9 October 2019

Update | Sector: Consumer

Jubilant Foodworks

BSE SENSEX	S&P CNX
38,178	11,313

CMP: INR1,308 TP: INR1,400 (+7%) Neutral

Opportunity to capitalize on corporate tax cut in weak environment

- **In our view, the Indian government's recent announcement to cut the corporate tax rate bodes well for Jubilant Foodworks (JUBI) as it was under the highest tax slab of 34%. The company's medium term same-store-sales (SSS) growth prospects might fortify further if it passes on the benefit of the tax cut because not only will it gain on an absolute basis but also score significantly over Westlife Development, Yum Brands and Burger King, which are either barely profitable or incurring losses. Thus, if JUBI chooses to be aggressive on passing on the benefits, it can either boost SSSG in a weak operating environment or make a cut such that peers bleed more profusely on profitability (in case they match JUBI's aggression).**
- **Importantly, the 'advantage JUBI' is likely to last long – at least for the next few years – because of the company's delivery based model and significantly higher scale compared to others. In fact, sales and PBT margins will continue to be much higher, fortifying its competitive positioning year after year (~INR450-500m PAT increase each year ceteris paribus).**
- **JUBI's recent history is replete with aggressive measures to boost growth, including not taking a price increase for 2.5 years, focusing on everyday value (EDV) unlike discounting in the past, and undertaking complete product revamp. It could thus be aggressive in passing on these benefits – in such a case, there will be a trade-off of near-term profitability (due to tax cut) for boosting SSSG.**
- **Valuations are in line with peers at 39.4x FY21E EPS. However, on the EV/EBITDA front, the stock trades at a huge discount – not only compared to consumer peers but also at 1SD below its own historical average. The only reason warranting caution is a further deterioration in the operating environment, particularly impacting dine-in, which forms half of its countrywide sales. The government's moves have led to improved corporate profitability but not yet translated into better demand. Nevertheless, it is worth watching JUBI's moves and its impact. Meanwhile, we maintain our Neutral rating on the stock.**

Stock Info

Bloomberg	JUBI IN
Equity Shares (m)	132
M.Cap.(INRb)/(USDb)	172.7 / 2.4
52-Week Range (INR)	1518 / 982
1, 6, 12 Rel. Per (%)	5/-2/2
12M Avg Val (INR M)	2224
Free float (%)	58.1

Financials Snapshot (INR b)

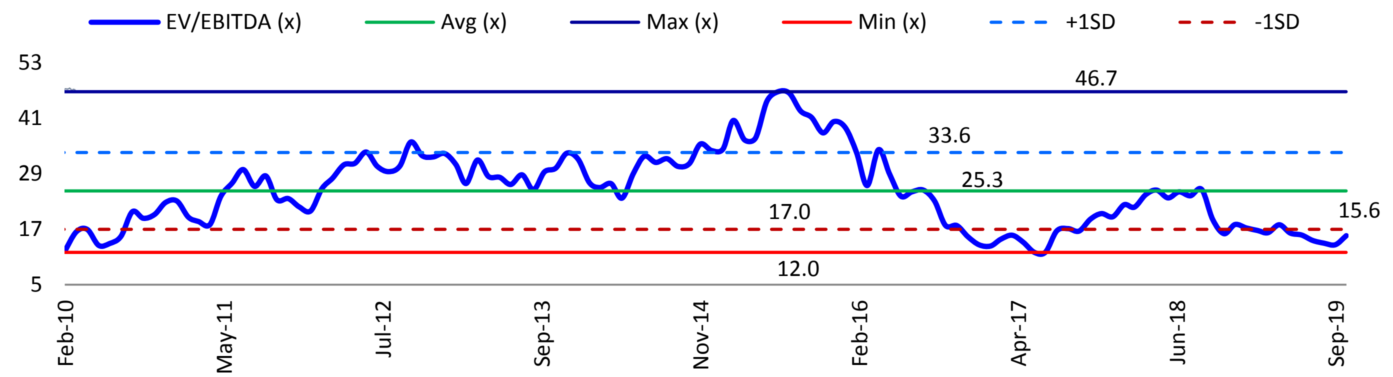
Y/E March	2019	2020E	2021E
Sales	35.6	40.3	45.9
EBITDA	6.0	9.9	11.1
Adj. PAT	3.2	3.9	4.4
Adj. EPS (INR)	24.1	29.3	33.3
EPS Gr. (%)	62.0	21.7	13.6
BV/Sh.(INR)	95.4	114.0	136.3
RoE (%)	25.2	25.7	24.4
RoCE (%)	28.5	36.5	33.8
Payout (%)	20.8	23.2	27.6
Valuations			
P/E (x)	54.3	44.8	39.4
EV/EBITDA (x)	27.7	16.2	13.9

