MOTILAL OSWAL

7 March 2017

ANNUAL REPORT THREADBARE

The ART of annual report analysis

- EBITDA margin expanded from 5.7% in FY12 to 14.1% in FY16, primarily led by gross margin expansion on account of (a) premiumisation, (b) benign commodity prices and (c) price hikes.
- High investments in non-core assets (106% of NW) led to RoE at 46%, despite RoIC of 165%.
- Investments in ICDs increased to 6.4b (36% of NW; FY15: INR3.3b, 26% of NW).

BRITANNIA FY16

Britannia's (BRIT) FY16 annual report highlights a healthy operating performance, with revenue growing 10% YoY to INR86.8b and EBITDA margin expanding 310bp YoY to 14.1% led by benign commodity prices and premiumisation. EBITDA grew 43% YoY to INR12.3b (FY15: INR8.6b). Operating cash flow increased to INR9.6b (FY15: INR5.8b), supported by INR1.5b reduction (FY15: INR1.6b increase) in bank deposits; adjusted for this, operating cash flow was INR8.2b (FY15: INR7.4b). Adjusted earnings to cash conversion declined to 99% (FY15: 121%) as cash conversion cycle marginally increased to -17 days (FY15: -20 days). Over FY12-16, although funds were primarily utilized for capex and repayment of borrowings, we note that 19% of funds were utilized to place inter-corporate deposits. This along with high in cash and treasury investments has resulted in widening of the gap between RoIC (165%; FY15: 101%) and RoE (46%; FY15: 55%). Contingent liabilities increased by INR1b to INR1.5b (FY15: INR0.5b) due to a rise in claims of statutory dues.

- **Expanding EBITDA margin drives stellar operating performance:** In FY16, consol. revenue grew 10% to INR86.8b (FY15: INR78.6b). Benign commodity prices and premiumisation led to expansion in gross margin to 42.4% (FY15: 40.3%), part of which was invested in advertising. Ad spends rose to INR7.4b (8.6% of revenue; FY15: INR6.5b, 8.4% of revenue). EBITDA rose 43% to INR12.3b (FY15: INR8.3b), with margin up 310bp to 14.1% (FY15: 11%).
- **Earnings to cash flow conversion robust, but down YoY:** Operating cash flow rose to INR9.6b (FY15: INR5.8b), helped by INR1.5b reduction in bank deposits (up INR1.6b in FY15); adjusted for this, operating cash flow was INR8.2b (FY15: INR7.4b). Adjusted earnings to cash conversion fell to 99% (FY15: 121%) as cash conversion cycle rose slightly to -17 days (FY15: -20 days).
- **36% of NW in ICDs, part of which are to group companies:** In FY16, investments in ICDs increased to INR6.4b (36% of NW; FY15: INR3.3b, 26% of NW). Several beneficiaries of these are also related parties. We note that apart from ICD of INR0.4b to Bombay Burmah Trading Co (related party), ICD of (a) INR1b extended to Bombay Dyeing & Manufacturing Company has not been classified as related entity and (b) INR1.5b has been given to Scal Services based on comfort letter issued by Bombay Dyeing.
- **High fund allocation to non-core investments weighs on RoE:** Superior operating performance led to a stellar increase in RoIC to 165% (FY15: 101%). High allocation of funds toward non-core investments which at INR18.7b, 106% of NW (FY15: INR13.3b, 107% of NW) with yield of 6%. This led to decline in RoE to 46% (FY15: 55%).

Stock Info

Bloomberg	BRIT IN
CMP (INR)	3,091
Equity Shares (m)	2,406.0
52-Week Range (INR)	3,575/2,523
1,6,12 Rel. Perf. (%)	-7/-11/-10
M.Cap. (INR b) / (USD b)	383.2/5.7

Shareholding pattern (%)

As on	Dec-16	Sep-16	Dec-15
Promoter	50.7	50.7	50.7
DII	11.0	9.5	27.8
FII	17.4	18.7	0.0
Others	20.9	21.1	21.4

Note: FII Includes depository receipts

Auditor's name

BSR & Co. LLP, Chartered Accountants

Sandeep Ashok Gupta (S.Gupta@MotilalOswal.com); +91 22 39825544
Mehul Parikh (Mehul.Parikh@MotilalOswal.com); +9122 3010 2492 / **Somil Shah** (Somil.Shah@MotilalOswal.com); +91 22 3312 4975

