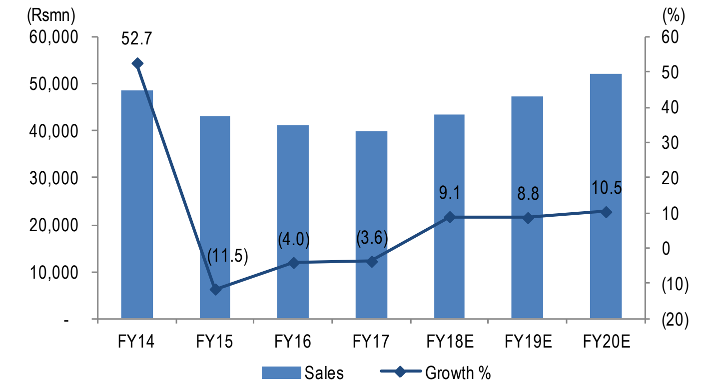
Source: Company, Nirmal Bang Institutional Equities Research

Marginal headroom for operating margin expansion

GSK Consumer enjoys highest gross margin in the foods space. Its major raw materials are milk, milk powder and barley. The company, in the past, went for price hikes to pass on the burden of increases in input prices to consumers. However, currently the commodity basket of the company is fairly stable and commodity prices have actually witnessed softening in the recent past. The management expects further softening of the prices of its major raw materials like milk powder and barley. Hence, we have not considered major dilution in gross margin. Marginal dilution could be because of aggressive pricing to cope with the competition which will be partially offset by the premiumisation trend which has limited presence in this category on a relative basis.

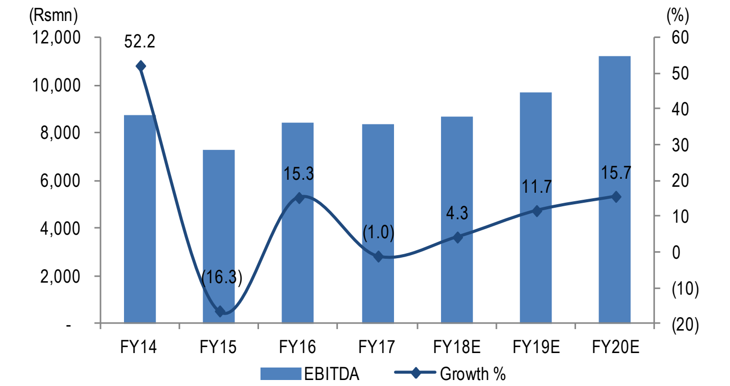
On the cost side, the company's performance has not been as impressive compared to other FMCG players. Following availability of input credit and change in the accounting treatment, reported EBITDA margin of various companies look on the higher side in the current financial year. In contrast, GSK Consumer has witnessed a decline in operating margin. Although, the company's innovation is tilted towards the premium segment, base variant of Horlicks still contributes around 50% to total brand sales. Hence, in our opinion, premiumisation tailwind is limited, at least in the near term. Also, the new products are priced aggressively to beat the competition. Building a business or a particular brand in this segment is a time-consuming process and this drives up expenses in the initial years for respective marketing and promotion, and of course ongoing R&D. Over the past four to five years, operating margin has not expanded (after adjusting for change in the accounting treatment) meaningfully. Also going forward, we believe that competitive pressure will remain and hence the company will have to spend more on marketing and brand promotion across media platforms. Thus, despite assuming softening of raw material prices, we don't see any major levers for maintaining cost leadership and therefore factor in around 150bps expansion in operating margin.