Shareholding pattern (%)

As On	Jun-19	Mar-19	Jun-18
Promoter	41.9	41.9	44.9
DII	11.8	10.3	8.4
FII	36.1	39.0	37.9
Others	10.2	8.7	8.8

FII Includes depository receipts

Exhibit 1: Valuations are below 1SD of longer-term average on EV/ EBITDA



Source: MOFSL, Company

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Key takeaways

A key beneficiary of corporate tax rate cut

- JUBI was expected to pay taxes at a rate of around 34% for FY20 and FY21 before the announcement of the corporate tax cut. However, we now believe that JUBI will be among the key beneficiaries of the cut in corporate tax to 25.2%, as it adds around 13% to its PAT.

Profitability significantly higher than other QSR players

- As mentioned in our note released after the announcement of the corporate tax cut, we need to assess the second-order effects of this measure. This includes the impact on:
  - Relative basis (v/s peers) in categories where the company operates,
  - Absolute profit and absolute savings versus peers and
  - The share of unorganized segment in this category.

- JUBI is well placed in terms of the first two factors. Yum Brands and Burger King do not make money at the PBT level in India, while Westlife has turned profitable only in FY19 and its absolute profit is a very small number.

- On the third factor, the corporate tax cuts provide an opportunity to JUBI to offer discounts and promotions and thus eat into the share of unorganized players.

What can JUBI do?

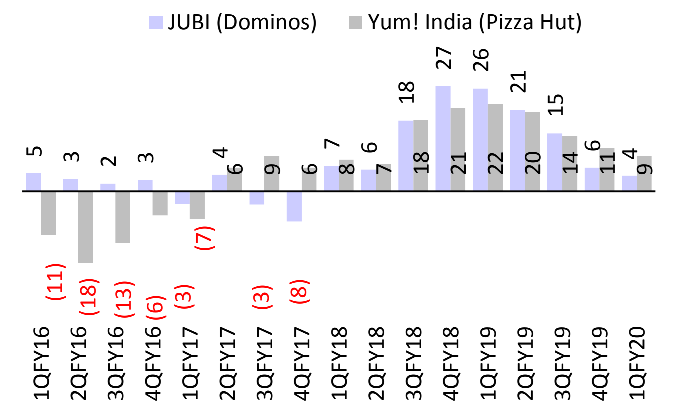
- It can spend a significant part of the INR450-500m incremental PAT on promotions/price offs in an attempt to gain market share. Four points are important here:
  - **Gain further share or lead to further bleeding of peers:** None of its competitors would have such windfall gains, and if they choose to match JUBI's efforts on promotions and price offs, they would end up bleeding further.
  - **Utilize/institutionalize multi-year benefit over peers:** Importantly, the corporate tax cuts offer multi-year benefits to JUBI, providing it with incremental benefit every year until competitors scale up well. The nature of JUBI's business model (delivery based Domino's business and massively large scale of business versus peers) means that such a convergence on PBT or PBT margins is unlikely anytime soon.
  - **Boost demand:** As it operates in the discretionary product category, there is a likelihood of boosting demand through price offs and promotions compared to companies in staples.
  - **Gain share from other eating options:** Aggression in terms of price cuts/promotional spends – if judicial – will also drive faster conversion of customers from other restaurant businesses to Domino's.