ART #1

Benign commodity prices and premiumisation led to expansion in gross margin to 42.4% (FY15: 40.3%)

ACCOUNTING / AUDITING MATTERS

Expanding EBITDA margin enables stellar operating performance

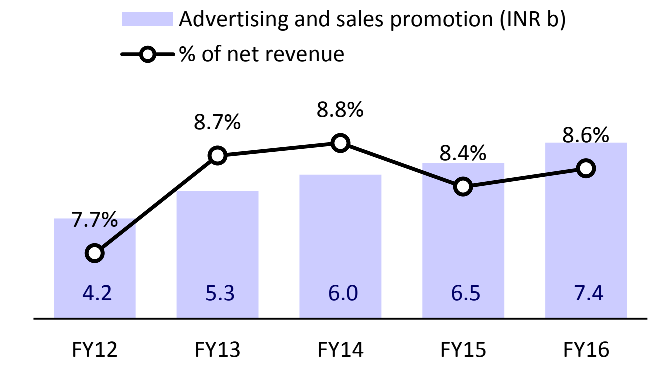
- In FY16, BRIT reported 10% growth in consolidated revenue to INR86.8b (FY15: INR78.6b), driven by standalone business (92% of consolidated revenue).
- Benign commodity prices and premiumisation led to expansion in gross margin to 42.4% (FY15: 40.3%), part of which was invested in advertising. Ad spends increased to INR7.4b (8.6% of revenue; FY15: INR6.5b, 8.4% of revenue).
- Decline in power & fuel and conversion costs helped contain operating and administrative expenditure at INR21.2b (FY15: INR20.2b, 25.7% of revenue).
- EBITDA increased 43% YoY to INR12.3b (FY15: INR8.3b), with margin expanding 310bp to 14.1% (FY15: 11%).
- PBT (before exceptional items) increased 51% to INR12.1b (FY15: INR8b).

Exhibit 1: Significant expansion of EBITDA margin aids profitability growth (INR b)

Particulars	Standalone				Consolidated			
	FY15	%	FY16	%	FY15	%	FY16	%
Net Revenue (Operations)	**71.8**	**100.0**	**79.5**	**100.0**	**78.6**	**100.0**	**86.8**	**100.0**
Raw Materials Consumed	43.2	60.2	46.2	58.2	46.9	59.7	50.0	57.6
Gross Margin	**28.6**	**39.8**	**33.3**	**41.8**	**31.7**	**40.3**	**36.8**	**42.4**
Operating and Administrative Expenses	19.1	26.6	19.8	25.0	20.2	25.7	21.2	24.4
Personnel Cost	1.8	2.5	2.1	2.6	2.8	3.6	3.4	3.9
EBITDA	**7.7**	**10.8**	**11.3**	**14.2**	**8.6**	**11.0**	**12.3**	**14.1**
Depreciation	1.2	1.6	0.9	1.1	1.4	1.8	1.1	1.3
EBIT	**6.5**	**9.1**	**10.4**	**13.1**	**7.2**	**9.2**	**11.1**	**12.8**
Financial Charges	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1
EBT	**6.5**	**9.1**	**10.4**	**13.1**	**7.2**	**9.1**	**11.1**	**12.8**
Other Income	0.9	1.2	1.0	1.2	0.9	1.1	1.0	1.2
PBT (Before Exceptional Items)	**7.4**	**10.3**	**11.4**	**14.4**	**8.0**	**10.2**	**12.1**	**13.9**
Exceptional Items	1.4	2.0	(0.1)	(0.1)	1.5	1.9	(0.1)	(0.1)
PBT	**8.8**	**12.3**	**11.3**	**14.2**	**9.5**	**12.1**	**12.0**	**13.8**
Tax	2.6	3.6	3.8	4.8	2.6	3.3	3.9	4.5
PAT	**6.2**	**8.7**	**7.5**	**9.4**	**6.9**	**8.8**	**8.1**	**9.3**

Source: Company Annual Report, MOSL

Exhibit 2: Increased investments in advertisements & promotions (INR b)