Exhibit 12: Top-line growth trend



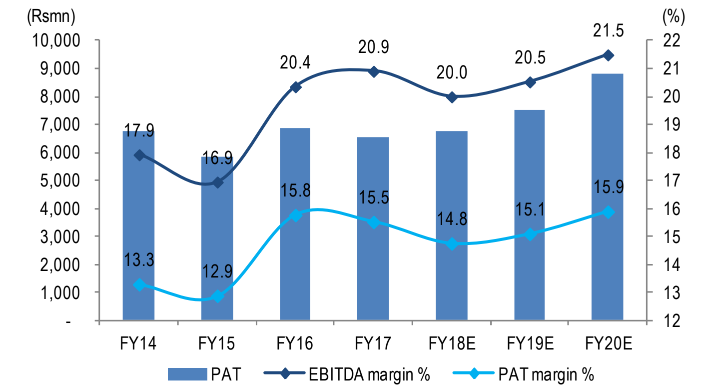
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: EBITDA growth trend



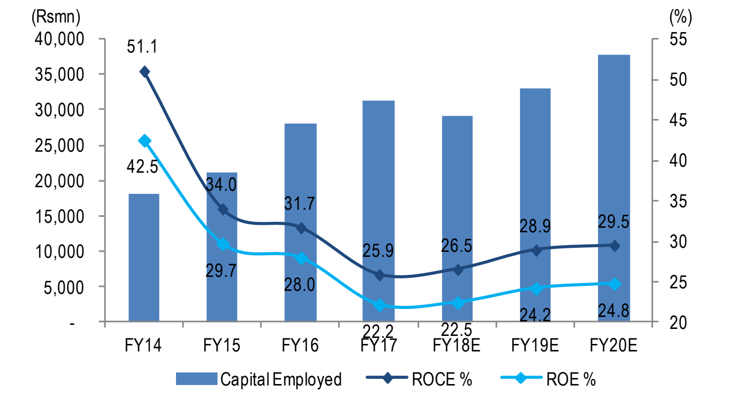
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Net profit versus net profit margin versus EBITDA margin



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: Return ratios



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: Our versus consensus estimates

Particulars	FY18E			FY19E			FY20E		
	Our estimate (Rsmn)	Consensus estimate(Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus estimate(Rsmn)	*Variance (%)*	Our estimate (Rsmn)	Consensus estimate (Rsmn)	*Variance (%)*
Sales	43,474	42,826	*1.5*	47,291	47.688	*(0.8)*	52,242	53,180	*(1.8)*
EBITDA	8,693	8,377	*3.8*	9,708	9,702	*0.1*	11,229	11,093	*1.2*
Net income	6,779	6,905	*(1.8)*	7,532	7,949	*(5.2)*	8,792	9,013	*(2.5)*

Source: Bloomberg, Nirmal Bang Institutional Equities Research

Comparative performance

We compared the financial performance of some F&B companies. GSK Consumer has been clearly struggling on both top-line and profitability fronts in the past four to five years before which the company had delivered double-digit growth in both revenue and net income fronts on a consistent basis. When players like Britannia Industries delivered volume-led revenue growth during this period, GSK Consumer's volume profile was under pressure because of sluggish category growth and competition. Despite aggressive price hikes in the recent past, revenues declined in the past two to three years. Also, on the profitability side, a volatile trend was observed because of the rise in input prices and other overheads. Clearly, GSK Consumer in the past few years has underperformed other big players in the foods space. We believe that although the consumer sentiment is slowly improving and premiumisation play is prevalent in the market, malt food drink as a category will only post modest growth and that too on a favourable base with the growth shared among a few key names including GSK Consumer.

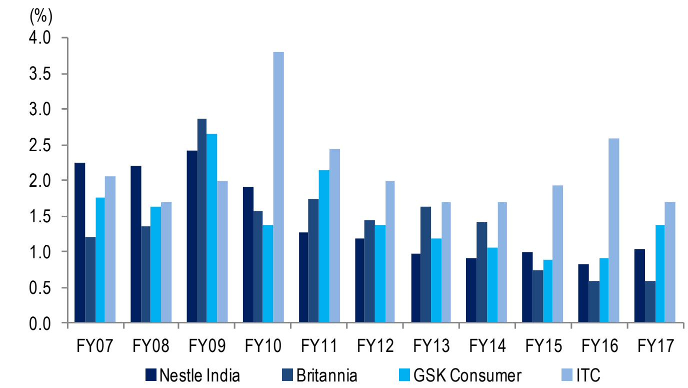
Exhibit 17: Top-line and profitability trends of the food companies