JUBI's recent history demonstrates such moves with success

- **No price increases for nearly 30 months:** Until the last quarter, JUBI had not taken any price increase for nearly 2.5 years. Even in 1QFY20, the price increase was fairly small. The corporate tax cuts could be used for reversing the price hikes or even decreasing prices further in order to boost demand.
- **Focus on Every Day Value (EDV):** Instead of selective promotions, the company decided to focus on providing 'Every Day Value' since the arrival of the new CEO. This meant that promotion of discounted sales reduced. JUBI could upgrade EDV to offer more attractive combos along with lower prices.
- **Willingness to completely revamp products:** Another initiative that the new CEO undertook early in his tenure was a complete product upgrade. While this was following a similar move at the parent level (Domino's in the US) way back in 2009, it showed an admission by management that improvements need to be made for growth to come back.

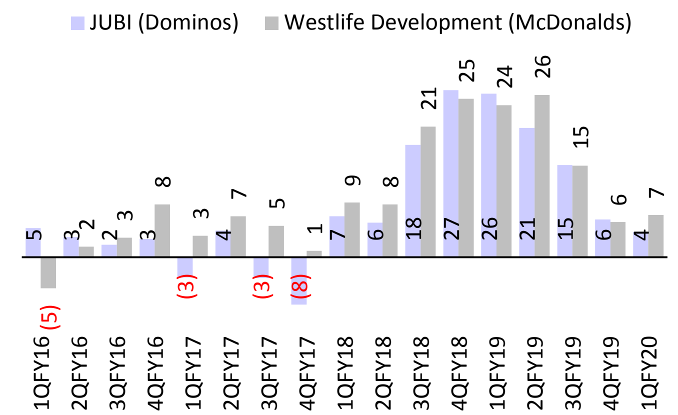
Following these events, JUBI was successful in elevating its SSSG to closer/ higher than peer levels after lagging earlier (barring 1QFY20), despite being much larger in size.

Exhibit 2: YoY SSSG (%) – JUBI v/s Yum! India



Source: Company, MOFSL

Exhibit 3: YoY SSSG (%) – JUBI v/s Westlife Development



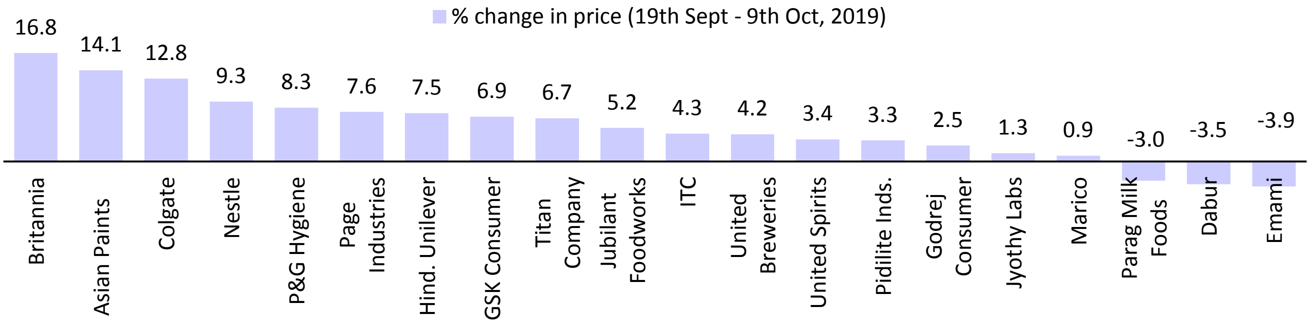
Source: Company, MOFSL

- **Two extremely creditable reasons for recent outperformance:**
  - The scale of JUBI is over 2-4x higher than peers in terms of the number of stores. Thus, SSSG outperformance is even more creditable.
  - This growth was achieved despite a massive scale-up of presence by aggregators like Swiggy and Zomato. This was because JUBI completely revamped and developed its ordering app, resulting in 81% of delivery sales now coming from online ordering.