Source: Company Annual Report, MOSL

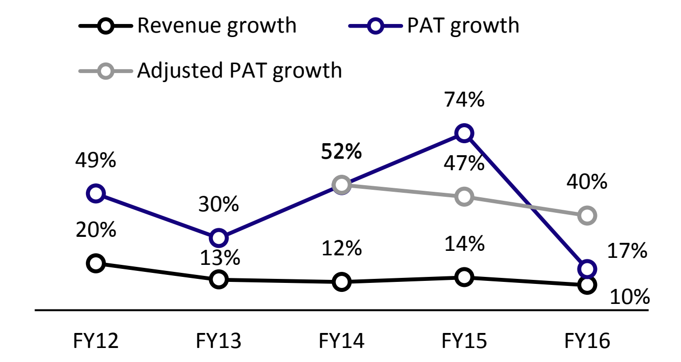
Exhibit 3: Association with marquee events aids brand scaling

Source: Company, MOSL

Earnings growth primarily led by EBITDA margin expansion

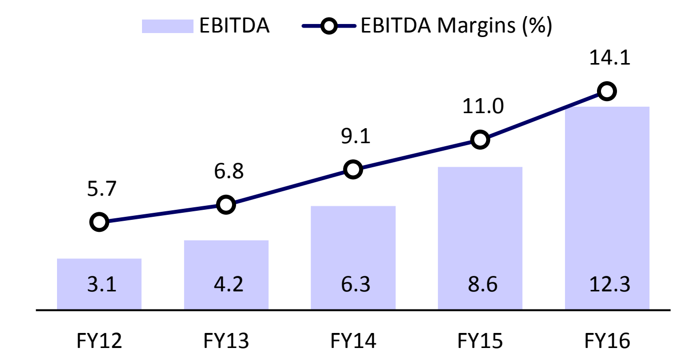
- Over FY12-16, PAT growth was significantly driven by margin expansion; revenue growth has been on a declining trend.
- EBITDA margin expanded from 5.7% in FY12 to 14.1% in FY16, primarily led by gross margin expansion on account of (a) premiumisation, (b) benign commodity prices and (c) price hikes.
- This led to an increase in PAT (adjusted for exceptional items) from INR2b in FY12 to INR8.1b in FY16.

Exhibit 4: PAT growth outpaces revenue growth…



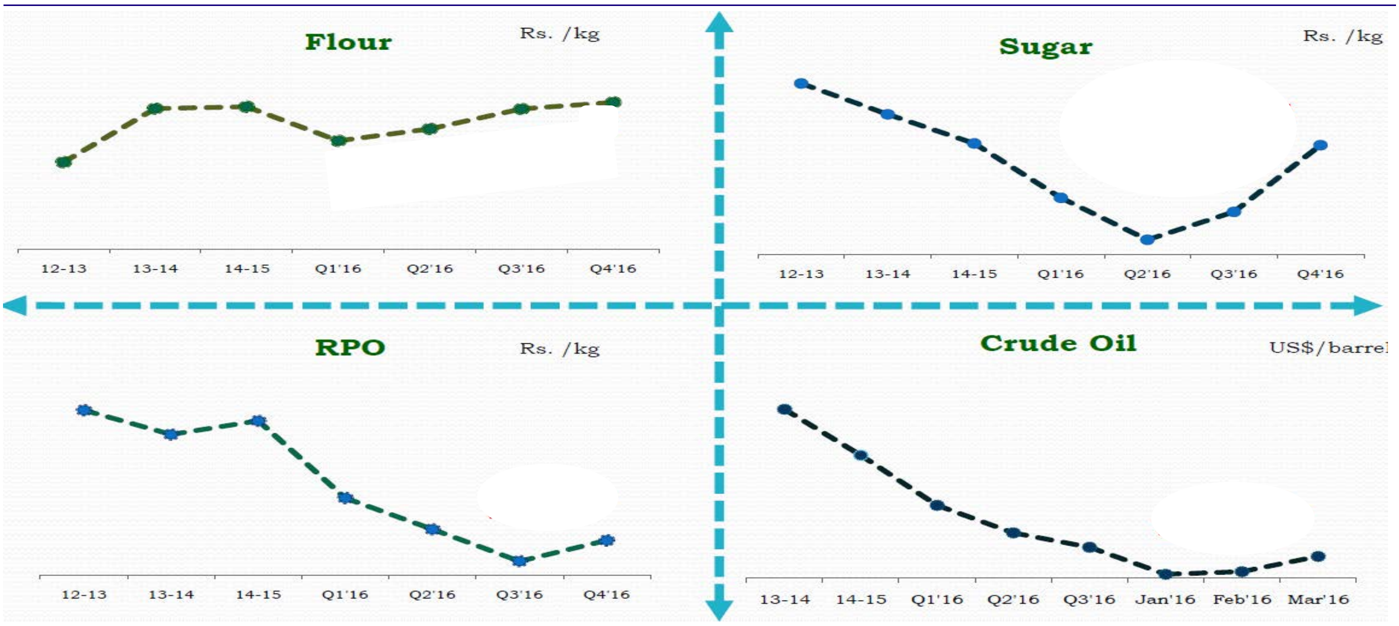
Adj. for exceptional items Source: Company Annual Report, MOSL