Sales growth (%)	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
ITC	14.7	11.9	16.3	18.2	17.3	18.8	11.2	9.8	0.2	9.6	2.7	8.1	8.5
Nestle India	24.4	23.4	18.6	21.9	20.1	10.9	9.2	8.3	(17.0)	11.8	9.5	12.7	12.7
Britannia Industries	22.5	23.2	10.3	22.2	19.0	12.8	11.8	13.7	6.9	7.8	9.4	12.5	14.7
GlaxoSmithkline Consumer Healthcare	15.0	20.6	24.6	20.0	16.5	18.7	52.7	(11.5)	(4.0)	(3.6)	9.1	8.8	10.5
Total	**17.1**	**15.8**	**16.4**	**19.5**	**18.0**	**16.5**	**13.7**	**8.1**	**(2.1)**	**8.7**	**5.1**	**9.5**	**10.3**
EBITDA growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	11.3	10.3	25.0	22.0	19.4	20.1	17.2	8.2	1.8	6.3	8.2	9.9	9.6
Nestle India	39.0	10.5	19.1	24.1	23.4	20.2	9.8	4.7	(22.2)	13.5	13.3	17.5	15.9
Britannia Industries	81.6	1.2	(31.4)	45.3	31.3	35.3	49.1	37.7	40.6	5.3	16.5	24.2	24.5
GlaxoSmithkline Consumer Healthcare	2.0	5.7	30.8	21.3	12.8	34.9	52.2	(16.3)	15.3	(1.0)	4.3	11.7	15.7
Total	**15.9**	**9.8**	**22.3**	**22.8**	**19.9**	**21.1**	**18.7**	**7.6**	**1.4**	**6.5**	**9.1**	**11.8**	**11.7**
PAT growth (%)	**FY08**	**FY09**	**FY10**	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**	**FY18E**	**FY19E**	**FY20E**
ITC	15.6	4.6	24.4	22.8	23.6	20.4	18.4	9.4	(3.1)	9.5	5.3	13.2	9.6
Nestle India	55.2	9.2	22.6	25.0	17.5	11.1	4.6	6.0	(52.5)	77.8	21.7	23.3	20.5
Britannia Industries	67.9	(18.8)	(28.0)	30.2	48.8	30.1	52.3	74.0	19.7	7.3	11.8	26.3	25.2
GlaxoSmithkline Consumer Healthcare	28.2	15.8	23.6	28.8	18.5	23.0	54.5	(13.5)	17.8	(4.5)	3.2	11.1	16.7
Total	**21.6**	**4.6**	**22.3**	**23.5**	**23.1**	**19.6**	**19.5**	**9.9**	**(5.6)**	**11.9**	**7.0**	**14.9**	**12.3**

Source: Bloomberg, Nirmal Bang Institutional Equities Research

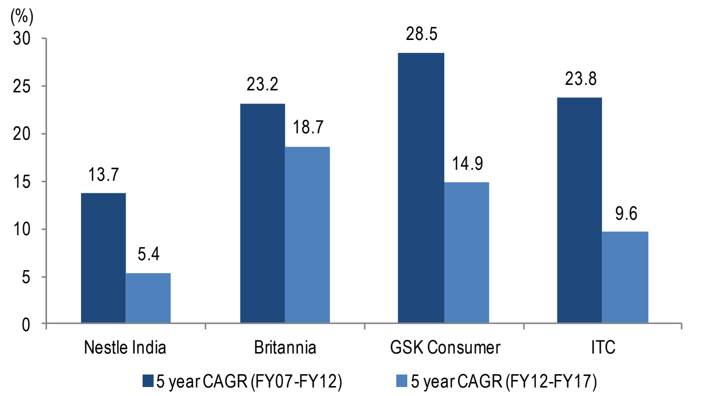
We have compared DPS growth of food companies by forming bands of five years each. All companies in our F&B coverage universe have witnessed the reduction in growth rate in DPS during the period FY12-FY17 compared to the same period earlier. Reduction in DPS has a direct co-relation with weakening fundamental performance.