Stock price reaction since corporate tax cut

- JUBI is up by only 6% since the announcement of the corporate tax cuts, well below the 13% addition to the EPS taking into account the corporate tax cuts. Fear of worsening near-term environment may have played a part here, in our view.

Exhibit 4: JUBI is up by only 6% since announcement of corporate tax cuts

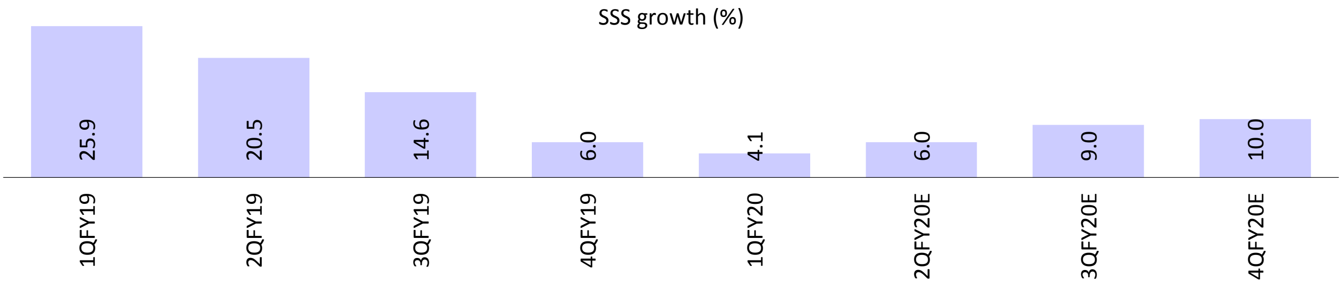


Source: Company, MOFSL

Near term remains highly challenging

SSSG base high for 2QFY20 and to a lesser extent in 3QFY20

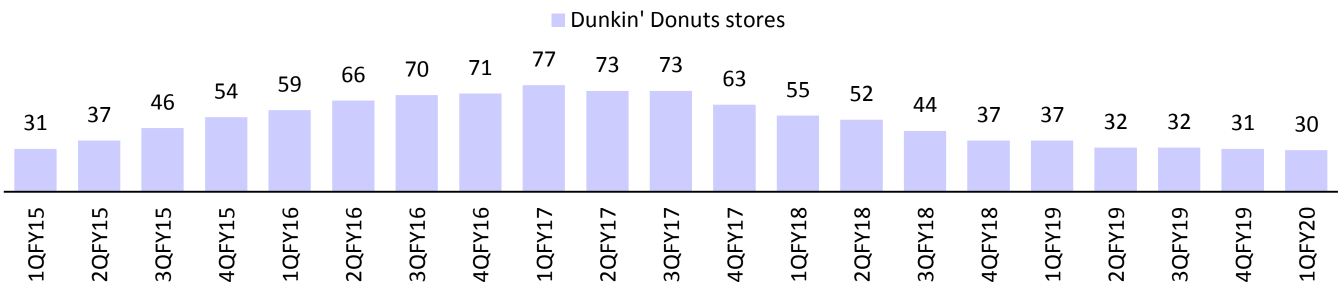
Exhibit 5: Very high SSSG base in 2QFY20 and to a lesser extent in 3QFY20



Source: Company, MOFSL

- **Significant and continued slowdown in dine-in:** While JUBI has continued doing well in delivery despite the onslaught of aggregators, we note that dine-in has weakened in recent quarters. Thus, part of remarkable growth witnessed in delivery can be offset by any further slowdown in dine-in, which makes up around half of its sales.
- **Weak operating environment:** Corporate tax cuts are beneficial but subsequent measures to boost consumption demand are still awaited.
- **Weakness in Dunkin Donuts:** Dunkin Donuts, despite being less than 10% of sales even at peak, used to contribute negatively by around 250bp at the overall JFL level. The company's efforts on revamping the menu and closing down unprofitable stores have meant that the there is no negative impact as of now. However, Dunkin Donuts is largely dine-in and thus vulnerable to a slowdown, detracting again from company level profitability – even if not at the same level as earlier.