Exhibit 5: …driven by EBITDA margin expansion (INR b)



Source: Company Annual Report, MOSL

Exhibit 6: Benign commodity prices aid EBITDA margins



Source: Company, MOSL

Operating cash flow remains robust

- Cash flow from operations increased to INR9.6b (FY15: INR5.8b), primarily supported by higher earnings. Further, we note that part of the operating cash flows is supported by liquidation of bank deposits, adjusted for which operating cash flow stood at INR8.2b (FY15: INR7.4b).
- Earnings to cash conversion remained high on the back of robust operating cash flow; it further improved to 111% (FY15: 103%). However, adjusted for variance in bank deposits, it declined to 99% (FY15: 121%).

- Cash conversion cycle has deteriorated from -20 days in FY15 to -17 days in FY16. This is owing to an increase of a day each in inventory and receivables, while reduction of a day in payables has resulted in cash conversion cycle marginally deteriorating to -17 days (FY15: -20 days).

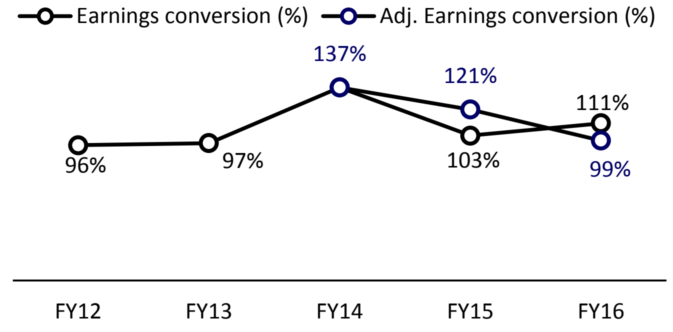
Part of the operating cash flows is supported by liquidation of bank deposits, adjusted for which operating cash flow stood at INR8.2b (FY15: INR7.4b).

Exhibit 7: One-offs amplify otherwise robust operating cash flows (INR b)

Particulars	FY15	FY16
PBT	**9.5**	**12.0**
Add/Less: Non-cash adjustments	1.4	1.1
Add/Less: Non-operating adjustments	(2.3)	(0.8)
Less: Direct Taxes Paid	(3.0)	(4.0)
Operating Profit Before Working Capital Changes	**5.6**	**8.3**
(Increase) / decrease in inventories	0.2	(0.4)
(Increase) / decrease in trade receivables	(0.2)	(0.3)
(Increase) / decrease in loans and advances and other assets	0.1	(0.2)
(Increase) / decrease in bank balances (other than cash & cash equivalents)	(1.6)	1.5
Increase / (decrease) in liabilities and provisions	1.8	0.8
Cash Generated from Operations after Tax	**5.8**	**9.6**
Less: Financial Cost paid	(0.0)	(0.1)
Free Cash Flow from Operations post Interest	**5.8**	**9.6**
Less: Capital Expenditure	0.5	(2.5)
Cash Flows post Capex	**6.3**	**7.1**

Source: Company Annual Report, MOSL

Exhibit 8: Earnings to cash conversion consistently high



Source: Company Annual Report, MOSL

Exhibit 9: Negative cash conversion aids CFO

Particulars	FY12	FY13	FY14	FY15	FY16
Inventory Days	45	35	37	31	32
Receivable Days	8	7	6	6	7
Advance from customers	1	1	1	1	1
Deposit from customers	1	1	1	1	1
Payable Days	40	37	49	55	54
Cash conversion cycle (Days)	**11**	**3**	**-8**	**-20**	**-17**

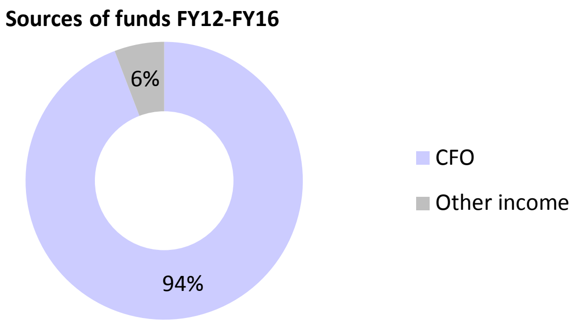
Source: Company Annual Report, MOSL

19% of funds have been utilized to place inter-corporate deposits.