Exhibit 18: Dividend yield trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: DPS in five-year CAGR band



Source: Company, Nirmal Bang Institutional Equities Research

Valuation and recommendation

Pre-CY13, GSK Consumer delivered healthy returns and outperformed Nifty 50 and other players in the F&B space during most of the years led by its strong performance. However, its deteriorating fundamentals are clearly reflected by its stock price performance over the past three to four years. Although the stock price has delivered healthy double-digit returns in three out of past five calendar years, on a relative basis it was almost in line with Nifty 50's returns and in fact underperformed the index a couple of times. Against this, Britannia Industries has delivered superior returns - both in absolute and relative terms.

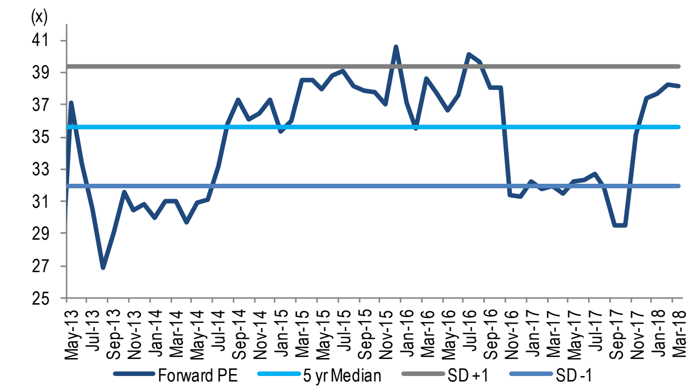
Exhibit 20: Absolute and relative price performance history

F&B companies	CY07	CY08	CY09	CY10	CY11	CY12	CY13	CY14	CY15	CY16	CY17	2MCY18
Absolute performance (%)												
ITC	19	(18)	46	42	16	42	12	15	(11)	11	9	2
Nestle India	32	(3)	75	50	7	22	6	21	(9)	3	31	(4)
Britannia Industries	35	(10)	27	23	8	11	85	100	61	(3)	63	5
GSK Consumer Healthcare	31	(23)	130	80	10	50	17	32	9	(22)	31	4
Relative performance (%)												
ITC	(23)	70	(17)	21	54	12	5	(13)	(7)	8	-15	3
Nestle India	(15)	102	-	27	42	(5)	(1)	(8)	(5)	-	1	(3)
Britannia Industries	(13)	86	(28)	4	44	(13)	73	52	68	(6)	27	6
GSK Consumer Healthcare	(16)	59	31	52	46	17	9	1	14	(24)	2	4

Source: Bloomberg, Nirmal Bang Institutional Equities

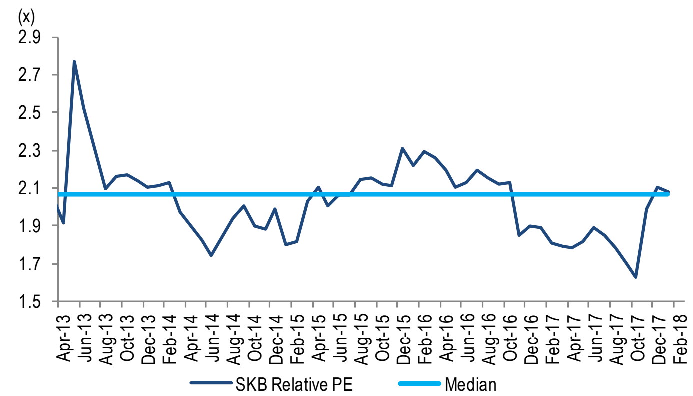
GSK Consumer stock currently trades at 38.2x one-year forward earnings i.e. at a premium of 8% to five-year median P/E. Similarly, the stock trades at a premium of 6% and 12% to five-year median EV/EBITDA and P/sales, respectively. The stock price has recently run up quite substantially after the announcement of a change in management and hence currently trades at close to +1 SD level. We have also compared forward P/E of the stock with the indices and it was observed that Nifty FMCG index and GSK Consumer trade at similar P/E and at a significant premium to Nifty P/E.