Exhibit 6: Dunkin Donuts: Focus on closing down unprofitable stores to boost profitability



Source: Company, MOFSL

Financial performance

Exhibit 7: Expect revenue CAGR of 14.1% over FY19-21

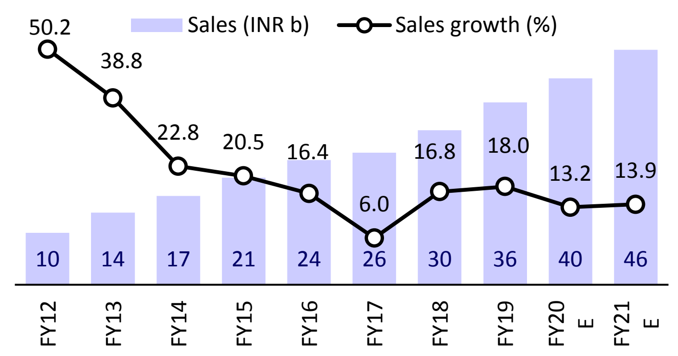


Exhibit 8: Expect gross margin expansion of 10bp over FY19-21

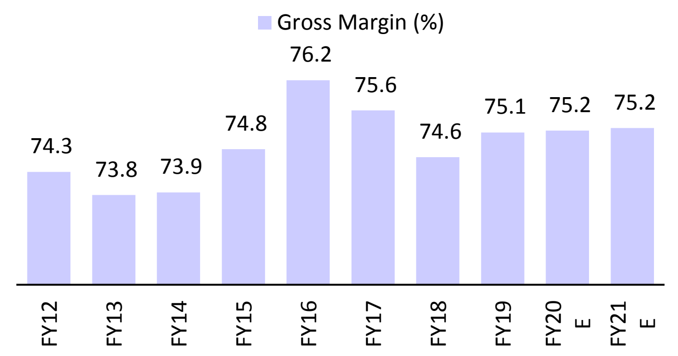


Exhibit 9: Expect EBITDA CAGR of 36.2% over FY19-21