Cash flow from operations primary source of funds

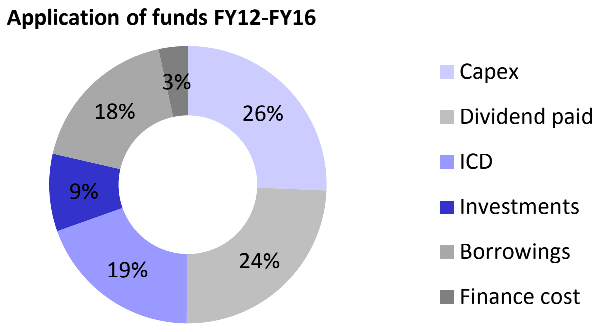
- Over FY12-16, operating cash flows remained the primary source of funds, contributing 94% of fund requirement.
- 26% of funds have been utilized for capex, 24% for repayment of borrowings, and 18% for dividend distribution. However, we note that 19% of funds have been utilized to place inter-corporate deposits.

Exhibit 10: CFO primary source of funds



Source: Company Annual Report, MOSL

Exhibit 11: 19% of funds utilized for ICDs



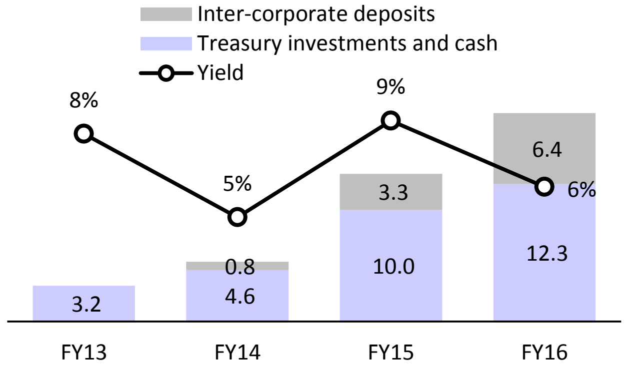
Source: Company Annual Report, MOSL

In FY16, ICDs increased by INR3.1b to INR6.4b, 36% of NW (FY15: INR3.3b, 26% of NW).

High fund allocation in non-core investments weighs on RoE

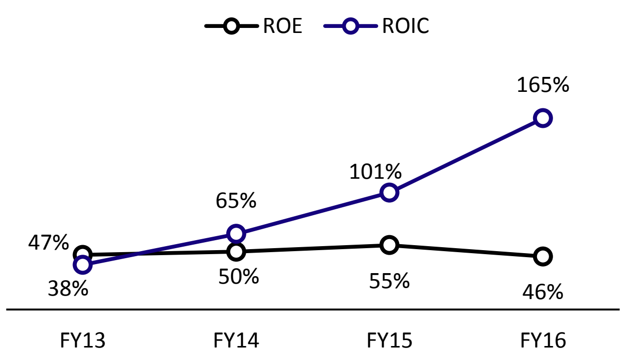
- Superior operating performance has led to a stellar increase in RoIC to 165% (FY15: 101%). However, RoE has declined to 46% (FY15: 55%).
- The widening gap between RoE and RoIC is on account of high allocation of funds toward treasury investments (primarily MFs and bonds), cash and inter-corporate deposits (ICDs) which stood at INR18.7b, 106% of net-worth (FY15: INR13.3b, 107% of net-worth) with yield of 6%.
- In FY16, ICDs rose INR3.1b to INR6.4b (36% of NW; FY15: INR3.3b, 26% of NW).
- Several beneficiaries of these are also related parties. We note that ICD of (a) INR1b extended to Bombay Dyeing & Manufacturing Company has not been classified as a related entity, and (b) INR1.5b has been given to Scal Services based on comfort letter issued by Bombay Dyeing & Manufacturing Company.