Exhibit 21: One-year forward P/E of GSK Consumer



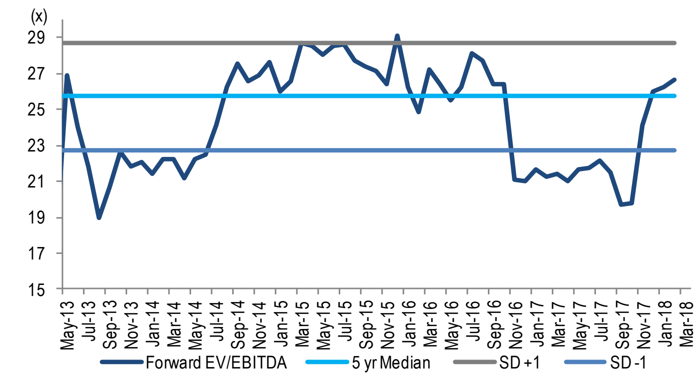
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 22: Relative P/E (Nifty) of GSK Consumer



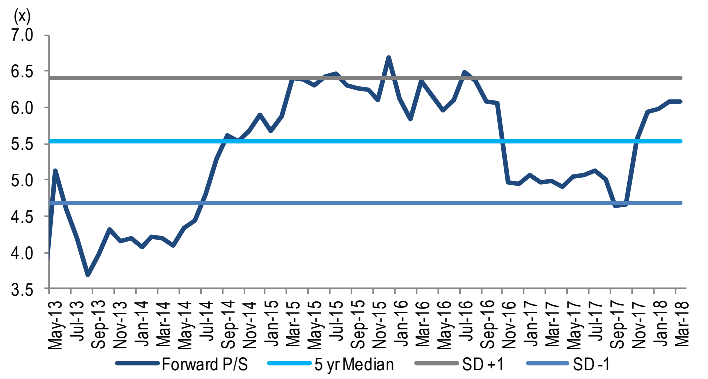
Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Exhibit 23: One-year forward EV/EBITDA



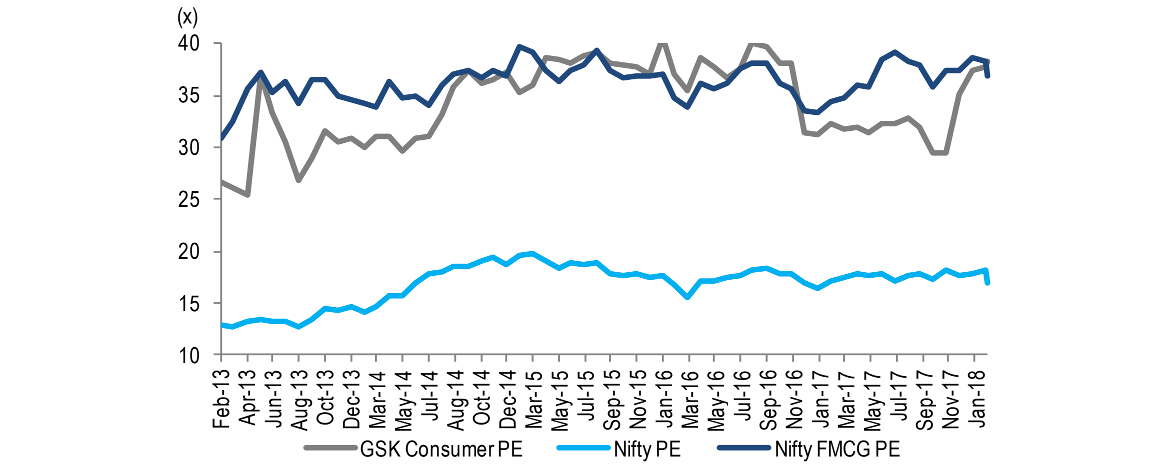
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 24: One-year forward P/Sales