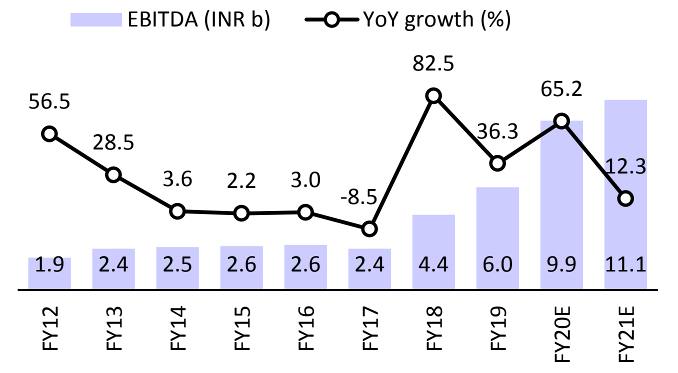


Exhibit 10: Expect EBITDA margin expansion of 740bp over FY19-21

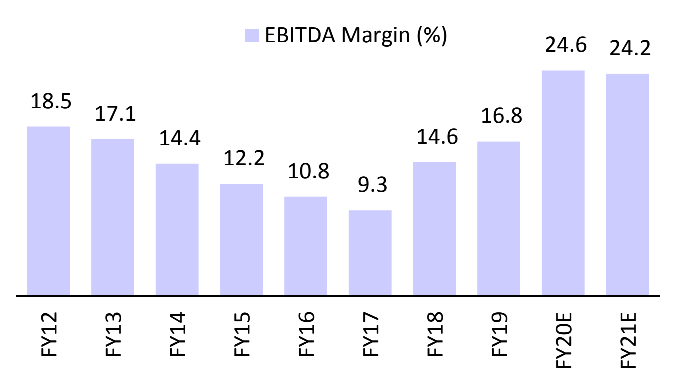


Exhibit 11: Expect PAT CAGR of 17.6% over FY19-21

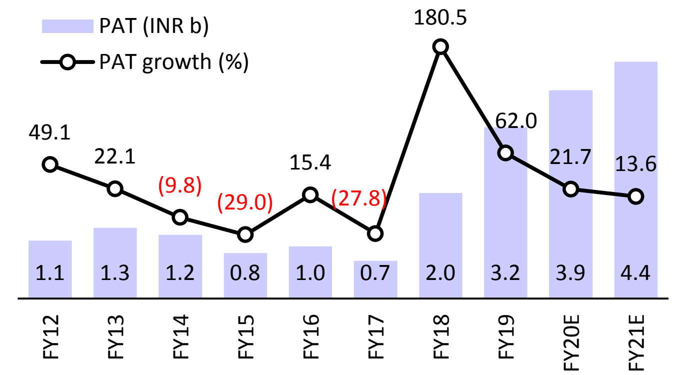


Exhibit 12: Expect ROCEs to improve further

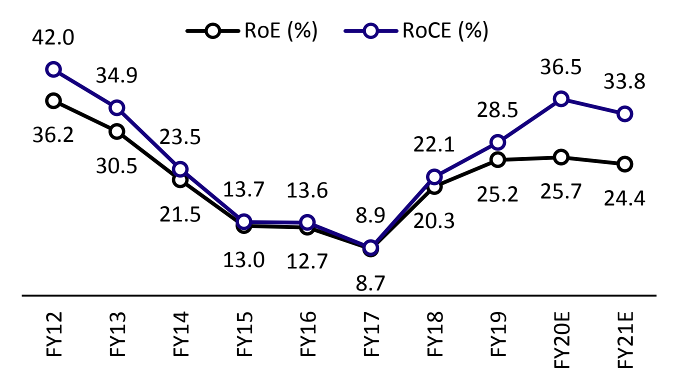
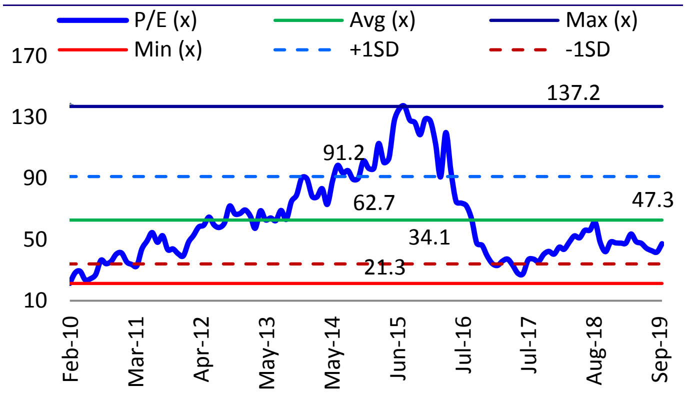
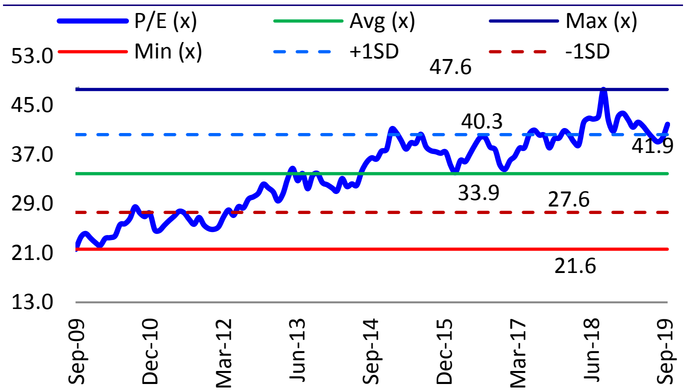