Exhibit 12: High investments in treasury and ICDS (INR b)…



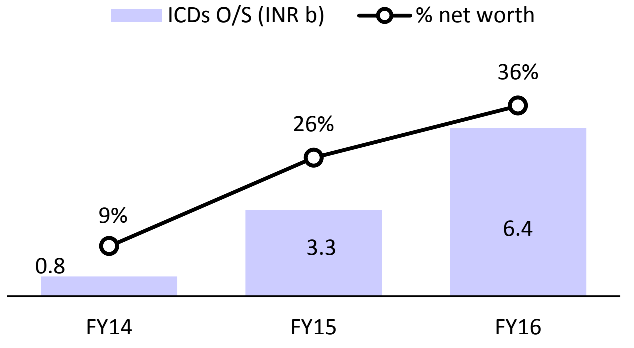
Source: Company Annual Report, MOSL

Exhibit 13: …weigh on RoE



Source: Company Annual Report, MOSL

Exhibit 14: ICDs at 36% of NW (INR b)…



Source: Company Annual Report, MOSL

Exhibit 15: Related parties are beneficiaries of ICDs (INR b)

Particulars	FY15	FY16
Related Party:		
The Bombay Burmah Trading Corporation Limited	0.4	0.4
Others:		
Bombay Dyeing & Manufacturing Co. Ltd.	-	1.0
Scal Services Ltd.*	2.0	1.5
Others	0.9	3.5
Total	**3.3**	**6.4**

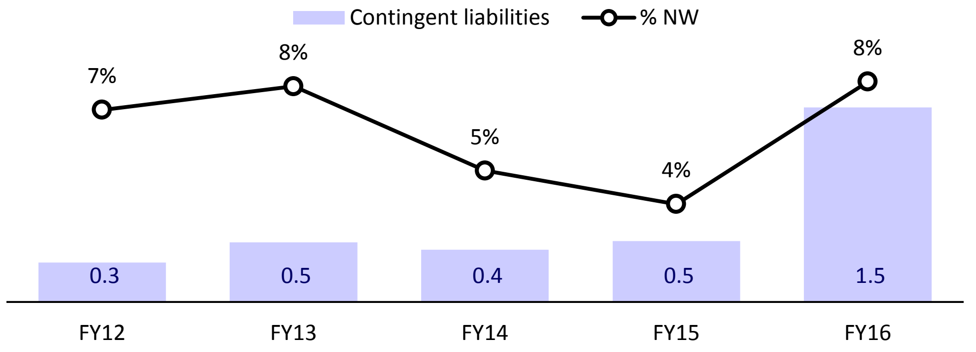
*Based on comfort letter from Bombay Dyeing & Mfg Co. Ltd

Source: Company Annual Report, MOSL

Contingent liabilities rises

- Contingent liabilities increased INR1b to INR1.5b (8% of NW; FY15: INR0.5b, 4% of NW). This is entirely on account of an increase in claims against the company (including statutory dues contested) by INR1b to INR1.5b (FY15: INR0.5b).

Exhibit 16: Significant rise in contingent liabilities (INR b)



Source: Company Annual Report, MOSL

ART #2 GOVERNANCE MATTERS

All directors regular in attending board meetings

- The board comprises 13 members, out of which 8 are independent directors.
- The company is regular in calling board meetings. In FY16, 7 board meeting were held. All directors have been generally regular in attending the board meetings.
- Independent directors Mr Nimesh Kampani, Mr Keki Dadiseth and Mr Avijit Deb have been on the board for a period of more than 10 years. The Companies Act 2013 mandates compulsory rotation of independent directors after 10 years, prospectively from the date of implementation of the statute.

Exhibit 17: Directors regular in attending board meeting

Name of Director	Category of Directorship	No. of Meetings held	No. of Board Meetings Attended
Mr. Nusli N Wadia	Non-Executive Chairman	7	7
Mr. Varun Berry	Managing Director	7	7
Mr. A K Hirjee	Non-Executive Director	7	7
Mr. Avijit Deb	Non-Executive and Independent Director	7	5
Mr. S S Kelkar	Non-Executive and Independent Director	7	7
Mr. Nimesh N Kampani	Non-Executive and Independent Director	7	6
Mr. Jeh N Wadia	Non-Executive Director	7	7
Mr. Keki Dadiseth	Non-Executive and Independent Director	7	5
Dr. Ajai Puri	Non-Executive and Independent Director	7	6
Mr. Nasser Munjee	Non-Executive and Independent Director	7	5
Mr. Ness N Wadia	Non-Executive Director	7	6
Dr. Vijay L Kelkar	Non-Executive and Independent Director	7	4
Mrs. Ranjana Kumar	Non-Executive and Independent Director	7	5

Source: Company Annual Report, MOSL

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