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 25: GSK Consumer vis-à-vis Nifty and Nifty FMCG



Source: Company, Bloomberg, Nirmal Bang Institutional Equities Research

Current valuation is not supported by the future earnings growth outlook

Indian consumer and F&B stocks have consistently traded at a significant premium to their peers and this has been evident not just in a bear market, but also in a bull market. As discussed above, we expect a recovery in the F&B segment on account of a favourable base and pick-up in growth slowly. To understand the sustainability of current price multiples, we have compared the PEGs of F&B companies which are over and above 2.5. In case of GSK Consumer, we believe the current valuation is not supported by growth outlook going forward and hence the stock will trade at a lower multiple than the current level. Therefore, we have assigned a P/E multiple to the stock which is at a 10% discount to the current level.

Exhibit 26: Valuation of Indian F&B players

Company	CMP* (Rs)	Mkt cap (USD mn)	P/Sales (x)			EV/EBITDA (x)			P/E (x)			Sales CAGR %^	EBITDA CAGR %^	EPS CAGR %^	PEG (x)
			FY18E	FY19E	FY20E	FY18E	FY19E	FY20E	FY18E	FY19E	FY20E				
ITC	270	50,679	8.0	7.4	6.8	19.9	18.0	16.3	30.5	27.0	24.6	6.4	9.2	9.3	3.3
Nestle India	7,619	11,302	7.3	6.5	5.8	33.7	28.4	24.2	60.2	48.9	40.5	11.6	15.6	21.9	2.7
Britannia Industries	4,867	8,989	5.9	5.2	4.6	38.9	31.0	24.5	59.1	46.8	37.4	12.6	21.7	20.9	2.8
GSK Consumer Healthcare	6,837	4,423	6.6	6.1	5.5	29.7	26.1	22.1	42.4	38.2	32.7	9.4	10.4	10.2	4.2

**CMP is closing price as on 12th March 2018 ^3-year CAGR (FY17-FY20E)*

Source: Nirmal Bang Institutional Equities Research

We initiate coverage on GSK Consumer with an Accumulate rating and a target price of Rs7,300 by March 2019, implying an upside of 7% from the CMP. Our target price is based on P/E multiple of 35x (March 2020E EPS), which is largely in line with the current P/E and five-year median P/E. We believe that category growth is likely to remain modest and there are a lot of competitive challenges that the company is facing right now. Hence, growth rate in both top-line and profitability will be on the lower side compared to fast-growing companies like Britannia Industries and Hindustan Unilever. We believe that GSK Consumer's stock will continue to trade at the current multiple unless future earnings surprise our estimates in a big way.

Risks

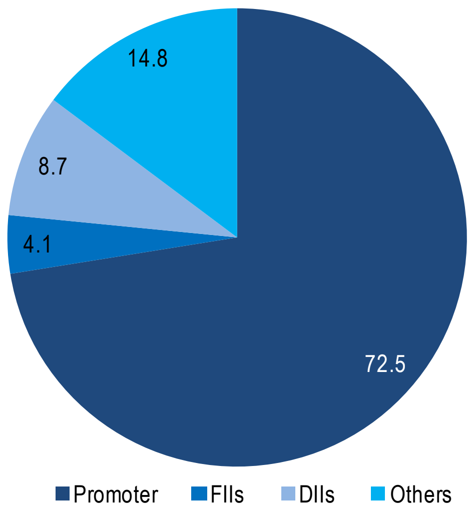
- Consumers are fairly demanding of high quality standards and any adverse product related issues that emerge in the future could pose significant risk to growth and recommendations
- We expect the rural economy to see gradual improvement after being weak substantially in the past three years. Any weather or policy-related issue that impacts this recovery could also pose risk to our earnings estimate and recommendation.
- We expect HFD category to witness modest growth even though rural economy and consumption picks up in a big way. GSK Consumer can positively surprise our estimates if the category starts growing rapidly led by improved distribution and penetration.
- We expect softening of key raw materials prices for GSK Consumer. If things move other way round, earnings profile of the company would be further stretched.
- Most companies have been moderating marketing and investment spending in the recent past and any substantial increase in spending does pose substantial risk to our estimate.