Exhibit 13: JUBI P/E (x)



Source: Company, MOFSL

Exhibit 14: Consumer P/E



Source: Company, MOFSL

Financials and Valuations

Income Statement							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Net Sales	**20,937**	**24,379**	**25,834**	**30,184**	**35,631**	**40,329**	**45,929**
Change (%)	20.5	16.4	6.0	16.8	18.0	13.2	13.9
Material Consumed	5,279	5,801	6,308	7,660	8,861	10,013	11,380
Gross Profit	**15,659**	**18,579**	**19,526**	**22,524**	**26,770**	**30,315**	**34,549**
Gross Margin %	74.8	76.2	75.6	74.6	75.1	75.2	75.2
Operating expenses	13,098	15,942	17,115	18,123	20,773	20,408	23,428
EBITDA	**2,561**	**2,636**	**2,411**	**4,401**	**5,998**	**9,907**	**11,121**
Change (%)	2.2	3.0	-8.5	82.5	36.3	65.2	12.3
Margin (%)	12.2	10.8	9.3	14.6	16.8	24.6	24.2
Depreciation	1,282	1,282	1,554	1,601	1,575	3,940	4,582
Int. and Fin. Ch.	0	0	0	0	0	1,580	1,580
Other Non-recurring Inc.	65	116	147	231	474	785	917
PBT	**1,344**	**1,470**	**1,004**	**3,031**	**4,897**	**5,171**	**5,876**
Change (%)	-25.5	9.4	-31.7	201.7	61.6	5.6	13.6
Margin (%)	6.4	6.0	3.9	10.0	13.7	12.8	12.8
Tax	504	501	305	1,068	1,717	1,301	1,478
Tax Rate (%)	37.5	34.1	30.4	35.3	35.1	25.2	25.2
Adjusted PAT	**840**	**968**	**699**	**1,962**	**3,180**	**3,871**	**4,398**
Change (%)	-29.0	15.4	-27.8	180.5	62.0	21.7	13.6
Margin (%)	4.0	4.0	2.7	6.5	8.9	9.6	9.6
Non-rec. (Exp)/Inc.	0	0	-122	0	0	0	0
Reported PAT	**840**	**968**	**578**	**1,962**	**3,180**	**3,871**	**4,398**

*Drastic change in EBITDA margins for FY20E and FY21E due to IND AS-116 impact

Balance Sheet							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Share Capital	1,311	1,316	1,319	1,320	1,320	1,320	1,320
Reserves	5,151	6,304	6,734	8,358	11,277	13,728	16,669
Net Worth	**6,462**	**7,620**	**8,053**	**9,677**	**12,596**	**15,048**	**17,988**
Loans	144	17	18	30	9	0	0
Capital Employed	**6,606**	**7,637**	**8,071**	**9,708**	**12,631**	**15,073**	**18,014**
Gross Block	10,810	9,466	10,604	11,748	13,107	15,685	18,259
Less: Accum. Depn.	3,438	1,181	2,603	3,838	5,007	8,947	13,530
Net Fixed Assets	**7,373**	**8,285**	**8,001**	**7,910**	**8,100**	**6,737**	**4,729**
Lease Deposits	**1,142**	**1,363**	**1,822**	**1,776**	**2,056**	**1,682**	**1,887**
Capital WIP	199	261	608	124	152	175	201
Investments	746	908	936	2,631	1,808	9,453	13,491
Deferred tax assets	-578	-729	-693	-550	-500	-500	-500
Curr. Assets, L&A	**1,287**	**1,404**	**1,539**	**2,525**	**6,441**	**4,664**	**6,587**
Inventory	433	552	607	642	771	878	1,029
Account Receivables	119	125	161	157	274	274	312
Cash and Bank Balance	389	332	354	1,290	4,943	3,041	4,775
Others	346	396	417	437	454	471	471
Curr. Liab. and Prov.	**3,564**	**3,854**	**4,143**	**4,710**	**5,426**	**7,138**	**8,380**
Other Current Liabilities	704	722	798	656	915	1,037	1,180
Creditors	2,555	2,960	3,142	3,890	4,209	4,894	5,595
Provisions	305	172	202	164	303	1,207	1,605
Net Curr. Assets	**-2,276**	**-2,450**	**-2,604**	**-2,184**	**1,015**	**-2,473**	**-1,793**
Appl. of Funds	**6,606**	**7,637**	**8,071**	**9,708**	**12,631**	**15,074**	**18,015**