Exhibit 27: Management committee

Name	Designation
Mr. Navneet Saluja	MD, CEO
Mr.Vivek Anand	CFO
Mr.Surinder Kumar	VP- Legal Corp Affairs
Mr. evdas Baliga	VP - Legal
Mr.Sawan Malik	VP -Sales
Mr.Sanjeev Khanna	VP- Field sales
Mr.Ongmu Gombu	VP - HR
Mr.Arun Mishra	Head - Regulatory Affairs
Mr.Anup Dhingra	Director - Operations
Mr.Shanu Saksena	Compliance Officer
Mr.Sunil Mehra	General Manager - Sri Lanka
Mr.Prashant Pandey	General Manager - Myban
Ms.Deepa Dey	Head - Communications

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 28: Shareholding pattern (%)



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 29: Top 10 public shareholders

Particulars	% holding
LICI New Endowment Plus-Balanced Fund	2.67
ICICI Prudential Value Fund - Series 2	2.49
Vanguard Group	0.84
Nomura	0.74
UTI Asset Management Co.	0.73
Aditya Birla Sun Life Asset Management	0.52
SBI Funds Management	0.46
Sundaram Asset Management Co.	0.33
Kotak Mahindra	0.3
HDFC Asset Management Co.	0.19

Source: Company, Nirmal Bang Institutional Equities Research

Financials

Exhibit 30: Income statement

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Net Sales	41,364	39,864	43,474	47,291	52,242
% Growth	***(4.0)***	***(3.6)***	***9.1***	***8.8***	***10.5***
COGS	13,436	12,969	14,770	16,273	18,036
Staff costs	5,050	4,672	5,134	5,443	5,884
Other expenses	14,459	13,888	14,877	15,867	17,092
Total expenses	32,944	31,530	34,781	37,583	41,012
EBITDA	8,420	8,335	8,693	9,708	11,229
% growth	***15.3***	***(1.0)***	***4.3***	***11.7***	***15.7***
EBITDA margin (%)	***20.4***	***20.9***	***20.0***	***20.5***	***21.5***
Other income	2,215	2,439	2,470	2,609	3,086
Interest costs	23	28	25	25	25
Depreciation	613	642	667	705	764
Profit before tax (before exceptional items)	9,999	10,104	10,471	11,588	13,526
Exceptional items	561	-	-	-	-
Tax	3,687	3,537	3,693	4,056	4,734
PAT	6,873	6,566	6,779	7,532	8,792
Adj PAT	6,312	6,566	6,779	7,532	8,792
Adj PAT margin (%)	***14.5***	***15.5***	***14.8***	***15.1***	***15.9***
% Growth	***17.8***	***4.0***	***3.2***	***11.1***	***16.7***