E: MOFSL Estimates

Financials and Valuations

Ratios							
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
Basic (INR)							
EPS	**6.4**	**7.4**	**5.3**	**14.9**	**24.1**	**29.3**	**33.3**
BV/Share	49.3	57.9	61.1	73.3	95.4	114.0	136.3
DPS	0.0	1.3	1.2	2.5	5.0	6.8	9.2
Payout %	0.0	17.0	23.4	16.8	20.8	23.2	27.6
Valuation (x)							
P/E	204.3	177.7	246.7	88.0	54.3	44.8	39.4
EV/Sales	8.1	7.0	6.6	5.6	4.7	4.0	3.4
EV/EBITDA	66.6	64.8	71.0	38.3	27.7	16.2	13.9
P/BV	26.5	22.6	21.4	17.8	13.7	11.5	9.6
Return Ratios (%)							
RoE	13.0	12.7	8.7	20.3	25.2	25.7	24.4
RoCE	13.7	13.6	8.9	22.1	28.5	36.5	33.8
RoIC	16.7	15.6	9.7	30.6	50.4	109.8	501.6
Working Capital Ratios							
Debtor (Days)	2	2	2	2	3	2	2
Inventory (Days)	8	8	9	8	8	8	8
Creditor (Days)	45	44	44	47	43	44	44
Asset Turnover (x)	3.2	3.2	3.2	3.1	2.8	2.7	2.5
Leverage Ratio							
Debt/Equity (x)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Cash Flow Statement							(INR Million)
Y/E March	**2015**	**2016**	**2017**	**2018**	**2019**	**2020E**	**2021E**
OP/(loss) before Tax	1,615	1,470	883	3,031	4,897	5,171	5,876
Int./Div. Received	1	61	-34	-120	-165	-785	-917
Depreciation & Amort.	1,011	1,282	1,554	1,601	1,575	3,940	4,582
Interest Paid	3	3	58	71	256	-1,580	-1,580
Direct Taxes Paid	352	386	366	1,262	1,779	1,301	1,478
Incr in WC	-488	308	-57	-912	14	-1,587	-1,054
CF from Operations	**2,761**	**2,117**	**2,036**	**4,091**	**4,256**	**10,193**	**10,697**
Incr in FA	-2,864	-2,264	-1,996	-1,160	-1,657	-2,601	-2,600
Free Cash Flow	**-103**	**-147**	**40**	**2,931**	**2,600**	**7,592**	**8,097**
Others	41	67	102	48	262	885	780
Pur of Investments	196	200	28	-1,695	958	-7,645	-4,038
CF from Invest.	**-2,626**	**-1,998**	**-1,866**	**-2,808**	**-437**	**-9,361**	**-5,858**
Issue of Shares	9	21	50	210	230	0	0
Incr in Debt	0	0	0	0	0	-9	0
Dividend Paid	0	164	165	164	329	1,077	1,457
Others	0	-33	-34	-393	-68	-1,648	-1,648
CF from Fin. Activity	**9**	**-177**	**-148**	**-347**	**-167**	**-2,734**	**-3,105**
Incr/Decr of Cash	**143**	**-57**	**22**	**936**	**3,652**	**-1,901**	**1,734**
Add: Opening Balance	246	389	332	354	1,290	4,943	3,041
Closing Balance	**389**	**332**	**354**	**1,290**	**4,943**	**3,041**	**4,775**

E: MOFSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	**Expected return (over 12-month)**
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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