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 32: Balance sheet

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
Share capital	421	421	421	421	421
Reserves	27,566	30,806	28,735	32,651	37,434
Minority Interest	-	-	-	-	-
Net worth	27,987	31,227	29,155	33,072	37,855
Total debt	127	84	-	-	-
Deferred tax liability	(1,131)	(1,278)	(1,278)	(1,278)	(1,278)
Total liabilities	**51,294**	**32,313**	**30,486**	**34,631**	**39,711**
Gross block	5,694	6,316	7,016	7,816	8,616
Depreciation	882	1,442	2,108	2,813	3,577
Net block	4,813	4,874	4,908	5,003	5,039
Intangible assets	-	85	85	85	85
Capital work-in-progress	514	492	542	592	642
Investments	-	-	-	-	-
Inventories	4,616	4,611	5,667	5,479	6,380
Debtors	3,542	3,210	3,936	3,578	4,294
Cash	27,123	30,874	28,994	34,288	39,130
Loans & advances	24,489	3,427	4,347	4,966	6,269
Other current assets	703	672	783	851	1,019
Total current assets	37,576	41,446	41,988	47,270	54,480
Creditors	7,852	8,604	10,820	11,651	13,847
Other current liabilities & provisions	3,660	4,359	4,782	5,107	5,485
Total current liabilities	14,567	16,011	18,863	20,305	23,251
Net current assets	23,009	25,435	23,125	26,965	31,229
Total assets	**51,294**	**32,313**	**30,486**	**34,631**	**39,711**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 31: Cash flow

Y/E March (Rsmn)	FY16	FY17	FY18E	FY19E	FY20E
PAT	6,873	6,566	6,779	7,532	8,792
Depreciation	613	642	667	705	764
Other income	(2,215)	(2,439)	(2,470)	(2,609)	(3,086)
(Inc.)/dec. in working capital	(2,656)	1,781	1,069	1,988	1,329
Cash flow from operations	**2,615**	**6,550**	**6,045**	**7,616**	**7,799**
Capital expenditure (-)	(599)	(681)	(750)	(850)	(850)
Net cash after capex	**2,017**	**5,869**	**5,295**	**6,766**	**6,949**
Dividends paid (-)	(2,313)	(2,944)	(2,983)	(3,013)	(3,341)
DDT paid (-)	(471)	(599)	(597)	(603)	(668)
Inc./(dec.) in investments	-	-	-	-	-
Cash from financial activities	**1,195**	**(25,787)**	**(3,418)**	**(3,386)**	**(3,712)**
Opening cash balance	22,965	27,123	30,874	28,994	34,288
Closing cash balance	27,123	30,874	28,994	34,288	39,130
Change in cash balance	4,157	3,751	(1,880)	5,294	4,842

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 33: Key ratios

Y/E March	FY16	FY17	FY18E	FY19E	FY20E
Per share (Rs)					
EPS	163.4	156.1	161.2	179.1	209.1
Book value	665.5	742.5	693.3	786.4	900.1
DPS	55.0	70.0	70.9	71.6	79.4
Valuation (x)					
P/Sales	6.1	5.4	6.6	6.1	5.5
EV/sales	5.5	4.7	5.9	5.4	4.8
EV/EBITDA	26.9	22.3	29.7	26.1	22.1
P/E	36.9	33.0	42.4	38.2	32.7
P/BV	9.1	6.9	9.9	8.7	7.6
Return ratios (%)					
RoCE	31.7	25.9	26.5	28.9	29.5
RoE	28.0	22.2	22.5	24.2	24.8
Profitability ratios (%)					
Gross margin	67.5	67.5	66.0	65.6	65.5
EBITDA margin	20.4	20.9	20.0	20.5	21.5
EBIT margin	18.9	19.3	18.5	19.0	20.0
PAT margin	24.2	23.9	22.8	23.2	24.4
Liquidity ratios (%)					
Current ratio	2.6	2.6	2.2	2.3	2.3
Quick ratio	2.3	2.3	1.9	2.1	2.1
Solvency ratio (%)					
Debt-to-equity ratio	-	-	-	-	-
Turnover ratios					
Total asset turnover ratio (x)	0.6	0.8	0.9	0.9	0.8
Fixed asset turnover ratio (x)	7.8	7.4	8.0	8.5	9.2
Inventory days	126.0	129.8	127.0	125.0	120.0
Debtor days	29.5	30.9	30.0	29.0	27.5
Creditor days	209.9	231.6	240.0	252.0	258.0

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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